COMPARATIVE NOTES ON SHAREHOLDERS' VOTING AGREEMENTS

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1. The problems concerning voting agreements seem to be a suitable topic for discussions among lawyers.[1] It is, perhaps, the close connection of such contracts with the struggle for economic power that makes even their legal aspects fascinating.

2.1.1. The task of describing the various forms of shareholders' voting agreements is not an easy one. Even where there exists a statute concerning voting agreements—as until recently was the case in France (décret-loi du 31.8.1937)—the legal description will probably be too vague to be of much use. In most jurisdictions, the source by which lawyers are normally supplied with knowledge of the factual situations, viz. case law, fails. Moreover, voting agreements are often shrouded in secrecy. If some legal problem arises it will—as a rule—be solved in the utmost privacy, either by the parties themselves and their lawyers, or by arbitration.[2] As far as the Swedish material is concerned, the only way of collecting it was to obtain copies of agreements and contract forms from lawyers dealing with corporation law.

As was to be expected, the material thus gathered contained many different types and variations of agreements. In what follows the basic contract types have been described in relation to the concept of "control". For the purpose of my study, therefore, a definition of this concept must be given.

2.1.2. When the term "control" is used in expressions like "obtain control of a corporation", it can—approximately—be replaced by "power [over]" and similar terms. It is well known that an accurate definition of power is extremely difficult to arrive at.[3]

[1] The subject of this study was discussed, for instance, in 1955 by the members of the Juridisk Forening, Copenhagen, and in 1956 at a meeting of the Association Henri Capitant. In 1959 the topic was dealt with in the Schweizerische Juristenverein.

[2] Glattfelder, "Die Aktionärbindungs-Verträge", 78: 2 *Zeitschrift für schweizerisches Recht* 155 (1959), Houin and Foyer in 10 *Travaux de l'Assoc. Henri Capitant* 207, 233 f.

[3] Berle and Means, *The Modern Corporation and Private Property*, New York 1932, p. 69.

Hence, it is preferable to use the notion of "control" in a more technical sense.

The following definition, which has been given by Berle and Means, seems useful. "For practical purposes [it may be said] that control lies in the hands of the individual or group who [have] the actual power to select the board of directors (or its majority)".[4] This definition, however, is a little too narrow for use in jurisdictions where the management of a corporation is not, as in the United States, exclusively the task for its board of directors. When one has to describe the situation in countries where the directors tend to follow the decisions of the general meeting, as is the case in France and the Scandinavian countries, the term control might be defined as the power to enforce ordinary decisions at the general meeting of the corporation in question. In this definition, the choice of the directors is also included. Indeed, our definition covers a wide variety of control situations, forms which depend on ownership and on legal devices as well as forms which are extralegal, e.g. when a creditor determines the policy of an indebted corporation.[5]

The following three basic types of agreements can be distinguished: (i) agreements used to *concentrate* control of the corporation in as small a group of shareholders as possible, (ii) agreements with the purpose of *distributing* control among as many shareholders as possible, and (iii) arrangements found useful because of a desire to *transfer* control from one group of persons to another.

2.1.3. Some reflections about different types of corporations may now be made. The corporation as a legal institution may be used as a form for all the different kinds of enterprises that exist, from the one-man corporation to the giant enterprise with millions of shareholders. When discussing corporation law, a difference should be made between small and big corporations, since the legal and practical problems of these differ in many respects.

A common distinction is that made between the *open corporation,* in which the public is invited to invest its savings, and the *close corporation,* in which only a limited number of persons are allowed to take part.[6] The legal prototype of a corporation lies

[4] *Ibid.*

[5] *Op. cit.*, p. 70.

[6] See Kobbernagel, *Ledelse og ansvar,* Copenhagen 1945, pp. 20 f., O'Neal, *Close Corporations,* vol. 1, Chicago 1958, p. 5, Glattfelder, *op. cit.*, p. 172, Berle and Means, *op. cit.*, p. 4.

somewhere between these two opposites: the number of shareholders should be small enough to get all of them interested in the administration of the corporation, and big enough to make majority decisions necessary.

In this connection, I should like to make it clear that while the shareholder group in a close corporation is usually composed of shareholders who are all actively interested in the enterprise, the shareholders in the open corporation may be divided into at least two different groups. Some of them are actively interested in the management of the corporation's affairs, while others have entered into the corporation only to gain the supposed advantages that an investment in it may give. Hence, there are good reasons for distinguishing between the *shareholders of control* and the *shareholders of investment* when questions concerning shareholders in open corporations are discussed.[7]

The corporation rules were originally made for enterprises where some capital came from outside investors. In some countries the legislators, however, have created a form specially designed for the close enterprise, as in Germany the *Gesellschaft mit beschränkter Haftung* and in France the *société à responsabilité limitée.* Such forms naturally induce other problems regarding contracts between the participants than those that arise in common corporations, but this special aspect of the subject will not be dealt with here.

2.2.1. One type of shareholders' voting agreement with characteristic features is used in open corporations and sometimes in the above-mentioned "prototype corporations". In these corporations there is a marked and sometimes criticized tendency among the shareholders of control to make arrangements that allow them to continue controlling the corporation without sharing their control with a growing group of shareholders of investment. Such a concentration of control among a minority group of shareholders can be achieved in many ways.

In open corporations minority control can generally be attained without special effort. The shareholders of investment have little interest in going to the general meeting and influencing the ad-

[7] Champaud, *Le pouvoir de concentration de la société par actions,* Paris 1962, p. 29. Cf. Nial, in 1933 *Nationalekonomiska föreningens förhandlingar* 58, and *idem, Om aktiebrev och andra aktierättsliga dokument,* Stockholm 1929, p. 34 note 114, Söderström in 1931 *Sv.J.T.* 564, and Tunc, "Les conventions relatives au droit de vote et l'organisation des sociétés anonymes", 1942 *Revue générale de droit commercial* 111.

ministration of the corporation by their voting.[8] Thus, the shareholders of control can often manage well enough with their "practical majority" at the general meeting.

