VILNIUS UNIVERSITY
GHENT UNIVERSITY

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COMPANY LAW ASPECTS OF SHAREHOLDERS' AGREEMENTS IN LISTED COMPANIES

Doctoral dissertation

Social sciences, law (01 S)

Vilnius, 2014

The dissertation was prepared during the period of 2009 – 2013 at Ghent University and Vilnius University.

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AKCININKŲ SUTARČIŲ BENDROVIŲ TEISĖS ASPEKTAI BIRŽINĖSE BENDROVĖSE

Daktaro disertacija
Socialiniai mokslai, teisė (01 S)

Vilnius, 2014

Disertacija rengta 2009-2013 Vilniaus universitete ir Gento universitete.

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AB – a public limited liability company in the Republic of Lithuania (abbreviation from Lithuanian *akcinė bendrovė*).

ABI – Law on Companies of the Republic of Lithuania (abbreviation from Lithuanian *Akcinių bendrovių įstatymas*).

CA – Companies Act 2006 of the United Kingdom.

CC – Civil Code of the Republic of Lithuania (in Lithuania *Civilinis kodeksas*).

CCL – The Constitutional Court of the Republic of Lithuania (in Lithuanian *Lietuvos Respublikos Konstitucinis Teismas*).

NV – a public limited liability company in Belgium (abbreviation from Dutch *de naamloze vennootschap*).

PLC – a public limited liability company in the United Kingdom (abbreviation from English *public limited company*).

SCL – the Supreme Court of Lithuania.

W.Venn. – Companies Code of Belgium (abbreviation from Dutch *Wetboek van Vennootschappen*).

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CONCEPTS AND DEFINITIONS

Action plan 2003 – a communication that outlines the approach which the European Commission intended to follow during 2003-2009 (and onwards) in the area of company law and corporate governance[1].

Action plan 2012 – a communication that outlines the approach which the European Commission intends to follow in the upcoming years in the area of company law and corporate governance[2].

Agency costs – a sum of: 1) monitoring costs and incentives expenditures by the principal in order to align the interests of the agent with the interests of the principal, (2) the bonding expenditures by the agent in order to guarantee that he will not take certain actions that might harm the principal, (3) the residual loss despite the monitoring by the principal and bonding by the agent.

Agency problem – a presumption that the agent is more likely to act in his own interest than for the benefit of the principal. Three agency problems have been identified: 1) between shareholders and management body; 2) between majority and minority shareholders; 3) between shareholders and stakeholders.

Agency relations – a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.

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[1] European Commission. Communication from the Commission to the Council and the European Parliament Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward, COM(2003) 284 final.

[2] European Commission. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 0740 final.

Agency theory – a theory of the firm that stresses the relations between the agent and the principal and provides theoretical grounds for legal intervention in order to mitigate negative consequences of the agency problem.

Company – a limited liability company having its securities traded on a public stock exchange, such as NASDAQ OMX Vilnius in Lithuania, NYSE Euronext Brussels in Belgium or London Stock Exchange in the UK. Company is considered to be established for business purposes only, *id est* to generate profit.

Conflict of interests – a situation where the private interest of the agent (or any third party) hinders the ability of the agent to act and make decisions in the interests of the principal when such duty is based on legal, contractual, customary, professional or fiduciary relations.

Constituents – throughout this dissertation are understood as shareholders, members of the management body, employees and creditors of the company.

Corporate governance – the system by which companies are directed and controlled. This dissertation adopts a narrow definition of corporate governance adopted in Cadbury report. However, it is recognized that a vast array of definitions exists in theory and in practice[3].

IPO – means initial public offering when shares of the company are offered on the regulated for the first time. This is one of the processes when companies become publicly traded on regulated markets.

Management (or Management board or Management body) – the governing body of the company that includes the principal executive officers

[3] For an overview of some of the definitions see part I chapter 1.3.2.

who design and implement business strategy. In one-tier jurisdictions boards are comprised of executive directors who are responsible for management of the company and non-executive directors who supervise the executives, while in two-tier jurisdictions the supervisory board monitors the management board comprising only of executive directors[4].

Report on the proportionality principle – a study commissioned in order to identify existing diversions from the proportionality principle across EU listed companies. The study analyses a list of control enhancing mechanisms which do not follow the proportionality principle, including shareholders' agreements[5].

Shareholders' agreement – a written or oral contract between the shareholders of a company (at least by one of the shareholders) that is governed by the general principles of contract law. The subject matter of the agreement must be related to 1) the company; 2) the shares of the company, and; 3) rights, duties and obligations of shareholders' towards each other or towards the company.

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[4] According to: ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: the Interests of Shareholders as a Class. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 56-57.

[5] Institutional Shareholder Services Europe, European Corporate Governance Institute and the law firm Shearman & Sterling. *Report on the Proportionality Principle in the European Union,* 2007 [interactive]. [Accessed on 2011-01-27] Available online at: <http://ec.europa.eu/internal_market/company/docs/shareholders//study//final_report_en.pdf>.

INTRODUCTION

The company, as a form of organisation, is a phenomenon that transcends the law. There are various social[6], economic[7], historical[8] and even religious[9] aspects (and problems) associated with the company that the law alone is incapable of identifying and tackling. However, if these problems are revealed and explained, company law might be able to provide feasible solutions.

In this context, company law has been influenced and accompanied by the corporate governance discourse for more than thirty years (with a rapidly increasing impact over the last ten years). Corporate governance research has enriched company law debate with insights into the functioning and internal structure of the company[10], the composition of the management body[11], the role of the shareholders[12], and many other issues[13]. One of the key tasks of corporate governance is to balance the diverse interests of various corporate constituents, including shareholders[14]. This key task is shared with the

[6] See: MAY, S.; CHENEY, G.; ROPER, J. *The Debate Over Corporate Social Responsibility*. Oxford: Oxford University Press, 2007.

[7] See: BROWN, L. D.; CAYLOR, M. L. *Corporate Governance and Firm Performance*, 2004 [interactive]. [Accessed on 2012-07-14] Available online at: <http://ssrn.com/abstract=586423>.

[8] See: SCHMIDT, R. H.; SPINDLER, G. Path Dependence, Corporate Governance and Complementarity. *International Finance*, 2003, Vol. 5, No. 3, p. 311-333.

[9] HILLARY, G.; HUI, K. W. Does religion matter in corporate decision making in America? *Journal of Financial Economics*, 2009, Vol. 93, No. 3, p. 455-473.

[10] Starting with the insights that ownership is separate from the control function of the company and the critically acclaimed agency theory. See: BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932; JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 305-360.

[11] HOPT, K. J. LEYENS, P. C. Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy, 2004. *ECGI - Law Working Paper No. 18/2004* [interactive]. [Accessed on 2012-07-13] Available online at: <http://ssrn.com/abstract=487944>.

[12] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 63-72.

[13] For an overview of what constitutes good corporate governance see: FILATOTCHEV, I. *et al*. Key Drivers of 'Good' Corporate Governance and the Appropriateness of UK Policy Responses: Final Report to the Department of Trade and Industry, 2007 [interactive]. [Accessed on 2013-03-28] Available at: <http://eprints.hud.ac.uk/473/>.

[14] CLARKE, T. Introduction: Theories of Governance – Reconceptualizing Corporate Governance Theory After the Enron Experience. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 1-2.

company law[15], and thus the two disciplines unavoidably interact with each other. Furthermore, with the growing number of direct (by owning the shares) and indirect (for example, through participation in pension funds) shareholders throughout the world, increasing capitalisation of securities markets and the fact that 94 % of the world population live in countries with at least one regulated securities market[16], the task to balance different interests of the "insiders" of listed companies becomes even more crucial.

There are two types of conflicts of interest (or agency problems, as will be explained in this dissertation) that are significant for the current debate[17]. The first conflict of interests arises between the management body of the company and the shareholders as a class. The second type exists between the majority and minority shareholders. These conflicts of interest are the cause of most of the modern corporate scandals[18]. In countries with a dispersed ownership structure, the management body tends to abuse its powers to the detriment of the shareholders (most of the times through fraudulent accounting), while in jurisdictions with a concentrated structure of share ownership, the majority shareholders are likely to expropriate minority shareholders in order to gain private benefits of control[19]. To prevent corporate

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[15] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 2.

[16] GROUT, P. A., MEGGINSON, W. L.; ZALEWSKA, A. One Half-Billion Shareholders and Counting - Determinants of Individual Share Ownership Around the World, 2009. 22nd Australasian Finance and Banking Conference, 2009 [interactive]. [Accessed on 2013-03-28] Available at SSRN: <http://ssrn.com/abstract=1457482>.

[17] There is also a third type, but it will not be addressed in this dissertation. ARMOUR, J.; HERTIG, G.; KANDA, H. Transactions with Creditors. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 115-151.

[18] For an overview in the US, see: MARKHAM, J. W. *A Financial History of Modern U.S. Corporate Scandals from Enron to Reforms*. New York: M.E. Sharpe, 2006. For an analysis of the most notorious corporate scandal in Europe see: BUCHANAN, B.; YANG, T. The Benefits and Costs of Controlling Shareholders: The Rise and Fall of Parmalat. *Research in International Business and Finance*, 2005, Vol. 19, No. 1, p. 27-52.

[19] COFFEE, J. C. A theory of corporate scandals: Why the USA and Europe differ. *Oxford review of economic policy*, 2005, Vol. 21, No. 2, p. 198-211. In more economic terms this problem is defined as 'ways in which suppliers of finance to corporations assure themselves of getting a return on their investment'. SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. *The Journal of Finance*, Vol. 52, No. 2, 1997, p. 737.

failures and align the interests of different corporate constituents, company law, together with corporate governance, must provide effective legal measures, tools and solutions.

This debate on the mitigation of the negative consequences of conflicts of interest is relevant throughout the world and is not limited to one jurisdiction or one legal family[20]. In Europe this debate started only recently (at the turn of the millennia)[21] and is at its peak. The relevance of the debate is revealed by various initiatives at the EU legislative level[22], by non-profit associations being active in promoting corporate governance research[23], and by corporate governance codes and best practices being adopted, amended and improved in every Member State[24]. Throughout the debate, shareholders and their rights, empowerment and protection are at the core of the discussions[25].

During this discourse, prominent corporate scholars have offered their view on how to solve the existing conflicts of interest[26]. They identified two types of strategies in dealing with the agency problems: regulatory strategies and governance strategies. Although these strategies offer various legal tools and measures to tackle conflicting interests, none of them address contractual tools (and in particular shareholders' agreements) as a possible legal solution

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[20] For an overview of corporate governance debate in most of the important jurisdictions see: HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998.

[21] ENRIQUES, L.; VOLPIN, P. Corporate Governance Reforms in Continental Europe. *Journal of Economic Perspectives*, 2007, Vol. 21, No. 1, p. 117-140.

[22] For a full list of European commission initiatives see: [Accessed on 2013-03-28] <http://ec.europa.eu/internal_market/company/modern/index_en.htm>.

[23] The most influential one is the European corporate governance institute which provides 'a forum for debate and dialogue between academics, legislators and practitioners, focusing on major corporate governance'. See: [Accessed on 2013-03-28] <http://www.ecgi.org/organisation/overview.htm>.

[24] For the convergence debate of the corporate governance codes see: CICON, J. E.; FERRIS, S. P. *European Corporate Governance Codes: An Empirical Analysis of Their Content, Variability and Convergence*, 2008 [interactive]. [Accessed on 2013-03-28] Available online at: <http://cori.missouri.edu/pages/seminars/Cicon-Ferris-08.pdf>.

[25] This is especially true in light of the recent action plan of the European Commission. See: European Commission. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, COM(2012) 0740 final.

[26] For an overview, see Part I, Chapter 4.

for the two agency problems. Furthermore, there are only few empirical studies on the availability of shareholders' agreements in listed companies. Therefore, in light of the above mentioned corporate governance debate, this dissertation develops insights into whether shareholders' agreements can be used in order to mitigate negative consequences of conflicts of interest. As will be explained, the answer to this question is complicated as theoretical assumptions often fail against the reality of practice. To the best knowledge of the author, this dissertation is the first scholarly contribution to legal science comprising a comparative, empirical analysis of shareholders' agreements concluded in listed companies in Belgium, Lithuania and the UK.

Purpose and object of the research

The principal purpose of this dissertation is to analyse, comment and discuss, as objectively as possible[27], the legal regulation and practice of shareholders' agreements in listed companies from the context of corporate governance, using the conceptual approach formulated by agency theory. This research is to improve the theoretical view on shareholders' agreements in listed companies by analysing whether theoretical assumptions that shareholders' agreement could mitigate agency problems[28] correlate (and how) with the empirical results on shareholders' agreements concluded in listed companies on stock exchanges in Belgium, Lithuania and the UK.

The aim of the dissertation is reached by providing qualitative research and empirical evidence on one of the possible legal tools to mitigate negative consequences of the agency problems. On the one hand, qualitative research in selected jurisdictions analyses the similarities and differences of legal regulation of shareholders' agreements. On the other hand, empirical data and research are to reveal findings on the number of shareholders' agreements

[27] The author acknowledges that this might be hard, as the brain of a human being is known to distort and disguise the truth. For an analysis on the functioning of the brain see: FINE, C. *A Mind of Its Own: How Your Brain Distorts and Deceives*. New York: W. W. Norton & Company, 2006.

[28] Taking into account that it should not worsen the position of other corporate constituents or create other types of agency problems.

concluded in the analysed jurisdictions, the reasons for entering into shareholders' agreements and voting power of shareholders entering into contractual relations. This qualitative research and empirical analysis on the shareholders' agreements in publicly listed companies contributes to the contemporary discussion on legal strategies to solve agency problems in context of comparative company law and corporate governance. The results presented in this dissertation will be especially useful for legislature, stock exchanges and scholars conducting research in the law and economics field.

Due to the interdisciplinary nature of corporate governance, academic research in this field usually includes some aspects of economics. Therefore, the theoretical foundation of this dissertation is based on agency theory[29], which exposes problems that exist in the relationships between various corporate constituents. As agency problems are considered to be at the core of corporate governance, this dissertation develops insights whether negative consequences of conflicts of interest could be mitigated using contractual tool, *id est*, the shareholders' agreement.

The sub-objectives of the research are as follows:

1) to provide a descriptive analysis of the main characteristics of limited liability company and corporate governance, which will provide theoretical foundation for the rest of the dissertation;
2) to analyse whether theories of legal personality developed by legal scholars explain the internal relations between different corporate constituents. The question is how are legal personality theories important and why do they fail to provide insights into internal relations within the company?
3) if legal theories are insufficient, the dissertation is to analyse the existing economic theories that best explain the internal relations of the company. Analysis on the state of the art encompasses the following questions: a) what are the economic theories of the firm; b) how these

[29] See: Part I, Chapter 2.2.3.

theories differ from the theories of legal personality; and c) what is the significance of agency theory for company law?

4) to provide a theoretical analysis on the characteristics and purposes of the shareholders' agreement. This sub-objective aims at answering: a) what is shareholders' agreement; b) what are the main qualifying characteristics of the shareholders' agreement; c) what are the main purposes of shareholders' agreement from agency theory perspective; d) what are the obstacles for conclusion of shareholders' agreements?
5) to analyse regulation of shareholders' agreements in the selected jurisdictions and to provide comments from the perspective of Lithuanian and Belgian law. This objective aims to answer these questions: a) are shareholders' agreements regulated in Lithuania, Belgium and the UK?; b) what types of shareholders' agreements are regulated? c) is regulation of shareholders' agreements extensive or limited?; d) what are the differences and similarities of regulation shareholders' agreements in the selected jurisdictions?
6) to carry out an empirical analysis on the shareholders' agreements in companies listed on stock exchanges in Belgium, Lithuania and the UK. The main questions to be answered are: a) are shareholders in listed companies concluding shareholders' agreements?; b) what type of shareholders' agreements are concluded; c) what is the purpose of shareholders' agreements concluded in listed companies?; d) what is the size of contracting shareholders (in terms of voting rights)?; e) what level of control are shareholders aiming to achieve by entering into voting agreements; and f) does ownership structure prevailing in a particular jurisdiction have an effect on the number and type of shareholders' agreements?
7) to conduct empirical analysis on the ownership structure dominant in the companies listed on the NASDAQ OMX Vilnius stock exchange;

8) to provide insights based on agency theory whether shareholders' agreement could be used as a legal tool to mitigate negative consequences of conflicts of interest in publicly listed companies.

Objects of this dissertation are a publicly traded limited liability company, relationships between different corporate constituents active in such a company (special emphasis and most attention is devoted to shareholders (both minority and majority) and members of the management board), shareholders' agreements concluded between these constituents and regulation of shareholders' agreements in selected jurisdictions.

Although the main object of the dissertation is a contract (shareholders' agreement), contract law is not at the centre of this dissertation. Company law and all problems associated with its scope of application is the driving force behind this scholarly work. Therefore, the analysis of shareholders' agreement from the perspective of contract law is limited and is primarily aimed at revealing the nature and characteristics of shareholders' agreement. Different possible clauses, their formulation, impact on the validity of the agreement and their enforceability questions are not dealt with in this scholarly work. This dissertation is not aimed at comparing shareholders' agreement with other legal instruments (for example, articles of association) and does not provide an example of shareholders' agreement.

Furthermore, joint venture agreement[30] and investment agreement[31] do not constitute part of this research[32]. These agreements do not fall in the scope

[30] An agreement whereby parties agree to establish a new private company (sometimes joint ventures are pursued without incorporation of legal entity), which is jointly controlled by the incorporators and is aimed at pursuing their mutual goals. Due to the private nature of joint venture agreements they are almost never found in publicly listed companies. For an analysis of the concept of this agreement see: MIKALONIENĖ, Lina. Jungtinės veiklos (partnerystės) sutarties teisinė kilmė ir samprata. *Mokslo darbai: Teisė*, 2010, No. 75, p. 81-92; CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 96-159.

[31] Investment agreement provides funding to the company by injection of venture capital (for equity investments in company venture capitalists usually get certain control over the company). As publicly listed companies seek funding on the markets through stock exchanges there is no need for venture capital. For a detailed analysis on venture capital see: RIMAS, J. *Privataus kapitalo sandoriai: bendrovių teisės aspektai (daktaro disertacija)*. Vilnius: Vilnius University, 2010.

as they are not considered to be relevant for publicly listed companies. Voting trusts have been included in the data only in those cases where the annual report of the company expressly states that such voting trusts are considered to be as shareholders' agreements (voting agreements) in their function[33]. Securities lending agreements are analysed only from a functional comparative perspective as contractual instruments that might create similar legal consequences as the transfer of voting rights agreement. Therefore, securities lending agreements are analysed from the perspective of Belgium and the UK and are compared to the transfer of voting rights agreement in Lithuania[34]. Securities lending agreements are not analysed as separate financial instruments used by the capital market participants.

Lastly, shareholders' agreements are not analysed as a mechanism that provides defence from takeovers. In other words, shareholders' agreements are analysed as coordination tools and not as mechanisms preventing takeovers and entrenching the management body. Takeover regulations are touched upon in as much as they provide for requirements to disclose any restrictions on transfer or exercise of voting rights (which in most cases also means disclosure of shareholders' agreement).

This dissertation does not deal with liability issues or claims for damages for breach of shareholders' agreement.

The research is limited to listed companies only, although basic assumptions and theoretical analysis could be applied to private companies as well. In listed entities, both the conflict between majority and minority shareholders and between shareholders and the management body is often

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[32] Although sometimes these agreements are characterised as being shareholders' agreements, the author agrees with such qualification only with some reservations (for example, joint venture agreements might be executed through partnerships and not through a company). THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 17-27.

[33] An example in this regard is AB InBev NV, a company listed on NYSE Euronext Brussels stock exchange. See: AB InBev NV. *Annual Report 2010* [interactive]. [Accessed on 2011-06-19] Available online at: <http://www.ab-inbev.com/pdf/AB_InBev_AR10.pdf>;

[34] Securities lending agreements are not analysed from the Lithuanian perspective because there is regulated transfer of voting rights agreement available for the shareholders of listed companies.

sharper than in non-listed companies. Furthermore, due to their nature and scale publicly traded companies affect not only the private interests of the constituents of the company, but public interests as well. Companies, which have their shares traded on stock exchanges, have a huge impact on the economies of the states and they also affect the interests of private investors (present and future). Due to these reasons, the possibility of failure of these companies has to be reduced to a minimum. Lastly, listed companies have an obligation to publicly disclose inside information, which also includes shareholders' agreements. Private limited liability companies do not have an obligation to reveal restrictions on voting rights, and thus empirical research would be extremely hindered.

Methodology

Taking into account influence of the law and economics discourse on the analysis of company law[35], the research and conclusions in this dissertation are drawn from agency theory perspective. This approach is being accompanied by the following legal methods.

Comparative method. The research on shareholders' agreements in Part II of this dissertation is based on the comparative legal method. This method is used from a functional approach, and therefore this dissertation compares only those legal instruments that fulfil the same function[36] (for example, it is presumed that securities' lending agreement might be used for the same function as the transfer of voting rights agreement). There are two main reasons for using the comparative legal method. First, to compare regulation of shareholders' agreements in the selected jurisdictions in order to identify any

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[35] For an excellent overview see: POSNER, R. A. *Economic analysis of law*. 8th edition. New York: Aspen Publishers, 2011, p. 1-36; 528-585. The cooperation between law and economics in the field of company law has become so natural that no serious company law scholarship can avoid economic concepts and analysis (this is a claim that other schools of modern jurisprudence can hardly make). BAINBRIDGE, S. M. *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 1997 [interactive]. [Accessed on 2012-06-19] Available online at: <http://ssrn.com/abstract=10335>, p. 3.

[36] KÖTZ, H.; ZWEIGART, K. *Introduction to comparative law*. 3rd edition. Oxford: Oxford University Press, 1998, p. 34-36.

similarities or differences. Second, to compare empirical results on shareholders' agreements in different stock exchanges in each of the analysed countries in order to identify any patterns and induce more general rules from the observations.

Analysis of applicable legislation and empirical data of companies listed on the stock exchanges is provided from three jurisdictions: Lithuania, Belgium and the UK. There are three main reasons why these countries were selected. Firstly, each of them represents very different legal systems. The UK represents a common law system and was one of the first to introduce corporate governance codes for publicly listed companies. Belgium in this regard has a standard system of corporate governance common to most continental states in Europe. Lithuania has a relatively young legal system (with just over 20 years of experience after the independence was restored) in North and Central Europe (also it represents a quite new Member State in the European Union). Secondly, the above countries were chosen due to different size and capitalisation of their securities markets. The UK has the most sophisticated and biggest stock exchange, while Lithuanian stock exchange is very small with just over 30 listed companies. In Belgium the stock exchange is of a relatively medium size. Thirdly, selected jurisdictions have different shareholding structures. The UK has a widely dispersed shareholding structure with no dominant shareholders, while Lithuania and Belgium have more concentrated ownership structures with high presence of controlling shareholders. This characteristic is especially important while analysing the correlation of number and type of shareholders' agreements to the ownership structure in each jurisdiction.

Empirical method. Taking into account the fact that 'corporate governance is of enormous practical importance'[37], research dealing with the agency problems cannot be complete without an empirical inquiry. Empirical

[37] SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. *The Journal of Finance*, Vol. 52, No. 2, 1997, p. 737.

method in general is used not to determine or interpret the law, but to analyse the consequences of law in action[38]. Empirical method throughout this dissertation is used in order to identify, for example, whether shareholders' agreements are concluded in listed companies, what types of shareholders' agreements are concluded, what is the main purpose of the shareholders' agreements, what is the ownership structure dominant in the companies listed on the NASDAQ OMX Vilnius stock exchange. It should be emphasized that the empirical analysis is based on the annual and interim reports of the companies and not on the shareholders' agreements.

The empirical analysis includes companies that have their primary listing on the NASDAQ OMX Vilnius stock exchange in Lithuania, the NYSE Euronext Brussels in Belgium and the London stock exchange in the UK, and are incorporated in the same jurisdiction as the stock exchange in which they are listed. Empirical research represents only shareholders' agreements that have shareholders of the company or shareholders of the shareholders of the company (if shareholders of the company are legal entities) as parties to the agreement. Thus, the empirical research does not include shareholders' agreements where the listed company is contracting as a shareholder of another company (for example, one of its subsidiaries). However, shareholders' agreements related to the internal structure or management of the company that have company itself joined as a party are included in the analysis. An extensive explanation of the data and methodology in analysing shareholders' agreements in listed companies is presented in Part III, Chapter 1.

