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Optionality Limits of the Conclusion of Shareholders' Agreements under Kazakhstan and German Law

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Abstract: This article briefly analyzes the optionality limits of the conclusion of shareholders' agreements under Kazakhstan and German law. Such issues as parties to the shareholders' agreement, terms of the shareholder's agreements, the law, applicable to the shareholders' agreement, ways to enforce the obligations under the shareholders' agreement, as well as the responsibility of parties for breach of the agreement are considered. Shareholders' agreements as a statutory concept that allows shareholders to regulate more optimally various issues of corporate activity, such as voting at a general meeting in a certain way, shareholders' limitation in disposal of their shares, introduction of a certain order of forming the bodies of the company, distribution of profits, financial flows, etc., acquired with wide recognition in world practice. Originally, shareholders' agreements appeared in the countries with the Anglo-Saxon legal system, but they quickly spread in the countries with Roman-German law.

Key words: Shareholders' agreement · Joint-Stock Company · Shareholder · Non-defined contract · Freedom of contract

INTRODUCTION

In Germany, shareholders' agreements are used starting from the second half of the twentieth century, as evidenced by Germany Imperial Court awards adopted at that time on recognition of legitimacy of parties to the agreement in respect to obligations to vote in a certain way [1], as well as scientific works on the subject of such German scientists as R. Fisher [2], M. Sims [3] and others. But despite this, Germany is among the countries that have not developed a single legislative decision on the regulation of shareholders' agreements yet. There aren't any special rules on shareholders' agreements in German civil law. Only certain specific issues, which will be discussed further, are regulated. The content of such agreements if defined by general principles and rules on obligations and contracts of civil legislation, by general norms of corporate legislation as well as by traditions that have been developed at the doctrinal level and in judicial practice [4].

Since the early 1990s, with the occurrence of foreigners investing in Kazakhstan market, they also began to use this legal instrument in Kazakhstan. Nevertheless, Kazakhstan is included in the group of

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countries without special legal regulation of shareholders' agreements. The legislative framework for the conclusion of shareholders' agreements is general norms of civil and corporate law. Article 380 of the Civil Code of the Republic of Kazakhstan (hereinafter – CC RK) [5], proclaiming the principle of freedom of contract shall be referred to as a general basic rule of the civil legislation. This principle is defining both for the use of shareholders' agreements and for establishing the limits of the specific content of a shareholders' agreement [6].

Parties to a Shareholders' Agreement: In Germany the joint-stock company itself, as well as shareholders and third parties subject to certain limitations, which are based on the basic principles of civil law, may act as a party to shareholders' agreements. However, in practice, mainly shareholders act as participants of shareholders' agreements. Moreover, only several shareholders of a company can be parties to the agreement [7].

Third parties in shareholder's agreements are usually those who have a certain interest protected by the law. As some German scientists note, the conclusion of such agreements with the participation of third parties is allowed even when these agreements are intended to create the possibility to influence the activity of a company for the latter. The impulsive cause for consolidating of such concept is shareholders' intention to ensure a balance of their interests associated with the activity of a company. The practical importance is attached to such agreements when involving financial investors to a company, who want to secure their investments with the help of relevant contractual rules. Separate limitations for the conclusion of shareholders' agreements with third parties are established where the third party is granted an integral and unrestricted right to determine the behavior of company's participants. The invalidity of such an agreement is based on the principle of prohibition of self-elimination from participation in the affairs of a company [8].

If a company itself participates as a party in shareholders' agreements, the rule § 136 of the Law on Joint Stock Companies should be noted [9], according to which the implementation of the voting right according to the instructions of the company, board or supervisory board of the company is not allowed.

In Kazakhstan, shareholders, a joint-stock company and third parties may also be participants of shareholders' agreements [10].

As a rule, a company acts as a party to an agreement in which all shareholders of the company participate or at least some of them, but according to which the company only receives rights and does not bear obligations to other parties of the agreement. For example, when under the terms of the agreement a company is given the right to file a lawsuit against shareholders - parties to the agreement, if the latter abuse their shareholder rights with respect to the company and thereby cause harm to it.

As the law enforcement practice shows, company creditors and shareholders creditors who are interested in preserving the shares of the respective shareholder for the purpose of foreclosure in case of violation of the obligation, potential investors, spouse of the shareholder in order to control the exercise of rights with respect to joint ownership for shares, etc. may act as third parties [11].