If this form of control is not satisfactory, there are many ways of stabilizing the situation. One method is to have the corporation distribute shares with a large number of votes among the shareholders of control, while the shares offered to other investors give fewer votes or no votes at all. Different jurisdictions have different attitudes towards this device, varying from absolute freedom to prohibition.[9]

There is also the possibility of making use of the votes which the shareholders of investment have no interest in using themselves. A method used in several jurisdictions is to distribute proxy forms among the shareholders, offering them representation by a member of the board or by some other appropriate person at the general meeting. This solicitation of proxies and votes on behalf of the shareholders of control has turned out to be quite effective. The methods and the rules concerning this device have to some extent been elaborated somewhat differently in different countries.[1]

Another method is often used, but it is less discussed and is difficult to regulate. It is called pyramiding,[2] which means transferring a sufficient part of the corporation's shares to an investment corporation. Thus a simple majority of votes at the general meeting of the investment corporation will be sufficient to retain control of the original enterprise. The majority of shares in the investment corporation may then be purchased by another corporation, and so on. In that way, a fairly modest investment at the apex of a pyramid of corporations may be enough to control great values in the enterprise that forms its base.

2.2.2. There is a form of voting agreement that has a certain

[8] Manning in 67: 2 *Yale Law Journal* 1487; cf. Champaud, *op. cit.*, p. 21, Nial in 1932 *Ekonomen* 95, Thomas, "Irrevocable Proxies", 43 *Texas Law Review* 752, and Berr, *L'exercice du pouvoir dans les sociétés commerciales*, Paris 1961, pp. 248 f.

[9] See for a survey *Betænkning om revision af aktieselskabslovgivningen*, 1964: 362, Copenhagen 1964, pp. 151 ff.

[1] See, for instance, Ballantine, *Ballantine on Corporations*, rev. ed. Chicago 1946, p. 413, Gower, *The Principles of Modern Company Law*, 2nd ed. London 1957, p. 442, Ripert, *Traité élémentaire de droit commercial*, 5th ed. Paris 1963, p. 551, Hueck, *Gesellschaftsrecht*, 13th ed. Munich & Berlin 1965, p. 162, and Rodhe in 1950 *Ekonomisk Revy* 288 f.

[2] See Berle and Means, *op. cit.*, pp. 72 ff., Berr, *op. cit.*, pp. 240 f., Ballantine, *op. cit.*, p. 417.

similarity to pyramiding. It occurs when a contract is entered into by shareholders of control as well as by mere investors. The purpose of the agreement is to tie up in a form of syndicate a number of shareholders, whose combined votes would form a decisive majority at the general meeting. The shareholders participating in the syndicate will meet some time before the general meeting to discuss and take up a position upon the questions that will be handled at the general meeting. What is important here is that the shareholders who have joined the agreement are, according to the wording of the contract, bound to vote at the general meeting—in person or by proxy—in such a way as the syndicate meeting has decided. That means that the majority in the syndicate, consisting of the shareholders of control, will decide the voting of the minority of the syndicate, the participating shareholders of investment, at the general meeting. According to the idea of the syndicate, the shareholders of investment will always be a minority among those who have joined the agreement.

To establish a stable position for the controlling shareholders, the contract concluded will embody a long-duration clause and the participants must be prohibited from selling their shares to persons outside the agreement. An arbitration clause is usually part of the contract. Under some contracts, violation of the agreement renders the violator liable to a fine or to pay compensation for damage caused.

This type of agreement exists in many countries.[3] Where corporation law makes it possible, the organization may be less complicated: the associates transfer their voting rights to the leader of the syndicate. In France, the so-called "syndicats de blocage" are organized in this way.[4] In the United States, however, voting agreements to concentrate control seem to be rare. In American law, the *voting trust* has developed into a corresponding device; the construction is similar to the "syndicats de blocage".[5]

[3] See, for instance: for Denmark, Borum in *Juristen* 1962, p. 262; for Sweden, Nial, *Aktiebolagsrättsliga studier,* Stockholm 1935, pp. 58 ff.; for Germany, Hueck, *op. cit.,* p. 164; for Switzerland, Glattfelder, *op. cit.,* p. 163; for France, Champaud, *op. cit.,* pp. 118 ff.; for Italy, Cassoni in 10 *Travaux de l'Assoc. Henri Capitant,* 263 (1956).

[4] Champaud, *op. cit.,* pp. 120 f., Freyria, "Étude de la jurisprudence sur les conventions portant atteinte à la liberté du vote dans les sociétés", 1951 *Revue trimestrielle de droit commercial* 423 f.

[5] Cf. Brand, *Der Stimmrechtsbindungsvertrag im deutschen und amerikanischen Recht,* Cologne 1963, p. 43, Hornstein, *Corporation Law and Practice,* vol. 1, St. Paul 1959, pp. 190 f.; see for further references regarding voting trusts, Leavitt, *The Voting Trust,* New York 1941, Ballantine, *op. cit.,* pp. 427 ff., O'Neal, *op. cit.,* pp. 305 ff., Hornstein, *op. cit.,* pp. 288 ff.

2.3.1. In the close corporation, where there is no market for the shares of the corporation, an investment involves a greater risk than in a public corporation. The affairs of the enterprise are watched neither by those gambling on the Stock Exchange nor by inquisitive journalists. The shareholder who disapproves of the management cannot without difficulty sell his shares at a fair price, since his fellow-shareholders will probably be the only prospective buyers.

Thus every shareholder in a close corporation is interested in exercising control over the corporation; his own financial position usually depends in part on how the enterprise is managed. The problem is that corporation law places control where the majority of the votes lies, and the shareholder must have a voice in corporate affairs larger than that derived from the right to cast a lone minority vote against a majority. There are several methods in corporation law for attaining the distribution of control that may be necessary to satisfy the shareholders in a close corporation. For example, there are rules giving every shareholder representation on the board of directors and rules preventing the general meeting from taking decisions against the will of the minority.

Representation on the board of directors may be arranged by proportional elections; technically, such an election is difficult to regulate, especially when there are two shareholders or shareholder groups who have made equal investments in the corporation. A similar method, practised chiefly in the United States, is *cumulative voting,* which means that the shareholder has a number of votes which corresponds to his shares multiplied by the number of directors being elected. Thus he can concentrate his votes on a certain candidate.[6] Another method is to prescribe in the company's articles of association that certain persons are entitled to a seat on the board of directors.[7] The desired pattern of control can also be achieved by classification of shares, so that each class of shares entitles the holders to appoint a certain number of directors.[8]

[6] See, for instance, O'Neal, *op. cit.,* pp. 149 ff., Hornstein, *op. cit.,* pp. 150 f., 449 f.

