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Attorneys at Law
News in Laws – Legal Monthly Newsletter
September 2018

cover article

Shareholder options - added value of a business acquisition or just a theory?

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On an active merger and acquisitions market, as it has been in Romania in recent years, investors have always sought advantageous, innovative and "nonconformist" transaction structures in order to transpose as closely as possible the intended medium or long term investment plan.

With the opening of the market and the infusion of foreign capital into the local economy, not only services, products or business models were imported, but also new concepts and legal structures reflecting the progress of the market they were regulating. The Anglo-Saxon law system and the business practice attached to it were the main source of influence for the Romanian law system, as it probably inspired other law systems in Central and South-East Europe countries characterized as emerging economies.

An essential part of a merger or acquisition, and particularly in the context of establishing a joint venture, is negotiating shareholder agreements, including so-called shareholder options. In Anglo-Saxon law, the options reserved by shareholders are varied: the *call option* - option to buy other shareholder's shares, the *put option* - option to sell shares to the other shareholders, the *tag along option* - option to sell together with other shareholders, or the *drag along* option - requesting the package sale of the shares of others shareholders too.

Options have also been introduced in local business practice, being widely used in complex deals negotiated between partners with a certain degree of sophistication. Beyond the terminology borrowed from Anglo-Saxon law, "options" are nothing more than shareholder agreements, within the meaning of the Civil Code and Companies Law 31/1990.

The shareholder agreements are the result of a business compromise, but they can not intervene under any circumstances, however favorable to the commercial interests pursued by the parties, and instead must be coordinated with the applicable law and the limits imposed by it. There are no formal requirements for the validity of a shareholder agreement. Whether established by statutory documents or have extra-statutory basis, the written form of the shareholder agreement is sufficient for its validity, enjoying all the rights of a legally concluded covenant.

Concerning the substance of an option-type agreement, in judicial practice, though poor in the matter, there are opinions whereby it is subject to the provisions of Art. 128 of the Companies Law 31/1990 prohibiting the assignment of the right to vote and the nullity of the covenant by which the shareholder undertakes to exercise the voting right according to the given instructions or the proposals made by the company or the persons with representation authority. According to an earlier decision of the High Court of Cassation and Justice, the clause in a sale-purchase agreement concluded with AVAS, according to which within one year the company will benefit from investments in a set amount,

is null and void, since by this clause a certain way to vote in the general meeting of shareholders is anticipated. The interpretation of the court is at least controversial, since the purpose of the above-mentioned regulation is to protect the company from shareholders' occult dealings, which could adversely affect the company's operation and activity, and not to eliminate and sanction any strategy which associates could set up in advance regarding the business of the company.

The prohibition under the Companies Law do not refer to any shareholder agreements, tacit or explicit, which may be concluded by virtue of contractual freedom, but only to those which have the object of voting in a certain way to the detriment of the priority interest of the company, agreements which, by their scope and purpose, affect the freedom of the right to vote, which is exercisable free of any constraint.

As has been said, "voting covenants imply a restriction of voting freedom, but this is done through the exercise of another freedom, namely contractual freedom." Therefore, shareholder agreements should be analyzed in a much wider context, taking into account the specific situation of each company, the shareholding structure and business model, the context of the market in which it operates, etc. Otherwise, the rules of law and their interpretation and application should keep up with the reality of business activity, which are continuously changing.

Subsequent to the validity assessment, how efficient are the effects of a shareholder agreement, carefully negotiated and regulated by the parties, if the bound party refuses to execute it? It is an essential aspect that can add to the value of a deal or, on the contrary, can render very sophisticated agreements merely theoretical.

The answer should be sought in the Civil Code provisions on compulsory enforcement. In principle, the obligations imposed on the parties by the shareholder agreements are *to do* obligations. The *to do* obligation is circumscribed, for example, by the obligations undertaken by a shareholder regarding the promise of sale or purchase of shares (e.g. call option or put option), the obligation to vote on a share capital increase, to vote in favor of appointing directors, to vote on contracting a loan, etc.

According to **art. 1528 of the new Civil Code,** in the event of failure to perform a *to do* obligation, the creditor may execute itself the obligation or cause it to be enforced. However, this general principle of compulsory enforcement has an important limit when interfering with companies law: the intangibility of the right to vote and, to a certain extent, the prohibition of covenants on voting. When the shareholder bound by an agreement votes in the general meeting contrary to what they have undertaken to do, said decision of the general meeting remains valid and the vote is deemed valid irrespective of the obligation assumed through the shareholder agreement stipulating the contrary.

In light of Art. 128 of the Companies Law 31/1990 which explicitly prohibits the assignment of the right to vote, a vote expressed in the general meeting by the beneficiary of a shareholder agreement, as a form of compulsory enforcement of the *to do* obligation breached by the party bound by the agreement, will never be validated. However, it would be worth analyzing the possibility of recognizing the validity of a mandate granted *a priori* for the exercise of the right to vote in a future general meeting, with the agenda of the legal operation in the scope of the shareholder agreement (for instance, the vote for the sale of shares in the conditions set out in the shareholder agreement, or the affirmative vote for a share capital increase). This, all the more so since the company itself (through a legal representative and, possibly,

based on a decision of the general meeting of shareholders) can be included as a signatory of the shareholder agreements.

As regards the compulsory enforcement shareholder agreements, French case-law - which may be a source of influence on the jurisprudence of Romanian courts - has been more flexible in accepting the compulsory enforcement of certain shareholder agreements, such as the first refusal right or the establishment of a certain composition of the supervisory committee of a company. However, even in France, case law is not consistent in this respect.

In practice, in order to grant more legal power and efficiency to a shareholder agreement, the parties provide the payment of damages (often in the form of a penal clause) for the situation in which the bound party refuses to execute its obligations. This is the classic way of enforcing the obligation to pay a sum of money, verifying in this case the quality of writ of enforcement of the shareholder agreement, together with the certain, liquid and payable nature of the amount. Regarding the first element to be verified, obviously the authenticated form of a shareholder agreement would help. However, in practice, shareholder agreements are rarely authenticated, the most used form being the document under private signature. This, all the more so since the parties to shareholder agreement often choose to only include in the company's statutory documents (public documents that ensure the opposability of their agreement towards third parties) a summary of these agreements, keeping the details thereof confidential. The practical correlative disadvantage is the hindrance of the compulsory enforcement procedure.

As regards the certain, liquid and payable nature of the damages as a result of non-compliance with a shareholder agreement, they depend to a large extent on the way in which the relevant clause was drafted. Setting clear amounts and benchmarks on how to pay will facilitate the recovery of damages in the case of refusal to voluntarily execute the obligation.

Concluding on the above, and as already stated in the specialty literature, the weakness of the shareholder agreement is its enforcement. It will be interesting to see how the jurisprudence will align the way of interpreting and applying the rule of law to the reality of business activity which ideally should allow for the possibility of enforcing such agreements in kind.