MATERIALS AND METHODS

Terms and Conditions of Shareholders' Agreements: When choosing the terms of a shareholders' agreement, the parties to the agreement must take into account permissible limits of its optionality, otherwise, the agreement can be declared invalid in full or in part as a transaction, which contradicts the requirements of the law. This rule is common for both German and Kazakh legislation. As L.V. Kuznetsov notes, such limits can be divided into three levels [12].

The First Level of Optionality Limits of a Shareholders' Agreement Is Determined by the Restrictions and Requirements Established by Law and Other Legislative Acts: A shareholders' agreement must not contradict the law and its mandatory provisions. The analysis of German and Kazakh legislation on joint-stock companies has shown that many norms in-laws are formulated imperatively and cannot be changed at the discretion of parties to the agreement. It is done to protect the rights and legitimate interests of participants in corporate legal relations, primarily minority shareholders, as well as other individuals, primarily creditors of a company [13]. Nevertheless, when deciding whether each specific rule of law is mandatory or dispositive, it is necessary to proceed from the fact that the norm is mandatory if it contains an expressed prohibition on the establishment of a condition by the agreement of the parties, which differs from the rule stipulated by this norm. For instance, it stipulates that such agreement is void, forbidden or not allowed, or it indicates to the parties' right to deviate from the norm contained in the rule only in one direction or the other, or the prohibition mentioned is otherwise rendered unambiguously in the text of the norm [12]. § 12 of German Law "On Joint-Stock Companies", where it is stipulated that the release of many-voiced shares is not allowed, § 26 indicating that any pre-emptive right granted to an

individual shareholder or a third party must be specified in the company's charter with the indication of the empowered person and others may be referred to such norms. The Law of the Republic of Kazakhstan "On Joint-Stock Companies" - clause 5 of Article 13, which prohibits the transfer of the right to veto, certified by "golden share"; part 3 of clause 1 of Article 22, which establishes a ban on payment of dividends on preferred shares of a company by securities, etc. A particular attention should be paid to clause 3 of Article 14 of the Law, which stipulates that the restriction of shareholders' rights set forth in clauses 1 and 2 of this article is not allowed. But Kazakhstan's judicial practice is based on the fact that no one has the right to restrict shareholders' rights, if a shareholder himself does not want to, referring to Item 2 of Article 2 of the Civil Code of Kazakhstan, according to which citizens and legal entities acquire and exercise their civil rights and also refuse, unless otherwise provided by legislative acts, from the rights of their self-will and interest. They are free to establish their rights and obligations based on an agreement and in determining any of its conditions that do not contradict the law [14].

However, as it was noted above, in the event of a discrepancy between a shareholders' agreement and mandatory norms of the law, as a rule, the invalidity of its relevant terms or the agreement as a whole may be the possible consequence. As an example, it is possible to specify the award of the Specialized Inter-district Economic Court of Almaty dated 23.02.2015 on invalidation of clause 3.2 of a shareholders' agreement between shareholders of "Almatystroy" JSC, according to Article 158 of CC RK, due to the fact that the parties to the agreement changed the statutory period for payment of shares from 30 to 60 days (Part 3, Clause 3, Article 25 of the Law of the Republic of Kazakhstan on JSC) [15].

The Second Level of Optionality Limits of a Shareholders' Agreement Is Restrictions and Requirements Established by the Constituent Documents (Charter) of a Legal Entity.: In some special studies, the establishment of different types of correlation between the charter of a joint-stock company and a shareholders' agreement is justified:

- Shareholders' agreements may clarify (explain) norms and rules specified in the company's charter;
- Shareholders' agreements may be concluded on issues not considered in the company's charter (in some cases and in the legislation either, thus compensating shortfalls of the institutional environment);
- Shareholders' agreements may be used instead of the company's charter (i.e., be a hybrid form of managing contractual relations for the creation of a joint venture);
- Both the charter and the shareholders' agreement can operate in the company, but since creation and modification of terms of the shareholders' agreement are associated with lower costs, it de facto serves as the main document that governs the company's activity [16].