Interpretation and analysis methods. There are four main types of interpretation and analysis methods that are used in this dissertation: linguistic, systematic, logical and teleological[39]. Linguistic interpretation method that focuses on the wording and syntax of legal provisions is used to interpret

[38] SMITS, J. M. *The Mind and Method of the Legal Academic*. Cheltenham: Edward Elgar Publishing Limited, 2012, p. 28-32.

[39] HESSELINK, M. W. A Toolbox for European Judges. In NEERGAARD U. *et al.* (eds.). *European Legal Method – Paradoxes and Revitalisation*. Copenhagen: DJOF Publishing, 2011, p. 200-208; STELMACH, J. BROZEK, B. *Methods of Legal Reasoning*. Dordrecht: Springer, 2006, p. 69-89.

different statutory acts regulating certain aspects of shareholders' agreements (for example, Belgian Companies Code (W.Venn.) or Lithuanian Civil Code (CC) provisions). Teleological interpretation method is used in order to distinguish the *ratio legis* and the policy aim under the particular legal rule (for example, this method is especially relied on when analysing the voting agreement under Lithuanian CC). Systematic interpretation method in this research is not limited only to the interpretation of different statutory provisions, but is also aimed at analysing certain legal concepts from a broader perspective (for example, the author systemically looks at the theoretical propositions, empirical results and ownership structure in each of the analysed jurisdictions). From the logical analysis mainly the inductive analysis[40] is used in order to build a more general pattern from the specific observations presented in this dissertation (for example, the observations provided regarding the correlation between the number and type of shareholders' agreements and the ownership structure of the jurisdiction is based on the inductive analysis).

State of the art and relevance of the research

At the end of the second millennium it was stated that '[t]he governance of the corporation is now as important to world economy as the government of countries'[41]. In order to prove this point the world has started the third millennium with a continuation of financial scandals (starting with Enron[42]) followed by a financial and economic crisis that was partially caused by the

[40] PATTON, M. Q. *Qualitative Research and Evaluation Methods*. 3rd edition. London: Sage Publications, 2002, p. 55-58.

[41] This statement was made by the former World Bank president James D. Wolfensohn. See: Global Corporate Governance Forum, First Review 2003 [interactive]. [Accessed on 2012-06-19] Available online at: <http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Forum_Review_2003/$FILE/GCGF_Annual_Review.pdf>, p. 5.

[42] MARKHAM, J. W. *A Financial History of Modern U.S. Corporate Scandals from Enron to Reforms*. New York: M.E. Sharpe, 2006, p. 49-140.

lack of good corporate governance standards, insufficient regulatory regime and weak implementation of strategies for reducing agency costs[43].

Publicly listed companies have been at the centre of the corporate governance debate since the enactment of the first corporate governance codes. This can be explained by the significance that companies traded on the stock exchanges have on the economy of the state and even continents of the world (for example, the single largest company on the NYSE Euronext Brussels stock exchange accounts nearly for half of the total market capitalization)[44]. This reason alone is enough for the legislature, governmental bodies responsible for the supervision of publicly listed companies and even non-governmental organizations to be interested in and influence the corporate governance debate, various problems stemming from management of the companies and the role of law in providing possible solutions for such problems. It should be stressed that the importance of the publicly listed companies is not likely to diminish over the upcoming years[45].

Furthermore, it has been established that corporate governance is relevant for both developed economies and countries that do not yet have strong markets[46]. From Lithuanian point of view (a country where corporate governance research is still in its embryo stage), the relevance of corporate governance and the need for research in this field has been signalled by the

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[43] OECD Steering Group on Corporate Governance. The Corporate Governance Lessons from the Financial Crisis, 2009 [interactive]. [Accessed on 2013-04-04] Available online at: <http://www.oecd.org/finance/financial-markets/42229620.pdf>, p. 2.

[44] The company is Anheuser-Busch InBev NV with a market capitalisation of EUR 105.44 bn. For more information see the official websites of NYSE Euronext Brussels stock exchange and Anheuser-Busch InBev NV available online at: <https://europeanequities.nyx.com/en> and <http://www.ab-inbev.com>.

[45] DAVIES, P. L. *Gower and Davies‘ Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 17-18. It has to be noted that small and medium enterprises also play a huge role in the economy of the world. See for example: *ibid*, p. 19. For a comparative overview of regulation of private companies in Europe see: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 109-130.

[46] SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. *The Journal of Finance*, Vol. 52, No. 2, 1997, p. 738.

enactment of the corporate governance code[47] and by a recently carried study on the governance of the state owned enterprises[48]. Countries with much more sophisticated markets (the UK and Belgium) have long since recognized the importance of corporate governance. The UK has been on the pinnacle of the contemporary corporate governance research since 1992[49] and Belgium is not far behind. However, to the best knowledge of the author, analysis on shareholders' agreements in listed companies from agency theory perspective has not been carried out neither in Belgium, nor the UK. There is also no empirical data available on the actual existence of shareholders' agreements in listed companies in Belgium, Lithuania and the UK.

The current state of the research in context of corporate governance is indebted to the postulate by Berle and Means that ownership is separated from control[50]. This paradigm was elevated to a new level by Jensen and Meckling who introduced agency theory[51]. Since then there have been numerous studies on various aspects of corporate governance, but most of them have been carried out through the lens of the economist[52]. During the past twenty years more and more research on corporate governance has been done from the legal

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[47] Lithuanian Securities Commission and NASDAQ OMX Vilnius. The Corporate Governance Code for the Companies Listed on NASDAQ OMX Vilnius, 2010 [interactive]. [Accessed on 2012-07-14] Available online at: <http://www.nasdaqomxbaltic.com/files/vilnius/teisesaktai/The%20Corporate%20Governance%20Code%20for%20the%20Companies%20Listed%20on%20NASDAQ%20OMX%20Vilnius.pdf>.

[48] Ministry of Economics of the Republic of Lithuania. Study on the exercise of the ownership rights in the state owned enterprises, Ministry of Economics of the Republic of Lithuania, 2011[interactive]. [Accessed on 2012-08-11] Available online at: <http://vvi.ukmin.lt/index.php?r=document/view&id=1069>.

[49] The Committee on the Financial Aspects of Corporate Governance. *Report on the Financial Aspects of Corporate Governance*, 1992 [interactive]. [Accessed on 2012-07-14] Available online at: <http://www.ecgi.org/codes/documents/cadbury.pdf>.

[50] BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932.

[51] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 305-360.

[52] For example, EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991; WILLIAMSON, O. *The Mechanisms of Governance*. Oxford: Oxford University Press, 1996; CLARKE, T. *International corporate governance: a comparative approach*. New York: Routledge, 2007; MONKS, R. A. G.; MINOW, N. *Corporate Governance*, 3rd ed. Oxford: Blackwell Publishing, 2004; CHARKHAM, J. P. *Keeping Better Company Corporate Governance Ten Years On,* 2nd ed. Oxford: Oxford University Press, 2005.

point of view[53] and recently one of most authoritative academic works classified all legal strategies that can be used in order to address the agency problems[54]. Despite of the above, the interdisciplinary scholarship in the company law context in continental Europe is not as developed as compared to the U.S., Canada or Australia[55]. Thus, there is a great need for additional academic research in the field of corporate governance.

Moreover, the topic on shareholders' agreements and the influence they have on the control of listed companies is currently underdeveloped in corporate governance discourse[56]. The research that is available mostly focuses on privately held companies. There are a number of reasons provided by legal scholars as to why shareholders' agreements are not found in listed companies (usually not supported by any evidence and data)[57], and thus require no further research. However, these reasons are most of the times unfounded. Corporate governance debate does not provide well founded and reasoned arguments as to how many shareholders' agreements are concluded in listed companies, what are the factors that influence the existence of shareholders' agreement, what impact the conclusion of the shareholders' agreement has on the control of the company. The author in this dissertation tackles and analyses these topics in detail.

To the best knowledge of the author, currently there are no in-depth, up-to-date comparative studies on shareholders' agreements in listed companies in

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[53] For example, HOPT, K., *et al. Comparative Corporate Governance, the State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998; MCCAHERY, J., *et al. Corporate Governance Regimes: Convergence and Diversity.* Oxford: Oxford University Press, 2002; SIEMS, M. *Convergence in Shareholder Law*, Cambridge: Cambridge University Press, 2008.

[54] For an overview of different strategies to mitigate agency costs see: Part I Chapter 4.

[55] CHEFFINS, B. R. *The Trajectory of (Corporate Law) Scholarship*, 2003 [interactive]. [Accessed on 2012-06-18] Available online at: <http://ssrn.com/abstract=429624>. p. 32-34, 39.

[56] The only study in Europe that partially addresses the shareholders' agreement topic in context of corporate governance is the Report on the proportionality principle. See: Part I, Chapter 5.4. However, this topic is starting to get some attention in law conferences. For example, see: VENTORUZZO, M. *Why Shareholders' Agreements are Not Used in U.S. Listed Corporations: A Conundrum in Search of an Explanation*, 2013 [interactive]. [Accessed on 2013-06-18] Available online at: <http://ssrn.com/abstract=2246005>.

[57] See Part III, Chapter 1.1.

Lithuania, Belgium and the UK. Academic works that are available for each of the countries deal mainly with shareholders' agreements in private companies and do not provide any comparative aspects of the regulation (although theoretical legal analysis on the concept of shareholders' agreement is provided)[58]. In addition, there are no empirical data on the actual usage of shareholders' agreements in the selected jurisdictions. The author was able to identify four studies concentrating on the shareholders' agreements in listed companies in Europe[59]. In the first study Baglioni provided empirical data on the shareholders' agreements in Milan stock exchange and argued that shareholders' agreements severely affect the link between the voting rights and voting power[60]. Furthermore, he provided empirical analysis from which he concluded that 'for low levels of ownership concentration, the reshuffling of voting power favours the first owner, while for high levels of ownership concentration it favours the other participants'. In other words, he tried to prove that shareholders' agreements are effective and are concluded only in two extreme cases: when there is a large majority shareholder or if the ownership inside the company is very dispersed. Another study by Belot identified 67 shareholders' agreements in 301 companies listed on the

[58] For Belgium see: NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991*. Antwerpen: Maklu Uitgevers, 1992, p. 254-270; NELISSEN GRADE, J. M. De la validité et de l'exécution de la convention de vote dans les sociétés commerciales. *Revue Critique de Jurisprudence Belge*, 1991, Vol. 45, p. 214-257 ; HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 185-203. For Lithuania see: MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, 2011, No. 71, p. 5-27. For the UK see: CADMAN, J. *Shareholders' Agreements. 4th ed.* London: Sweet & Maxwell, 2004; HOLLINGTON, R. *Shareholders' rights. 6th edition*. London: Sweet & Maxwell, 2010; THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009.

[59] The author provides studies that are published in English and deal only with publicly listed companies. There are a number of studies on shareholders' agreements in private companies.

[60] BAGLIONI, A. Shareholders' Agreements and Voting Power: Evidence from Italian Listed Firms. *Applied Economics*, 2011, Vol. 43, No. 27, p. 4043-4052.

Euronext Paris stock exchange[61]. This research concluded that 'shareholder agreements tend to mitigate conflict that could arise from a large dispersion of powers across large shareholders'. Thus, Belot's research concluded that shareholders' agreements are feasible only between large shareholders who share the power to control the company. The third study by Madelon and Thomsen applies a case analysis approach and they study five selected shareholders' agreements concluded in companies listed on the Euronext Paris stock exchange[62]. In their article Madelon and Thomsen conclude that shareholders' agreements have a huge influence on the formal ownership structure of the company. Moreover, they argue that shareholders' agreements are more likely in companies with specific ownership patterns: 'intermediate concentration of ownership, long time horizons and non-financial goals'. The fourth research conducted by Roth discusses shareholders' agreements in listed companies in Germany[63]. The article deals with the types, validity and legal nature of shareholders' agreements in Germany. However, it does not provide any empirical data.

From the Lithuanian perspective there are three dissertations that up to a certain degree overlap with this dissertation. Firstly, dissertation by A. Tikniūtė analyses the problem of limited liability and deals with different theories of the company (with emphasis on the nexus of contracts theory)[64]. In contrast, research provided in this academic work is based on agency theory and does not analyse limited liability characteristic in detail. Secondly, J. Rimas in his dissertation tackles conflicts of interest problems between different corporate

[61] BELOT, F. Shareholder Agreements and Firm Value: Evidence from French Listed Firms. *AFFI/EUROFIDAI, Paris December 2008 Finance International Meeting AFFI – EUROPIDAI*, 2008 [interactive]. [Accessed on 2012-01-28] Available online at: <http://ssrn.com/abstract=1282144>.

[62] MADELON, C.; THOMSEN, S. Contracting Around Ownership: Shareholder Agreements in France. In *Modern Firm, Corporate Governance and Investment*. Cheltenham: Edward Elgar Publishing Limited, 2009, p. 253-291.

[63] ROTH, M. *Shareholders' Agreements in Listed Companies: Germany*, 2013 [interactive]. [Accessed on 2012-05-21] Available online at: <http://ssrn.com/abstract=2234348>.

[64] TIKNIŪTĖ, A. Juridinio asmens ribotos atsakomybės problema: teisiniai aspektai. Daktaro disertacija. Socialiniai mokslai (teisė). Vilnius: Mykolas Romeris University, 2006.

constituents[65]. His analysis is focused on private equity transactions and only to closed limited liability companies. Therefore, the object of this dissertation is different as it is limited to publicly traded companies, while conflicts of interest issues are analysed in perspective of shareholders' agreement. The third dissertation by R. Čiočys deals with corporate governance codes, fiduciary duties, managerial pay and governance of state owned enterprises. This dissertation also deals with different corporate governance theories and it could partially overlap on the theoretical level while defining corporate governance phenomenon. Furthermore, Čiočys provides empirical evidence regarding the ownership structure of Lithuanian listed companies. The empirical method applied in this dissertation is slightly different and might yield additional insights.

Taking into account the arguments provided above, this dissertation presents comparative analysis and interpretation of shareholders' agreements together with empirical evidence from publicly listed companies in the selected jurisdictions in a way that has never been done before, and therefore should be considered as an original contribution to legal science.

Sources of the research

The interdisciplinary approach provided in this dissertation coupled with the aim to offer both theoretical and empirical insights are the cause of a wide array of sources used for the research.

Firstly, legal doctrine of company law and shareholders' agreements form one of the most important sources for this dissertation. These sources were relied upon when analysing theoretical foundations of the company and theoretical aspects of the shareholders' agreements. The most influential doctrinal works are, for example: KRAAKMAN, R. *et al. The Anatomy of Corporate Law: A Comparative and Functional Approach*; CADMAN, J.

[65] RIMAS, J. *Privataus kapitalo sandoriai: bendrovių teisės aspektai (daktaro disertacija).* Vilnius: Vilnius University, 2010.

Shareholders' Agreements; DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law*; DAVIES, P. *Introduction to Company Law*.

Secondly, academic texts in economics form a considerable part of the sources used in this research. They were mainly used to explain different economic theories of the firm and provide economic arguments and justifications for legal intervention. In addition, theoretical economic works were used to explain rationale behind different legal concepts and rights (for example, the voting right). The examples of such sources include: EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*; WILLIAMSON, O. *The Mechanisms of Governance*; JENSEN, M. C.; MECKLING, W. H. *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*; CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*.

Furthermore, in order to gain better understanding into corporate governance issues and their implications in actual management of companies, more practice oriented works on corporate governance were studied, for example: CARTER, C. B.; LORSCH, J. W. *Back to the Drawing Board: Designing Corporate Boards for a Complex World*; GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors*.

Fourthly, the comparative analysis of regulation of shareholders' agreements in Belgium, Lithuania and the UK relied on the company laws of each country. The most important statutory acts analysed are: Companies Code of Belgium (*Wetboek van Vennootschappen*); Law on Companies of Lithuania (*Akcinių bendrovių įstatymas*); Civil Code of Lithuania (*Civilinis kodeksas*); the Companies Act 2006 of the UK. In addition, EU legislation was taken into account, especially the directives that require disclosure of issues related to shareholders' agreements, for example, Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57); Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

Fifthly, law formulated by the courts was used as a source in this dissertation. This is especially important for the UK, which as a common law country relies on the case law. Decisions of the courts were analysed, for example, in order to understand the functioning of the statutory provisions, identify shareholders' agreements concluded in the listed companies or to determine whether shareholders' agreements are enforceable in practice.

Sixthly, various studies and reports conducted by national or international institutions were used as sources for the research. The most important report for this scholarly work is considered to be the *Report on the Proportionality Principle in the European Union*.

Lastly, the empirical results presented in this dissertation are based on the annual and interim reports and transparency declarations provided by the companies listed on the NASDAQ OMX Vilnius stock exchange in Lithuania, the NYSE Euronext Brussels in Belgium and the London stock exchange in the UK (together with other information provided in various online information sources, newspapers and magazines). All the sources used for gathering empirical data can be referred to in the references section of this dissertation.

Outline of the Dissertation and Structure

The interdisciplinary and comparative character of this dissertation requires adoption of a structure divided into four parts (each part divided into chapters and sub-chapters). The first part tackles theoretical foundations of company law and corporate governance. This part presents the state of the art research in context of the dissertation. It continues with explanation of legal strategies offered by legal scholars to mitigate agency problems and provides current EU approach to the shareholders' agreements and rights of shareholders. The second part starts with the analysis of theoretical aspects of shareholders' agreements. The subsequent chapters discuss and comment on regulations of shareholders' agreements in all three selected jurisdictions and examine differences and similarities of legal approach. The third part is the empirical analysis. It presents data and interpretations on the existence of shareholders' agreements on the NASDAQ OMX Vilnius stock exchange in Lithuania, the NYSE Euronext Brussels in Belgium and the London stock exchange in the UK. Furthermore, different aspects of the empirical findings, including the long term and short term goals, number of contracting parties per agreement, size of contracting parties, types and purpose of the shareholders' agreement, are analysed and commented. The fourth part summarizes the findings of the dissertation, provides a discussion on the correlation of theoretical presumptions and empirical data and offers conclusive remarks on the role of shareholders' agreements in context of corporate governance debate. Final conclusions are presented at the end of the dissertation. The dissertation is also accompanied by four annexes: Annex 1: Shareholders' agreements in companies listed on NASDAQ OMX Vilnius stock exchange; Annex 2: Shareholders' agreements in companies listed on NYSE Euronext Brussels stock exchange; Annex 3: Shareholders' agreements in companies listed on London stock exchange; Annex 4: Ownership structure in Lithuania.

Statements defended in the dissertation

The research, data and arguments provided in this dissertation are aimed at defending the following statements:

1. Academic research in the field of company law should partially rely on the economic theories of the firm and not only on the legal theories of legal personality, because the former provide insights into the nature and character of the relations between various corporate constituents and internal organization of the company.
2. Although the shareholders' agreement is based on the principle of freedom of contract, its subject matter should be limited to the company, the shares of the company and rights, duties and obligations of shareholders towards each other or towards the company.

3. Extensive and detailed regulation of shareholders' agreements is undesirable as it would prevent shareholders from effectively protecting their rights and interests. However, the legislature should address two issues. First, the validity and enforceability of shareholders' agreements should be clearly and unambiguously stipulated in the statutory acts. Second, statutory acts should provide a limited number of restrictions on the scope and subject matter of the shareholders' in order to prevent any misuse of the contractual tool or abusive behaviour. Statutory restrictions should at least stipulate that shareholders' agreements must not: 1) undermine the interests of the company; 2) contain provisions on voting or refraining from voting for consideration; 3) allow voting according to the instructions of the company, its subsidiaries or any of the legal bodies (or their members) formed within the company.
4. Shareholders' agreements are used in practice by companies listed on the regulated markets in the selected jurisdictions. However, in contrast to theoretical assumptions and arguments, shareholders' agreements in jurisdictions with the concentrated ownership structure are used to further concentrate control, while in jurisdictions with dispersed ownership structure they are used to protect the interests of minority shareholders. Voting agreements are mostly concluded amongst medium sized shareholders in order to gain *de jure* or *de facto* control of the company, while minority shareholders are prevented from contracting effectively.
5. The availability of shareholders' agreements in listed companies depends on a number of factors, including: the ownership structure prevailing in the jurisdiction, available legislation, case law and statutory provisions, per cent of voting rights that shareholders of a particular company have, goals of the shareholders, number of contracting parties needed to achieve the goals and type of the shareholders' agreement.

PART I: THEORETICAL FOUNDATIONS OF THE CORPORATE GOVERNANCE DEBATE AND THE ROLE OF SHAREHOLDERS

Chapter 1. Corporate Governance and Problems Within

Theoretical background for further inquiry into the role that shareholders' agreements play in context of corporate governance is presented in this Part. The author is of an opinion that in order to analyse shareholders' agreements, firstly some fundamental company law and corporate governance principles and postulates (including the role that shareholders play in companies) have to be addressed. Therefore, the structure of the first Part of this dissertation is as follows. First, the definition and main characteristics of both the company (which is the core of corporate governance discourse) and corporate governance are discussed in the following paragraphs. With these fundamental theoretical questions in mind this Part in Chapter 2 continues with an analysis of legal theories of corporate personality and economic theories of the firm. This theoretical background, in the opinion of the author, is relevant in order to understand the relations between different corporate constituents who act within the company and the problems that arise due to their conflicting interests. Thus, the theoretical basis provided in this part of the dissertation is used in further research.

1.1. What is a company and why it is important

1.1.1. The significance of the company form

Companies are the blood of modern economies flowing through various markets and enabling the growth and prosperity of humanity's social organism by providing it with the needed energy[66]. Though the form company is arguably not the optimal and ideal form, it is, like democracy, the best of all

[66] The role of the company as a vehicle to promote business can be hardly contested. It is impossible to imagine the modern world without companies as it is impossible to imagine our life without the modern technologies (starting with electricity). As it was put in the Cadbury Report: "country's economy depends on the drive and efficiency of its companies". See: The Committee on the Financial Aspects of Corporate Governance. *Report on the Financial Aspects of Corporate Governance*, 1992 [interactive]. [Accessed on 2012-07-14] Available online at: <http://www.ecgi.org/codes/documents/cadbury.pdf>, para. 1.1.

available options in order to foster economic growth and prosperity. It is true that in some cases the corporate vehicle can be used for illicit purposes[67] and due to this reason sometimes it is depicted in grey colours[68], attract attention from popular classical writers[69] or even whole anti-corporate movements are started[70]. However, the importance of the companies in terms of world economy can be hardly challenged[71]. Since the first appearance of the modern company (and the introduction of the limited liability and publicly traded shares)[72], it started dominating large projects that required huge amounts of financing (for example, building of railways, bridges or canals)[73]. It happened due to two main reasons. First, large scale financing was achieved through

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[67] Organisation for Economic Co-operation and Development. *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*. OECD Report, 2001. This report states that almost every economic crime involves misuse of corporate entities, although private companies are used for illicit purposes more often than the publicly listed ones. See: p. 3, 22-24. See also: HARTLEY, R. D. *Corporate Crime: A Reference Handbook*. Santa Barbara: ABC-CLIO, Inc., 2008.

[68] BAKAN, J. *The Corporation: The Pathological Pursuit of Profit and Power*. New York: Free Press, 2004.

[69] The famous English writer Daniel Defoe has rhymed about the follies of the company: 'Some in clandestine companies combine; Erect new stocks to trade beyond the line; With air and empty names beguile the town, And raise new credits first, then cry 'em down; Divide the empty nothing into shares, And set the crowd together by the ears'. See: DEFOE, D. Reformation of Manners. In LONSDALE, R. (ed.) *The New Oxford Book of Eighteenth-Century Verse*, Oxford: Oxford University Press, p. 33-35.

[70] OSBORNE, E. *The Rise of the Anti-corporate Movement: Corporations and the People Who Hate Them*. Westport: Praeger Publishers, 2007.

[71] CLAESSENS, S. *Corporate Governance and Development*, 2003 [interactive]. [Accessed on 2012-06-18] Available online at: <http://www1.ifc.org/wps/wcm/connect/7fc17c0048a7e6dda8b7ef6060ad5911/Focus_1_Corp_Governance_and_Development.pdf?MOD=AJPERES>, p. 2. See also MICKLETHWAIT, J.; WOOLDRIDGE, A. *The Company: A Short History of a Revolutionary Idea*. New York: Modern Library, 2003, p. xv. It has to be noted that companies are becoming increasingly involved in other areas of life and not just economics. The increased societal role of the company as a 'corporate citizenship' concept is analysed in: PIES, I.; KOSLOWSKI, P. (eds.). *Corporate Citizenship and New Governance: the Political Role of Corporations*. Dordrecht: Springer, 2011.