[7] See, for instance, Augdahl, *Aksjeselskapet efter norsk rett,* 3rd ed. Oslo 1959, pp. 249 f., *Betaenkning* 1964: 362, pp. 134 f., Gower, *op. cit.,* p. 119, O'Neal, *op. cit.,* pp. 97, 169 f., and Noirel, *Les tendances modernes de la jurisprudence commerciale en matière de sociétés anonymes,* Paris 1958, p. 167.

[8] See O'Neal, *op. cit.,* p. 100, Hornstein, *op. cit.,* pp. 181 f., Augdahl, *op. cit.,* p. 250, Stenbeck, Wijnbladh & Nial, *Aktiebolagslagen,* 5th ed. Stockholm 1966, p. 618.

Decisions against the will of a minority will as a rule be avoided by provisions that demand more than a bare majority for a decision (two-thirds, three-fourths, four-fifths)—or even unanimity. Such clauses can be troublesome when there is no group among the shareholders that is big enough to make any decision at all. The remedy is an arbitration clause, stating that in a deadlock situation the decision of one or a few arbitrators shall be accepted by the shareholders, who will have to vote accordingly.[9]

2.3.2. It is not easy to meet the need for a distribution of control by a statutory enactment. A general rule might do more harm than good, since different companies need different control patterns. A striking example is the compulsory rule of cumulative voting in some American state jurisdictions, which has forced corporations to choose other states as their residence and has produced devices designed to make cumulative voting indecisive (staggered elections).[1]

A regulation in the company's articles of association may also cause certain trouble. When the control situation will change, for instance, in an enterprise which is about to be sold, it may become necessary to replace certain provisions, something which will cost time and money, especially if the amendments to the articles must be entered in an official register, and where there are strict legal rules concerning the contents of its provisions. In many countries, a desired clause may not legally be inserted in the articles; thus, privileges of certain shareholders, mentioned by name, and arbitration clauses to solve deadlock situations will not be approved of in the articles of a Swedish corporation.[1a]

2.3.3. To avoid complications, the most practical method of achieving the desired distribution of control is a contract among the shareholders. These agreements seem to be common in most jurisdictions. They occur in corporations with private shareholders as well as in corporations created by other enterprises, often called joint-venture corporations, and their contents vary accordingly.[2]

Unlike the agreements for concentration of control, agreements of this type do not contain any general directives for voting at the general meeting. The contract usually states how the shareholders want the board of directors to be composed, how the auditors are to be appointed and what is to be done with the pro-

[9] See especially O'Neal, *Close Corporations*, vol. 2, chapter IX.
[1] Hornstein, *op. cit.*, pp. 449 f.
[1a] 1940 RÅ 32, 1951 RÅ 98.
[2] O'Neal, *Close Corporations*, vol. 1, pp. 8 f.

fits. It is assumed that the party to the contract will vote accordingly, although often this is not actually spelled out. The agreement sometimes contains detailed prescriptions concerning the prospective business. As the shareholders are economically dependent on the corporation, they are also anxious to settle salaries and other remuneration, as well as pension questions, in the agreement. Even these provisions may materialize as directives for voting at the general meeting. Where the composition of the board and the chief objectives of the enterprise are fixed in the agreement, it may be unnecessary to prescribe a high percentage of the votes for decisions at the general meeting or a right of veto for every shareholder; in Swedish practice, such provisions seem to be rare.

Another problem that will be dealt with is how to prevent a shareholder from transferring his shares to an outsider without the prior assent of the other shareholders. Common solutions are option clauses and prescriptions that the share certificates must be deposited. In contracts between individuals, the situation when one of the shareholders dies must also be regulated. Generally, the other shareholders are entitled to buy the shares from the deceased's estate, at a price that will be decided in a given way.

Many different conditions can be found regarding the question of the duration of a contract of cooperation between shareholders and the question of a right to dissolve the venture. A definite period of time and an automatic prolongation for a new period if none of the parties gives notice to terminate the agreement is common in Sweden. The contract sometimes contains a penalty clause, and, as a rule, a provision for arbitration.

2.4. Where a considerable part of the shares in the corporation is to be transferred to new owners, this will obviously have an effect on the control of the corporation in question. Sometimes the situation calls for a solution by agreement or otherwise. This may be the case when a majority of the share capital in a corporation is sold and the definite transfer of the shares will take place a considerable time after the take-over agreement. The buyer of the shares often wants to exercise control over the corporation before the formal transfer; this may be prescribed in the contract between buyer and seller.

As a condition for accepting a take-over bid, the selling group may insist on restrictions being imposed on the buyer's control; how strict and permanent these restrictions are will depend on the respective status of the parties in the negotiations for a take-over.[3]

[3] Cf. Champaud, *op. cit.*, pp. 100 f.

Thus the contract may contain provisions that secure for the selling group some representation on the board of directors or continued employment in the enterprise, minimum salaries for those who remain in the service of the corporation, pensions for those who do not, etc. Especially when the payment for the shares consists of new shares in the company which is taking over, the take-over can be described as a distribution of the control between the buyers and the sellers.

Problems concerning transfer of control may also materialize when shares are given away to the future heirs of a shareholder. If the object of making the gift is to diminish estate duties, the owner may prescribe that he shall keep the voting right attached to the shares he has given away. A need for a transfer—complete or partial—of the control of a corporation may arise when the enterprise is in considerable debt to some creditor. When the corporation's shares are handed over to the creditor as security for a loan, it may be natural to prescribe that the creditor shall be entitled to vote for the shares or determine the composition of the board of directors. Corresponding clauses may even be included in situations where the shares are not handed over as security but precautions aimed at diminishing the creditor's risk seem desirable. In Swedish banking practice, however, conditions of this kind seldom appear in writing.

A transfer of the control connected with shares may also be a suitable solution in cases where one person is entitled to the dividend from the shares, while another is the formal owner of the shares. In this case it seems fair that the former should have some influence in the general meeting; otherwise the owner may perhaps be in a position to prevent a distribution of the profits.