The analysis of German corporate legislation allows concluding that the issue of correlation of the charter and the shareholders' agreement is undoubtedly determined in favor of the charter. As H. Weber states, relations regulated by the charter are preferred in most cases, even if another option for the distribution of interests is stipulated in the shareholders' agreement [17]. In other words, the parties to the agreement at their own discretion may not subsequently change the provisions of the charter, which are subject to mandatory securing in the charter, according to law [18]. Generally, such agreements are void. At the same time, German judicial practice admits exceptions to this rule, but only if, despite the violation of the charter, a participant whose rights are somehow affected by an actual change, cannot refer to invalidity in relation to other participants, since otherwise such participant would behave inconsistently, as he has earlier expressed his agreement to the actual change that was reflected in the agreement and then he referred to its invalidity due to formal non-compliance of the procedures for changing the charter [19].

For example, in one of the court cases, the dispute was the fact that participants, who together owned more than 3/4 of shares before holding a meeting between them, have agreed on their voting behavior. However, during the general meeting, one of the participants did not adhere to the agreements reached and voted against the decision previously taken by the participants (by contract). In the course of an adversary proceeding, participants sought compensation for damages from the participant who violated the agreement of the parties [20]. The defendant objected, referring to the fact that the resolution adopted by a simple majority of votes is invalid and therefore the previously reached agreement of the participants is invalid, since in accordance with the Law on JSC, for the adoption of such a resolution, a qualified majority of 3/4 of the votes is required. The German Supreme Court considered such a vote at the general meeting to be valid, since the participant in his behavior at the meeting was

not bound by the agreement, but at the same time it indicated that shareholders' agreement on the exercise of the right to vote was also valid and therefore the participant who voted at the meeting in a different way, actually violated his duties. Thus, the German Supreme Court confirmed that violation of obligations and legal agreements between participants does not affect corporate relations [8].

In Kazakhstan's civil law doctrine, little attention has been paid to the issue of the relationship between terms of a shareholders' agreement and a company's charter. The common position that has prevailed among scientists of civilization and lawyers is that conditions of shareholders' agreements should not contain provisions that contradict the charter of a company. Moreover, judicial and arbitration practice in this area is completely absent. Therefore, we will try to find an answer to this question based on a system analysis of the legislation [21].

Clause 2 of Article 9 of the Law on Joint-Stock Companies establishes a minimum set of information that should be reflected exactly in the charter. In this regard, the provisions listed in this article must necessarily be reflected in the company's charter, their inclusion in any other document, in our case, in shareholders' agreement, does not fill the gap and is considered non-fulfillment of mandatory requirements of the law. Other provisions that are expressly indicated to be reflected in the charter may either be included in it or not but may be fixed in a shareholders' agreement. Those provisions that should not be necessarily reflected in the charter due to the law can be regulated by shareholders' agreements. If there are provisions contradicting each other in the charter and the corporate agreement, the priority should be given to the base of the above distinction [22].

Thus, the shareholders' agreement is given a secondary role in relation to the charter, that is, it should not contradict it under those provisions that, by virtue of the law, must be reflected in the charter on a mandatory basis and provisions affecting the interests of third parties, primarily creditors of a company. In the remaining part, the shareholders' agreement is subject to the general principle of freedom of contract [23].

The Third Level of Optionality Limits of a Shareholders' Agreement Is the Level of Restrictions and Requirements Established by Other Agreements, Primarily by Another Shareholders' Agreement: A participant of an agreement upon entry into an agreement of shareholders may be bound by other agreements that, in one way or another, prevent from or restrict the conclusion of a shareholder's agreement. At the same time, it is necessary to take into account relevant general provisions of the civil legislation of the countries under consideration, which certainly apply to shareholders' agreements and stipulate that unilateral refusal to fulfill the obligation and unilateral change of its conditions are not allowed, except in cases stipulated by the law or by the agreement of the parties [24].

For example, a shareholder enters into a preliminary contract for the sale of shares and then enters into a shareholders' agreement that provides for his obligation with respect to the same shares in terms of their sale under certain conditions and in a certain time to other shareholders. These obligations contradict each other; the fulfillment of one makes it impossible fulfill another one. In other words, in the situation under consideration, it is impossible to challenge a shareholders' agreement only because it contradicts the earlier transactions since the law does not give us a direct reason for this. It is also impossible to challenge a transaction that contradicts the terms of a shareholders' agreement on the same basis. Accordingly, either one or the other obligation will be violated. The compensation for damages or the use of other remedies provided for by the relevant agreement will be a possible remedy in this case [25].