[72] MICKLETHWAIT, J.; WOOLDRIDGE, A. *The Company: A Short History of a Revolutionary Idea*. New York: Modern Library, 2003, p. 17-24.

[73] In certain cases companies ruled even continents and commanded armies as large as 200 000 soldiers. Such tremendous impact sometimes even leads to claims that modern world (in terms of historians) began not when Johannes Gutenberg in 1440 invented the printing press or when Christopher Columbus in 1492 discovered America but when Elizabeth I granted a company of 218 merchants a monopoly of trade to the east of the Cape of Good Hope. See: The Economist. The Company that Ruled the Waves, 2011 December 17 [interactive]. [Accessed on 2012-06-30] Available online at: <http://www.economist.com/node/21541753>. There is also a negative side to the activities of the mentioned company: ROBINS, N. *Loot: in search of the East India Company, the world's first transnational corporation*, 2002 [interactive]. [Accessed on 2012-06-30] Available online at: <http://eau.sagepub.com/content/14/1/79.full.pdf>.

accumulation and management of investments from multiple small investors. Secondly, the fact that each project needed only relatively small investments from each individual stimulated further investments by enabling the said individuals to diversify their risks (introduction of limited liability meant that investors were liable no more than the amount they contributed to the project). Nowadays, companies are active in almost all the fields and sectors starting with agriculture, construction and ending with pharmaceutical and banking sectors. Every day people in one way or another (by being employed, by buying goods or using services) are dealing with companies that operate not only in their home country but throughout the whole world. From the economic point of view, this means that companies are well suited to serve their purpose, *id est*, to enable the accumulation of large amounts of capital (with possibility to diversify risks) through capital markets in order to carry out projects that later benefit investors, compensate debt creditors and employees[74].

Throughout the history companies came into existence in various ways[75]: by a papal bull, royal charter and later – incorporation by registration[76]. Nowadays, legislation in most parts of the world allows incorporation of companies if all the minimum legal requirements provided in the laws of a particular jurisdiction are satisfied (the goal of the legislation is to provide for a fast, easy and cheap incorporation procedure)[77]. Thus, it can be suggested that a company is one of the most important human creations that allows easy allocation of available capital (to the people that have knowledge and

[74] PETTET, B. *Company Law. 2nd edition*. Harlow: Pearson Education Limited, 2005, p. 3; FRENCH, D.; MAYSON, S. W.; RYAN, CH. L. *Company Law. 27th edition*. Oxford: Oxford University Press, 2010, p. 27-28.

[75] For an overview of legal theories of corporate personality see Chapter 2.1. of Part I.

[76] FARRAR, J. H. *Corporate Governance: Theories, Principles and Practice*. 2nd edition. Oxford: Oxford University Press, 2005, p. 8-9. Also see: TALBOT, L. *Critical Company Law*. New York: Routledge-Cavendish, 2008, p. 5-11.

[77] For a detailed analysis on the formation of the companies in the EU jurisdictions see: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 52-98; FRENCH, D.; MAYSON, S. W.; RYAN, CH. L. *Company Law. 27th edition*. Oxford: Oxford University Press, 2010, p. 44-50;

experience on how to manage it) in order for it to be used to increase the wealth of the investors and to benefit the whole economy and the wealth of the society along the way[78].

1.1.2. Company in legal terms

Companies in the legal context are sometimes defined as a group of people carrying activities for economic purposes[79]. It should be noted that the term 'company' has a slightly different meaning in common law countries and in continental Europe[80]. In common law jurisdictions the term 'company' is distinct from partnerships and partnership law[81], whereas in continental Europe the term 'company' is closer to the meaning of the concept of a legal entity and encompasses partnerships and other legal forms. Thus, the first meaning is typical for the UK, while in Belgium and Lithuania the term 'company' has a broader meaning. As it was mentioned in the introduction, unless explicitly indicated otherwise, the term 'company' further in this dissertation will be understood as a publicly traded company, *id est*, a limited liability company having its securities traded on a public stock exchange, such as the NASDAQ OMX Vilnius in Lithuania or the NYSE Euronext Brussels in Belgium[82].

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[78] This view represents the enlightened shareholder value model. Please see Part I, Chapter 3.3.

[79] See: MARTIN, E. A. (Ed.). *A Dictionary of Law. 5th edition. Oxford: Oxford University Press*, 2003 p. 98; GARNER, B. A. (Ed.). *Black's Law Dictionary. 9th edition*. St. Paul: Thomson Reuters, 2009, p. 318-320; WILD, S. E. (Ed.). *Webster's New World Law Dictionary*. Hoboken: Wiley Publishing, 2006, p. 82.

[80] English language presents certain difficulties as well and depending on whether the British or American English is used (and, of course, which jurisdiction is meant), terms 'company' and 'corporation' also differ. Under the UK law 'corporation' is a wider concept and the term 'company' is usually understood as a corporation aggregate, a corporation made up from a totality of individuals. See: PETTET, B. *Company Law. 2nd edition*. Harlow: Pearson Education Limited, 2005, p. 14-15. It is also interesting to note that nowadays company is construed (because it is regarded as such) as a singular noun. However, before the First World War the term company was construed in plural: the company was regarded as they (due to the different understanding of corporate personality). See: FRENCH, D.; MAYSON, S. W.; RYAN, CH. L. *Company Law. 27th edition*. Oxford: Oxford University Press, 2010, p. 160-161.

[81] DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 4.

[82] In certain cases the context might explicitly indicate that company is understood not as publicly listed company.

Company is said to be the way that law defines and regulates economic reality[83]. In order to better understand the legal concept of the company and what features made company as important (and attractive for the purpose of carrying out business) as it is today the following part of this chapter provides a brief overview of the main characteristics of the company: legal personality, limited liability, centralized management under a board structure, transferable shares and shared ownership by contributors of capital[84].

1.2. Core features of the company

It is argued by the most prominent company law scholars that the main purposes of company law is to provide a corporate form that has all of the below listed core features[85] and to set default (or mandatory) rules and standards to lower transactions costs between different corporate constituents[86]. The core features of the company presented in the following paragraphs not only distinguish it from other types of legal entities (for example, partnerships) but also demonstrate the reasons why companies are the dominating form in the corporate law. This argument is strengthened by each of the characteristics which add a piece of functionality to the whole company picture. However, for the purpose of this dissertation, the considerations on the five characteristics of the company form are limited only to providing the basic meaning and concept

[83] FARRAR, J. H. *Corporate Governance: Theories, Principles and Practice*. 2nd edition. Oxford: Oxford University Press, 2005, p. 20.

[84] The structural characteristics of the company are presented according to ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 5. Other authors use the above classification of the core features of the company as well. See: CAHN, A.; DONALD, D. C. *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA*. Cambridge: Cambridge University Press, 2010, p. 9

[85] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 2.

[86] Thus, company law should also provide rules effectively dealing with disputes and conflicts between corporate constituents in running companies. As it will be explained further in this dissertation, corporate governance is partly dealing with this question as well as it is concentrated on how companies are governed and controlled.

of each feature[87] as to enrich the reader with basic knowledge which is needed to understand further parts of the dissertation.

1.2.1. Legal personality

A fundamental attribute of any company is its legal personality – it is a legal entity that is distinct from the persons that created it (shareholders)[88]. A company enjoys its own rights and has its duties that are also distinct form its members. For example, article 2.33(1) of the CC[89] states that any legal entity can have its own duties and rights, can sue and be sued in courts. The legal entity acts and enters into obligations in its own name and not in the name of its shareholders. This rule applies to all legal entities including the company (AB[90]). The same situation exists in Belgium where a company (NV[91]) is treated as a separate legal person with its own rights, duties and property[92]. In the UK the concept of separate legal personality was clearly formulated in the famous decision by the House of Lords *Salomon v Salomon & Co*[93] where it was stated that a company is a separate legal entity and business belongs to the company and not to its members. However, separate legal personality is a fiction created by law and comes into existence only if natural persons decide

[87] This dissertation does not provide for an extensive legal and economic analysis of all the five characteristics of the company.

[88] The company is so different in nature from its members that sometimes it is considered as a person that never dies. BLACKSTONE, W. *Commentaries on the Laws of England*, 1765-1769 [interactive]. [Accessed on 2012-07-02] Available online at: <http://www.lonang.com/exlibris/blackstone/>, Book 1, Chapter 18. This analogy is made in relation to a secondary characteristic of company: perpetual life.

[89] CC – Civil Code of the Republic of Lithuania (in Lithuania Civilinis kodeksas).

[90] AB – a public limited liability company in the Republic of Lithuania (abbreviation from Lithuanian akcinė bendrovė).

[91] NV – a public limited liability company in Belgium (abbreviation from Dutch de naamloze vennootschap).

[92] GEENS, K.; CLOTTENS, C. Corporations and Partnerships. Belgium. In *International Encyclopaedia of Laws*. Hague: Kluwer Law International, 2006, p. 67-68, para. 85.

[93] House of Lords. Salomon v Salomon & Co [1987]. *Law reports, Appeal cases.* For an overview of the case see: DAVIES, P. L. *Gower and Davies‘ Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 33-37. For an analysis of the case see: GODDARD, D. Corporate Personality – Limited Recourse and its Limits. In RICKETT, CH. E. F.; GRANTHAM, R. B. (eds.). *Corporate Personality in the 20th Century*. Oxford: Hart Publishing, 1998, p. 11-64.

to incorporate a company[94]. Thus, the peculiarity of the concept of separate legal personality is that a company is formed by a group of investors (shareholders) who act as a group of people sharing common goal. Nevertheless, being an association of shareholders, the company is at the same time separate from them – this reveals the dual nature of the company[95].

Moreover, separate legal personality entails that shareholders do not have any direct ownership rights to property of the company, and therefore the company is entitled to act and deal with property as it chooses (company laws and articles of association can stipulate certain limits to this right[96]). In this regard, shareholders have a bundle of pecuniary (for example, a right to part of profits of the company in a form of dividends) and non-pecuniary rights (the most important of which is voting right) that allow them to influence the control (up to a certain degree) of property of the company. However, this is possible only through exercise if their rights and only through the bodies formed in the company[97].

Separate property regime also means that personal creditors of shareholders do not have rights to satisfy their claims from the assets of the company[98]. Theoretically, the protection of company's assets from the creditors of shareholders has been termed as 'entity shielding'[99] which is built upon two main rules. First, the creditors of the company are granted priority over personal creditors of the shareholders which means that claims of personal creditors of the shareholders can be satisfied only after the claims of

[94] As it will be explained further, a company is sometimes viewed as a nexus that acts as a medium that brings different corporate constituents together and influences their relationships. See Part I, Chapter 2.2.2.

[95] This question is further addressed in Part I Chapter 2.

[96] For example, article 34(5) of the ABI stipulates that certain decisions regarding the long-term assets of the company have to be approved by the general meeting of the shareholders.

[97] Thus, shareholders might have a final say on how property and assets of the company are treaded but this does not mean that they have direct ownership of company's property.

[98] In contrast, limited liability protects property of the shareholders from the creditors of the company.

[99] This term was introduced in HANSMANN, H.; KRAAKMAN, R.; SQUIRE, R. Law and the Rise of the Firm. *Harvard Law Review*, 2006, Vol. 119, No. 5, p. 1333-1403.

the creditors of the company are satisfied (the company has gone through bankruptcy procedure and has been liquidated)[100]. Thus, as long as company is going concern it cannot be held liable for the obligations of its shareholders. Second element of the entity shielding prevents shareholders of the company from withdrawing their part of the value of the company (pro rata to their shareholdings) at will without the company being liquidated. Usually a decision by at least a majority of shareholders is required in order to start the liquidation procedure of the company[101] at the end of which shareholders are entitled to their part of the value of the company. However, even in these cases shareholders are not entitled to full assets of the company if there are outstanding claims of the creditors of the company[102]. Thus, entity shielding (as an element of separate legal personality), on the one hand, prevents shareholders (and their personal creditors as well) from withdrawing their parts of value from the company at will and in this way prevents unilateral liquidation of the company[103]. On the other hand, it lowers the risk of creditors of the company as they do not have to take into account private creditors of the shareholders. The importance of separate legal personality (and entity shielding) can be demonstrated by the benefits that it creates: lowers the monitoring costs for creditors, reduces managerial agency costs, protects the

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[100] *Ibid*, p. 1337-1338. In other words, claims of personal creditors of the shareholders can be satisfied only from the private assets and property of the shareholders.

[101] For example, article 2.107(1) of the Lithuanian CC stipulates that a decision of the general meeting of shareholders to liquidate a company can be adopted only by a 2/3 qualified majority. Furthermore, article 73(13) of the Lithuanian ABI states that a company that is being liquidated has to satisfy the claims of its creditors before it can distribute any outstanding dividend or satisfy claims of the shareholders. Similar rules apply in Belgium according to article 645 and 190(2) of the W.Venn. For an analysis of the UK bankruptcy regime see FINCH, V. *Corporate Insolvency Law: Perspectives and Principles. 2nd edition*. Cambridge: Cambridge University Press, 2009, p. 30, where it is also emphasized that claims of the creditors should be satisfied before the ones of the shareholders.

[102] HANSMANN, H.; KRAAKMAN, R.; SQUIRE, R. Law and the Rise of the Firm. *Harvard Law Review*, 2006, Vol. 119, No. 5, p. 1338.

[103] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 7.

going-concern value of the company, enables better capital accumulation and investment diversification and facilitates transferability of shares[104].

In addition, separate legal personality entails that companies act and enter into relationships with third parties in their own name, and thus have to be represented accordingly. The body that transacts and has the power to bind the company against third parties, as a general rule, is the management body: either a sole person management body[105] or a collective management board (which in most cases depends whether one- or two-tier board structure is implemented)[106]. This further emphasizes that company is a separate person from its shareholders.

Arguments presented above suggest that the concept of separate legal personality enables the company to act and contract as a single unit although made up from many different parties with even more different interests. Separate legal personality together with limited liability form the most essential pair of all the characteristics of the company. Together they ensure that the company is protected from personal creditors of the shareholders and that shareholders are protected from the creditors of the company. Thus, the concept of limited liability will be addressed in the following paragraphs.

1.2.2. Limited liability

Although the first limited liability companies (as they are understood today) started to appear in only late eighteenth century when special clauses were put into their charters (companies were registered by special charters of the government) that the liability of shareholders was limited to the amount

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[104] For a detailed analysis of these benefits see: HANSMANN, H.; KRAAKMAN, R.; SQUIRE, R. Law and the Rise of the Firm. *Harvard Law Review*, 2006, Vol. 119, No. 5, p. 1343-1350. Of course, there are costs associated with the entity shielding which include debtor opportunism, higher enforcement costs, illiquidity of the investment and exploitation by controlling shareholders. *Ibid*, p. 1350-1354.

[105] For example, article 19(6) of Lithuanian ABI provides that sole management body of the company (usually this is the CEO) acts on behalf of the company in relationships with third parties.

[106] For an analysis of different rules on representation of companies in the European countries see: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 265-376.

contributed, it was only in the middle and late nineteenth century that registered companies were granted limited liability by laws applicable to all companies and not only by privileged charters[107]. Despite these facts, it might be argued that the first signs of limited liability appeared in Ancient Rome. As slavery was legitimate in Roman times, slaves were used not only for hard labour as tools, but also for commercial purposes[108]. Slaves were entitled to engage in business by means of *peculium* – a fund (which could consist of money, land and even other slaves) provided by the masters to their slaves[109]. In context of limited liability *peculium* was considered to be separate from the property of the master (*patrimonium*) and was even considered to be *de facto* property of the slave. It is for this reason that the liability for the commercial activities of the slave arose not to the master but to *peculium*[110]. In other words, as long as *peculium* existed creditors could satisfy their claims from it and could not ask the master of the slave to satisfy their claims from *patrimonium*, even in cases where not enough assets were available in *peculium*. To translate the above situation into modern terms (this interpretation is oversimplified) the master of the slave might be considered as a shareholder of a legal entity called *peculium* in which he has shares and is liable only to the amount of capital that he contributes to the *peculium*. Thus, the ideas underlying the concept of limited liability have a long history.

Nowadays, limited liability is considered to be the most important of all five core characteristics of the company[111]. There are good reasons why it is

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[107] CARNEY, W. J. Limited Liability. In BOUCKAERT, B.; DE GEEST, G. (eds.), *Encyclopedia of Law and Economics, Volume III. The Regulation of Contracts*. Cheltenham, Edward Elgar, 2000, p. 661-664. For a history of limited liability in the UK see: MCQUEEN, R. *A Social History of Company Law: Great Britain and the Australian Colonies 1854-1920*. Farnham: Ashgate Publishing Limited, 2009.

[108] For an analysis of Roman law of slavery see: BUCKLAND, W. W. *The Roman Law of Slavery: The Condition of the Slave in Private Law from Augustus to Justinian*. New York: Cambridge University Press, 1970.

[109] *Ibid*, p. 187-188.

[110] *Ibid*, p. 207-208.

[111] This is evident from the name that is used for naming legal entity with this kind of characteristic – limited liability company. Other core features of the company are never used in the name of the form

impossible to imagine a modern publicly traded company that would not have limited liability[112]. The reasons include a number of benefits that are conferred to various corporate constituents[113]: the need for the shareholders to monitor their agents is decreased (members of the management board in terms of agency theory) because they can diversify their risk by investing in a number of companies, the shareholders' costs for monitoring each other are reduced as wealth of fellow shareholders is no longer important and a more efficient diversification of shareholder wealth is made possible which results in a more efficient investment decisions. These reasons play a huge role in the formation, management and organization of companies.

Limited liability means that shareholders are shielded[114] from the claims of the creditors of the company which are limited only to the assets held in the name of the company (as a distinct person from shareholders)[115]. Shareholders are liable only in the amount that they have contributed to the capital of the company (or the amount they paid for shares). Thus, the risk (and possible loss which is higher than total amount of company's assets) is shifted from shareholders to creditors[116] who in turn require a higher rate of return (interest)

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of a legal entity. There are no names like 'separate legal personality company', 'company with centralized management structure' or 'company with freely transferable shares'.

[112] WOODWARD, S. E. Limited Liability in the Theory of the Firm. *Journal of Institutional and Theoretical Economics*, 1985, Vol. 141, No. 4, p. 601. There is a consensus amongst scholars that publicly traded companies enjoy the greatest benefits of the limited liability feature. For this argument see: HALPREN, P.; TREBILCOCK, M.; STUART, T. An Economic Analysis of Limited Liability in Corporation Law. *University of Toronto Law Journal*, 1980, Vol. 30, No. 2, p. 147.

[113] For an analysis of these and other benefits provided by limited liability see: EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 41-44.

[114] In contrast, separate legal personality enables entity shielding that shields company from the creditors of shareholders.

[115] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 9.

[116] For example, when a company is financed purely with equity shareholders bare all possible losses and gain all the profits from successful projects. However, when debt financing is introduced the risk (and accordingly the gains from such risk) starts to shift to creditors. This entails that shareholders bear all of the initial risk of possible losses and in case of bankruptcy it is they who suffer the most.

for issued debt[117]. However, the shift of the risk is justified. Joint and several unlimited liability would discourage investors from starting or investing in more risky projects. For one point, they would have to closely monitor the managers of the company (as their agents) and it is argued that this would not be worth the cost (especially in companies with widely dispersed shareholding structure)[118]. Secondly, under unlimited liability regime more wealthy investors would be the primary targets of creditors of the company (despite the fact their shareholding might be even smaller than other shareholders'). This would discourage them from diversifying their investment and force them to concentrate their investments on projects that they are able to monitor (monitoring would have to also include managers and other shareholders)[119]. In other words, limited liability feature attributed to companies functions as facilitator of diversified investments in large projects. It enables large multinational companies with widely dispersed ownership structure to exist and to engage in highly financially demanding projects (starting with railways and canals in nineteenth century)[120] as well as allows functioning of organized securities markets[121].

Furthermore, it could be argued that limited liability sets equal rules of the game for all financial contributors: shareholders and creditors. Creditors are always aware of their risks. For example, if they offer a loan of 1 000 Euros

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[117] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 44.

[118] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 41-42. Higher level of monitoring would be required because managers of the company would be able to undertake obligations not only in the name of the company but also in the name of the shareholders.

[119] CARNEY, W. J. Limited Liability. In BOUCKAERT, B.; DE GEEST, G. (eds.), *Encyclopedia of Law and Economics, Volume III. The Regulation of Contracts*. Cheltenham, Edward Elgar, 2000, p. 670-671.

[120] WETTSTEIN, F. *Multinational Corporations and Global Justice: Human Rights Obligations of a Quasi-Governmental Institution*. Stanford: Stanford University Press, 2009, p. 10-11.

[121] Under unlimited liability regime shareholders depending on their wealth would each put a different price to the share of the same company. Wealthy investors would be willing to pay much less (a situation might be that other shareholders would have to pay the wealthy one only for becoming a shareholder) for the shares of the company. Thus, there could not be a efficiently functioning securities market. See: HALPREN, P.; TREBILCOCK, M.; STUART, T. An Economic Analysis of Limited Liability in Corporation Law. *University of Toronto Law Journal*, 1980, Vol. 30, No. 2, p. 129-131.

to a company, they know that this is the amount that they risk losing in case the company encounters financial difficulties. In case of limited liability shareholders' position is more close to that of creditors. If shareholders contribute 1 000 Euros to the capital of the company they know that they will not be risking more than they invested. Without the limited liability shareholders would not be able to estimate their risks as creditors do[122].

As the above arguments suggest limited liability is the central feature of the company.[123]. However, despite all the benefits provided by limiting liability, it has its own costs. Limited liability creates pressure on actors in civil relationship to consider all possible negative consequences of their actions, encourages to externalize their costs to others and take more risks with less liability (and possibly higher monetary gains)[124] (for example, by limiting their liability shareholders might try to shift majority of their risks to creditors, employees or even society). Thus, in order to prevent misuse of the benefits provided by limited liability certain legal mechanisms have been developed. One of such mechanisms is the doctrine of corporate veil piercing that allows courts[125] to disregard the limited liability and hold shareholders personally

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[122] EASTERBROOK, F. H.; FISCHEL, D. R. Limited Liability and the Corporation. *University of Chicago Law Review*, 1985, Vol. 52:1, p. 89-90.

[123] It has been introduced on the European level as a mandatory feature which is not depended on the number of shareholders. Thus, even a single person company can have this feature. Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies (OJ 1989 L 395/40-42). Currently a codified version of this Directive has been adopted: Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies (OJ 2009 L 258/20-25). Also see: DORRESTEIJN, A. et al. *European Corporate Law. 2nd edition*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 83-84.

[124] CARNEY, W. J. Limited Liability. In BOUCKAERT, B.; DE GEEST, G. (eds.), *Encyclopedia of Law and Economics, Volume III. The Regulation of Contracts*. Cheltenham, Edward Elgar, 2000, p. 665.

[125] For example, article 2.50(3) of Lithuanian CC states that shareholders are held liable for the obligations of the company in cases when company cannot discharge the claims of the creditors due to the shareholders acting in bad faith. For example, bad faith under Lithuanian case law is considered to exist in cases where a new legal entity is formed in order to transfer all assets of the indebted company (the so called phoenix syndrome) and in all cases involving fraudulent bankruptcy. See: SCL civil case No. 3K-3-124/2004, 2004 February 18, *UAB "Göllner spedition"* v. *S. B. and J. B.* and SCL civil case No. 3K-3-342/2012, 2012 July 4, *OMV Refining & Marketing GMBH* v. *R. A. P.*

liable for the obligations of the company if certain criteria are met[126]. Overall, although limited liability feature is not absolute and under certain circumstances it can be restricted, it should be considered as a cornerstone of a modern company and security markets.

1.2.3. Centralized management

Together with the separate legal personality and limited liability public companies are also characterised by a system of centralized management. Because of the separation of ownership and control[127] shareholders in publicly listed companies are not in a position to manage companies themselves and this function is delegated to more competent and experienced professionals[128]. Although shareholders are essential in controlling companies and exercise their power mainly through the general meeting of shareholders[129], the control and monitoring of day to day activities and representation of the company with third parties is in the hands of the management body. Company law usually sets a default rule that company is represented by a sole or collective management body[130]. For example, Lithuanian ABI[131] stipulates that executive manager (in Lithuanian *vadovas*) acts on behalf of and has the authority to

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[126] For an analysis of piercing of corporate veil doctrine see: MILLON, D. K., Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability. *Washington & Lee Public Law Research Paper No. 03-13*, 2003 [interactive]. [Accessed on 2012-07-12] Available online at: <http://ssrn.com/abstract=451520>. It is argued that courts are reluctant to pierce the veil of publicly listed companies while shareholders of the closely held companies are likely to be held liable for the obligations of the company more often. *Ibid*. p. 22-23.