In these situations the methods for placing the control in the desired way vary somewhat in different jurisdictions. When the entire right to vote is going to be transferred, a temporary transfer of the shares or an irrevocable proxy to vote may be suggested instead of an agreement to the effect that control must be exercised in a certain way. For the moment, an indication of the situations in question should be sufficient; an analysis from a legal point of view will follow later on.

3.1. When a transfer of control is needed, the simplest and most secure way seems to be a transfer of the right to vote. Such a transfer may also be considered in situations where a concentration of control is the main object. A separate assignment of the right to vote is in many jurisdictions prohibited by rules against

separating voting rights from share ownership. Another solution, namely a temporary transfer of the shares from the owner to the person who is to exercise the right to vote, will in some jurisdictions meet with obstacles. The statute may provide that only those inscribed in the company's register of shareholders have the right to vote and that only true shareholders are entitled to be entered in the register. The difficulties of achieving a valid and enforceable transfer of the right to vote in different jurisdictions will be discussed in the following sections.

3.2.1. In Danish law the opinion prevails that there are no obstacles to a separate transfer of the vote. Thus the Danish Stock Corporation Act, sec. 28, subsec. 2, where the rules on registration are laid down, says nothing expressly about entry in the register of shareholders as a conditon for voting at the general meeting.[4] Nor is there any provision in French law stipulating registration of a shareholder as a condition for voting.[5]

In Denmark and France, an agreement that somebody who is not a shareholder shall be entitled to exercise the right to vote seems to be valid and enforceable. In Danish legal writing, however, opinions differ as to whether a voting right can be transferred to a pledgee.[6] On the other side, according to Danish law, an executor, even though not registered as a shareholder, is indisputably entitled to vote for shares deposited with him in accordance with a will or a provision in connection with a gift.[7] In French law the power to dispose freely of the right to vote has been recognized in case law.[8]

3.2.2. In English and American law, on the contrary, there is a rule that no one but the registered owner of a share is entitled to vote.[9] There is, however, nothing to prevent somebody who is not a true shareholder from being inscribed in the register. The person whose voting is desired may be recorded in the register as a *nominee* instead of the shareholder.[1] When a transfer of control

[4] *Betaenkning* 1964: 362, p. 111, cf. Gomard, *Aktieselskabsret,* Copenhagen 1966, pp. 160, 151.

[5] Cf. Noirel, *op. cit.,* p. 152.

[6] Negative: Sindballe, *Dansk selskabsret,* Copenhagen 1949, p. 230, note 20, and Borum in 1962 *Juristen* 261. Positive: among others Krenchel, *Håndbog i dansk aktieret,* 4th ed. Copenhagen 1965, p. 274, David in 1947 U.f.R. B 214, Gomard, *op. cit.,* pp. 166 ff.

[7] 1949 U.f.R. 637.

[8] See, for instance, 1938 Recueil Sirey I 204 and references by Ripert, *op. cit.,* p. 552.

[9] Gower, *op. cit.,* p. 370, Ballantine, *op. cit.,* p. 397.

[1] Cf. Ballantine, *op. cit.,* pp. 399 f.

is desired, the shares are often put into a trust and the voting rights are then exercised by the trustees. In German law, the situation is identical. Only those who are legitimated as shareholders of the corporation may exercise voting power.[2] But a person can be made the legitimate "owner" for voting purposes by a transfer of the share certificate to him, a process known as *Legitimationsübertragung*,[3] and this is the method recommended by German writers when a non-shareholder, for example a pledgee, is to be assigned the right to vote.[4] Thus it is true that in Anglo-American and German law voting rights should not be separated from share ownership,[5] since only the person considered to be the owner is entitled to vote. But the "owner" need not be the true shareholder; he may equally well be a pledgee, a creditor or some other person who wants the right to vote in respect of the shares.

3.2.3. Rigid regulations are found in Norwegian and Swedish law. The attitude of Finnish law is presumably the same, although the relevant provisions are ambiguous. Entry in the corporation's register of shareholders is compulsory for those who want to vote.[6] The principle of the indivisibility of the shareholder's rights—a reflection of the policy against separating voting rights from share ownership—is laid down in the Corporation Acts in Norway, Sweden and Finland;[7] it is not permissible to register anyone but the real shareholder.[7a] In the Swedish Act there is a provision to the effect that anyone acting as a shareholder at the general meeting has a duty to make, upon request, a formal statement that he is the true owner of the shares which he represents.[8] The idea is to prevent registration of nominees for the purpose of voting. It is doubtful, however, whether this effect is always

[2] Cf. the German Stock Corporation Act, sec. 67, subsec. 2.

[3] See the German Stock Corporation Act, sec. 129, subsec. 3.

[4] See, for instance, Gadow & others, *Aktiengesetz*, Berlin 1939, p. 479.

[5] See the German Stock Corporation Act, sec. 8, subsec. 3.

[6] The Norwegian Stock Corporation Act, sec. 41, subsec. 1, para. 2, the Swedish Stock Corporation Act, sec. 114, subsec. 1; see for Finnish law Taxell, *Om aktierätt vid bolagsstämma*, Åbo 1959, pp. 13 ff.

[7] The Norwegian Stock Corporation Act, sec. 30, subsec. 4, the Swedish Stock Corporation Act, sec. 3, subsec. 3, the Finnish Stock Corporation Act, sec, 5, subsec. 2.

[7a] There is one exception in the Swedish Stock Corporation Act—sec. 220—in the case of special testamentary arrangements, where the shareholder as well as the person who draws the dividend and exercises the voting right can be inscribed.

[8] The Swedish Stock Corporation Act, sec. 115. See for Finnish law Taxell, *op. cit.*, pp. 29 ff., and for Norwegian law, Marthinussen, *Aksjeloven*, Oslo 1960, p. 150.

achieved, since it is extremely difficult on a given occasion to decide who should be considered the true owner of a share.