RESULTS AND DISCUSSION

The Law Applicable to a Shareholders' Agreement: In Germany, the issue on the applicable law is decided in accordance with the personal statute of a joint-stock company. Nevertheless, there is no way to determine such a statute at the legislative level. However, as the analysis of judicial practice and the work of German scientists show, when entering into agreements with companies that are part of the countries of the European Union, the personal statute of the legal entity determined at the place of establishment of the company is applied, since in EU countries the statute of a legal entity is determined by the incorporation theory. In relation to companies of other states that are not part of the European Union, the statute of a legal entity is determined by the location of the company's management bodies. In cases where the characteristics of a legal entity are not available, the statute of a contract (agreement) determines the applicable law. On other relations arising out of a shareholders' agreement its parties have the right to choose the applicable law at their discretion. If the applicable law is not specified in the agreement for some

reason, the court determines the applicable law with the law of the country with which the agreement has the closest relationship [26].

It should be noted immediately that there is no judicial practice in Kazakhstan on this issue. However, proceeding from the analysis of the Kazakhstan legislation we can conclude that the issue on the applicable law in relation to a joint-stock company is solved in accordance with its personal law, in turn, the law of the country where it was established is the personal law of the legal entity (Article 1100 of the CC RK). On other issues arising from the agreement, the applicable law is chosen at the discretion of the parties. If it failed to reach an agreement between the parties on the applicable law, the law of the country where the party, which carries out the execution of crucial significance for the content of such agreement, is established, has the place of residence or principal place of business, applies [27]. If it is impossible to determine the execution that is crucial for the content of the contract, the law of the country with which the contract is connected more closely is applied (Clause 4 of Article 1113 of the CC RK).

Ways to Enforce a Shareholders' Agreement: One of the key issues related to the conclusion of shareholders' agreements is the definition of the best ways to enforce obligations of the parties. Thus, various views are expressed in the scientific literature about what means of securing obligations can be used in relation to shareholders' agreements and which of them are the most effective ones, taking into account the specific features of the obligations arising from the shareholders' agreement [28].

As the analysis of scientific works and law enforcement practice shows, in Germany, quite different security measures are used for the obligations arising from the shareholders' agreement. For example:

- A joint deposition, including sequestration, of shares to a third party,
- A delegation of authority to exercise of shareholders' rights to a specially authorized person or another third party who will act as a representative with respect to implementation of rights on shares and rights from shares encumbered by the conclusion of a shareholders' agreement,
- An agreement on a penalty in case of breach of the contract,
- A transfer of shares belonging to the party to the shareholders' agreement into the common ownership of all participants;
- Entering shares in a holding company in which all shareholders authorized by the agreement participate,
- A fiduciary transfer of shares to a third party performing trust management of shares,
- A transfer of the right of use in the event of a breach of the contract
- A transfer of the contingent right of sale in case of breach of the contract [29].

The parties' choice of one or another interim measure always depends on the subject of the shareholders' agreement. The contractual penalty, for example, is used if the shareholders' agreement provides for such obligations of the parties as to acquire or to dispose shares at a predetermined price; to refrain from alienating shares before certain circumstances arise [30].

Under Kazakhstan law, obligations from shareholders' agreements, like any other civil obligations, can be ensured by the methods expressly provided for in Clause 1, Article 292 of the CC RK, namely - penalty, pledge, withholding the debtor's property, guarantee, deposit, guarantee fee and other means provided by the law or the contract. This means that the parties to a shareholders' agreement may foresee in the text of such an agreement other means of securing obligations than those provided by Article 292 of the CC RK. For example, in one of the shareholders' agreements between three major shareholders of the company, the work in which the author of this article participated, the parties established the right of preferential purchase of shares as an interim measure in the event of violation of the terms of the contract [31].

Mandatory Bid: In German take-over law, a mandatory bid takes place only in the case of a change of control, Section 35 German Take-Over Code. For the change of control, Section 35 German Take-Over Code refers to the general principle laid down in Section 29 (2) German Take-Over Code. Control is the holding of at least 30 per cent of the voting rights of the issuer. There is no additional mandatory bid for other quotas of voting rights; even if a shareholder surpasses the quotas of fifty or seventy-five per cent, there is no additional duty for a public offer [32].