[127] See Part I, Chapter 3.1.

[128] It would be hard to imagine a company with hundreds of shareholders being managed (including day to day operations) by a collective body of shareholders. Such company would very likely encounter decision making and coordination problems on the first day of its existence.

[129] For the role of shareholders see Part I, Chapter 3.4.

[130] For an analysis of different management board structures in European countries see: HOPT, K. J. LEYENS, P. C. *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy*, 2004. *ECGI - Law Working Paper No. 18/2004* [interactive]. [Accessed on 2012-07-13] Available online at: <http://ssrn.com/abstract=487944>.

[131] ABI – Law on Companies of the Republic of Lithuania (abbreviation from Lithuanian Akcinių bendrovių įstatymas).

enter into agreements in the name of the company (AB)[132], with certain exceptions where approval of the board or general meeting of shareholders is required[133]. Executive manager is controlled and monitored by the board, unless articles of association state that board is not formed in the company[134]. Similar provisions exist in Belgium where company (NV) is managed and represented by the board, unless laws or articles of association state that certain powers are reserved for the meeting of the shareholders[135]. A different situation is found in the UK. The CA 2006 is silent upon what kind of power and rights the management body of the company should have, and thus the distribution of powers is left for the shareholders to decide at the moment of incorporation. Nonetheless, model articles for public and private companies set default rules for distribution of decision making powers in the company[136]. In case of publicly listed companies there is an additional set of rules (with comply or explain regime) stipulated under the UK Corporate Governance Code[137].

The above suggests that as a default rule companies are governed and most fundamental decisions are either approved or made by the management body of the company. There are four basic features of the management board provided by legal scholars[138]:

1) Management board is separate from the operational (or day to day) managers of the company. Such a distinction is made not

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[132] Article 37(10) of Lithuanian ABI. Under ABI companies can choose either one-tier or two-tier board structure.

[133] Articles 34(4) and 34(5) of the ABI.

[134] The peculiarity of the company law regime in Lithuania is that board is not a mandatory body under the ABI.

[135] Articles 522 and 526 of Belgian W.Venn. Also see: DORRESTEIJN, A. et al. *European Corporate Law. 2nd edition*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 184-185.

[136] KERSHAW, D. *Company Law in Context: Text and Materials*. Oxford: Oxford University Press, 2009, p. 181-184.

[137] Financial Reporting Council. *The UK Corporate Governance Code*, 2010 [interactive]. [Accessed on 2012-07-13] Available online at: <http://www.frc.org.uk/getattachment/b0832de2-5c94-48c0-b771-ebb249fe1fec/The-UK-Corporate-Governance-Code.aspx>. Formerly known as the Combined Coded on Corporate Governance. For a history of enactment see:

[138] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 13.

only in theoretical[139] but also in more practical works[140]. This is evident in Lithuania and Belgium as distribution of powers is clearly established in ABI and W.Venn.[141] respectively. In Lithuania day to day management is assigned to executive manager who is then controlled and monitored by the management board[142]. If a two-tier structure is selected, then the supervisory board monitors the management board of the company[143]. In Belgium unitary management board can set up an executive committee (in Dutch *directiecomité*) and delegate certain management powers to it. However, the management board has the duty to monitor such a committee[144]. It should be noted that under European legislation companies are provided with a choice of one-tier or two-tier management board structure through the European Company (SE)[145].

2) As a general rule, management board is elected by the shareholders of the company which strengthens the accountability of the members of the management board to the shareholders. The right to appoint and dismiss separate members or whole management board allow shareholders to take action if they think that their interests are undermined while managing the

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[139] For the role of the management board and top officers of the company in different jurisdictions see: SJAFJELL, B. *Towards a Sustainable European Company Law: A Normative Analysis of the Objectives of EU Law, with the Takeover Directive as a Test Case*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 46-50; 60-63.

[140] GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 80-83. It is argued that the main tasks of the board are: policy formulation and foresight, strategic thinking, supervising management and ensuring accountability.

[141] W.Venn. – Companies Code of Belgium (abbreviation from Dutch *Wetboek van Vennootschappen*).

[142] Article 34(2) and 37(3) of the Lithuanian ABI. However, there are certain discrepancies in the ABI as both executive manager and the board are regarded as two separate management bodies of the company. Theoretically such regulation is inconsistent.

[143] Article 32(1) of the Lithuanian ABI.

[144] Article 524bis of Belgian W.Venn.

[145] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) (OJ 2001 L294/1-21). For an analysis of regulation see: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 391-411.

company. For example, under Lithuanian law either shareholders or supervisory board is entitled to appoint and dismiss members of the collegial management body[146]. Shareholders of Belgian[147] as well as the UK[148] companies are also entitled to this right.

3) Management body is distinct from shareholders and general meeting of shareholders. In other words, management body has to serve the interests of the company[149] and not individual interests of separate shareholders. As it was mentioned above, laws or articles of association, as a rule, allocate decision making powers to the management body of the company and approval of the shareholders is required only under exceptional circumstances. In some jurisdictions this division of power is expressed more than in others. For example, under Lithuanian ABI powers of the shareholders and management body are, in contrast to the UK CA 2006, stipulated in detail in the act and cannot be delegated to other bodies of the company[150].
4) The last feature is that management board is usually a collective decision making body. In case of Lithuania this is true if there is a board structure adopted in the company[151]. The law in this case requires a management board consisting of minimum 3 members. The same rule for the number of directors applies in Belgium[152]

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[146] Article 33(3) of the Lithuanian ABI.

[147] Article 518(2) of the Belgian W.Venn.

[148] Article 160 of the CA 2006.

[149] On the interests of the company see: Part I, Chapter 3.3.

[150] This is true in majority if the Continental European countries. For example, under articles 19(5) and 32(2) of the Lithuanian ABI general meeting of the shareholders and supervisory board are prohibited from transferring their powers to other bodies of the company (including management board). In the UK the situation is different as CA 2006 does not regulate the distribution of powers between the bodies of the company which is usually done in the articles of association. However, powers by the CA 2006 attributed explicitly to the shareholders cannot be delegated to the management. For example, articles of association of the company can only be amended by a special resolution (article 20(1) of the CA 2006).

[151] Article 33(2) of the Lithuanian ABI.

[152] Article 518(1) of the Belgian W.Venn.

and in the UK there is a requirement for public companies to have at least 2 members in the management board[153]. Collective decision making allows decisions of the management body to be adopted by the majority of the members of the body. However, in order for the management body to qualify as good it has to comply with more stringent requirements[154]. The most important of these are for a certain number of members to be independent[155], to have required knowledge in order to carry out their functions[156] and to separate the roles of executive manager and chairman of the management body[157].

Throughout this dissertation the characteristic of centralized management will be understood primarily as delegated management with a board structure (either one-tier or two-tier).

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153 Article 154 of the UK CA 2006.

154 For an analysis of such criteria in Belgian listed companies see: VAN DEN BERGHE, L. A. A.; LEVRAU, A. Evaluating Boards of Directors: what constitutes a good corporate board? *Corporate Governance: An International Review*, 2004, Vol. 12, No. 4, p. 461-478.

155 Independence is important for both the non-executive members in the unitary boards and for members of supervisory boards in companies with two-tier structure. For a concept of independent member see: Commission Recommendation No 2005/162 EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (OJ 2005 L 52/51-63).

156 This requirement is not always explicitly applied towards the members of the management body. Sometimes it is applied to the members of various committees that have to be formed in the company. For example, in Lithuanian listed companies the audit committee should be composed of at least three members. One of them should be independent and have at least 5 years of experience in accounting or audit fields. See: Securities commission of the Republic of Lithuania. Resolution No 1K-18 of 21 August 2008 regarding requirements for audit committees (Valstybės Žinios, 2008, No. 98-3827). It should be noted that after a recent reform all the functions of the Securities commission have been transferred to the Central Bank of the Republic of Lithuania.

157 The debate for separating roles of the CEO and chairman of the management boards is more relevant to the USA companies. See: CARTER, C. B.; LORSCH, J. W. *Back to the Drawing Board: Designing Corporate Boards for a Complex World*. Boston: Harvard Business School Press, 2004, p. 98-106. There it is proposed to have at least a lead director if the roles of the CEO and chairman are not separated. In continental Europe majority of the companies adopt the rule that CEO and chairman of the management are two separate persons with different responsibilities. For some statistics see: COOMBES, P.; WONG, S. C. Y., Chairman and CEO - One Job or Two? *The McKinsey Quarterly*, No. 2, 2004 [interactive]. [Accessed on 2012-07-14] Available online at: <http://ssrn.com/abstract=897485>, p. 44. In cases of two-tier management board structures the role of the chairman of the management board and supervisory board is clearly distinct. For example, article 31(6) of the Lithuanian ABI stipulates that member (including chairman) of the supervisory board cannot at the same time be the executive manager or member of the management board.

1.2.4. Transferable shares

Fully transferable shares allow the stock exchanges to flourish by enabling shareholders (investors) to buy and sell shares of various listed companies at will. In turn, shareholders are enabled to diversify their portfolios and minimize their risks and costs in case companies are managed poorly. If this happens and company is managed against the interests of shareholders the transferability of shares allows them to exit the company by selling the shares[158]. In other words, if shareholders do not like the risk (it is too high) they can get rid of the shares[159]. Limited liability and separate corporate personality, which were discussed above, form a foundation for transferability of shares[160]. On the one hand, limited liability shields shareholders from the creditors of the company which reduces monitoring costs for shareholders[161] and allows for a less costly transfer of shares (the wealth of new shareholders is not important for existing shareholders as long as the shares are paid up). On the other hand, separate legal personality (and entity shielding) decreases the monitoring costs of other shareholders of the same company as the personal creditors of the shareholders are not entitled to satisfy their claims from the assets of the company[162]. Thus, transferability of shares directly depends on the existence of separate legal personality and limited liability.

Full transferability of shares does not mean that there can be no restrictions for the transfer of the shares and that shareholders are entitled to

[158] This is one of the legal strategies to mitigate possible negative consequences of the agency problem. See Part I, Chapter 4.

[159] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 29.

[160] WOODWARD, S. E. Limited Liability in the Theory of the Firm. *Journal of Institutional and Theoretical Economics*, 1985, Vol. 141, No. 4, p. 601-602.

[161] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 42.

[162] HANSMANN, H.; KRAAKMAN, R.; SQUIRE, R. Law and the Rise of the Firm. *Harvard Law Review*, 2006, Vol. 119, No. 5, p. 1350.

sell and buy them at will without any legal consequences[163]. As it will be discussed below, restrictions on the free transferability of shares are being used by shareholders in listed companies[164].

Furthermore, transferability of shares allows shareholders to transfer their shares anonymously through the stock exchange to other investors (shares are considered to be a liquid investment[165]) which enables a more rapid separation of ownership from control. However, at the same time it sharpens the agency problem between the shareholders and members of the management board[166]. The benefits provided by the transferability of shares outweigh the costs as shareholders are able to withdraw from the company at any time. Furthermore, transferability of shares is directly related to the perpetual life of the company. The existence of the company is independent from individual shareholders or their change. Thus, the company is guaranteed that liquidation is not required in order to change the shareholders of the company[167].

Fully transferable shares (and free transferability as a default rule for publicly traded companies) are an important characteristic of the company that enable different ownership structures in publicly listed companies. As it will be

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[163] Shares of publicly listed companies are by default considered to be freely transferable using the stock exchange. However, in certain cases contractual arrangements among shareholders limit their rights to sell the shares at will. For example, shareholders of a company listed on London stock exchange have agreed to limit their transferability rights. See: Daily Mail & General Trust plc. Annual report and accounts 2010 [interactive]. [Accessed on 2011-06-26] Available online at: <http://www.dmgt.co.uk/uploads/files/6423-DMGT-AR-2010-5JAN2011-FINAL-Linked.pdf>. By contrast, shareholders of private limited liability companies have to undergo a special procedure before selling their shares to third parties. For example, under article 47 of the Lithuanian ABI shareholders of the private limited liability companies have the right of first refusal, *id est*, they are entitled to a priority right to buy the shares before such shares are sold to third parties (at the same prices and on pro rata basis). In contrast, there is no such default provision in the UK (although parties can bind themselves by contract). See: DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 942-945.

[164] See Part III, Chapter 2.5.

[165] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 19.

[166] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 3.

[167] It could be also argued that transferability of shares allows shareholders to avoid additional costs of liquidating legal entity and then forming a new one. The same business with different shareholders can be conducted through the same legal entity.

further discussed in this dissertation, different ownership structures are an important factor influencing the number and type of shareholders' agreements.

1.2.5. Investor ownership

Contemporary companies depend on the capital contributed by the investors who become shareholders of such companies. In most of the countries company formation is directly related to the capital contribution (especially in continental Europe[168]). This means that without the contribution of shareholders no company could start its life. Theoretically, it could be well argued that companies should be able to get all the needed capital from creditors (by debt financing). However, the costs of borrowing (compared to contributions by shareholders) are too high and companies are prevented from effectively acquiring needed finances themselves[169]. Unlike in other forms of ownership of legal entities[170] the only way to become a shareholder of a company is to make a contribution to the capital and in return get a bundle of rights represented by a share.

Investor ownership directly correlates with limited liability. As shareholders invest part of their wealth into a company, they display to third parties the amount they are willing to risk in case the company falls into financial distress (shareholders make financial contributions against a promise for future gains). Shareholders provide capital and are usually not experienced in managing the company (unlike in sole proprietorship where the owner is also an employee and a manager of business[171]), while managers of the

[168] For a comparative analysis on the formation of companies in some European countries (including the minimum capital requirements in order to form a company) see: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 52-98.

[169] Asymmetric information and lock-in are the two major costs that prevent borrowed capital from dominating the initial financing and establishment of companies. See: HANSMANN, H. *The Ownership of Enterprise*. Cambridge: The Belknap Press of Harvard University Press, 1996, p. 53-56.

[170] For an analysis of different ownership forms see: HANSMANN, H. *The Ownership of Enterprise*. Cambridge: The Belknap Press of Harvard University Press, 1996.

[171] FRENCH, D.; MAYSON, S. W.; RYAN, CH. L. *Company Law. 27th edition*. Oxford: Oxford University Press, 2010, p. 11.

company do not contribute as shareholders but provide management service to the company. In other words, separation between ownership and control occurs[172].

Two main groups of shareholders' rights are attributed to the characteristic of investor ownership by legal scholars: the control rights of the company and the right to profit[173]. The control rights of shareholders manifest themselves primarily through the voting rights[174]. Shareholders are the only constituents in the company entitled by the law to adopt and alter articles of association – the most important document of the company[175]. Articles of association set the purpose and aim of the company (for example, whether it is for profit or a non-profit organization) and stipulate other rules that might deviate from the default rules provided in the laws of the country. Therefore, it can be stated that shareholders for their contributions into the capital of the company (in addition to arguments that they are the residual claimants) get the strongest participation rights in the company[176].

The second element entitles shareholders to get profit in form of dividends if company is successful[177]. As creditors are entitled to get interest

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[172] This phenomenon is discussed in Part I, Chapter 3.1.

[173] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 14.

[174] A more detailed analysis of the role of shareholders in company law is provided in Part I, Chapter 3.4.

[175] For a detailed analysis on different approaches to articles of association of the company see: MIKALONIENĖ, L. Legal nature of a limited liability company's articles of association. *Current Issues of Business and Law*, 2011, No 6(2), p. 265-285.

[176] Control rights also mean that shareholders are in a position to monitor managers of the company. However, it can be argued that this is not the case if the company has a highly dispersed ownership structure as each shareholder holding only a small stake in the company is presumed to be passive and not large enough to provide efficient monitoring and control over the management board. This situation leads to rational shareholder apathy where they do not care about exercising their voting rights as it is too costly. See: BLACK, B. S. Shareholder Passivity Reexamined. *Michigan Law Review*, 1990, Vol. 89, No. 3, p. 526-529; GORDON, J. N. The Mandatory Structure of Corporate Law. *Columbia Law Review*, 1998, Vol. 89, No. 7, p. 1575-1577.

[177] However, if company is unsuccessful shareholders are last in line to the distribution of company's assets. Nowadays shareholders risk only the amount they have invested (in contrast to ancient Rome or Greece where enslavement or death for unpaid debts was common). See: RAJAK, H. The Culture of Bankruptcy. In OMAR, P. J. (ed.). *International Insolvency Law: Themes and Perspectives*, Hampshire: Ashgate Publishing Limited, 2008, p. 3-26.

for the borrowed sum so are the shareholders entitled to get a part of future earnings of the company for invested capital. Furthermore, creditors can protect their interests and charge higher interest rates according to risk by means of contracting. They are also always entitled to their claim (it is fixed). Shareholders, in contrast, do not have fixed claim and are entitled to their share of profit only in case of success of the company.

It can be concluded that investor ownership, on the one hand, provides companies with the capital that is needed for the company to establish itself in the market. On the other hand, for the monetary input shareholders are entitled to vote in the general meetings of shareholders and to get part of the profit of the company in form of dividends.

1.3. Corporate governance

After establishing what constitutes a company and what the main features of the company are, the concept of corporate governance should be addressed in the following paragraphs. Although core characteristics of the company discussed above are the reason why the company form is so important in the business world, these characteristics also have trade-offs that, as it will be explained in Part I Chapter 3, corporate law has to deal with[178]. The most important cost of cooperation through a company is the divergence of interests among different constituents of the company[179]. Corporate governance is aimed at balancing these different interests. Furthermore, corporate governance discourse has become so important to the management of the modern companies that it is even argued that '[a] civil society cannot exist without

[178] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 6.

[179] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 9-11.

effective corporate governance to best employ its economic and social capital'[180].

1.3.1. Brief genesis of corporate governance

Although it should be agreed that corporate governance[181] as an idea exists for as long as the large company[182], the term that is used today is quite new. This could be explained by the fact that the actual need to address various corporate governance problems have emerged together with the modern company. One of the first officially recorded companies with dispersed ownership structure was the Dutch East India Company (early seventeenth century) which had 'more than 1000 investors [who] put their money into it, and were thus rapidly confronted with key corporate governance issues'[183]. Up until that point the owner of the business was either a manager, who monitored the whole business process, or a group of investors who conducted business together through partnerships, where every partner had equal rights and authority. Though there were some earlier insights into the subject, for example, the famous passage by

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[180] GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 193.

[181] For the origins of the term "corporate governance" and its etymology see: CLARKE, T. *International corporate governance: a comparative approach*. New York: Routledge, 2007, p. 1; LEE, G. M.; et al. (eds.). *Oxford Latin Dictionary*. Oxford: Oxford University Press, 1968, p. 448-449, 778; FARRAR, J. H. *Corporate Governance: Theories, Principles and Practice*. 2nd edition. Oxford: Oxford University Press, 2005, p. 3; EELLS, R. *The Government of Corporations*. New York: Free Press of Glencoe, 1962.

[182] DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 359.

[183] FRENTROP, P. *A History of Corporate Governance 1602-2002*, Brussels: Deminor, 2003, p. 46.

Adam Smith[184], corporate governance came into active life both in the works of academics and practitioners only in the late 1980s[185].

1.3.2. What does corporate governance mean?

Despite the fact that the term corporate governance has been used for more than half a century, there is no standard definition available that all academics and practitioners would support and agree upon. Definitions provided by different authors or studies vary from one another and usually are ambiguous[186]. Nevertheless, the basic concept and notion of corporate governance will be provided below in order to clarify the meaning of corporate governance in context of this dissertation[187].

Corporate governance can be understood a system of rules and principles that provide guidelines on how companies should be organized for them to be effective, and at the same time it is a process of how rules and principles are implemented in practice. The overall goal of corporate governance should be viewed as to facilitate companies in becoming more efficient in their organizational structure in order to decrease the costs of operating through the company form. Otherwise, it would be hard to explain the need and existence of corporate governance[188]. Essentially, this means that

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[184] Adam Smith being greatly ahead of his time wrote that '[t]he directors of [joint stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company'. See SMITH, A. *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776. Reprinted edition. Cambridge: The Electric Book Company, 1998, p. 990.

[185] TRICKER, B. *Corporate Governance: Principles, Policies and Practices. 2nd edition*. Oxford: Oxford University Press, 2012, p. 4.

[186] Some authors have even stated that the concept of corporate governance is treated 'as an indefinable term, something – like love and happiness – of which we know the essential nature, but for which words do not provide an accurate description'. See: PLESSIS, J. J. *et al. Principles of Contemporary Corporate Governance. 2nd edition*. New York: Cambridge University Press, 2011, p. 3.

[187] It should be noted that the author does not aim at redefining the concept of corporate governance in this dissertation.

[188] Corporate governance and firm performance is a question that has attracted quite a lot of attention from scholars. For example, it has been found that better-governed firms are relatively more profitable,

by guiding the internal structure of companies (including the distribution of powers between different corporate bodies) corporate governance is aimed at contributing to the economic welfare of society. Just like family is the most important social building block of the state[189], so the company is the most important building block of the economy. In order for the economy to prosper, a set of high standard rules must be adhered. There are numerous definitions of corporate governance some of which are short and ambiguous[190], while others are more detailed[191]. However, each of them stresses a particular aspect of corporate governance, for example, the need to control management body[192], guarantee the return for investors[193], the importance of applicability of rules in practice[194], the importance of the continues process to align different interests[195], the cultural and societal influence[196].

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more valuable, and pay out more dividends to their shareholders. See BROWN, L. D.; CAYLOR, M. L. *Corporate Governance and Firm Performance*, 2004 [interactive]. [Accessed on 2012-07-14] Available online at: <http://ssrn.com/abstract=586423>. In contrast, other studies have reported that there is no correlation between management board structure and performance of the company. See: BHAGAT, S. BLACK, B. The Relationship Between Board Composition and Firm Performance. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 281-306.

189 For example, Article 38(1) of the Constitution of the Republic of Lithuania states that family is the basis of society and the state.

190 For example, see: The Committee on the Financial Aspects of Corporate Governance. *Report on the Financial Aspects of Corporate Governance*, 1992 [interactive]. [Accessed on 2012-07-14] Available online at: <http://www.ecgi.org/codes/documents/cadbury.pdf>, para 2.5.

191 Organisation for Economic Co-Operation and Development. OECD Principles of Corporate Governance, 2004 [interactive]. [Accessed on 2012-06-18] Available online at: <http://www.oecd.org/dataoecd/32/18/31557724.pdf>.

192 LARCKER, D.; TAYAN, B. *Corporate Governance Matters: A Closer Look at Organizational Choices and Their Consequences*. New Jersey: Pearson Education, 2011, p.8-9.

193 SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. The Journal of Finance, Vol. 52, No. 2, 1997, p. 737.

194 Report of the HIH Royal Commission (Owen Report), *The Failure of HIH Insurance – Volume I: A Corporate Collapse and its Lessons*, 2003 [interactive]. [Accessed on 2012-06-18] Available online at: <http://www.hihroyalcom.gov.au/finalreport/index.htm>, p. xxxiii.

195 Commission on Global Governance. *Our Global Neighborhood*. Oxford: Oxford University Press, 1995, p. 1-2; TURNBULL, S. Corporate Governance: Theories, Challenges and Paradigms. *Gouvernance: Revue Internationale*, Vol. 1, No. 1, 2000. [interactive]. [Accessed on 2012-07-14] Available online at: <http://ssrn.com/abstract=221350>, p. 4-5.

196 BLAIR, M. M. *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century*. Washington: The Brookings Institution, 1995, p. 3.

From a legal point of view, corporate governance could be defined as follows[197]. Corporate governance is a system of legal norms and principles that regulate the relations between company, shareholders, different bodies of the company, their members and other constituents, who have relations with the company, and establish a control mechanism to monitor how the rules and principles are implemented in practice in order to facilitate the economic cooperation through a form of a company. Understood this way corporate governance partially overlaps with company law, securities law, employment law and other areas of civil law (like civil liability)[198]. However, it also adds something new that is beyond the reach of company and other branches of laws, *id est*, code of best practices. Hence, corporate governance is a combination of hard and soft law, of government regulation and self-regulation. Company law statutes (for example, ABI, W.Venn. and CA 2006) and securities laws (for example, Lithuanian Law on Securities[199]) constitute a huge part of the rules on corporate governance. Usually these sets of legal rules establish basic and default rules regarding the structure of the company, competence of its bodies and rights and duties of different constituents involved with the company. Case law in this regard is also part of corporate governance as courts tend to interpret and provide test cases for the rules imbedded in laws. The soft law side includes the so called corporate governance codes and best practices (for example, Belgian Code on Corporate

[197] There have already been attempts to define corporate governance from legal perspective. For example, de Groot states that 'corporate governance is the regulation of the corporate form that – by rethinking corporate law with the purpose of guaranteeing the enhancement of shareholder value in the long term – addresses the roles of the corporation's centralized administration (the unitary or dual board and the managers) and of the corporation's shareholders, by specifically taking into account elements like integrity, transparency, proper supervision and accountability'. See: GROOT, de C. *Corporate Governance as a Limited Legal Concept*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 18.

