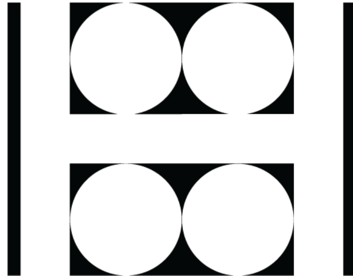
LEGAL BRIEFING – Banking & Finance

by Alexandros Kosmopoulos – Managing Partner



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a.kosmopoulos@aklawgfirm.gr

Shareholders' Agreements; 10 focus areas

Shareholders' agreements are one of the most common business agreements. However, they are also amongst the least standardized and most extensively negotiated types of arrangements, owing to the endless variations resulting from diverse business situations and different dynamics amongst shareholders.

Various different factors affect the range of issues regulated by shareholders' agreements. Perhaps the most objective factor is the allocation of voting rights and resulting dynamics; majority shareholders that are able to control a corporation under applicable law tend to have little incentive to dilute their statutory privileges and concede additional rights to minorities, while minority investors are reluctant to consider significant investments in minority stakes without the additional protections offered by shareholders' agreements.

The balance of power resulting from this fundamental clash is also driven by other factors, including: (i) the perception of the majority as to the value and criticality of capital or other contributions envisaged to be made by the minority shareholders (including the time sensitivity of such contributions, particularly for businesses not yet stabilized, under distress or in need of capital to realize their growth potential);

(ii) the relative power of individual shareholders and that of potential alliances amongst shareholders; (iii) legal or regulatory requirements or limitations; and (iv) the deal generation process (bilateral negotiation vs. competitive process). 50%-50% joint ventures are in a class of their own, as they present unique issues not observed in scenarios involving a clear majority and a clear minority.

The following list illustrates the most common focus areas for practitioners active in drafting and negotiating shareholders' agreements. The list is indicative, non-exhaustive and is not a substitute for legal advice. Successfully tailoring a shareholders' agreement requires advice specific to each case, by professionals possessing a thorough understanding of the underlying business parameters and experience applying the appropriate legal tools available to address the unique requirements of each case.

1. **The Business.** Defining the business is more straightforward for special purpose vehicles, but can be more challenging for commercial corporations. It is important for parties to identify the perimeter of the business of the corporation, as well as conditions for expansion to other business lines, products or jurisdictions. Equally importantly, the parties may wish to regulate the ability of shareholders to pursue competing business activities or activities in adjacent business sectors directly or through other business entities, and the referral of relevant business opportunities to the jointly held entity.

2. **Shareholders' contributions.** Agreeing on shareholders' contributions typically involves provisions on funding the business (including initial, ongoing or contingent equity contributions), the instruments to be used to provide such funding and the terms applicable to such instruments. However, the agreement may also need to deal with other resources that are to be contributed by one or more shareholders, such as the supply of goods or services, intellectual property rights, know-how, business processes or management services, clientele, etc.

3. **Corporate Governance.** One of the most extensively negotiated aspects of shareholders' agreements are its governance provisions. These invariably include provisions on the composition of the board of directors and rights to appoint its members, and typically extend to rules on the formation and composition of committees, the selection, appointment and functions of key officers, delegated authorities (including four eyes' rules, signing limits or matrix systems), reporting and information rights. It is not uncommon for shareholders' agreements to introduce corporate governance standards beyond those applicable to a particular entity by operation of law (such as the requirement for independent NEDs to sit on the boards of non-listed companies).

4. **Connected persons.** There are obvious sensitive issues around a corporations' dealings with its shareholders and management or persons associated with, or capable of being influenced by, or having interests aligned with, its shareholders or management. Such issues include conflicts of interest and the risk of such arrangements not being on market terms and resulting to inappropriate leakage. Accordingly, shareholders' agreements

would typically contain restrictions, including specific approval processes and quantitative and other limitations applicable to dealings with connected persons.

5. **Performance.** It is common for shareholders' agreements to contain provisions relating to targets (financial or other) that relate to the valuation of shares, the measurement of the performance of management or the assessment of the overall success of the entity's business, together with incentives for achievement and consequences for failure to perform adequately. These arrangements typically come together with mechanisms on curing shortfalls and on the resolution of disputes specific to the measurement of performance, including in particular disputes having a bearing on valuation of shares. As part of discussions around financial performance, minority shareholders would typically prioritize agreeing on a clear and transparent dividend and distributions policy.

6. **Reserved Matters.** Reserved matters are those specific pre-agreed categories of matters requiring the consent of a supermajority of shareholders (i.e., a majority exceeding the one required by law), or one or more specifically named shareholders. It is easy to see that reserved matters are one of the most critical aspects of shareholders' agreements. Without them, the minorities would be exposed to the supremacy of the majority and potential arbitrary action. With them, the minorities can leverage power in the corporate workings that goes beyond the power of their nominal holding. Some of the most sensitive topics related to structuring reserved matters include: (i) the possibility for resulting deadlocks and the process to apply to resolve deadlock and enable the corporation to function normally; and (ii) the extent of veto powers vested with minorities. The range of veto powers can result in these arrangements being seen as arrangements affording joint control of the majority and the minority over the entity, which may in turn have significant repercussions in various areas, including the competition law assessment, and (for listed companies) whether shareholders may be seen to be acting in concert and therefore be under an obligation to launch a mandatory tender offer.

7. **Transfers.** Rules on transfers come in various formats, but tend to include temporary (absolute or qualified) restrictions on transfers (a lock-up period), the criteria needed to be satisfied by transferees, the obligation to offer one's shares to other shareholders before transferring to a third party, third-party approvals (such as approvals by the company's lenders or regulators), as well as options. Options are unilateral rights to cause a transfer on pre-agreed terms and subject to pre-agreed conditions, and can be seen as an entirely separate chapter, owing to their different variations and their application to different scenarios. Ancillary mechanics (such as escrow arrangements, powers-of-attorney, etc.) are required to ensure that, once, exercised, options can be fully implemented without the need for further consents.

8. **Exit.** Different shareholders may have different strategies, preferences and expectations regarding exit. Typical exit paths include joint sale processes, a drag-along process, the exercise of options, a merger or an IPO. The approach to exit is often driven by the investment mandates of shareholders that are institutional investors; these prescribe

maximum holding periods for investments, beyond which investments are to be monetized, and may also include minimum required returns. Key contested issues include the priority of exit, access of shareholders to opportunities to exit (such as through tag along rights or drag along rights), access of minorities to deals involving a control premium, and provisions around investor preference over the proceeds of a liquidity event.

9. **Default.** Damages resulting from a breach under a shareholders' agreement are very challenging to quantify and, by consequence, notoriously challenging to pursue legally as a matter of Greek law. Accordingly, a properly structured shareholders' agreement would need to contain provisions that deal effectively with default, such as provisions on escalation, dispute resolution, penalty clauses (the civil law equivalent of liquidated damages) or forced exit provisions.

10. **Articles.** Last, but not least, it is essential to consider how best to structure the company's articles of association to reflect those of the provisions of the shareholders' agreement that are capable of being incorporated therein. The benefits of properly aligned articles include opposability to third parties and access to additional legal remedies to challenge corporate action taken in violation of the arrangement.