The quota of 30 per cent provides a strong indication that an acquirer will be in a position to have the majority of votes in a general meeting, it might be set even too high for covering "control" of the company in the majority of cases. According to a contribution of Andreas Cahn, in Germany, the average attendance at general meetings of the DAX-30 companies was 49, 87 percent in 2006 and

of 57,58 percent in 2011, the average in the years from 2006 to 2011 was 56,36 percent, with the high of 58,63 percent in 2009. The average in 15 European countries was slightly higher with 52,97 percent in 2006 and 65,06 percent in 2011 [33].

Acting in concert, Section 30 (2) German Take-Over Act

The Concept: Acting in concert is discussed in Germany under the English expression and is beside the board neutrality rule and the mandatory bid at the center of academic interest. Acting in concert is in short defined in the European directive as co-ordination to get control of the company. Whether control has to have a long-term element like the acting in concert provision in the transparency directive is not clear, at least not necessarily from the phrasing of the Take-Over directive. The amendment of the acting in concert provision in 2008 aimed to expand the provision but also to keep it harmonized with the acting in concert-provision under the German Securities Act. Nevertheless, the different purposes of the Securities and the Take-Over Act might make differences necessary.

Section 30 German Take-Over Act defines acting in concert in short as shareholders' agreement which aims at coordinated conduct with the other shareholders in the voting at the shareholder's meeting or in other forms with the purpose of a long-lasting and significant change of the business practice of the issuer. In full in the translation of the Financial Supervisory Authority: Any voting rights attached to shares in the target company which belong to a third party shall also be attributed to the offer or in his subsidiary coordinates, on the basis of an agreement or in another manner, his conduct with such third party in respect of the target company; agreements in individual cases shall be excluded. Coordinated conduct requires that the offer or his subsidiary and the third party reach a consensus on the exercise of voting rights or collaborate in another manner with the aim of bringing about a permanent and material change in the target company's business strategy.

The financial supervisory authority (BaFin) restricts the assignment of shares to shares included in a shareholders' agreement, other shares held by the partner in the shareholders' agreement do not have to be taken into account. Practitioners report that this rule is practice also in take-over situations, but hold that the wording of the Take-Over Act requires the assignment of all shares held by the partner in the shareholders' agreement, even if they are in part explicitly not covered by the agreement.

Shareholder voting agreements are to be seen as the "classical" case of acting in concert. Acting in concert is also applied when the free will of all parties is lacking. Controversially discussed is the question whether shares must be attributed to all partners in the shareholders' agreement. While the Financial Services Authority (BaFin) requires this at least for the disclosure, practice demands that at least for the acting in concert provision in the German Take-Over Act, the attribution has to be restricted to a controlling partner in a shareholders' agreement.

There are also differing views concerning the content of the shareholders' agreement necessary to establish acting in concert. Some assume that also agreements introducing only duties to consult with the other partners of the shareholders' agreement, leaving the voting in the general meeting nevertheless at the discretion of the partner in the shareholders' agreement, while others exclude such arrangements.

The establishment of parallel purchase of shares as an explicitly regulated special form of acting in concert was skipped during the legislative process. When Allianz sold its stake in Beiersdorf, some supposed that two buyers who together hold more than thirty per cent of the shares are (or at least: should be seen as) acting in concert. In the acquisition process of Continental, conducted by Schaeffler, the question arose whether a swap might constitute acting in concert.

Election of Supervisory Directors: Due to the restricted powers of a general meeting in German stock corporation law – Germany introduced a rule generally excluding shareholders from the management of the company, transforming the US rule into the German Stock Corporation Act 1937 –, especially electing supervisory directors is discussed as acting in concert. The election only of supervisory directors is treated as a singular case, not leading to the application of the acting in concert provision in the German Take-Over Act, according to the German Supreme Court and a widespread view in academia, for in Germany regular occurring consultations of major shareholders even a unanimous view in literature is assumed. Election of the chairman of the board: independence of the supervisory board.