[198] There are views provided in the legal literature that corporate governance is a branch only of company law. See: GROOT, de C. *Corporate Governance as a Limited Legal Concept*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 5.

[199] Law on Securities of the Republic of Lithuania (Valstybės Žinios, 2007, No. 17-626; Valstybės Žinios, 2011, No. 145-6819).

Governance[200]). Currently, the adopted view regarding the non-obligatory nature of such codes is the so called 'comply or explain' principle, which essentially means that companies have to comply with the corporate governance codes requirements or to state the reasons for deviation from such rules[201]. Usually there are no law based sanctions for noncompliance with this requirement or for not explaining the deviation from the corporate governance code. However, it is thought that markets should sanction the inefficient disclosure of information regarding the compliance with corporate governance codes. In between the hard and soft law are the listing rules of stock exchanges. Each stock exchange has its own rules that apply to companies listed on that stock exchange and violation of such rules can even result in delisting from the market. Above suggests that corporate governance from a legal perspective is composed of hard and soft law rules, but the purpose of such rules is similar – to enhance the environment of business by making the corporate form more effective.

The scope of corporate governance is expanding ever since the first companies started to be governed by professional managers. The ever increasing standards towards the management boards, shareholders and company itself require new ways to deal with old (and new) problems. As the popularity of the corporate social responsibility debate takes root not only in the philosophical academic works, but also in the annual reports of the

[200] Corporate Governance Committee. The 2009 Belgian Code on Corporate Governance, 2009 [interactive]. [Accessed on 2012-07-14] Available online at: <http://www.corporategovernancecommittee.be/library/documents/final%20code/CorporateGovUKCode2009.pdf>.

[201] WYMEERSCH, E. O. Enforcement of Corporate Governance Codes. *ECGI - Law Working Paper No. 46/2005*, 2005 [interactive]. [Accessed on 2012-07-14] Available online at: <http://ssrn.com/abstract=759364>, p. 7-8. Comply and explain principle is also embedded in the European legislation. Directive 2006/46/EC requires companies to include a statement about corporate governance in their annual reports. See: Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (OJ 2006 L 224/1-7).

companies[202], the applicable standards go well beyond the requirements of law (not to brake rules imposed by the state) and economics (to run a profitable and successful business). Thus, companies are expected from the society and socially aware shareholders to conduct their business according to higher ethical and moral standards. No doubt this is to create a better and prosperous society. However, agency problems, as they will be described below, still plague the world of corporate governance. Conflicts of interest are still dominating the legal relationship of the members of management board, majority and minority shareholders. Although the world of corporate governance is populated with various constituents and the scope encompasses more than just internal structure of the company and relations between its most important players, this dissertation will be limiting the scope. The central matter of corporate governance in this research is to look only at the relationships and conflicts of interest between management body, majority and minority shareholders. The scope is even more limited as this dissertation analyses only one legal tool – shareholders' agreements – that might be used to coordinate and align the interests of the parties mentioned above. Moreover, this is done through the lens of agency theory. Having this in mind, further chapters of this part deal with legal and economic theories of the company (especially emphasizing agency theory).

1.4. Chapter conclusions

Each of the characteristics (legal personality, limited liability, freely transferable shares, centralized management and investor ownership) adds to the functionality and versatility of the company form. Although publicly listed companies represent a fraction of such companies, their impact on the welfare

[202] For an analysis of social responsibility situation in Lithuania (with emphasis on environmental protection) through the lens of company law see: LAURAITYTE, E.; MILIAUSKAS, P. Sustainable Companies under the Lithuanian Company Law, *University of Oslo Faculty of Law Research Paper No. 2013-10*, 2013 [interactive]. [Accessed on 2013-07-02] Available online at: <http://ssrn.com/abstract=2248591>.

of each state is crucial. In order for the impact of listed companies to be positive a set of rules regulating the internal organizational structure must be adhered to. This set of rules (hard law as well as soft law) is the matter of corporate governance, which aims at enhancing the cooperation of various corporate constituents by limiting conflicts of interest (in the broadest sense of the term). The balance of various conflicting interests of corporate constituents is the ultimate gaol of corporate governance. As it has been argued above, the scope of corporate governance is far reaching and it goes beyond the matters of company law. Nevertheless, as this dissertation is aimed at providing insights on the shareholders' agreements as a tool to mitigate negative consequences of conflicts of interest, the use of corporate governance will be, in most of the cases, limited to legal context.

Chapter 2. Legal and economic theories of the company (firm)

Before moving on forward with the issues of corporate governance, there is a need to address the legal discourse on the corporate personality and economic debate on the theory of the firm. Why are these theories relevant? Corporate law scholars have been debating on the concept of personality of the corporation since the enactment of the first modern corporate laws. According to legal historians, '[b]eginning in the 1890s and reaching a high point around 1920, [there was] a virtual obsession in the legal literature with the question of corporate personality'[203]. This discussion died out with a statement that whole jurisprudence on the legal theory of corporate personality was fruitless and too abstract to serve any meaningful purpose[204]. While lawyers have long abandoned this debate, the economists (in some cases together with legal scholars) are still searching for a highly developed theory of the firm (it is even

[203] HORWITZ, M. J. *The Transformation of American Law 1870-1960: The Crisis of Legal Orthodoxy*. New York: Oxford University Press, 1992, p. 101.

[204] DEWEY, J. The Historic Background of Corporate Legal Personality. *Yale Law Review*, 1925-1926, Vol. 35, No. 6, p. 673; BRATTON, W. W. The New Economic Theory of the Firm: Critical Perspectives from History. *Stanford Law Review*, 1989, Vol. 41, No. 6, p. 1491.

argued that they have inherited the discourse on the theory of the company/firm from the lawyers[205]). All the economic theories that have been introduced up until now are 'capable only of portraying hypothetical firms that bear little relation to the complex organizations we see in the world'[206]. Nevertheless, due to the fact that traditional legal theories of legal personality (company) do not provide reasons and insights into internal relations between various corporate constituents active inside the company, the economic theories have to be relied upon.

Considering the fact that laws and legal intervention by the legislature are usually based on the needs expressed in the society, the failure of the neoclassic economic theory to address the firm as more than just a 'black box'[207] is reflected in the legal theories of the company. In other words, none of the legal theories presented below identify the complex relations between different corporate constituents or try to explain them. Instead, they provide reasons for only the existence and nature of the company[208]. After the introduction of new economic theories and understandings of the firm that go beyond the 'black box', the landscape of legislation of company law has changed. However, legal theories of the company had little to do with this change.

Despite of the above, legal theories of the corporate personality and economic theories of the firm in the corporate governance context serve two purposes. First, they help to understand the underlying ideas and concepts behind the complex relations between numerous constituents of the modern

[205] BRATTON, W. W. The New Economic Theory of the Firm: Critical Perspectives from History. *Stanford Law Review*, 1989, Vol. 41, No. 6, p. 1493.

[206] HART, O. An Economist's Perspective on the Theory of the Firm. *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1757.

[207] According to Hart, the neoclassical economists treated the firm as 'a perfectly efficient 'black box', inside which everything operates perfectly smoothly and everybody does what they are told'. Thus, there is no need to address authority, decision delegations and internal organization questions. See: HART, O. *Firms, contracts, and financial structure*. Oxford: Clarendon Press, 1995, p. 17.

[208] In the author's opinion, such limited view from legal scholars is sometimes even reflected in the company laws that treat certain problems that a modern company faces today as non-existent.

company. Secondly, although being limited in their nature, different theories help identifying and explaining problems that arise or might arise within the company. Only after the problems are identified and clearly formulated can the law provide legal solutions to them. The main purpose of the next two chapters is to present an overview of the legal theories of the corporate personality (very briefly) and economic theories of the firm. Some of these theories will be used in identifying and formulating the problem to which shareholders' agreement might provide one of the possible solutions.

2.1. Legal Theories of the company

2.1.1. Contractual and concession theories

The first two legal theories, namely contract theory ad concession theory, are focused on explaining the origins of the company[209]. These theories conflict with each other as one of them states that companies are formed only by the will (expressed in a form of a contract) of incorporators while the other claims that private individuals can form a company only after such right is granted by the state.

The origins of the contractual approach are traced back to the Roman *societas* and the medieval canon law[210]. The contractual theory views the company as an outcome of private negotiations and contracting while the influence of the state is limited only to enforcement of such contracts[211]. This clearly eliminates the role of the state as the existence of the company is argued to be based only on contracts between private individuals. Furthermore, the contractual theory is argued to be closely linked to the nexus of contracts

[209] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 10.

[210] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 8-9.

[211] BUTLER, H. N. The Contractual Theory of the Corporation. *George Mason University Law Review*, 1989, Vol. 11, No. 4, p. 100.

theory formulated by the economists[212]. These two theories overlap up to a certain degree. However, the emphasis of the legal contractual theory is on the limited role of the state rather than on the actual contractual relationships between various constituents of the company[213].

The roots of the opposing concession theory lie in the involvement of the state during the sixteenth-nineteenth centuries in granting various special charters which were required for incorporating a legal entity[214]. This theory stipulates that the company owes 'its existence to the positive law of the state rather than the private initiative of individual incorporators'[215]. Thus, the role of the state, in contrast to the contractual theory, is considered to be fundamental. Nowadays, with the enactment of general laws and statutes the role of the state did not diminish, only the angle of its influence changed. Instead of granting various types of permits on a case by case basis, the state uses its regulatory power to enact general laws that allow for incorporation of various legal entities including the company (with certain exceptions, for example, banks). Thus, all persons that comply with the standards set by the state are entitled to incorporate a company.

It should be observed that currently these two theories coexist (although their origins are contradictory). States enact company laws (this is in line with the concession theory) which allow incorporation of any legal entity. At the same time the will of individual persons is also necessary for the company to be actually incorporated (which is the feature of contractual theory).

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[212] For arguments see: BUTLER, H. N. The Contractual Theory of the Corporation. *George Mason University Law Review*, 1989, Vol. 11, No. 4, p. 99-123.

[213] This theory is often used by the opponents of statutory intervention into company's affairs.

[214] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 9. The requirements of special permit by the state were justified due to various reasons, including the restriction for other persons to carry out the same activities and the accumulation of wealth that might manifest itself into political power. For more explanations see: MILLON, D. Theories of the Corporation. *Duke Law Journal*, 1990, Vol. 39, No. 2, p. 207-208; DEWEY, J. The Historic Background of Corporate Legal Personality. *Yale Law Journal*, 1926, Vol. 35, No. 6, p. 666-668.

[215] MILLON, D. Theories of the Corporation. *Duke Law Journal*, 1990, Vol. 39, No. 2, p. 206.

2.1.2. Real (or Organic), aggregate and fiction theories

The other three most influential legal theories of the company (legal person) are concentrated not on the origin of the company, but on its nature – whether it is artificial and fictitious or whether it should be treated as a real natural person.

Fiction theory is largely based on the arguments provided by the German Romanist Friedrich Karl von Savigny[216]. The main claim provided by Savigny was that all transactions and relations ultimately take place among natural persons (meaning not companies) and a company does not have any independent rights that could be exercised without interference of natural persons[217]. Therefore, legal entities (companies) cannot exist on their own, and their existence is possible and is justified as long as it is recognized by laws. Savigny did not deny the fact that company is a separate legal personality which is distinct from its shareholders. However, he claimed that the natural existence of companies is impossible and they exist only if supported by the law – as such they are a legal fiction[218]. One of the most famous quotes in this regard was made by the UK courts where a company was described as 'a juristic fragment of the imagination, lacking both a body to be kicked and a soul to be damned'[219]. Thus, supporters of the fiction theory claim that existence of the company, as a legal entity, is possible only if it is allowed by state laws.

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[216] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 10. It should be noted that the origins of this theory are associated with Pope Innocent IV and the real reasons for treating legal persons as fiction might be related to religious purposes. See: DEWEY, J. The Historic Background of Corporate Legal Personality. *Yale Law Journal*, 1926, Vol. 35, No. 6, p. 665-666.

[217] SCHANE, S. A. The Corporation is a Person: the Language of a Legal Fiction. *Tulane Law Review*, Vol. 61, p. 565.

[218] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 11.

[219] Chancery division. Decision dated March, 22, 1974, *Northern counties securities LTD v. Jackson & Steeple LTD*. *The Weekly Law Reports*, 1974, p. 1143. There is also a quite famous negative quote by the U.S. Supreme Court Justice Louis Brandeis where he was referring to the huge companies dominating the twentieth century U.S. He said that corporation is 'the Frankenstein monster which states have created by their corporation laws'. However, this quote also reflects a degree of fiction theory. See: U.S. Supreme Court. Louis K. Liggett Co. v. Lee - 288 U.S. 517, 1933, March 13.

While fiction theory is argued to be partly based on the concession theory[220] as both of them stress the importance of the influence of the state made laws, the aggregation theory is founded on the arguments of contractual theory[221]. R. von Jhering is considered to be one of the prominent exponents of this theory[222]. Aggregate theory is based on the claim that one of the natural rights of persons is to establish contractual relations between each other in order to form companies which in turn are considered not as separate persons, but as the aggregate of the contracting individuals[223]. In other words, a company is treated as continuation of its shareholders and not as a person in itself[224] (and, according to aggregate theory, it is irrelevant if law allows the existence of the company or not). Thus, the company is an aggregation of groups of individuals who are contracting between each other. It should be noted that this theory is used in order to base the shareholder value model in company law. However, it is hard to reconcile with the fact that company has legal personality.

With the growth of companies their contractual nature (only in a legal sense) diminished and the possibility for large numbers of shareholders to change without changing the company itself weakened the influence of the aggregate theory. A new theory that reflected the reality of the beginning of twentieth century[225] was offered by German scholar Otto van Gierke. He claimed that companies are 'organic constructions'[226] that they are 'a living

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220 Although it should be agreed that fiction theory is of philosophical origin while concession theory is indifferent to the reality or fiction of the company. See: DEWEY, J. The Historic Background of Corporate Legal Personality. *Yale Law Journal*, 1926, Vol. 35, No. 6, p. 667.

221 DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 11-12.

222 He claimed that 'association is <…> a business contract'. See: JHERING VON, R. *Law as Means to an End*. Boston: The Boston Book Company, 1913, p. 160.

223 DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 12.

224 SCHANE, S. A. The Corporation is a Person: the Language of a Legal Fiction. *Tulane Law Review*, Vol. 61, p. 566.

225 MILLON, D. Theories of the Corporation. *Duke Law Journal*, 1990, Vol. 39, No. 2, p. 211.

226 GIERKE VAN, O. *Political Theories of the Middle Age*. Cambridge: Cambridge University Press, 1900, p. 67-73.

organism and a real person, with body and members and a will of its own'[227]. Thus, his theory differed from fiction theory in that it claimed that legal entity is not a legal fiction but a real person[228] which does not require legal recognition in order to exist[229]. The law in itself does not create companies but can only confirm their natural existence (like a natural person)[230]. The main implication of this theory is the argument that the company is not simply a continuation of the interests and will of the shareholders (as the fiction theory claims) and at the same time it is more than just a sum of shareholders (like the aggregate theory states). According to real theory the company might have goals and interests that are distinct form its shareholders[231]. Certain aspects of this theory can still be found in the modern company law, for example, the term 'interests of the company'. Furthermore, real theory can be viewed as a cornerstone for the stakeholder approach advocated by some legal scholars[232].

2.1.3. Relevance of legal theories

Contractual and concession legal theories of the company attempt to provide either reasons for or against the intervention of the state into formation of the company. Thus, they are more concentrated on explaining the relations between a company as a separate legal personality and the state (in other words, the origin of the company). For example, concession theory argues that

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[227] MAITLAND, F. W. Translator's Introduction. In GIERKE VAN, O. *Political Theories of the Middle Age*. Cambridge: Cambridge University Press, 1900, p. xxvi.

[228] Although the main criticism of this theory is that companies are usually owned and treated at some level similarly as things and not as human beings, there is a philosophical argument that if companies were allowed to own all of their shares they would become totally independent and separate persons. See: IWAI, K. Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance. *The American Journal of Comparative Law*, 1999, Vol. 47, No. 4, p. 597-598.

[229] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 13.

[230] PHILLIPS, M. J. Reappraising the Real Entity Theory of the Corporation. *Florida State University Law Review*, 1994, Vol. 21, No. 4, p. 1067-1073.

[231] SCHANE, S. A. The Corporation is a Person: the Language of a Legal Fiction. *Tulane Law Review*, Vol. 61, p. 567;

[232] For an overview of stakeholder and shareholder debate see Part I, Chapter 3.3.

company is granted its legal status from the state, while contractual theory, in contrast, is based on an argument that the company originates from a contract between private individuals. Although it had been important in the seventeenth-nineteenth centuries to have a sound legal theory of the nature of the company[233], nowadays this is not as important. It is widely accepted that a company becomes a separate legal person after it is incorporated under the rules provided in laws that are equally applicable to all persons. At the other end of the spectrum, real, aggregate and fiction theories tried to explain the nature of the company and whether it should be treated as a fictitious or organic creature. In the author's view, these different theories might be applied to the same company but at different stages of its lifecycle. Furthermore, manifestation of these theories can also be found in modern company laws. For example, there is a requirement for registration in order for the company to be recognised as such (which is part of the concession and part of the fiction theory) or the, already mentioned, company interest that suggests that companies might have certain degree of realism in them.

Although legal theories contemplate on the nature and origin of the company, they do not always analyse and are not oriented at explaining the inside relations between different constituents active within the company. For example, they do not provide insights on why shareholders have voting rights in the company, whose interests should the management board take into account while making decisions and what kind of conflicts of interest plague the company[234]. Despite the lack of focus on internal structure of the company some legal theories are closely related to economic theories of the firm analysed below. For example, legal fiction and aggregate theories are related to the nexus of contracts theory as all of them advocate more shareholder oriented

[233] During this period in history the company and its concept was being actively debated and brought into existence. See: MICKLETHWAIT, J.; WOOLDRIDGE, A. *The Company: A Short History of a Revolutionary Idea*. New York: Modern Library, 2003.

[234] For example, the organic theory states that company functions as a natural person and has its own interests. Under such presumption there cannot be any conflicting interests between different constituents active within the company because they are bound to serve the interests of the company.

approach. On the other hand corporate realism and managerialism claim that the company is a real thing and managers are the *de facto* controllers of the company[235].

Company law is closely related to economics as one of its functions is to facilitate economic transactions through an organizational form called the company, as opposed to the transactions taking place directly through the market[236]. Thus, company law only translates and reflects the needs of society (in this case needs that are more business related) into legal rules and principles. Accordingly, company law can document the real world situation and provide rules together with legal remedies and tools in order to deal with different problematic situation in least costly way. However, company law in itself is incapable of explaining the reasons for the companies to exist and grounds for the relations between different actors active within the company. In other words, without the help of other sciences company law would be unable to efficiently regulate the relations arising within the company. Having in mind that legal theories of the company fail to explain the relations between different parties active in a company, it is necessary to take into account theories of the firm provided by the scholars of other sciences. For these reasons the next chapter will focus on economic theories of the firm and especially agency theory which helps to identify and explain existing relations between different parties in the company. Only after the relations (and possible problems) between different corporate constituents are identified, the issue regarding the possible legal remedies (shareholders' agreements) will be addressed.

[235] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 39-40.

[236] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 2.

2.2. Economic Theories of the Firm

Economic theories of the firm are important both to the analysis of company law and, in particular, to the analysis of corporate governance related issues. Economic theories help explain why companies exist and why economic activity is carried through them instead of dealing directly through the market, they also provide reasons for the internal structure of the company and existing relations between different corporate constituents. However, from the lawyer's perspective, the benefit of economic theories (and especially agency theory) is that they enable to identify problems that plague the company, and thus provide reasons for the interference of company law in order to regulate or solve such problems.

Moreover, economic theories of the firm shed some more light on the corporate governance debate and are helpful in explaining what should be the purpose of corporate governance. For example, transaction cost theory and agency theory are based on the idea that the main concern of corporate governance is the control of managers by shareholders[237]. Hence, different economic theories stress different aspects of corporate debate and it depends on the theory used which elements of corporate governance will be emphasized.

Up until the formulation of economic theories, the firms under standard neoclassical economic theory were viewed as 'black boxes characterized by production functions and their horizontal expanse governed by economies of scale driven by the underlying technological attributes of these production functions'[238]. Thus, a firm (or a company in legal terms) was envisaged as a huge factory that only provided goods according to the forces and needs of

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[237] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 5.

[238] JOSKOW, P. L. Introduction to New Institutional Economics: A Report Card. In BROISSEAU, E.; GLACHANT, J. M. (eds.) *New Institutional Economics: A Guidebook*. Cambridge: Cambridge University Press, 2008, p. 2

markets. Corporate governance (and all the problems associated with it) in this context was either assumed to exist and operate perfectly and without costs or was completely ignored. Only the introduction of different economic theories of the firm let the theory catch up with the reality and enabled scholars to analyse the internal relations within the so called 'black box'. The traditional (neoclassical) economic theory uses a number of theoretical assumptions[239] that are important to note at this stage of the chapter as some of them will be also relevant in explaining different theories of the firm. The first assumption is that the distribution of production factors within the firm is distributed according to the market[240]. While the market automatically allocates the resources within the firm it is assumed that there is no need for the management to exist or (if it exists) it should act accordingly to the market with the only function – selecting of profit maximizing quantities of outputs and inputs[241]. This assumption eliminates the hierarchical structure of the firm as management board is assumed to function without error or costs. Perfect markets also mean that regulatory intervention is unnecessary[242]. Secondly, it is assumed that all economic actors seek to maximize profits and that the single goal of the firm is also profit[243]. This assumption does not distinguish between the long-term and short-term profit maximization and states that profit during independent short-term periods lead to profit in long-term[244]. Third fundamental assumption is that the firm has full and free knowledge of

[239] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 19-20.

[240] As it will be explained further this argument was attacked by Coase who argued that transaction costs are lower if production factors are coordinated using authority within the firm.

[241] DEMSETZ, H. The Theory of the Firm Revisited. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 143.

[242] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 21.

[243] JENSEN, M. C.; MECKLING, W. H. *The Nature of Man*, 1994 [interactive]. [Accessed on 2012-08-03] Available online at: SSRN: <http://ssrn.com/abstract=5471>. In their article Jensen and Meckling argue for the REMM model of human behaviour.

[244] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 20.

production possibilities and prices while making decisions[245]. Thus, all present and future information is at the disposal of the firm and allows rational decision making in order to achieve the profit maximization goal[246]. Due to the perfect knowledge both management board and shareholders are enabled to make optimal decisions at any given time.

With the above assumptions, which are also regarded as weaknesses of the neoclassical model, the theory was easy to apply and to analyse different problems posed by the science of economics[247]. However, existing relations within the firm were ignored, the issue of conflicts of interest between different corporate constituents remained unexposed and the internal structure of the firm was untouched by the economic (and also legal) analysis[248]. The below provided theories of the firm address some of the weaknesses of the traditional neoclassical economic theory. It should also be noted that although some insights have been provided that theories of the firm might be converging towards a more developed and comprehensive theory[249], different theories will be addressed as there is still no universally applicable theory currently available.

As this dissertation is based around agency theory, most of the focus will be put to this economic theory. However, as agency theory is closely related to the transaction cost economics and nexus of contracts theory, these two theories will be addressed in the beginning of this chapter. After agency

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[245] DEMSETZ, H. The Theory of the Firm Revisited. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 143.

[246] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 20.

[247] According to Hart three reasons prolonged survival of the classical approach: 1) the theory lends itself to an elegant and general mathematical formalization; 2) it is very useful for analysing how a firm's production choices respond to exogenous change in the environment, such as an increase in wages or a sales tax; 3) the theory is also very useful for analysing the consequences of strategic interaction between firms under conditions of imperfect competition. See: HART, O. An Economist's Perspective on the Theory of the Firm', *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1758.

[248] HART, O. An Economist's Perspective on the Theory of the Firm', *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1758.

[249] HART, O. An Economist's Perspective on the Theory of the Firm', *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1774.

theory is introduced a few of the most dominant alternative models of the theory of the firm will be addressed as well, including stewardship and stakeholder theories.

