

THE SIGNIFICANCE OF SHAREHOLDERS AGREEMENTS IN A POST COVID-19 ERA

January 2021

The recent COVID-19 outbreak has heavily shaken the financial markets worldwide during the past year. In light of the positive news of the various vaccines which are now becoming slowly available in the European Union and the rest of the world we are all looking forward to returning back to market stabilization and normality.

The pandemic has forced various business owners to take tough decisions. Various clients of E&G Economides LLC have reached out for advice on how to tackle the numerous challenges conveyed upon them by the aforesaid pandemic.

Even though in modern society such a pandemic was unprecedented, the issues that arose in relation to companies' processes and operating environment were not. We have seen situations in family businesses, whereby the unavailability of all three Directors and their alternates to exercise their duties was holding back significant decisions on daily operation matters of a company. In other occasions, a deadlock arose as to the "decisions" which had to be made in a very brief amount of time for the sustainability of a company.

On the one hand, it has become clear to us that companies where the decision making shareholders (siblings and/or investing partners) involved, had a Shareholders Agreement ("SHA") in place, no significant problems arose. On the other hand, Joint Ventures or companies without such agreements in place, faced huge difficulties in operating within the new framework imposed by the pandemic.

Briefly explaining the basic framework and operation of a SHA under the laws of the Republic of Cyprus and in accordance with the Companies Law Cap.113 (the "Law"), Cyprus companies are governed and controlled by their Memorandum and Articles of Association ("M&AA").

The main difference between the two, is that the Memorandum of each company states the purposes for which each specific company was incorporated whereas the Articles of Association state the various core principles which govern the day to

We have seen situations, whereby the unavailability of all directors was holding back significant decisions.

day procedures of operations in a company. In general, the Articles of Association ("AoA") of a company may implement any of the principles, which can be found in Table A of the Law.

It should be noted that certain issues may arise, such as when the AoA do not specifically define what happens where there are different views regarding the operations of a company or the purchase and sale of shares to rival corporations or even a simple voting for the approval of important decisions, that concern the company and all its shareholders. However, the practice is that, where AoA are insufficient, the Law shall apply.

Despite the Law itself, there is no higher form of protection since in the corporate world; matters are usually complex and composite. Indeed, it is not uncommon for majority shareholders to take advantage of this and in cases where they control more than 75% of the shares (themselves or in a cooperation); they amend the provisions which protect the minority with a 'special resolution' and eventually control the company any way they prefer. This of course, raises serious problems to the minority shareholders thus not being able to have a say or will not be protected against the Majority shareholders decisions.

Moreover, there are cases where a minority shareholder could prevent a majority shareholder on selling their shares or even be able to transfer their

A SHA, mainly contains precise rules relating to the company and the relationship between its shareholders.

shares to anyone which may have negative impacts to the company's future growth. For example, this could be done by providing confidential information to a competitor; something that would greatly affect the company's future. Data Protection Laws and Contract Law restrict unauthorized disclosure of information. Having in place a SHA can restrict such unauthorised disclosure and can protect the confidentiality of the members of the company. It can also implement severe damages to the breaching party.

In order to prevent the aforementioned matters, we generally endorse and recommend to our

clients the implementation of a SHA during the formation of the company or in case where additional shareholders are joining in a corporate venture. It is always recommended that such agreements be executed at an early stage. This will allow the shareholders to comprehend whether a common understanding exists as regards to their investment.

A SHA is in short an agreement between either all or some of the shareholders of a company (e.g. when shareholders own a specific class of share) entering into a contract between themselves, by regulating what they can or cannot do and how the company will be managed in general. It is important to mention that the provisions of the SHA are de jure binding and enforceable by all parties thereto. Such SHA, mainly contains precise and useful rules relating to the company and the relationship between the shareholders and further benefit both minority and majority shareholders. An example that benefits the minority Shareholders if a SHA is in place, is the presence of a provision, stating that if somebody is prepared to acquire the share capital held by a majority shareholder, that said shareholder could only proceed with the transaction only after the same proposition was offered to all members of the company whose shares are subject to acquisition. This can safeguard the company and its members and hence reinforce the constitution of the company contained in the Articles of Association. Furthermore, once a SHA is implemented, it allows the formation of just relations amongst the shareholders and allows a smoother and better operation of a company.

Adding to the above, a well-drafted agreement should fully clarify what a shareholder's responsi

bilities, for running the company, are. This provides the structured operation of a company without any unwanted deadlocks. A SHA records the intentions of the concerned affiliates as regards the business, banking etc. Such agreements are usually necessary in Private Limited Companies with more than one shareholder.

In Cyprus Law, a Shareholders agreement can exist and will be valid without the registration of the agreement to the Registrar of Companies according to s137 of the Companies Law Cap.113. Under common Law principles however, the provisions of the AOA will always prevail over a SHA, though in this case it is advisable to file the SHA as a public document with the Registrar of Companies. In actual practice, however, it is not always possible since shareholders usually prefer to keep such agreements confidential. Where the parties choose that the SHA is governed by other jurisdiction(s), great care should be taken. Ensuring that the provisions of the SHA are not materially inconsistent with mandatory provisions of Cyprus law is vital; therefore, advice proper from professionals should always be sought out.

Such agreements can:

- Provide the framework for efficient operation during times of Crisis such as a pandemic.
- Modulate the process required for the sale of shares of a company;
- Designate how the corporation is going to be run i.e. Directors Voting Process and limitations;
- Specifically exhibit each shareholders obligations and/or privileges accruing from a SHA;
- Adjust the appointment and

resignation/removal of Directors;

- Set out provisions to easily resolve deadlock situations (Winning Vote);
- Standardize the issuance, allocation and sale of shares of the company;
- Exhibit the matters reserved to be determined by the shareholders;
- Adjust the amount and method of declaring dividends;
- Clear up disagreement resolution processes;
- Demonstrate how critical decisions are to be made;
- Provide competition restrictions.
- Offer an element of defence for minority shareholders and the company;

It is a valuable tool that provides a procedural background for the administration of the business.

It is undisputable that in certain occasions the SHA is a valuable tool that provides a procedural background for the administration of the business. However in cases where there are conflicting clauses between the AOA and the SHA, the SHA will prevail at a shareholders level but won't prevail over company related issues. Secondly, in case the SHA violates any statute of the Law then the agreement becomes invalid and unenforceable under the current laws. In general, no statutory right of a shareholder can be limited or extinguished by such a contract.

In the event of a breach of the SHA, any party to the contract can bring an action before the court

for any specific action and damages, as well as request an injunction to block the breach thereof. However, if there were a violation of the terms of the Memorandum and Articles, the provisions would possibly be invalid. Simply put, any shareholder of the company and the Company itself are entitled to seek damages for the specific execution of the contractual agreement found in the company's M&AA, as well as an injunction blocking the breach thereof.

Without any doubt, it became clear that the pandemic had a great impact in every aspect. Relevant amendments to the Articles of Association of the company are highly recommended to be made or further, and more efficiently, the implementation of a SHA, which will provide all necessary procedures which may be needed during a pandemic crisis. The aforesaid are required in order to be able to avoid any malfunction in the company or any potential danger against the company, such as legal actions for omissions or acts of the company and/or its Director who was unable to perform his duties due to any negative impact that a pandemic may have caused.

All of the above is generic information and in no way constitutes legal advice. In case of any further and specific information feel free to contact us.

Panagiotis Sofokleous LL.B.

Advocate

panagiotis.sofokleous@economideslegal.com