Admittedly, the Act is based upon the assumption that to transfer the shares to a pledgee in order to enable him to vote or to continue voting for a person who has sold or given away his shares is illegal. However, this does not necessarily mean that a prescription that somebody other than the shareholder should be entitled to vote is entirely void. Consequently, Swedish courts have interpreted a provision that the donor of a number of shares was entitled to continue to vote in respect of them as a prescription that the new shareholder must conform to the donor's directives when voting at the general meeting.[9]

On the other hand, such a prescription might be disregarded by the corporation, and a buyer of the shares in question would not be bound to comply even if he knew about the prescription when he acquired the shares.[1]

3.3.1. Another method of transferring the voting right is the issuing of a proxy by the shareholder. An ordinary proxy, however, is not a suitable device for transferring control, since it can be revoked at any time at the shareholder's discretion. Consequently the proxy has to be declared irrevocable. This device for escaping from the prohibition against separating voting right and share ownership is one which the courts can be expected to sanction only rarely, if ever. Even general agency rules may be invoked.

3.3.2. In Danish law, where, as we have seen before (*supra*, 3.2.1), there is no absolute prohibition against recognizing votes from persons other than the true shareholders, a liberal attitude might be expected.

In the case 1926 U.f.R. 1012, however, a shareholder was allowed to withdraw a proxy which was declared to be irrevocable. The court, the Østre Court of Appeal, seems to have founded its judgment on general principles of agency law. The proxy was issued to a person X, who wanted it to support a decision for the winding up of the corporation. When, some days before the general meeting, the shareholder changed his mind, he tried to withdraw the proxy, being now anxious that the company should continue its business. The court stated that the proxy had been issued solely in the interest of the shareholder, and consequently he was entitled to revoke it.

[9] See judgment 4.9.1970, no. 10 DT 19, the Svea Court of Appeal.
[1] 1915 N.J.A. 590.

In another, rather special case, 1963 U.f.R. 111, the Supreme Court of Denmark restrained a shareholder from revoking a proxy containing an irrevocability clause. Here, the dominating shareholder had handed over his shares to the corporation's creditors as security. The sole possibility for the creditors to recover seems to have been through a successful management of the debtor corporation. The shareholder had issued an irrevocable proxy to a third party, a bank. The Court held that the proxy could not be revoked but was to remain as an essential protection for the other creditors. Commenting on the case, Mr. Justice Spleth emphasized the *ad hoc* character of this decision. The Court had not relied upon a general doctrine of irrevocability of proxies in situations where creditors are furnished with the shares as security.[2]

In French law, irrevocable proxies are *per se* void as obstacles to a free exercise of the right to vote.[3] Transfer of control may, however, according to French law be arranged without using the device of a proxy (see *supra*, 3.2.1).

3.3.3. In German law, transfer of the right to vote can be achieved by a formal transfer of the shares, *Legitimationsübertragung* (*supra* 3.2.2). There should therefore be no need for the issuing of irrevocable proxies. However, in a case from 1951 an irrevocable proxy to vote in respect of a share in a partnership was held void by the Federal Supreme Court.[4] The Court based its decision on the prohibition against separating the voting right from the ownership of the share. Presumably the same rule applies to corporations.

In Anglo-American common law, the irrevocable proxy has been approved in various fields of law, when the proxyholder has an interest in the proxy. The rule that the proxy must be coupled with an interest is rather vague and has resulted in a somewhat inconsistent body of case law.[5] The concept of interest, however, is nowadays outmoded: to be irrevocable the proxy must be given "as security".[6] In the case of voting proxies, it is often stressed that an irrevocability clause is not valid unless the proxyholder's

[2] 1963 T.f.R. 61; cf. Borum in 1966 U.f.R. B 98 f., Marthinussen in 1967 T.f.R. 369 f. But see Gomard, *op. cit.*, pp. 168 f.

[3] 1938 Recueil Sirey II 124; see Freyria, *op. cit.*, p. 424, Tunc, *op. cit.*, p. 134, and 1938 Recueil Sirey IV, p. 17, note.

[4] 1952 Neue Juristische Wochenschrift 178.

[5] O'Neal, *op. cit.*, pp. 319 ff.

[6] *Restatement of Agency* 2nd, sec. 138, Thomas, *op. cit.*, p. 747, note 67; cf. O'Neal, *op. cit.*, p. 323 with note 55.

or to relate it to voting in political elections.[7] Whatever value these theoretical arguments may have, it seems evident that the courts are not likely to rely on the criterion of the free exercise of the voting right in their efforts to separate bad agreements from good ones. Needless to say, it is too difficult to discern whether a contract restricts the freedom to vote or not. In German law, it has even been argued that a shareholder is always free to vote as he wants and that no agreement can restrict this freedom, since it would be impossible to invalidate or alter a decision of a general meeting where the shareholder has voted in violation of a voting agreement.[8] This argument seems rather strange. Is there a freedom to vote when a shareholder will be subject to penalties or other sanctions because of his disobedience to the agreement?[9] All the same, the German attitude appears to be a striking illustration of the vagueness of the concept "freedom to vote".

5.2.2. It is evident that the existence of a shareholder's voting agreement will make the discussions and the decisions at the general meeting more or less a formality. Opinions which are expressed at the meeting will not be able to influence the voting of the parties to the agreement. As a matter of fact, the real decisions are often taken in advance through the provisions of the agreement. Arguments based on the role of the general meeting have especially been considered in Italian law.[1] It seems realistic, however, to recognize that the discussions at the general meeting generally have very little influence on the decisions, even where there is no shareholders' agreement.[2] The weight of these arguments is also diminished by the fact that a shareholder is allowed to determine his position in advance and to arrange for somebody else to vote for him at the general meeting.[3]

The agreements for concentration of control, where the share-

[7] Berr, *op. cit.*, p. 236, Cottino, *Le convenzioni di voto nelle società commerciali*, Milan 1958, pp. 77 ff., cf. Nial, *op. cit.*, p. 14. Tunc, *op. cit.*, p. 147, Glattfelder, *op. cit.*, pp. 261 f.

[8] See, for example, Sommerfeld, *Verträge über die Ausübung des Stimmrechts von Aktien*, Jena 1931, p. 62; cf. Patry, *op. cit.*, p. 75.

[9] Patry, *op. cit.*, p. 77, Houin in 10 *Travaux de l'Assoc. Henri Capitant* 210 (1956).

[1] 1954 Foro Italiano I 1432; cf. Glattfelder, *op. cit.*, p. 207 with further references.

[2] Cf. Patry, *op. cit.*, p. 72 note 99, Freyria, *op. cit.*, p. 429, Foyer in 10 *Travaux de l'Assoc. Henri Capitant* 242 (1956).