2.2.1. Transaction cost theory[250]

2.2.1.1. The original transaction cost theory

Coase with his seminal work 'The Nature of the Firm'[251] was one of the first to recognise the shortcomings of the standard neoclassical economics and to question the differences between the real world firm and firm in theory. He acknowledged that the dominant economic theory at that time assumed that allocation of resources is based on the price mechanism adjusted by the supply and demand (market)[252]. However, Coase argued that such theory does not provide a complete picture of the economic system. As an example of his reasoning Coase explains that workers within the firm are transferred between the departments not because of the change in prices, but because authority is exercised and they are ordered to do so[253].

While answering the question why firms emerged in the specialised exchange economies Coase claimed that there is a cost in using the price mechanism provided by the market, and it is more beneficial in some cases to establish a firm which minimises these costs. According to Coase, there are two major costs involved in using the price mechanism[254]: 1) discovering what

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[250] Transaction cost theory is attributed to the new institutional economics. See: GARROUSTE, P.; SAUSSIER, S. The Theories of the Firm. In BROISSEAU, E.; GLACHANT, J. M. (eds.) *New Institutional Economics: A Guidebook*. Cambridge: Cambridge University Press, 2008, p. 23-36; WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 16.

[251] COASE, R. H. The Nature of the Firm. *Economica*, 1937, Vol. 4, No. 16, p. 386-405.

[252] Coase cites Sir Arthur Salter: 'The normal economic system works itself. For its current operation it is under no central control, it needs no central survey. Over the whole range of human activity and human need, supply is adjusted to demand, and production to consumption by process that is automatic, elastic and responsive'. *Ibid*, p. 387.

[253] *Ibid*, p. 387-388.

[254] *Ibid*, p. 390-391.

the relevant prices on the market are; 2) negotiating and concluding a separate contract for each exchange transaction on the market. When these costs of using the market become too high, it is more efficient to organise business activities through a firm[255].

Transaction cost theory states that entrepreneur exercises authority through the organisational form of a firm and using this authority directs the allocation of resources more efficiently than given the same circumstances the resources would be allocated through the market. Explained in other words, the intra-firm coordination of resources occurs when it is more efficient than contracting directly through market[256]. Therefore, Coase defines the firm as a 'system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur'[257]. As the name of the theory suggests, firms exist as an alternative to the market. They reduce (Coase himself acknowledges that transaction costs cannot be eliminated) some of the transaction costs that would be otherwise incurred if business activities would be carried directly through the market. The main idea of the theory suggests that '[w]ithin the firm individual bargains between the various cooperating factors of production are eliminated and for a market transaction is substituted an administrative decision'[258]. In his inquiry into the nature of firm, Coase asked a logical follow-up question – if the firm is so efficient in reducing the costs, why is it that not all the business activities are carried through one big firm? Apparently, there are certain costs in using the firm as well[259]. First, with

[255] SCHWAB, S. J. Coase's Twin Towers: The Relation Between the Nature of the Firm and The Problem of Social Cost. *The Journal of Corporation Law*, 1992-1993, Vol. 18, No. 2, p. 360-361.

[256] Eisenberg describes the main issue of the transaction cost theory as arguing 'why some economic activity takes place within firms, so that the activity is directed by authority, while other economic activity takes place across markets, so that the activity is determined by contract'. See: EISENBERG, M. A. The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm. *The Journal of Corporation Law*, 1998-1999, Vol. 24, No. 4, p. 821.

[257] COASE, R. H. The Nature of the Firm. *Economica*, 1937, Vol. 4, No. 16, p. 393.

[258] These are the words that Coase later uses to rephrase his theory. See: COASE, R. H. The Problem of Social Cost. *The Journal of Law and Economics*, 1960, Vol. 3, p. 16. It should be mentioned that in this later work Coase analyses how transactions are carried in the markets as compared to the government regulation.

[259] COASE, R. H. The Nature of the Firm. *Economica*, 1937, Vol. 4, No. 16, p. 394-395.

increasing number of transactions within the firm the costs for each additional transaction might rise. Secondly, with increased number of transactions within the firm there might be failures to put factors of productions into their best use, and thus causing increased costs. Finally, the supply price of one or more factors of production may rise. Only if these costs are lower than the costs of carrying transactions through the market will they be organized through a firm[260]. Accordingly, Coase claimed that firms tend to get larger if the above mentioned costs of entering into transactions through a firm are mitigated[261].

With his theory Coase not only provided a pioneering attempt to explain the *raison d'être* for the firms to exist (firms are created because in some cases they are more efficient than the market) and linked costs with the organization[262], but also provided a very important insight into the organizational nature of the firm that is relevant even today. He claimed that the essence of the firm is the authoritative resource allocation function. In other words, firm is characterized by the hierarchical decision-making process[263]. Later Williamson added that according to transaction cost theory the firm is viewed not as a production function but as a governance structure[264]. Other theories of the firm have picked up on this and, as will be described below, have based their arguments on the hierarchical nature of the firm.

2.2.1.2. Critique

The theory provided by Coase has been criticized mainly on the grounds that it is too simplistic and that there is no definitive line between the market and firm

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[260] COASE, R. H. The Nature of the Firm: Influence. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 40.

[261] COASE, R. H. The Nature of the Firm. *Economica*, 1937, Vol. 4, No. 16, p. 396-397.

[262] COASE, R. H. The Nature of the Firm: Meaning. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 26.

[263] SCHWAB, S. J. Coase's Twin Towers: The Relation Between the Nature of the Firm and The Problem of Social Cost. *The Journal of Corporation Law*, 1992-1993, Vol. 18, No. 2, p. 362-363.

[264] WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 18.

transactions as it was portrayed in the article 'Nature of the Firm'[265]. To this critique Coase has replied that it is indeed hard to draw a distinctive line and markets can even exist within the firm[266]. Coase further agreed that his theory provides the reasons for the firms to exist but does not explain the structural relationships within them[267]. A further critique originated from the nexus of contracts theory. Scholars representing this theory claimed that little evidence exists that the firm could be characterized by authoritarian relations. According to them internal relations within the firm are more market-like and parties can always terminate such relations[268]. Hart has endorsed the same critical argument that there is little authority within the firm and claimed that employer has the same level of authority over the employee as the customer has authority over the grocer [269]. Furthermore, Demsetz provided critical comments over the Coase's theory[270]. He claimed that coordination of available resources through a firm is also costly – management costs are incurred. Demsetz further stated that these management costs are as important as transaction costs. His argument goes that if the transaction costs would be zero and management costs would be positive, it would still be more feasible in certain cases to organize activity through the firm. Demsetz explains that management costs in other firms supplying goods or services could be higher, and thus allocating resources through the firm as compared to the market would be more efficient. Thus, the transaction cost theory ignores differences existing between the

[265] KLEIN, B.; CRAWFORD, R. G.; ALCHIAN, A. A. Vertical Integration, Appropriable Rents, and the Competitive Contracting Process. *Journal of Law and Economics*, 1978, Vol. 21, No. 2, p. 326.

[266] COASE, R. H. The Nature of the Firm: Meaning. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 28.

[267] COASE, R. H. The Nature of the Firm: Influence. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 47.

[268] SCHWAB, S. J. Coase's Twin Towers: The Relation Between the Nature of the Firm and The Problem of Social Cost. *The Journal of Corporation Law*, 1992-1993, Vol. 18, No. 2, p. 365.

[269] HART, O. An Economist's Perspective on the Theory of the Firm', *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1761.

[270] DEMSETZ, H. The Theory of the Firm Revisited. *Journal of Law, Economics, and Organization*, 1988, Vol. 4, No. 1, p. 145-148.

firms. Despite of the above criticism, Coase's theory has been elevated to a new level by the next generation of scholars and especially Williamson.

2.2.1.3. Williamson and the transaction cost theory

Williamson (the most influential follower of the transaction theory) continued the work started by Coase and coined the term 'transaction cost economics'[271]. He contributed to the theory by precisely defining the nature and sources of transaction costs[272]. He distinguished environmental factors (uncertainty, frequency of transactions and asset specificity[273]) and behavioural factors (bounded rationality and opportunism)[274] which allowed for a more structured arguments why in certain cases firms are selected over the markets. He claimed that transaction costs are especially high in cases where asset specificity is present (*id est*, when parties make transaction specific investments) because the risk for the other party to engage in opportunistic behaviour becomes very high[275]. The hierarchical structure of the firm is aimed at providing safeguards in order to avoid such situations. He also noted that transaction cost theory

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[271] TRICKER, B. *Corporate Governance: Principles, Policies and Practices. 2nd edition*. Oxford: Oxford University Press, 2012, p. 64; SCHWAB, S. J. Coase's Twin Towers: The Relation Between the Nature of the Firm and The Problem of Social Cost. *The Journal of Corporation Law*, 1992-1993, Vol. 18, No. 2, p. 363.

[272] GARROUSTE, P.; SAUSSIER, S. The Theories of the Firm. In BROISSEAU, E.; GLACHANT, J. M. (eds.) *New Institutional Economics: A Guidebook*. Cambridge: Cambridge University Press, 2008, p. 28.

[273] Asset specificity refers to assets that are not redeployable after the initial investments in support of transactions are made and the second best value is much lower. See: WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 142-145; WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 52-61.

[274] Bounded rationality means that decision makers are limited by their knowledge, skill and time. Opportunism refers to self-interested behaviour that involves elements of guile, deception, misrepresentation and bad faith. See: WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 138-139; WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 45-49.

[275] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 36. Williamson himself distinguished four types of asset specificity: site specificity, physical asset specificity, human asset specificity and dedicated assets. See: WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 55.

depends on contract law[276] and this notion was later elaborated as meaning that due to bounded rationality the contracts are incomplete – a contract cannot anticipate all possible future outcomes[277]. Moreover, Williamson elaborated the vertical integration problem[278] and he addressed the question of when and under what circumstances firms make or buy particular goods or services. A textbook example of vertical integration is provided by Klein, Crawford and Alchian[279]. General Motors was buying car parts from Body Fisher. After some time during their contractual relationship (regulated by the demand and supply forces in the market) General Motors became dissatisfied about the prices offered for the parts and decided to purchase Fisher Body. In terms of the transaction cost theory the market transactions in buying car parts where substituted for organizing the production of parts within the firm as it saved costs that otherwise would be incurred using the market. Thus, by bringing the transaction from the market into the firm it was possible to mitigate behavioural factors and some of the environmental factors identified by Williamson.

According to Williamson '[f]rom a transaction cost point of view, the main purpose of studying internal organization is to better understand the comparative efficacy of internal governance processes'[280]. Therefore, the main purpose of economic institutions of capitalism (including the firm) is to economize the transaction costs[281]. Overall the transaction cost theory is

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[276] WILLIAMSON, O. *The Mechanisms of Governance*. Oxford: Oxford University Press, 1996, p. 10; WILLIAMSON, O. Transaction-Cost Economics: The Governance of Contractual Relations. *Journal of Law and Economics*, 1979, Vol. 22, No. 2, p. 235-238.

[277] SHELANSKI, H. A.; KLEIN, P. G. Empirical Research in Transaction Cost Economics: A Review and Assessment. *Journal of Law, Economics, & Organization*, 1995, Vol. 11, No. 2, p. 336.

[278] WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 150-159.

[279] KLEIN, B.; CRAWFORD, R. G.; ALCHIAN, A. A. Vertical Integration, Appropriable Rents, and the Competitive Contracting Process. *Journal of Law and Economics*, 1978, Vol. 21, No. 2, p. 308-310.

[280] WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 170.

[281] WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 17.

viewed as a part of a broader picture of different economic theories of the firm that are addressed using pluralistic approach[282]. Thus, scholars agree that different sets of views towards the firm exist and that they are needed in order to address different problems within the company.

Transaction cost theory differs from agency theory as corporate governance problems are seen to be originating from a set of contractual hazards: opportunism, bounded rationality and information asymmetries[283]. However, as the transaction cost theory concentrates on the internal measures and mechanisms to reduce transaction costs in some cases it can overlap with the approach taken by agency theory. For example, both theories suggest aligning interests of the management board with those of shareholders in order to avoid or mitigate either costs of organizing transactions within the firm or agency costs[284].

2.2.2. Nexus of contracts theory

The idea that contracts and firms are related has been already expressed in the transaction cost theory when Coase argued that long-term contracts are likely to create relationships that could be termed as a firm[285]. Similar idea was also expressed by Williamson who stated that transaction cost theory 'poses the problem of economic organization as a problem of contracting'[286]. However,

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[282] TADELIS, S.; WILLIAMSON, O. *Transaction Cost Economics*, 2010 [interactive]. [Accessed on 2012-08-01] Available online at: <http://faculty.haas.berkeley.edu/stadelis/tce_org_handbook_111410.pdf>, p. 1.

[283] CLARKE, T. Introduction: Theories of Governance – Reconceptualizing Corporate Governance Theory After the Enron Experience. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 6.

[284] WILLIAMSON, O. Corporate Governance. *The Yale Law Journal*, 1983-1984, Vol. 93, No. 7, p. 1197-1217-1218; ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: the Interests of Shareholders as a Class. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 75-78.

[285] COASE, R. H. The Nature of the Firm. *Economica*, 1937, Vol. 4, No. 16, p. 392.

[286] WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 20.

the origin of the theory is usually attributed to Alchian and Demsetz[287] and to Jensen and Meckling[288]. It should be noted at this point that the nexus of contracts theory and agency theory are closely related and even closely intertwined. This is also influenced by the fact that main ideas of nexus of contracts and agency theories were formulated in the same article by Jensen and Meckling.

Alchian and Demsetz 'see the firm characterized by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in the conventional market'[289] as a delusion because (according to them) there is neither power of fiat, nor authority in the firm that could be different from the market. The firm is regarded just as a type of market – a privately owned one[290]. By giving an example of employer and employee Alchian and Demsetz argue that employer's efforts to direct and manage an employee are the same as consumer's requests to the shopkeeper to sell one or another brand of the product. To put it differently, their idea is that employer and employee are continually involved in renegotiation of contract in order for it to be acceptable to both parties[291]. Thus, the relation between different corporate constituents is a *quid pro quo* contract and the concept of hierarchy is eliminated from the definition of the firm[292]. According to Alchian and Demsetz, a firm is a 'contractual organization of inputs'[293] with a 'centralized contractual agent in a

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[287] ALCHIAN, A. A.; DEMSETZ, H. Production, Information Costs, and Economic Organization. *The American Economic Review*, 1972, Vol. 62, No. 5, p. 777-795.

[288] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 3; JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 305-360.

[289] ALCHIAN, A. A.; DEMSETZ, H. Production, Information Costs, and Economic Organization. *The American Economic Review*, 1972, Vol. 62, No. 5, p. 777.

[290] *Ibid*, p. 795.

[291] *Ibid*, p. 777.

[292] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p.30.

[293] ALCHIAN, A. A.; DEMSETZ, H. Production, Information Costs, and Economic Organization. *The American Economic Review*, 1972, Vol. 62, No. 5, p. 783.

team productive process'[294]. This centralized contractual agent is not a firm but the residual claimant (shareholder) and is intended to monitor the inputs and outputs of other members of the team in order to prevent them from shirking[295].

Following the above provided line of thought Jensen and Meckling formulated the definition of the firm that is associated with the nexus of contracts theory. They regarded it as 'legal fiction which serves as a nexus for contracting relationships and which is also characterized by the existence of divisible residual claims on the assets and cash flows of the organization which can generally be sold without permission of the other contracting individuals'[296]. To put it differently, the firm is viewed not as a person (which is usually the case in legal context) but as a web or connecting core of explicit and implicit contracts[297] that establishes rights and obligations amongst various constituents active within the company[298]. However, the concept of contract in the nexus of contracts theory means neither an agreement in common sense, nor a legally enforceable promise in legal terms[299], but a reciprocal arrangement[300]. Hence, shareholders are regarded as the ultimate 'owners' and controllers of the firm, which in turn is conceived not as an entity in legal

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[294] *Ibid*, p. 778.

[295] Alchian and Demsetz view the firm as a contractual structure with: '1) joint input production; 2) several input owners; 3) one party who is common to all the contracts of the joint inputs; 4) who has rights to renegotiate any input's contract independently of contracts with other input owners; 5) who holds the residual claim; and 6) who has the right to sell his central contractual residual status. The central agent is called the firm's owner and the employer. No authoritarian control is involved; the arrangement is simply a contractual structure subject to continuous renegotiation with the central agent'. *Ibid*, p. 783; 794.

[296] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 311.

[297] This explanation is very similar to the aggregate theory of the company discussed above in Part I, Chapter 2.1.2.

[298] BAINBRIDGE, S. M. *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 1997 [interactive]. [Accessed on 2012-06-19] Available online at: <http://ssrn.com/abstract=10335>, p. 4. For a graphical representation of the ideas of this theory see: BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 10.

[299] For a meaning of contract and agency in law and economics see Part I, Chapter 3.5.

[300] EISENBERG, M. A. The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm. *The Journal of Corporation Law*, 1998-1999, Vol. 24, No. 4, p. 823.

terms but as a group of various constituents acting together to produce goods and services[301]. Due to the above understanding of the firm scholars who uphold the nexus of contracts theory are called contractarians.

There are different variations of the nexus of contracts theory and as the goal of this dissertation is not to provide a concise analysis of different economic theories of the firm only a few examples will be given. For example, some scholars have proposed that the firm should not be treated as a nexus and the focus should be not on the separate personality of the firm but on the ability of the parties to contract[302]. Others have suggested that the firm is not a nexus of contracts, but it has such a nexus and it rests in the management body (this view stresses that firms do not contract without the actions of natural persons)[303]. Yet another view argues that firm has a dual nature and from one point of view it is a set of reciprocal arrangements and from the other it is simply a bureaucratic hierarchical organization[304].

From the perspective of nexus of contracts theory, there is a view among company law experts that by providing a set of default rules company law actually offers a standard form contract. The parties (in case of companies – shareholders) can adopt or change this standard form to suit their needs and interests[305]. However, if the costs for deviating from default provisions are high, it is likely that parties will choose not to amend them and will follow the

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[301] BAINBRIDGE, S. M. *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 1997 [interactive]. [Accessed on 2012-06-19] Available online at: <http://ssrn.com/abstract=10335>, p. 4.

[302] GULATI, G. M.; KLEIN, W. A.; ZOLT, E. M. Connected Contracts. *UCLA Law Review*, 2000, Vol. 47, No. 4, p. 887-948.

[303] BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 1-34.

[304] EISENBERG, M. A. The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm. *The Journal of Corporation Law*, 1998-1999, Vol. 24, No. 4, p. 819-836.

[305] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 20.

rules stipulated in the laws[306]. A shareholders' agreement in this context is a pure contractual tool that enables shareholders to effectively regulate their interrelationships.

2.2.3. Agency theory

The most influential theory of the firm and corporate governance is agency theory[307], which was developed as the result of two seminal articles: *Production, Information Costs, and Economic Organization*[308] and *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*[309]. Agency theory is one of the most prominent theories in the debate on corporate governance and is mentioned in almost all company-law related academic texts[310], textbooks[311] and books for practitioners and board members[312]. Furthermore, the agency approach to corporate governance problems has been embraced not only by the leading academics in the field, but also by international institutions and policy makers[313]. It is noteworthy that agency

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306 ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 21.

307 LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 2.

308 ALCHIAN, A. A.; DEMSETZ, H. Production, Information Costs, and Economic Organization. *The American Economic Review*, 1972, Vol. 62, No. 5, p. 777-795.

309 JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 305-360.

310 This is especially true about the law and economics literature dealing with corporate governance issues. For example: MEURER, M. J. Law, Economics, and the Theory of the Firm. *Buffalo Law Review*, 2004, Vol. 52, No. 3, p. 727-755.

311 For example: KERSHAW, D. *Company Law in Context: Text and Materials*. Oxford: Oxford University Press, 2009, p. 163-178.

312 For example: GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 202-203.

313 World Bank. Corporate Governance: a framework for implementation, 2000 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/09/08/000094946_00082605593465/Rendered/PDF/multi_page.pdf>. It was stated in this report that 'the interests of those who have effective control over a firm can differ from the interests of those who supply the firm with external finance. The problem, commonly referred to as a principal-agent problem, grows out of the separation of ownership and control and of corporate outsiders and insiders. Balancing diverging interests in the absence of the protections that good governance supplies, asymmetries of information and difficulties

theory emerged from and rests upon the contractual view of the firm (nexus of contracts theory)[314], and is closely related to transaction cost economics[315]. In addition, this theory is used as a basis for further research into shareholders' agreements.

2.2.3.1. Principal-agent relations

At the core of agency theory there are different and conflicting relations among various corporate constituents[316]. Agency relations under this theory are defined as 'a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent'[317]. It should be noted that the term "contract" in this context does not have the meaning attributed to it by law[318]. According to the above provided definition, there are two main actors at any given time (although they can be treated differently depending on the situation): the principal and the agent. The principal in this relation is the stronger party that has the authority and power to appoint and direct the agent. The agent, on the other hand, performs all the

of monitoring mean that capital providers who lack control over the corporation will find it risky and costly to protect themselves from the opportunistic behaviour of managers or controlling shareholders'. See, p. 3-4.

[314] BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 6. CLARKE, T. Introduction: Theories of Governance – Reconceptualizing Corporate Governance Theory After the Enron Experience. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 4.

[315] TRICKER, B. *Corporate Governance: Principles, Policies and Practices. 2nd edition*. Oxford: Oxford University Press, 2012, p. 64; TADELIS, S.; WILLIAMSON, O. *Transaction Cost Economics*, 2010 [interactive]. [Accessed on 2012-08-01] Available online at: <http://faculty.haas.berkeley.edu/stadelis/tce_org_handbook_111410.pdf>, p. 1.

[316] In contrast, legal theories of the company are concerned with the origins of the company or state influence.

[317] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 308.

[318] See Part I, Chapter 3.5.

tasks with authority delegated to him in the best interests of the principal[319]. An important factor in this theory is the assumption that both the principal and the agent are rational utility maximizers[320]. Consequently, this leads to conclusion that the agent might favour his own agenda and not the interests of the principal.

There are multiple views on who constitutes the principal. For example, some of the scholars have argued that there is only one agent: the CEO. However, there are multiple principals: 'the shareholders, creditors, suppliers, clients, employees, and other parties with whom the CEO engages in business on behalf of the corporation'[321]. This view is particularly complex and could almost be treated as a certain form of stakeholder approach, because the agent has to act in the interest of many principals. If there are multiple principals, the interests between multiple different classes of principals can be in conflict (for example, shareholders and creditors). The question thus arises whose interests should the agent take into account when making decisions? In theory, the agent cannot prefer one principal over the other, but in practice the agent has to make such a decision as he/she is not in a position to satisfy all interests of different principals. Another problem is related to the control exercised by the principal. According to the standard agency theory, the principal delegates power to the agent to act on his behalf. In case of multiple principals, it is unclear what kind of power is delegated to the agent (the management body) by the creditors, suppliers, clients or employees. Thus, in the author's view, the multiple principals' approach to agency theory is flawed[322].

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[319] A practical and illustrative example on the principal-agent relations is given by Posner. See: POSNER, E. A. Agency Models in Law and Economics. *The Coase Lecture Series*, 2000 [interactive]. [Accessed on 2012-08-03] Available online at: <http://ssrn.com/abstract=204872>, p. 1.

[320] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 308.

[321] BECHT, M.; BOLTON, P.; RÖELL, A. A., Corporate Governance and Control. *ECGI - Finance Working Paper No. 02/2002*, 2002 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=343461>, p. 8.

[322] One of possible arguments could be that the view adopted regarding the principal is directly linked to the question, whether shareholder value model or stakeholder approach is upheld. For an overview of shareholder v. stakeholder see Part 1, Chapter 3.3.

2.2.3.2. Conflicts of interest

As relations between the agent and the principal are based on a contract, it is impossible to foresee all the probable outcomes of such relations, and a complete contract is thus highly unlikely[323]. Most of the times contracts are incomplete, therefore principal is forced to allocate a large part of power into the hands of the agent, who in turn is empowered to exercise such authority to make decisions that were not stipulated in the contract. As the agent is considered to be a utility maximizer, the agency theorists have assumed that the relationships between the principal and the agent are problematic because of their human nature[324]. Jensen and Meckling argue that REMM (the resourceful, evaluative, maximizing model of human behaviour) dominates agency relationships. According to this model, every individual: 1) is an evaluator concerned with well-being (and not only monetary gains) and is always willing to make trade-offs of one good for a larger amount of the other; 2) has unlimited wants that cannot be satiated; 3) acts in a way as to obtain the highest value possible; 4) is creative, reacts to the environment and exploits it or creates new opportunities to satisfy private interests[325]. Under such presumptions, the agent is likely to neglect the interests of the principal in order to pursue his own agenda.

