
# COMPLIANCE WITH SHAREHOLDER AGREEMENTS AS AN OBLIGATION SET OUT IN THE BY-LAWS: NOT "AN IMPOSSIBLE BLEND"

A recent decision of the Spanish Directorate General for Registries and Notaries Public(**DGRN**) dated 26 June 2018 (Official State Gazette of 10 July) has acknowledged the possibility that the corporate by-laws of a joint stock company (*sociedad anónima*) may include an ancillary obligation whereby shareholders must comply with the provisions of a shareholder agreement (or a family protocol, in family-owned businesses). This option, despite somewhat echoing Spanish legal opinion, apparently faced strong opposition until now from the commercial registries, which considered it a "heterogeneous mix" between two legal instruments that are impossible to blend.

**Key aspects**

- The DGRN allows an ancillary obligation to be established in the corporate by-laws whereby shareholders must abide by a shareholder agreement.
- This is a novel solution which should help to bolster the legal enforceability of shareholder agreements by establishing sanctions in the by-laws in the event of a breach of such ancillary obligation.

## THE DISTINCT LEGAL ENFORCEABILITY OF BY-LAWS AND SHAREHOLDER AGREEMENTS

### Rigidity of corporate by-laws

Corporate by-laws are conceived in law as the means available to shareholders to adapt the regulations governing their company to their particular circumstances or needs. Since they are binding, any breach of the by-laws may be prosecuted and sanctioned using a series of corporate remedies (challenge of resolutions, liability actions, invalidating transfers, removal of shareholders, etc.). But in the by-laws, only those shareholder agreements can be included which are not unlawful and do not breach what are known as the "principles which configure the company type" (i.e. the structural traits of each type of company). And according to the imperative approach that tends to prevail in Spanish legal culture regarding corporate regulations, the liberty granted to shareholders to transfer their freely-agreed rules of operation to the context of the company's by-laws faces severe constraints. The by-laws are presented like "*ready-to-wear*" outfits or models in which the operator has no other option than to choose from between two or three pre-set styles.

### Flexibility of shareholder agreements

Shareholder agreements, on the other hand, are like true made-to-order suits, ideal for being adapted to any form of contractual engineering to be done. Here shareholders find no restrictions as to their contents other than the general constraints on autonomous free will, which is tantamount to saying that in practical terms, there are almost no restrictions whatsoever. When configured purely at a contractual level, without being integrated into the company's corporate laws, the general rule is that shareholder agreements "shall not be enforceable in respect of the company" (Art. 29 of the Spanish Companies Act – *Ley de Sociedades de Capital* –"**LSC**"–). Shareholder agreements, like any other contract, are binding

upon the internal dealings of those shareholders who enter into them, but not upon the company itself, which is a third party in relation to them (meaning even though they sign such agreements, leaving aside other aspects for now).

## A VARIETY OF REMEDIES FOR THE BARRIER BETWEEN THE TWO INSTRUMENT TYPES

Since the legal nature and enforceability differs for these two types of legal instruments, corporate by-laws and shareholder agreements, the remedies available to aggrieved shareholders in the event of a breach of the former or the latter have usually also been found in various and parallel means. A breach of the by-laws opens the way to corporate remedies; whereas a breach of the shareholder agreement opens the way to remedies corresponding to contractual liability, including both general remedies (actions with respect to breach, loss and damage, etc.) as well as any specific remedies the parties may have agreed upon, as the case may be (penalty clauses, put and call options, etc.).

This legal barrier between the two types of legal instruments explains the widespread practice whereby as much content as possible from the shareholder agreement is "included" in the by-laws. The intention behind this is to bolster the legal enforceability of the shareholder agreement by including, with the ordinary contractual remedies, the "real" enforceability guaranteed by the by-laws, which comprise the rules governing the company.

## THE DGRN DECISION DATED 26 JUNE 2018

The DGRN decision fails to comply with the traditional principles described above, in the case of the by-laws of an SA, which:

- imposed on the shareholders "*the non-remunerated ancillary obligation whereby shareholders must comply with and fulfil the provisions established by them in the family protocol//shareholder agreements reflected in the public deed*" executed on a certain date before a Notary Public in Valencia (a protocol which had been previously agreed upon in a resolution approved by all the shareholders);
- rendered, as a result, the transfer of the shares contingent upon the company's authorisation, in compliance with the legal regime (Art. 88 LSC), without prejudice to the other restrictions established in the by-laws; and
- established that a voluntary breach of the agreement, decided at the discretion of the management body, was legal grounds for the exclusion of the shareholder in breach.

As the decision indicates, the initially warranted rejection of this clause was unanimously approved by the commercial registrars in Valencia.

The DGRN, however, upheld the appeal against such rejection and concluded that the clause can be registered:

- the decision focuses on the legal requirement to express in the by-laws the "specific and established content" of any ancillary obligation (Art. 86.1 LSC), understanding that in this case the obligation comprising the ancillary obligation would be perfectly identified by means of the reference to the public deed used to formalise the agreement;
- the decision also rejects the other defect invoked by the registrars, in the sense that the company would be tied to certain agreements which by law are characterised precisely by their unenforceability vis-à-vis the company (Art. 29 LSC), although the decision does not go into any particular detail as to the basis for and implications of the solution adopted.

## PRELIMINARY CONCLUSIONS

The decision, which provides nothing more than basic grounds, if its practical and dogmatic significance is taken into account, is undoubtedly courageous and bold, by daring to deviate from the generalised practice in commercial registries and, in actual fact, in the majority of our legal culture. In any case, notwithstanding further and more in-depth analysis, the decision triggers a series of preliminary comments:

- It presents a possibility which should be employed often in practice, as it is a remedy which is simple to implement and which serves to increase the legal enforceability of shareholder agreements;
- It does not seem, however, that this solution will produce the magical effect of binding the company to the full contents of the shareholder agreement, because the company will continue to be bound by the content of its by-laws, except with regard to those matters which specifically affect the shareholders' compliance with the ancillary obligation;

- It does not consequently release the shareholders from reproducing, in the by-laws, the content of their agreement with regard to the usual matters such as the system for determining majorities for passing resolutions or transferring shares or participations, for the purpose of binding the company;
- Its usefulness must be shown, especially in relation to restrictions on the transferability of shares as set out in the shareholder agreement and which are not reflected in the by-laws, because in the event of a breach, the company could deny that this has any effect on transfers in terms of the corresponding breach of the ancillary obligation;
- Notwithstanding the various sanctions that can be established in the shareholder agreement itself, this option should serve to bolster the agreement's enforceability by establishing other corporate sanctions associated with a breach of the ancillary obligation (including shareholders' removal from the company);
- All in all, the paucity of the decision leaves some key questions unanswered, such as for example how third parties might gain access to a shareholder agreement to which mention is merely made in the by-laws.

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