Acting in concert is assumed if the election of the supervisory board is part of a business concept. However, even in this context, practitioners hint to exclusion of agreements in individual cases from the acting in concert provision of the Take-Over Act. In the parliamentary proceedings, the Financial Committee

phrased the later enacted Section 30 (2) Take-Over Act and stated that an agreement on the election of supervisory directors "regularly" leads to the application of the acting in concert provision.

Individual Cases: Due also to the influence of institutional investors, the coordination in individual cases does not explicitly fall under the acting in concert provision, Section 30 (2) 1, 2. clause. Also multiple single cases do not lead to the application of the acting in concert provision, necessary is a Fortsetzungszusammenhang (continuation).

For the continuation, a stricter standard than in the Securities Trading Act seems to be appropriate. In Germany, it is difficult to prove acting in concert. Also, due to Deutsche Börse, acting in concert by institutional investors is discussed. Before the WMF-decision of the German Supreme Court literature referred to acting in concert as internationally understood.

3. Exemption German Supervisory Authority exempted dispended a shareholders' agreement from a mandatory take-over-bid in a case in which one member had before more than thirty percent and the whole pool owns less than fifty percent (Grenkeleasing).

CONCLUSION

In accordance with the general principles of German civil law, a shareholders' agreement may provide civil liability for non-fulfillment or improper fulfillment of such obligations. Namely, if one of the parties violates the terms of the agreement, the other party is entitled to claim damages or contractual penalty.

However, in practice with respect to compensation for damages, there are doubts about the effectiveness of this measure of liability, taking into account the specificity of shareholders' agreements that resides in the fact that in most cases losses cannot be estimated in monetary terms, which leads to inability of legal recovery [34]. Nevertheless, in this case, the law authorizes courts to assess a number of losses independently (§ 287 of the German CPC). As for the penalty, it is the most common measure of liability for breach of obligations arising from a shareholders' agreement. As a rule, parties independently determine its amount. At the same time, the German legislator attaches the right to the court, to reduce its amount to a reasonable amount upon the application of the debtor (§ 343 of the German Civil Code).

In Germany, shareholders' agreements were discussed primarily as a company law issue but are of practical importance also in listed companies. Shareholders' agreements occur primarily in the family held stock corporations but are at least not disclosed in all firms with different family members as shareholders. Forms of shareholders' agreements are shareholder voting agreements (Stimmbindungsverträge), pooling of shares, mutual understanding. Legally, shareholders' agreements are treated as a civil partnership, according to the German Federal Supreme Court shareholders' agreements are non-disclosed or internal civil partnerships. The application of the rules on partnerships does not transfer the majority requirements from the stock corporation to the decision-making in the shareholders' agreement. The general rule of unanimous decision-making might be transformed to simple majority voting but restrictions of the selling of shares by members of the agreement are to be controlled by the courts, selling clauses have to provide for a fair value, not necessarily the exact market price.

Legal provisions dealing with shareholders' agreements are limited in Germany. The Stock Corporation Act prohibits bound shares. Selling of voting is an administrative offense. In the Securities Trading Act and in the Take-Over Act, the legislator introduced a common concept, often referred to as acting in concert for both Acts. With the Financial Supervisory Authority, it might be more suitable to speak of coordinated conduct in terms of securities law and of acting in concert in terms of the take-over law. If there is a controlling partner in the shareholders' agreement, it seems sufficient that the latter has to take out a mandatory bid but all members of the shareholders' agreement should disclose all shares covered by the agreement. Nominating and voting for supervisory directors is regularly treated as an individual case.

For listed companies, transparency could (and should) be enhanced with a duty not only to name a figure for the shares held but also the shareholders' agreement itself. Further, it seems appropriate to publish also the majority voting rules in the shareholders' agreement. The same would apply if the shareholders would transform their shares into a limited liability company. For outside shareholders, unanimous or majority voting in the shareholders' agreement might make a difference.

In Kazakhstan, according to the general rules of the CC RK on obligations, in the case of non-fulfillment or improper fulfillment of obligations under the shareholder

agreement, general civil liability measures are applied, including compensation of damages and payment of penalties. These measures of liability with respect to shareholders' agreements are understood and applied in practice, in relation to other civil contracts either. To recover damages, the creditor must prove the fact of violation of the obligation and causing damage (Article 351 of the CC RK) and to recover the penalty - only the fact of violation of the obligation. Therefore, the requirement to collect penalties in practice is much more common than the claim for damages.

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