As theories of the firm tend to converge, concepts developed by some theories are adopted by others. Agency theory is no exception and has adopted the concept of 'opportunism' from the transaction cost theory[326]. Thus, the

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[323] CLARKE, T. Introduction: Theories of Governance – Reconceptualizing Corporate Governance Theory After the Enron Experience. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 5.

[324] JENSEN, M. C.; MECKLING, W. H. *The Nature of Man*, 1994 [interactive]. [Accessed on 2012-08-03] Available online at: SSRN: <http://ssrn.com/abstract=5471>.

[325] JENSEN, M. C.; MECKLING, W. H. *The Nature of Man*, 1994 [interactive]. [Accessed on 2012-08-03] Available online at: SSRN: <http://ssrn.com/abstract=5471>, p. 3-5.

[326] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 35.

agent is perceived as behaving opportunistically, which refers to 'self-interest seeking with guile'[327]. It includes all forms of deception, misrepresentation, incomplete or distorted disclosure of information and bad faith. Opportunism is the behaviour of the agent that creates uncertainty and risks for the principal and without which all behaviour of corporate constituents could be effectively regulated by laws and other rules. The behaviour of the opportunistic agent is always intentional and strategic (in contrast, force majeure or unanticipated events are never considered to be opportunistic), and is aimed at satisfying the interests of the opportunistically behaving party. Such opportunistic behaviour is preferred by the agent as it enables him to extract expected benefits from the opportunity, thus satisfying his/her own interest.

The question of conflicting interests is particularly important as all the corporate governance research is based upon the premise that conflicts of interest exist between different corporate constituents[328]. For example, a conflict of interest between the members of the management board and the company is usually presumed[329]. Despite this fact there has been very little attention from the agency theorists on the definition of conflict of interests (however, there is research on the legal definition of the concept).

Taking into account previous research[330] the author suggests defining a conflict of interests as a situation where the private interest of the agent (or any

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[327] O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 47-48.

[328] BURKART, M. C.; LEE, S. The One Share - One Vote Debate: A Theoretical Perspective. *ECGI - Finance Working Paper No. 176/2007*, 2007 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=987486>, p. 5.

[329] WYMEERSCH, E. A Status Report on Corporate Governance Rules and Practices in Some Continental European States. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1121. And if the interests of the company are understood as interests of the shareholders (even if the enlightened shareholder value model is adopted) then it could be concluded that a conflict of interests between the management body of the company and shareholders as a class exists in every company.

[330] For a detailed analysis on conflicts of interest see: DAVIS, M. Introduction. In *Conflict of Interest in the Professions*. New York: Oxford University Press, 2001; ISSACHAROFF, S. Legal responses to conflicts of interest. In *Conflicts of Interest: Challenges and Solutions in Business, Law, Medicine, and Public Policy*. New York: Cambridge University Press, 2005, p. 189-201; BOATRIGHT, J. R. Conflicts of Interest in Financial Services. *Business and Society Review*, 2000, Vol. 105, No. 2, p. 201-219; ARGANDONA, A. *Conflicts of interest: the ethical viewpoint*, 2005 [interactive]. [Accessed on

third party) hinders the ability of the agent to act and make decisions in the interests of the principal when such duty is based on legal, contractual (broader sense than legal meaning), customary, professional or fiduciary relations. This definition is broad enough to encompass all three agency problems and at the same time precise enough as to establish a duty of the agent towards the principal.

Following the above definition it could be stated that each agency problem essentially deals with two conflicting interests. Firstly, there is the principal's interest which is considered to be dominating the agent and principal relations. The other interest (it does not matter if it is agent's personal interest or the interest of any third party that he wants to satisfy) is viewed as an obstacle that prevents the agent from satisfying the interests of the principal. For example, in case of relationship between shareholders and management body, it would be presumed that the interest of the management body to increase the short term value of the company (and the remuneration of the members of the management body accordingly) might be against the interests of the shareholders to increase the long term value of the company[331]. Such interest is incompatible with the interest of the shareholders and in most cases they cannot be achieved simultaneously. Thus, the interest of the agent (or third party) prevents the agent from acting for the benefit of the principal. As agency theory is based on the relationship between the agent and the principal, the duty to act on behalf of the principal must originate either from contract, customs, professional or fiduciary duties, or from any other legal grounds. The contract in this regard should be understood not only in legal sense, but in broader economic meaning (as it allows explaining the relations between the majority and minority shareholders).

2013-01-23] Available online at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=683784>; MILIAUSKAS, P. Interesų konfliktas: sąvoka ir galimi sprendimo būdai. *Teisė*. Vilnius: Vilnius University, 2010, No. 75, p. 93-110. For a more philosophical look at conflicts of interest see: DAVIS, M. Conflict of Interest Revisited. *Business & Professional Ethics Journal*, 1993, Vol. 12, No. 4, p. 21-41.

[331] This is the case if we were to presume that the interests of the shareholders lie in the long term prosperity of the company.

2.2.3.3. Agency costs

Up until this point it has been explained that under agency theory the agent is obliged to act on behalf of the principal. However, due to nature of the agent to prefer his own interests over the interests of the principal conflicts of interest arise. These conflicts of interest are secondary, undesirable outcome of the agency relations that create the so called agency costs. Agency costs in agency theory are defined as a sum of: '(1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, (3) the residual loss'[332]. If the agency costs are low enough, the principal will engage in monitoring the agent and directing him to act in the interests of the principal. However, if the agency costs are high, the principal is likely to choose not to control the agent and instead allow the agent to act as he sees it fit. In context of corporate governance this would mean that management body would be able to put their interests above those of shareholders or majority shareholders would be allowed to expropriate the minority. These situations under the current corporate governance regime and company law structure are unacceptable and additional layers of protection are applied in order to lower the agency costs and prevent the agent from shirking at the cost of the interests of the principal.

From the economics point of view, agency costs are reduced by efficient markets (for example, market for corporate control) and such approach is consistent with the standard neoclassical approach of the economists. Therefore, efficiency of the markets and their facilitation is the main focus of agency theory[333]. On the other hand, lawyers tend to take a more legal

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[332] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 308.

[333] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 4.

approach and offer a whole set of legal strategies to counter the problems identified by agency theory[334].

The author is of an opinion that agency theory provides useful insights into the relations amongst various corporate constituents that are not provided by any of the legal theories of the company. Accordingly, this allows legal scholars to react to the problems identified by agency theory and offer certain solutions that would mitigate agency costs and align the interests of the agent and the principal. In the context of this dissertation, agency theory is considered to be a starting point in analysing shareholders' agreements as a tool that can mitigate the costs created while in agency relations.

2.2.3.4. Critique of agency theory

A critique of agency theory provided by Hart[335] suggests that agency theory fails to answer the vital question of what defines the firm and where the boundaries of its structure are located. To illustrate this Hart uses the famous General Motors and Body Fisher example[336] and argues that agency theory is silent upon how to organize the structure of the firm: whether firms should merge or should they carry on their activities as separate legal persons. Thus, according to Hart, the nature and extent of the firm are left out from agency theory.

To counter the above arguments first it should be agreed that transaction cost theory provides a better explanation on the nature of the firm and its organizational form. However, agency theory views markets as an efficient tool to solve agency costs. Thus, in the case of General Motors and Body Fisher the merger would occur only if General Motors would be able to manage Body Fisher in a more efficient way and extract private benefits of

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[334] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 35-53.

[335] HART, O. An Economist's Perspective on the Theory of the Firm. *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1759-1760.

[336] See part I, chapter 3.1.

control that would be unavailable if these companies would operate as separate firms. In other words, the agency costs of General Motors in managing Body Fisher would have to be lower than the agency costs incurred by Body Fisher operating without the interference from the General Motors.

The concept of opportunistic behaviour adopted from the transaction cost theory has also been criticised by some commentators. Ghoshal and Moran argue that: '[s]ocial sciences carry a special responsibility because of the process of the double hermeneutic: its theories affect the agents who are its subject matter. By assuming the worst, this theory can bring out the worst in economic behavior. <…> [t]his theory is likely to encourage the very behavior that it takes for granted and seeks so hard to control'[337]. In other words, theories assuming the opportunistic behaviour form the agents create stereotypes that prime the type of behaviour they are created to avoid[338]. An agent that is always considered to behave opportunistically will be treated accordingly with various defence mechanisms and this might lead the agent to respond with opportunistic behaviour. Ghoshal and Moran have also claimed that it is hard to *ex ante* distinguish between the opportunistic behaviour and entrepreneurship or leadership and by trying to eliminate opportunism the later behaviours might be discouraged as well[339]. While the arguments of the critique of opportunism are convincing they can be applied to almost every theory that makes some negative assumptions. For example, it is assumed that due to limited liability feature of the company the shareholders are more likely

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[337] GHOSHAL, S.; MORAN, P. Bad for Practice: A Critique of the Transaction Cost Theory. *The Academy of Management Review*, 1996, Vol. 21, No. 1, p. 39.

[338] Stereotypes create a self-fulfilling prophecy. Persons having stereotypes in their mind will expect behaviour that is in accord with the stereotype from others and will act in a way that is intended to counter the expected stereotyped behaviour. This leads the other persons to act in lines of the stereotype. In this way the stereotype is confirmed by the actions of the person who has stereotypical views. An example is given by Fine that seeing a black person triggers the stereotype of aggressive, hostile black. In line with this stereotype the person (the research found no difference of his colour) seeing a black person starts behaving aggressively which provokes the aggressive behaviour of the black person. Thus, the stereotype is confirmed (although mistakenly). FINE, C. *A Mind of Its Own: How Your Brain Distorts and Deceives*. New York: W. W. Norton & Company, 2006, p. 184-185.

[339] GHOSHAL, S.; MORAN, P. Bad for Practice: A Critique of the Transaction Cost Theory. *The Academy of Management Review*, 1996, Vol. 21, No. 1, p. 38.

to act to the detriment of the creditors (as the liability is limited to the amount they paid for the shares). However, law provides various regulatory and contractual mechanisms to avoid such situations. If it were not assumed that limited liability might create problems, law would not be able to base various legal remedies (for example, piercing of corporate veil doctrine) on any acceptable grounds. Another example is that just because criminal law assumes criminal liability for acts against human life it does not make everyone a killer. The author is of a position that theories are created to anticipate possible human behaviour and to provide insights into why and when such behaviour might occur. As Ghoshal and Moran themselves recognize opportunistic behaviour inside the firm is possible and cannot be neglected[340]. Thus, by assuming the opportunistic behaviour and self-interested nature of man agency theory is aimed at identifying situations of such behaviour and providing theoretical grounds for legal intervention to regulate relations between concerned parties. It should be agreed that negative stereotypes and unwanted automatic prejudices should be countered especially when research shows that they can be effectively suppressed by conscious effort[341].

Overall, there are no complete theories of the firm (including agency theory) that would actually reflect the reality and real life situations. However, certain theories are useful in explaining certain things, while other theories are good at coping with other problems. In the author's opinion, agency theory is the best theory that explains what happens inside the firm and what kind of relations exist between different corporate constituents. These are the reasons why from the lawyer's point of view it is necessary to rely on agency theory before proposing new legal tools that would mitigate negative consequences of the agency problems.

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[340] *Ibid*, p. 38.

[341] FINE, C. *A Mind of Its Own: How Your Brain Distorts and Deceives*. New York: W. W. Norton & Company, 2006, p. 199-200.

2.2.3.5. The need for agency theory

The question at this point is whether company law should recognise the possible reality that exists in the companies (conflicts of interests among various corporate constituents) or should it continue to exist in a closed off fictional world where there are no identifiable problems amongst different constituents of the company. From the perspective of the author, company law alone is incapable of identifying and explaining problems that lie in the social and legal relations among corporate constituents. To illustrate this point, law treats all shareholders equally. It follows that all shareholders should have equal voting rights (proportional to their invested capital) and should be able to exercise their rights in such a way that would best reflect their interests. There are no obligations or other fiduciary duties amongst the shareholders that would require them taking into account interests of their fellow shareholders and voting in such a way that would be in the long term beneficial for all the shareholders as a class[342]. Thus, company law theory does not presume that there might be conflicts of interest amongst shareholders. In order to go beyond such legal reasoning and to understand different relationships between various corporate constituents other sciences should be also considered. Thus, in order to identify agency problems and offer legal solutions to mitigate negative consequences of these problems company lawyers have to embrace agency theory.

2.2.4. Other theories of the firm

Besides the streamline theories presented above there are other theories of the firm that either contradict the discussed theories or introduce a different perspective. For the sake of objectivity (at least to the level that it can be

[342] For example, in one of the UK cases it was stated that '[t]he shareholders are not trustees for one another, and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties. They vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage'. High Court of Australia. Decision dated February 9, 1939. *Peters' American Delicacy Co Ltd v Heath*, *Commonwealth Law Reports*, 1939, Vol. 61, p. 504. THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 66.

achieved) a number of other theories of the firm are introduced below, albeit very briefly.

2.2.4.1. Managerialism

During the late nineteenth century and up to the middle of twentieth century the managers of the company were considered to be the dominant power[343]. The enormous growth of companies and ever increasing number of shareholders made it natural for one power (the one with most experience and day to day control) to take over. Studies at that time had shown that managers had enormous power over the company with the ability to influence the composition and structure of management board (board of directors)[344]. This lead to an outcome that is similar to the one promulgated by the legal organic theory of the company – companies became distinct creatures from their shareholders with their own existence. This allowed managers to pursue their own goals which were 'not only different from those of shareholders but can also be antagonistic to them'[345]. Thus, this theory stressed the influence of the managers against the one of shareholders. According to the managerialists, accountability structures of management were not necessary as the primarily function of the management was to manage the company neutrally and impartially weighing interests of all the corporate constituents of the company[346]. However, management board in itself is one of the corporate constituents and it has its own interests and agenda (which manifests from the personal interests of the members of the management board). Thus, the

[343] In order to emphasize and exaggerate this fact during the railroad constructions in the nineteenth century USA a governor of California, Newton Booth, stated that 'every tie in the road is the grave of a small stockholder'. See: CRAXE, L. E. (ed.) *Newton Booth of California: His Speeches and Addresses*, 1894 [interactive]. [Accessed 2012-06-19] Available online at: <http://archive.org/details/newtonboothofcal00boot>, p. 160.

[344] MACE, M. L. Directors: Myth and Reality – Ten Years Later. *Rutgers Law Review*, 1979, Vol. 32, No. 2, p. 293-308.

[345] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 28.

[346] DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 361.

management cannot be considered as an impartial party in the complex internal company relations. Due to these reasons the managerialist theories lost their influence by 1970s[347].

2.2.4.2. Stakeholder theory

Though the intellectual linage of the stakeholder theory can be traced back to famous debate between Berle[348] and Dodd[349], the development of this theory is usually attributed to Freeman[350] who argued that the ever increasing number of stakeholder groups requires a new approach to the 'traditional picture of the firm'[351]. This theory (and there are numerous variations of it) views the firm not as a vehicle for furthering the private agenda of shareholders but as a larger construct that influences a large number of groups of parties. Due to this reason the main claim is that firm should be managed not only for the benefit of shareholders, but also for employees, creditors, managers, partners, customers, bankers, local community, environment and the state[352]. Companies (and the management body) in this regard own duties and are responsible to all the stakeholders and not only to shareholders. Thus, this theory argues against the influence of the shareholders (as owners and as residual claimants) over the company[353].

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[347] DIGNAM, A.; GALANIS, M. *The Globalization of Corporate Governance*. Farnham: Ashgate Publishing Limited, 2009, p. 29.

[348] BERLE, A. A. For Whom Corporate Managers Are Trustees: A Note. *Harvard Law Review*, 1932, Vol. 45, No. 8, p. 1365-1372.

[349] DODD, E. M. For Whom Are Corporate Managers Trustees? *Harvard Law Review*, 1932, Vol. 45, No. 7, p. 1145-1163.

[350] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 9.

[351] FREEMAN, R. E. *Strategic Management: A Stakeholder Approach*. Marshfield: Pitman Publishing Inc., 1984, p. 24.

[352] TRICKER, B. *Corporate Governance: Principles, Policies and Practices. 2nd edition*. Oxford: Oxford University Press, 2012, p. 70.

[353] BLAIR, M. M. Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 181-184.

There has been a lot of criticism on the stakeholder theory and it has sometimes been viewed as a more utopian approach to the problem existing in large companies[354]. It has been also argued that by pursuing the shareholder value the interests of all the stakeholders are automatically taken into account as otherwise the value for the shareholders could not be increased[355]. Furthermore, it has been stated that agents cannot be accountable to multiple principals as they would be allowed to use too wide discretion[356].

2.2.4.3. Stewardship theory

Under the hypothesis of stewardship theory the assumption provided by agency theory that the agent is always self-interested and rationally maximizing his own economic gain, and thus there is an inherent conflict of interests between the agent and principal, is unfounded[357]. The theory claims that agents (stewards as they are named under this theory) should be trusted as they are not likely to depart from the interests of the principal[358]. In the words of stewardship theorists 'a steward protects and maximizes shareholders' wealth through firm performance, because, by so doing, the steward's utility functions are maximized'[359]. This means that if the agent is always acting for the benefit of the principal there is no need to monitor the agent and as a consequence the agency costs do not arise. Nevertheless, this theory still reflects the basic ideas

[354] FARRAR, J. H. *Corporate Governance: Theories, Principles and Practice*. 2nd edition. Oxford: Oxford University Press, 2005, p. 20.

[355] SUNDARAM, A. K.; INKPEN, A. The Corporate Objective Revisited. *Organization Science*, 2004, Vol. 15, No. 3, p. 350-363.

[356] For an answer to all these criticisms see: FREEMAN, R. E.; WICKS, A. C.; PARMAR, B. Stakeholder Theory and "The Corporate Objective Revisited". *Organization Science*, 2004, Vol. 15, No. 3, p. 364-369.

[357] CLARKE, T. Introduction: Theories of Governance – Reconceptualizing Corporate Governance Theory After the Enron Experience. In CLARKE, T. (ed.) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*. New York: Routledge, 2004, p. 8-9.

[358] The whole theory rests on psychological and behavioural arguments. See: DAVIS, J. H.; SCHOORMAN, F. D.; DONALDSON, L. Toward a Stewardship Theory of Management. *The Academy of Management Review*, 1997, Vol. 22, No. 1, p. 37.

[359] DAVIS, J. H.; SCHOORMAN, F. D.; DONALDSON, L. Toward a Stewardship Theory of Management. *The Academy of Management Review*, 1997, Vol. 22, No. 1, p. 24-25.

of agency theory. For example, that agent has a duty to act for the benefit of the principal (for example, shareholders) and interests of all other constituents might be considered only as secondary[360].

Stewardship theory has been received with varying opinions. Some legal researchers view stewardship theory as central to company law[361], but, according to Williamson, it is only convenient to presume that economic agents will fulfil all their promises stipulated in the contract, but due to existing opportunism stewardship behaviour is less likely[362]. The author consents with the later opinion as it is very appealing to believe that agents are always acting solely in the interest of the principals. However, recurring corporate scandals suggest otherwise and conflicts of interest amongst principals and agents are a proven phenomenon.

2.2.4.4. Trusteeship theory

The supporters of the trusteeship theory claim that the assets of the firm are neither legally, nor in any other sense owned by some other party than the firm itself[363]. According to trusteeship theorists, the problems identified by the transaction cost or agency theories are circumvented as the managers control the assets of the company in trust[364]. Thus, only the interests of the company are important and neither shareholders, nor other stakeholders are in position to monitor the management board, which is also not accountable to any of the

[360] TRICKER, B. *Corporate Governance: Principles, Policies and Practices. 2nd edition*. Oxford: Oxford University Press, 2012, p. 65.

[361] TRICKER, B. Re-inventing the Limited Liability Company. *Corporate Governance: An International Review*, 2011, Vol. 19, No. 4, p. 385.

[362] WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 140.

[363] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 13.

[364] Learmount provides for a detailed analysis of trust and its influence on the theories of the firm. *Ibid*, p. 14-17.

corporate constituents[365]. This also means that conflicts of interest between different corporate constituents cannot arise.

However, the above provided view of the firm circles around potential problems existing within the internal relations between different corporate constituents. It could even be stated that trusteeship theory ignores the relations between shareholders and management body and between minority and majority shareholders and presumes them to be non-existent. Trusteeship theory eliminates all the corporate players from the relations except for the company and management board[366]. The author believes that company law requires economic theories of the firm in order to explain the relationships between different corporate constituents and to justify legal regulation of such relations. Trusteeship theory in this regard fails to achieve these goals and does not provide sufficient arguments regarding the relations existing within the firm. Therefore, trusteeship theory is partly consistent with the company law perspective (that management board is the agent (or a trustee)) of the company but lacks insights into how potential conflicts of interest could be identified and solved.

2.3. Chapter conclusions

Both law and economics provide insights and explanations for the existence of the company (firm). Legal theories are more focused on the nature and origins of the company and especially they are concerned with the involvement of the state as opposed to the natural existence of the company through the will of incorporators. Economic theories of the firm, on the other hand, address

[365] *Ibid*, p. 13.

[366] This approach is probably adopted from the company law where management body is considered to be the agent of the company (according to legal agency regulation). However, modern company laws tend to expressly convey that management board has to act not only according to the interests of the company. For example, both Lithuanian and the UK company laws emphasize the significance of the shareholders. See: Article 172(1) of the CA 2006; Article 19(8) of the ABI.

questions such as why firms emerge, focus more on the internal organization of the company and try to improve efficiency of the firm.

Brief analysis of the legal theories has revealed that they fail to explain the relations between various corporate constituents active within the firm. They do not answer why there are shareholders who have residual claims, why companies are managed by professional managers and whether interests of different corporate constituents are aligned. Thus, in order to answer these questions, to better understand the internal organization of the company and even to justify possible need for regulatory intervention economic theories of the firm have to be relied upon.

Although none of the discussed theories provide a model that would completely reflect real life companies and situations[367], in the author's view, agency theory is the most useful in analysing relations between different corporate constituents. First, agency theory provides clear insights into internal relations of corporate constituents that are termed the agent and the principal. Secondly, it does not use legal terminology and avoids certain fictional presumptions that assert that possible problems are non-existent. Thirdly, it presumes that during principal-agent relations agency costs arise, and thus possible legislative intervention in order to minimize such costs is justifiable. Fourthly, it captures not only the manager-shareholder relations, but also relationships between majority and minority shareholders, where minority shareholders are considered to be principal and the majority is treated as their agent. Fifthly, it is the most widely used and accepted theory in the world of corporate governance and company law[368]. Thus, it is understood among different company law scholars throughout the world and it allows for a better and more coherent formulation of ideas. As the aim of this dissertation is to analyse shareholders' agreements as a legal tool that enables better regulation of internal relations between different corporate players, agency theory

[367] HART, O. An Economist's Perspective on the Theory of the Firm. *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1757.

[368] See Part I, Chapter 2.2.3.

provides to be the most useful analytical tool as it exposes the flaws existing within the internal relations of the company.

Chapter 3. Corporate Governance and the Role of Shareholders

3.1. Separation of ownership and control

One of the greatest works (in sense of insights provided[369]), that has been fuelling discussions and research in the field of company law ever since, has been published in 1932 by Berle and Means (a lawyer and an economist)[370]. The main idea provided in *The Modern Corporation and Private Property* is that corporate form has evolved from one man owner-manager companies (where control and ownership functions were concentrated in the same hands) into companies with wealth aggregated from numerous shareholders, who in turn have surrendered their control to a group of managers[371]. Thus, the owners of the companies (after making their investments) are essentially separated from the control function of the company[372]. A highly dispersed ownership structure where no individual holds a majority stake in the company weakens the role and power of shareholders, and exercise of control over the management body (and subsequently over the company) becomes harder. In addition, the role of active shareholder has changed into a passive one who is 'powerless through his own efforts to affect the underlying property'[373]. At the

[369] Although the idea has been there for a longer time. See: SMITH, A. *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776. Reprinted edition. Cambridge: The Electric Book Company, 1998, p. 990.

[370] BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932.

[371] BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 2.

[372] Berle and Means analysed 200 large US companies and found out that 44 % of them are controlled by the management. See: BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 69-70, 115.

[373] BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 66.

same time the decision-making power and discretion of the management body has increased[374]. Due to these reasons the separation of ownership from control gives rise to inherent conflicts of interest between the shareholders and management body of the company[375]. As it was discussed above, this is one of the most important premises for agency theory.