[3] Boesebeck, "Abstimmungsvereinbarungen mit Aktionären", 1960 *Neue Juristiche Wochenschrift* 7.

holder has to comply with a majority decision in a syndicate, may, however, have a rather peculiar influence on the decisions at the general meeting. It may occur that the shareholders outvoted in the syndicate, together with those outvoted at the general meeting, will constitute a majority against the minority that enforces its decision at the general meeting. This "falsifying of majority" has been referred to as a strong argument against the validity of this type of agreement.[4]

It must be stated, however, that the existence of a holding company would have had exactly the same effect upon the shareholders outvoted at the holding company's general meeting.[5] If one attacks the agreements for control over corporations, one will also have to attack the device of pyramiding and perhaps other concentration devices as well. In my opinion it would, for the reasons here discussed, be going too far to declare that these "syndicate" agreements are invalid.

5.2.3. Another argument concerns the protection of minority groups of shareholders. It has been argued that agreements to which a majority but not all shareholders have adhered constitute such a great danger to the rest of the shareholders that they should be held invalid.[6] This would mean that agreements for concentration ought as a rule to be invalidated, while agreements for distribution of control would as a rule remain unaffected. This attitude will, among other things, raise the question how large the fraction of the shareholders excluded from the agreement should be in order to render such an agreement invalid. It seems evident, however, that this argument does not rest on firm ground. What may cause harm to a minority shareholder is not the fact that a group of shareholders have joined an agreement, but what measures they take against their fellow-shareholders. And those measures may be taken quite independently of the existence of any contract at all. Minority protection should be arranged according to general principles of corporation law; shareholders' agreements seem to be irrelevant in this connection.[7]

5.3. General principles of contract law have sometimes been in-

[4] Freyria, *op. cit.*, p. 427, Patry, *op. cit.*, p. 127, Cottino, *op. cit.*, p. 17, Houin and Coppens in 10 *Travaux de l'Assoc. Henri Capitant* 206, 255 f. (1956).

[5] Glattfelder, *op. cit.*, p. 208 with further references, Augdahl, *op. cit.*, p. 314, note 2.

[6] See O'Neal, *op. cit.*, p. 285, Hornstein, *op. cit.*, pp. 190 f., Coppens in 10 *Travaux de l'Assoc. Henri Capitant* 258 (1956).

[7] Patry, *op. cit.*, pp. 107, 68, Glattfelder, *op. cit.*, pp. 286 f.

voked as a basis for invalidating voting agreements. In several jurisdictions, the courts have declared some types of agreements invalid on the ground that undue hardship would be suffered by the shareholders bound by such contracts. One of the factors that is emphasized in this connection is that the agreement shall not bind the shareholder for too long a period.[8] Opinions diverge, however, when it comes to deciding the duration of a valid agreement. Case law in Germany as well as in the United States indicates that the length of the contractual period is not alone decisive, but is only one of several factors that are taken into consideration.[9]

On one point, there seems to be only one opinion in the jurisdictions that are dealt with here: a promise to vote in a certain way for remuneration is void. This rule, which has caused certain troubles when determining what is to be considered remuneration, generally affects agreements of a less typical kind than those described above—chiefly bargains with persons outside the corporation who want to exercise control over it in some respect or other. In some jurisdictions there are more or less explicit rules for such situations,[1] while in others the courts may rely upon general principles regarding *pacta turpia* when invalidating the agreement.

5.4.1. Compliance with the provisions of a shareholder's voting agreement may in certain situations constitute an evasion of corporation law. Considerable importance in this respect is attached to the principle of American corporation law that the business of a corporation should be managed by its board of directors. It has been claimed that agreements infringing upon this principle are invalid. This rule affects contracts for distribution of control, where prescriptions concerning the shareholders' relations with the enterprise are included, for example provisions concerning wages, pensions and other employment conditions, as well as directives for the business.

Originally the courts showed a rather harsh attitude towards agreements that infringed upon the management of the corporation.[2] In course of time many courts have given up this position.[3] Several factors may have had an influence in this connection.

[8] See, for instance, Freyria, *op. cit.*, p. 424.

[9] Glattfelder, *op. cit.*, p. 251, O'Neal, *op. cit.*, p. 245, Hornstein, *op. cit.*, pp. 208, 210.

[1] *Restatement of Contracts*, sec. 569, the German Stock Corporation Act, sec. 405, subsec. 3, no. 6, the Norwegian Penal Code, sec. 373.

[2] Ballantine, *op. cit.*, p. 422, O'Neal, *op. cit.*, pp. 260 f.

[3] See O'Neal, *op. cit.*, pp. 237 ff.

The doctrine concerned is founded upon an unrealistic conception of corporate organization, for it is an odd idea that a board of directors should act independently of those electing them. It must also be recognized that this type of agreement is of considerable importance as a means of making a close corporation function smoothly. Sometimes the uncertainty as to how a court might decide in a case concerning a close-corporation agreement has called for intervention by the legislators.[4]

5.4.2. Another situation where a decision conforming with prescriptions in a shareholder's agreement may be contrary to corporation law may occur if for a particular decision of the general meeting more than a bare majority of the shareholders is required. If a shareholder has to comply with a majority decision in the shareholder syndicate, and if he is outvoted there, he cannot join those shareholders who oppose the decision at the general meeting. And this means that the prescribed majority was not reached, even though the voting at the general meeting so indicated. In the opinion of the present writer, the syndicate agreement should be held invalid for such situations where there is a requirement in a statutory provision or in the company's articles of association for more than a bare majority vote. Otherwise the shareholder will lose the protection against particularly far-reaching decisions that these clauses are intended to give him.[5]

A statutory rule or a provision in the articles that a shareholder may only vote in respect of a certain part of the share capital represented at the general meeting, may also be affected by the same type of shareholders' agreement. If the same limitation of the votes is not prescribed for decisions in the syndicate, a single shareholder may get more influence than he is entitled to at the general meeting. When the limitation of votes is founded on mandatory law, there are good reasons for invalidating an agreement contravening the rule.[6] If, on the other hand, a legal provision limiting the votes may be set aside by a clause in the company's articles of association, an agreement which has the same effect will not call for any intervention.[7]

6.1. From the discussion in section 5 above it follows that shareholders' agreements in their usual form do not contain any provisions that justify an invalidation. This means that a party violating

[4] See Hornstein, *op. cit.*, p. 204.
[5] Glattfelder, *op. cit.*, pp. 291 f.; cf. Nial, *op. cit.*, p. 31; *contra* Gomard in 1969 *Juristen* 361.
[6] 1947 Revue pratique des sociétés 296, cf. Glattfelder, *op. cit.*, p. 203.
[7] Cf. Nial, *op. cit.*, p. 42.

the agreement will have to compensate other parties for any damage his violation may have caused them. It may occur, however, that the parties to the contract are chiefly interested in the shareholders' compliance with the contract—one reason may be that it is rather difficult to estimate suitable compensation for a breach of a shareholder's agreement, another reason may be that they need the votes of the other party to enforce a certain decision or a certain policy. Then the question is the following one: Can the agreement be enforced by the means of specific performance, if there are reasons for an equitable intervention in the specific case? Several alternatives for a specific performance may be suggested—for instance, alteration of a decision at the general meeting in compliance with the agreement, annulment of a decision contrary to the agreement, or an injunction directing the party not to vote against or to vote for a certain decision. In discussing these problems, however, it will be convenient to deal with Anglo-American law separately from Scandinavian and Continental law, since the legal attitude is basically different. Thus, in Scandinavian and Continental law, the possibility of nullifying or altering a decision by a general meeting is dealt with in corporation law, while other ways of enforcing the agreement are matters for the legislation on execution, while in Anglo-American law all these problems are dealt with according to equity principles.

6.2.1. The provisions in the Scandinavian, German and French Corporation Acts regarding the possibility of having a decision at a general meeting nullified or altered by the intervention of a court are rather different in wording,[8] but as far as the problems dealt with here are concerned these jurisdictions take the same view. The rules on nullification or alteration have the purpose of protecting shareholders against violations of corporation law and the corporation's articles. When a shareholder has a right to attack the decisions of the general meeting, as, e.g., in the Swedish Stock Corporation Act, sec. 138, because the decision was not *passed in due order* or is contrary to law or the corporation's articles, the provisions in a shareholders' agreement are not deemed to be covered by the expression "in due order".[9]

[8] See, for instance, the Swedish Stock Corporation Act. sec. 138, the Finnish Stock Corporation Act, sec. 30, the Norwegian Stock Corporation Act, sec. 75, the Danish Stock Corporation Act, sec. 58, the German Stock Corporation Act, sec. 243.

[9] Carsten Arnholm in 1930 T.f.R. 366, Nial, *Om klanderbara och ogiltiga bolagsstämmobeslut,* Stockholm 1934, p. 8, Rodhe, *Aktiebolagsrätt,* 5th ed. Stockholm 1968, pp. 190 f.

Scandinavian case law, however, provides examples where courts have annulled decisions at a general meeting because of their being contrary to an agreement among shareholders. In a judgment by the Maritime and Commercial Court of Copenhagen, 1923 U.f.R. 636, a decision contrary to a previous contract among the shareholders, prescribing that the corporation should be wound up if certain conditions were not fulfilled, was reversed. Certain facts, however, indicate that the court's reasoning was based on a misunderstanding of the principle that a decision by the general meeting does not affect the rights of a third party.[1] This principle only means that the contractual right is unaffected by the decisions. It does not constitute a ground for nullification. Moreover, the principle concerns the relation of a third party to the company, and contracts among shareholders are not within its scope. There is, too, a decision by the Svea Court of Appeal, 1929 Sv.J.T. rf. 53, along the same lines at the Danish decision of 1923. However, this decision has been criticized by those legal writers who have had reason to analyse it.[2]

With the exception of these cases, there is no indication that a shareholders' agreement should affect the validity of a decision at the general meeting. Starting from the assumption that a voting agreement cannot be invoked as a ground for holding that a decision of a general meeting should be annulled or altered, one may ask the question: Why should not a contract, at least a contract between all the shareholders of the corporation, be granted the same protection as the provisions in the documents?

It is a common view that two different levels of judicial norms are affected, namely rules on the corporate level and rules on the individual level. The agreement belongs to the individual sphere, and what is contrary to the agreement does not affect the rule on the corporate level that decisions may under certain circumstances be annulled.[3]

Another explanation is that contracts do not concern anybody but the parties.[4] As the corporation is not a party to the agreement, the decisions of its institutions cannot be affected by it.

[1] Cf. Torp, *Den danske selskabsret,* Copenhagen 1919, pp. 241 f.; but see Gomard in 1969 *Juristen* 367, note 17.

[2] Nial, *Aktiebolagsrättsliga studier,* Stockholm 1935, pp. 10 f., David in 1947 U.f.R. B 216, note 9.

[3] See Patry, *op. cit.,* p. 53, Peyer, *Die Zweimannaktiengesellschaft,* Zurich 1963, p. 76, and 119 Entscheidungen des Reichsgerichts in Zivilsachen 386.

[4] Sommerfeld, *op. cit.,* pp. 90 f., Patry, *op. cit.,* p. 53, Peters, "Die Erzwingbarkeit vertraglicher Stimmrechtsbindungen", 156 *Archiv für die civilistische Praxis* 313, and 1950 Aargauische Gerichts- und Verwaltungsentscheide 54.

Some legal writers, however, probably thinking of contracts for the purpose of concentrating control, emphasize that voting agreements, although valid in principle, are somewhat too dubious for them to be allowed to be directly enforced.[5]

From a practical point of view, however, it has been argued that the dependence on agreements that are perhaps secret would make it difficult to appreciate the effects of a decision at a general meeting; the agreements would also cause confusion when invoked.[6] The present author submits that, *pace* the arguments put forward in legal writing, this point of view seems to be worth consideration.

6.2.2. In Anglo-American law there is no special rule regarding nullification of the decisions at the general meeting. This means that the same principles may be invoked when a decision is contrary to an agreement as when it is contrary to the company's articles of association. Non-compliance may result in specific performance, if there is nothing against an equitable intervention. The result may be the same as when invoking the above-discussed rule giving shareholders a right to attack decisions of the general meeting: the decision may be nullified or altered. In *Ringling Bros.—Barnum & Bailey Combined Shows* v. *Ringling*,[7] votes cast in violation of a shareholder's agreement were disregarded by the Supreme Court of Delaware in deciding how the board of directors should be composed. In *Clark* v. *Dodge*[8] there seemed to be nothing against installing one person as a director according to a previous agreement; however, the person in question had by his conduct disentitled himself to equitable intervention on his behalf.

In the United States the courts seem to have been fairly restrictive in enforcing shareholders' agreements by different forms of specific performance. Thus, it was often deemed to be a condition that practically every shareholder in the corporation should have adhered to the agreement;[9] if, nevertheless, specific performance was granted, the existence of an outside shareholder would affect the judgment, as happened in the Ringling case. It has even been held that specific performance was possible only when the corpora-

[5] See, for instance, Borum in 1962 Juristen 262 f., Marthinussen in 1967 T.f.R. 370.
[6] Nial, *op. cit.*, pp. 11 f., Sommerfeld, *op. cit.*, pp. 89 f.
[7] 53 A.2d 441 (1947).
[8] 199 N.E. 641 (1936).
[9] O'Neal, *op. cit.*, p. 283, Brand, *op. cit.*, pp. 88 f.

tion itself was a party to the agreement.[1] In recent cases the courts seem to have been less hostile than before in their attitude towards the granting of specific performance of shareholders' agreements.[2]

6.3.1. The remedies that are left for an enforcement of a shareholders' agreement in Scandinavian and Continental law are those of the law of execution. The question how to execute a voting agreement has been much discussed in Germany, but hardly at all in the other countries. The following remarks will principally deal with German law.

In the German Code of Civil Procedure, sec. 894, there is a provision to the effect that a declaration of intention by a party may be replaced by a court order to the debtor that he shall produce a declaration of intention. According to this section, where a debtor has been ordered to produce a declaration of intention, his declaration is assumed to have been made when the decision of the court becomes final.

In several cases, the plaintiff has claimed that a certain voting by the defendant should be considered to have been performed according to this provision. Generally, it has been considered improper to invoke the rule laid down in sec. 894 in connection with decisions at a corporation's general meeting. It has been argued that the court may replace the voting, but not the result of the different votes, the decision,[3] that voting should not be looked upon as a declaration of intention (a juristic act),[4] and that a court must not interfer in the decisions of a private assembly.[5] One rather powerful argument is, in my opinion, that an adjustment of a decision at a general meeting should not be allowed to be altered in a form that makes the boundaries established in corporative law meaningless.

Nevertheless, in a recent decision the Federal Supreme Court of Germany has sanctioned the use of this remedy to make a decision at a general meeting comply with a shareholders' agreement.[6]

Another way of enforcing a voting agreement may appear in

[1] See O'Neal, *op. cit.*, pp. 296 f.

[2] *Op. cit.*, pp. 301 f.

[3] Sommerfeld, *op. cit.*, pp. 99 f., Peters, *op. cit.*, p. 321; cf. Bergendal, *Aktiebolagets författning*, Lund 1922, p. 151.

[4] Cf. Sommerfeld, *op. cit.*, p. 99, Peters, *op. cit.*, p. 320.

[5] 112 Entscheidungen des Reichsgerichts in Zivilsachen 273; cf. Peters, *op. cit.*, p. 322.

[6] Judgment of May 29, 1967, 1967 Die Aktiengesellschaft 358; cf. Gomard in 1969 *Juristen* 359.

the form of a prohibition for a party to a voting agreement to vote against the provisions in the contract. In Danish and German law, for example, this form of performance means that the debtor may, if he violates the prescriptions in the judgment, be punished for his contempt of court.[7] In Swedish law, a fine must be expressly stated in the order issued by the court to make it possible to interfere in case of a violation. So far as I know, there is no reported case in which this device has been used.

The possibility of forcing a shareholder under the threat of a fine to vote according to his promise seems to exist in Swedish as well as in German law. The pertinent section in the German Code of Civil Procedure, sec. 888, has not, however, been applied in this connection, the somewhat dubious argument being used that this would mean too great an interference with the freedom of voting.[8]

Another alternative, also offered in German as well as in Swedish law, is performance by the creditor on behalf of the debtor.[9] This relief will only be granted where the person who performs the debtor's duty does not need to have any special qualifications. The general opinion among German writers seems to be that this remedy is out of the question, since voting may be legally performed only by the shareholder or his agent.[1]

6.3.2. In English law, corresponding results to those stated above may be achieved in equity by means of injunctions. An injunction for a shareholder to vote may be negative as well as mandatory: in *Greenwell* v. *Porter*,[2] the defendants were ordered not to vote against an agreement, while a duty to vote in a certain way was stated in *Puddephatt* v. *Leith*.[3] Similar cases are known from American case law.[4] Those who do not comply with such injunctions will be punished for contempt of court.

7. It is evident from these notes on enforcement of shareholders' agreements that the attitude towards adjustments in a general meeting's decisions is more generous in American law than in

[7] See Gomard, *Fogedret*, 2nd ed. Copenhagen 1966, pp. 146 f., the German Code of Civil Procedure, sec. 890.

[8] 1927 Juristische Wochenschrift 2992, Peters, *op. cit.*, pp. 323 ff.

[9] The German Code of Civil Procedure, sec. 887, the Swedish Execution Act, sec. 37, subsec. 1, no. 4.

[1] Brand, *op. cit.*, p. 34 with further references; but see Gomard in 1969 *Juristen* 365.

[2] 1902 I Ch. 530.

[3] 1916 I Ch. 200.

[4] Hornstein, *op. cit.*, p. 239 with note 95, Brand, *op. cit.*, p. 89.

Scandinavian and Continental law. There are certain possibilities of enforcement through the law of execution—but it seems clear that those provisions often give the shareholder incomplete protection. In my opinion, however, there is little need to extend the possibilities for enforcement. The arguments against extending the shareholders' right to attack decisions of the general meeting are not very convincing (see *supra,* 6.2.1). But in most cases there is not much to be gained by ordering performance—if a breach of a contract has affected the cooperation in a corporation, the best thing would be to release the parties from their obligations in a sensible way, rather than to force them to comply.[5] At least this would be the case in the close corporations, where the overwhelming majority of shareholders' agreements are to be found.

[5] Cf. Chayes, "Madame Wagner and the close corporation", 73 *Harvard Law Review* 1532–59; but see Gomard in 1969 *Juristen* 366 f.