There are good reasons for the separation of ownership and control to occur. On the one hand, people who have surplus wealth can employ it to create more economic value for themselves (for example, they can own a comparatively small share of a huge listed company without owning the whole company). On the other hand, people who do not have capital, but have extensive knowledge on how to manage it, can manage the wealth provided by the investors (for example, they can be employed as managers in listed companies). From the viewpoint of economics, there is a supply of capital from likely investors and demand of capital from likely managers. From the other side of the coin, there is a supply of management knowledge from likely managers and a demand of management knowledge from the likely shareholders. When the mentioned supply and demand meet in the market, a company is created[376]. The downside of the separation of ownership and control, as it was mentioned above, in companies with highly dispersed ownership structure is that the shareholdings are widely scattered and shareholders do not have good reasons to monitor the management, and thus they are sometimes considered to be ignorant and passive[377].

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374 Berle and Means argue that shareholders surrender their power to control companies for higher liquidity of shares. See: BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 67.

375 BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 6. Conflicts of interest are unlikely to occur in situations where ownership and management functions are vested in the same person.

376 VARIAN, H. R. *Intermediate Microeconomics: A Modern Approach. 8th edition*. New York: W. W. Norton & Company Inc., 2010, p. 3-7.

377 EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 11.

Although the inquiry and insights provided by Berle and Means were very useful for furthering company law research, later empirical studies revealed that separation of ownership and control (as between shareholders and management of the company) mainly exists in common law countries, while continental Europe follows a different path. Thus, different ownership structures exist in different states.

3.1.1. Differences in ownership structures

Empirical research regarding ownership structures in continental Europe carried out at the turn of this millennia revealed that, contrary to the Berle and Means hypothesis, large companies outside common law systems do not exhibit the separation of ownership and control feature (or the separation of ownership and control is not that severe). However, they have another characteristic – ownership tends to be highly concentrated.

It took some time for the European company law researchers to catch up with their US colleagues on this topic. In 1999 there was a study made which analysed ownership structures of 20 largest listed companies in each of selected jurisdictions (including European states)[378]. This study revealed that continental European countries tend to have more concentrated ownership structure where power is usually held in the hands of large families. This was the case for Belgium where ownership patterns tended to be highly concentrated. While a different situation existed in the UK, where, similarly to the US, shareholders were found to be widely dispersed and rarely did they have controlling block of shares[379]. Another study was published in 2001 and was focused only on the European countries and introduced ownership data for 1995[380]. It confirmed the results from previous studies about different patterns

[378] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A. Corporate Ownership Around the World. *The Journal of Finance*, 1999, Vol. 54, No. 2, p. 471-517.

[379] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A. Corporate Ownership Around the World. *The Journal of Finance*, 1999, Vol. 54, No. 2, p. 492-495.

[380] BARCA, F; BECHT, M. (eds.) *The control of corporate Europe*. Oxford: Oxford University Press, 2001.

of ownership in common and civil law jurisdictions. According to this study, the median voting block of largest shareholder in Belgium was 56 % and in the UK – 9,9 %[381]. A more recent study on ownership structure in European countries compared the data available from 1999 with new data set from 2007[382]. Some interesting conclusions were made regarding the ownership trends in Europe. It was established that ownership concentration is slightly decreasing in Belgium, while at the same time it is increasing in the UK[383]. However, due to slight changes in ownership patterns the classification of countries did not change and Belgium still remained as a highly concentrated jurisdiction, while the UK was considered as widely dispersed.

From the author's point of view, different ownership patterns in common law and continental European countries are important for the research in this dissertation as there might be a correlation between the number of shareholders' agreements (this would show that shareholders are active in participating in control of the company) and the ownership structure in particular jurisdiction (together with the size of contracting shareholders). This question is addressed when analysing and interpreting empirical results below[384].

3.1.2. Ownership structure in Lithuania

The author is not aware of any academic works that would analyse ownership structure in Lithuania. Considering the availability of such data about Belgium and the UK, the author has carried out empirical survey of largest shareholders in Lithuanian listed companies in order to determine whether Lithuania follows

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[381] BECHT, M.; MAYER, C. Introduction. In BARCA, F; BECHT, M. (eds.) *The control of corporate Europe*. Oxford: Oxford University Press, 2001, p. 19.

[382] VAN DER ELST, Ch. Shareholder Mobility in Five European Countries. *ECGI – Law Working Paper No. 104/2008*, 2008 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=1123108>.

[383] VAN DER ELST, Ch. Shareholder Mobility in Five European Countries. *ECGI – Law Working Paper No. 104/2008*, 2008 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=1123108>, p. 23.

[384] See Part III, Chapter 2.1.2.

the path of dispersed or concentrated ownership structure[385]. Detailed analysis of the research is provided in Annex 4.

At this point it is enough to state that following the trend of continental Europe shareholding structure in Lithuania is highly concentrated. From analysed 33 listed companies (all companies that have been listed on the NASDAQ OMX Vilnius stock exchange at the time of research) 30 had a single controlling shareholder (together with persons acting in concert, if any) holding at least 30 % of voting rights and in 25 companies such shareholder held more than 50 %. The median voting block of the largest shareholder (together with persons acting in concert, if any) was found to be 59,86 %. These facts clearly point out that ownership is highly concentrated amongst the Lithuanian companies and is similar to the one in Belgium. This data will be used below while discussing the impact of ownership structures on the number of shareholders' agreements in each of the jurisdictions.

3.1.3. Differences in shareholder protection

The debates on differing ownership structures also inspired research to be carried out in order to find out what influences different shareholding patterns. Seminal works by La Porta, Lopez-de-Silanes, Shleifer and Vishny[386] provided empirical evidences and claimed that shareholder protection differs greatly throughout different legal families (classification of national legal systems). They established that French civil law countries (this includes Belgium) offer low legal protection and enforcement of shareholder rights[387]. On the other hand, they showed that common law countries (including the UK) have a high

[385] This data is also available in LAURAITYTE, E.; MILIAUSKAS, P. Sustainable Companies under the Lithuanian Company Law, *University of Oslo Faculty of Law Research Paper No. 2013-10*, 2013 [interactive]. [Accessed on 2013-07-02] Available online at: <http://ssrn.com/abstract=2248591>.

[386] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A.; VISHNY, R. Law and Finance. *The Journal of Political Economy*, 1998, Vol. 106, No. 6., p. 1113-1155; LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A.; VISHNY, R. Legal Determinants of External Finance. *The Journal of Finance*, 1997, Vol. 52, No. 3, p. 1131-1150.

[387] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A.; VISHNY, R. Law and Finance. *The Journal of Political Economy*, 1998, Vol. 106, No. 6, p. 1129, 1141.

standard of shareholder protection and the enforcement of rights is average[388]. Their conclusion was that poor shareholder protection might result in high ownership concentration as the lack of rights might be compensated by higher levels of control[389]. In addition, weak shareholder protection might result in smaller equity markets (including stock exchanges)[390].

It should be mentioned that the studies mentioned above have been identified to contain a number of weaknesses[391]: they used a very limited number of variables[392], the selection of shareholder rights for the study was *ad hoc* selected, and thus biased, and the variables were too broad and vague. Lele and Siems subsequently analysed five jurisdictions (including the UK) and concluded that there are no substantial differences between countries belonging to civil and common legal families[393]. Van der Elst has been building upon this research and included Belgium in the list of countries[394]. He argued that Belgium has significantly increased the level of protections for shareholders and that the blocks of large shareholders in Belgium decreased (according to his compiled total investor protection index Belgium is just slightly behind the UK)[395]. Van der Elst concluded that available data does not show that

[388] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A.; VISHNY, R. Law and Finance. *The Journal of Political Economy*, 1998, Vol. 106, No. 6, p. 1129, 1141.

[389] This concentration, in author's view, could also result from control enhancing mechanisms that shareholders use (for example, shareholders' agreements).

[390] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A.; VISHNY, R. Law and Finance. *The Journal of Political Economy*, 1998, Vol. 106, No. 6, p. 1137, 1141-1142.

[391] ARMOUR, J. *et al*. Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis. *Journal of Empirical Legal Studies*, 2009, Vol. 6, No. 2, p. 348-351; LELE, P. P.; SIEMS, M. M. Shareholder protection: A leximetric approach. *Journal of Corporate Law Studies*, 2007, Vol. 7, No. 1, p. 19-21.

[392] Although interesting to note that due to high number of jurisdiction analysed the authors who criticise low number of variables as use only ten of them. See: SIEMS, M. M. Shareholder protection around the world (Leximetric II). *Delaware Journal of Corporate Law*, 2008, Vol. 33, No. 1, p. 116-120.

[393] LELE, P. P.; SIEMS, M. M. Shareholder protection: A leximetric approach. *Journal of Corporate Law Studies*, 2007, Vol. 7, No. 1, p. 43-44.

[394] VAN DER ELST, Ch. The Influence of Shareholder Rights on Shareholder Behavior. *La Revue Trimestrielle de Droit Financier*, 2010, No. 1, p. 1-13.

[395] VAN DER ELST, Ch. The Influence of Shareholder Rights on Shareholder Behavior. *La Revue Trimestrielle de Droit Financier*, 2010, No. 1, p. 9-10.

shareholder protection is directly linked with the ownership structures of the companies and the size of the equity markets[396]. It is interesting to note that Van der Elst also proposed that if there is a lack of strong shareholder protection, minority shareholders might want to increase their voting power in order to counterbalance the position of controlling shareholder[397]. The author believes that shareholders' agreements could be used to achieve this goal and empirical research provided in this dissertation might reveal if minority shareholders are actually using contractual means to strengthen their position in the company.

The findings described above are important for present research as shareholders' agreements could also function as control enhancing mechanism and might reflect some insights on the shareholder protection in the analysed jurisdictions. To put it differently, the number of shareholders' agreements might be considered to depend on the actual protection and rights available to shareholders in a particular jurisdiction as well as on the development of equity markets (if it would be presumed that La Porta *et al*. hypothesis is true).

3.2. Three agency problems

The phenomenon of separation of ownership and control discussed above was one of the cornerstones for the development of agency theory[398]. Initially, the main focus of the research was on the relations between the management body of the company and the shareholders. This was identified as the first agency problem because shareholders parted with their capital and delegated control to

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[396] Other studies also concluded that that due to convergence between common and civil law systems there is no longer a link between the level of protection of shareholders and stock market development. See: ARMOUR, J. *et al*. Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis. *Journal of Empirical Legal Studies*, 2009, Vol. 6, No. 2, p. 372-373.

[397] VAN DER ELST, Ch. Shareholder Rights and the Importance of Foreign Shareholders. *Tilburg Law School Research Paper*, 2010, No. 007/2010 [interactive]. [Accessed on 2012-08-03] Available online at: <http://ssrn.com/abstract=1553091>, p. 4.

[398] SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. *The Journal of Finance*, Vol. 52, No. 2, 1997, p. 740.

the professional members of the management body. Subsequently, the research has shown that not all the countries were following the common law path and the ownerships structures are different in continental Europe. It became evident that there are situations when the agency problem manifests itself between the majority and minority shareholders. The third agency problem emerged later and stressed that conflicts of interest exist between the shareholders as a class and other stakeholders[399]. All of the above agency problems stem from the relations of principal and agent as it is presumed that agent will not always act for the interests of the principal. Each of the agency problems is analysed in more detail below.

The first agency problem occurs between shareholders and the management body of the company. In terms of agency theory, shareholders are considered to be the principals while the managers acting through a centralized management with a board structure are the agents of the shareholders[400]. Thus, shareholders have the most dominant and influential role in the internal relationships within the company. However, this is not because they are the owners of the shares[401], but because they are the residual claimants[402]. The status of the shareholders as residual claimants enables them to act as monitors of other corporate constituents who have relations with the company. This way (at least theoretically) other parties are controlled and prevented from shirking,

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[399] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 35-36.

[400] ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: the Interests of Shareholders as a Class. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 55-56.

[401] Through the eyes of a lawyer it could be argued that shareholders are the most important corporate constituents because they are the owners of the shares (but not of the company as it is popular to believe). Ownership of the shares entitles shareholders, besides other things, to receive residual claims. In other words, persons who do not own shares cannot be considered as the residual claimants because the essence of the residual claims lies in the rights conferred by the shares.

[402] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 3; ALCHIAN, A. A.; DEMSETZ, H. Production, Information Costs, and Economic Organization. *The American Economic Review*, 1972, Vol. 62, No. 5, p. 794.

and thus shareholders are entitled to the profit for good monitoring or are penalized with loss if monitoring does not prevent other constituents from shirking[403]. Therefore, the shareholders are regarded as principals and the members of the management body – their agents. It should be emphasized that, unlike in legal agency relations, the agent does not have to act for the benefit of the company, as a separate legal person.

In a standard case scenario, where the ownership structure of the company is dispersed, each shareholder has a very small stake in the capital of the company. This means that managers are *de facto* controlling information about the company (how the company is run) and can use this information against the interests of the shareholders[404]. The possibility for the members of the management board to act and operate the company for their own interests was quickly recognized by the scholars after agency theory had been introduced[405]. As already observed by Berle and Means '[t]he separation of ownership from control produces a condition where the interests of owner and ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear'[406]. These conditions presuppose that shareholders (as principals) are not capable of protecting their own interests without the interference from external forces (including law), and the agents are more likely to prefer their own interests over the interests of the shareholders.

The second agency problem arises in companies that do not have highly dispersed ownership structure but, on the contrary, have one or few shareholders that hold a majority block of shares and can substantially

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[403] LEARMOUNT, S. Theorizing corporate governance: new organizational alternatives. *ESRC Centre for Business Research University of Cambridge, Working paper No. 237*, 2002 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www.cbr.cam.ac.uk/pdf/WP237.pdf>, p. 3.

[404] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 1.

[405] WILLIAMSON, O. Corporate Governance. *The Yale Law Journal*, 1983-1984, Vol. 93, No. 7, p. 1199.

[406] BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 6.

influence the control of the company (including the members of the management body)[407]. Thus, the concentration of ownership enables majority shareholders to put an end to the largely unchecked behaviour of the management. Although this ends the shareholder-manager agency problem, it creates another type of the same problem – majority shareholders become agents and minority shareholders principals[408].

The control over the company enables majority shareholders to extract extra benefits from the company which otherwise would be unavailable. The so called private benefits of control[409] (and the fact that majority shareholders can disregard minority shareholders in decision making) motivate majority shareholders to act in way that might be detrimental to the minority shareholders[410]. Because minority shareholders are regarded as a weaker party[411], various mechanisms (including legal) are employed to protect their rights and interests. Under such considerations, agency theory implies that the agent (majority shareholder) has to take into account the interests of the principal (minority shareholder). However, as the opportunistic behaviour of the agent is presumed, certain tools have to be devised either to empower minority shareholders[412] or to prevent majority shareholders from gaining possible disproportionate returns at the expense of minority shareholders.

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[407] ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 89.

[408] MORCK, R.; WOLFENZON, D.; YEUNG, B. Corporate Governance, Economic Entrenchment, and Growth. *Journal of Economic Literature*, 2005, Vol. 43, No. 3, p. 655-720.

[409] DYCK, A.; ZINGALES, L. Private Benefits of Control: An International Comparison. *The Journal of Finance*, 2004, Vol. LIX, No. 2, p. 537-600.

[410] ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 107-110.

[411] The importance of protection of interests of the minority shareholders is recognized not only by legal scholars, but also by practitioners who see it as one of the most important duties of the board of directors. See: GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 185-186.

[412] There has been a lot of attention on the level of the EU on the empowerment of shareholders. See: Part 1, Chapter 5.

The third agency problem involves 'the conflict between the firm itself – including, particularly, its owners – and the other parties with whom the firm contracts, such as creditors, employees, and customers'[413]. The scope of this agency problem is broader but the underlying principles are the same. Company (with emphasis on the shareholders) is considered to be the agent and various other stakeholders (excluding shareholders) are presumed to be the principals. This agency problem is closely related to the stakeholder theory as it presupposes that the company (or shareholders as a class) has a duty to take into account interests of various corporate constituents associated with the company.

This dissertation is aimed at dealing with the first two agency problems, and therefore the third agency problem is out of the scope of this dissertation. Shareholders' agreements can be used both to strengthen the position of the shareholders against the management body in order to deal with the first agency problem and to empower minority shareholders against the majority shareholder in order to deal with the second agency problem.

3.3. The chicken or the egg debate[414]

Should the companies be managed for the interests of the shareholders or the stakeholders? If companies are managed only for the interests of the stakeholders (disregarding the interests of the shareholders[415]), the shareholders

[413] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 36.

[414] This chapter is named after a famous infinite regress paradox about which came first: the chicken or the egg? The chicken comes from the egg, but the egg comes from the chicken. Which came first? For an illustration of the chicken and the egg paradox see: GARDNER, M. *aha! Gotcha: Paradoxes to puzzle and delight*. New York: W. H. Freeman and Company, 1982, p. 10. For a definition of regress see: RESCHER, N. *Infinite regress: the theory and history of varieties of change*. New Brunswick: Transaction Publishers, 2010, p. 7-18. The main idea here is that there might be no definite answer to this question.

[415] It should be noted that shareholders are also part of stakeholders. However, if the interests of all the stakeholders are taken into account, it is natural that all or part of the interests of the shareholders are neglected. Thus, to make a contrast when stakeholders approach is mentioned it is assumed that

will not invest in new ventures and will not start more companies (as it is against their interests). On the other hand, if companies serve only the interests of the shareholders[416], then the stakeholders (creditors, employees, suppliers, customers and etc.) will stop providing needed labour, necessary supplies and even stop buying the goods or services all together[417]. In this case the company is certain to perish as well. The question then is whose interests should the company serve? Interests of the shareholders? But the company will not be able to function, if the stakeholders are dissatisfied. This means that the company has to satisfy the interests of the stakeholders. But the company will cease to exist as the disinterested shareholders will start the winding up or liquidation procedures. Then the company has to satisfy the interests of the shareholders. But the company will not be able to function, if the stakeholders… Thus, a debate whether the interests of shareholders or stakeholders have to prevail might create an infinite regress dilemma[418]. In other words, it is unfruitful to try and answer this question with only black and white answers. As this dissertation is not aimed at addressing the shareholders versus stakeholders debate in detail, only a brief introduction will be given below.

The shareholder wealth maximization (or shareholder primacy) approach stipulates that the best interests of the company are advanced when

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interests of the shareholders are either neglected or the interests of other stakeholders are preferred over the interests of shareholders.

[416] The idea that shareholders are the ultimate beneficiaries and that companies should be managed for their interests is not new. It has been expressed by Berle and Means in their seminal work in 1932. 'All powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears'. See: BERLE, A. A.; MEANS, G. C. *The Modern Corporation and Private Property*. New York: The Macmillan Company, 1932, p. 248.

[417] For a basic illustration on how the company is managed and functions see: BLAIR, M. M. *Ownership and control: rethinking corporate governance for the twenty-first century*. Washington: The Brookings institution, 1995, p. 21-22.

[418] It has to be admitted that this dilemma was created superficially in order to emphasize that a strict and radical division between the satisfaction of interests of the shareholders or stakeholders yields negative results.

only the interests of the shareholders are taken into account[419]. 'Under shareholder primacy in its strongest form, attention to non-shareholders, corporate philanthropy, or any other socially responsible activity that is profit-reducing is generally impermissible, because such activities necessarily impair the company's ability to achieve maximum shareholder profits'[420]. This view clearly puts the interests of the shareholders[421] above the interests of any other constituent active in the relations with the company[422].

The contradictory model propagating the stakeholder view argues that in the process of management of corporation not only interests of the shareholders, but also interests of all other parties dealing with the company have to be included (employees, creditors, customers, etc.). Although there are different variations of stakeholder approach they can be clustered into two different groups[423]. The first group argues that the stakeholder approach should be implemented at the fiduciary level and members of the management body should be able to make their decisions for the benefit of the company instead of primarily focusing on shareholders' interests[424]. The second group promulgates that the management or supervisory body should consist of members who

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[419] For an intellectual genesis of the shareholder value model see: AGLIETTA, M. REBERIOUX, A. *Corporate Governance Adrift: A Critique of Shareholder Value*. Northampton: Edward Elgar Publishing, 2005, p. 23-32.

[420] HO, V. H. "Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide. *The Journal of Corporation Law*, 2010, Vol. 36, No. 1, p. 73.

[421] But this might not always be the case. An interesting argument against a blind maximization of shareholder value could be made in case the ownerships structure is largely diversified. An investor who has a small stake in a lot of companies is considered to be investing in the economy as a whole and is generally interested in not only private corporate governance rules (related only to one specific company) but also with social rules that have a possibility to maximize value of all the companies, in which he has a stake, put together. A strict application of shareholder value maximization model could cause an increase in the value of one company at the higher cost of the value of other companies. In other words, the investor (and a shareholder) of a number of companies could be actually worse of if the strict shareholder value maximization model is used in the strategy of the company.

[422] STOUT, L. A. Bad and Not-so-bad Arguments for Shareholder Primacy. *Southern California Law Review*, 2002, Vol. 75, No. 5, p. 1189-1209.

[423] HANSMANN, H.; KRAAKMAN, R. End of History for Corporate Law. *The Georgetown Law Journal*, 2000, Vol. 89, No. 2, p. 447-448.

[424] BLAIR, M. M.; STOUT, L. A. A Team Production Theory of Corporate Law. *Virginia Law Review*, 1999, Vol. 85, No. 2, p. 247-328.

represent different interests of various groups of stakeholders[425]. Despite of certain differences the overall stakeholder approach advocates interests of more corporate constituents than just shareholders.

It is agreed by most of the legal scholars that neither of the above models is perfect[426]. The shareholder primacy model is centred only on the interests of shareholders and neglects the interests of other constituents. On the other hand, the stakeholders approach is too broad and contains a risk that companies might be managed to neither the interests of shareholders, nor the company itself[427]. Due to the flaws of the above two theories, a third approach has been developed[428] that includes elements from both the shareholder primacy model and stakeholder approach and is called the enlightened shareholder value model[429]. The enlightened shareholder value model consists of two underlying blocks of ideas[430]: 1) the primary driver is the long term

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[425] SCHMIDT, R. H.; SPINDLER, G. Path Dependence, Corporate Governance and Complementarity. *International Finance*, 2003, Vol. 5, No. 3, p. 323. An argument for the protection of stakeholders' interests viewed from a little bit different angle states that other than shareholders corporate constituents do not need representation on the management body (there is no need for an additional member of the management board for each group of the stakeholders). WILLIAMSON, O. Corporate Governance. *The Yale Law Journal*, 1983-1984, Vol. 93, No. 7, p. 1207-1215. All the stakeholders are in position to protect their interests either directly through market (for example, employees with general purpose skills and knowledge can find employment in other companies) or by using contractual tools to safeguard their position (for example, creditors can put legally binding safeguarding mechanism before concluding a contract). Thus, a strict stakeholder approach is not justified as well as strict shareholder primacy model.

[426] For an in-depth analysis of both approaches including criticism see: KEAY, A. R. *The Enlightened Shareholder Value Principle and Corporate Governance*. New York: Routledge, 2013, p. 14-53.

[427] As Mark Roe has put it: 'a stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own'. ROE, M. J. The Shareholder Wealth Maximization Norm and Industrial Organization. *University of Pennsylvania Law Review*, 2001, Vol. 149, p. 2065.

[428] The enlightened approach to the debate on shareholders versus stakeholders is attributed to Jensen. See: JENSEN, M. C. Value Maximization, Stakeholder Theory, and the Corporate Objective Function. *Journal of Applied Corporate Finance*, 2001, Vol. 14, No. 3, p. 8-21; KEAY, A. R. *The Enlightened Shareholder Value Principle and Corporate Governance*. New York: Routledge, 2013, p. 61-62.

[429] The UK CA 2006 article 172(1) is a clear example of enlightened shareholder value model. For an analysis on the UK see: KEAY, A.; ZHANG, H. An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law. *European Company and Financial Law Review*, 2011, Vol. 8, No. 4, p. 445-475.

[430] JENSEN, M. C. Value Maximization, Stakeholder Theory, and the Corporate Objective Function. *Journal of Applied Corporate Finance*, 2001, Vol. 14, No. 3, p. 16; HO, V. H. "Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide. *The Journal of Corporation Law*, 2010, Vol. 36, No. 1, p. 97-100.

shareholder value as the end goal of the company; 2) this primary driver is constrained with the requirement to consider the financial and non-financial effects of the decisions taken to various groups of non-shareholder constituencies. From these two main features some differences from the shareholder primacy model can be deducted. First, the shareholder primacy model is more concentrated on the short term shareholder value, whilst enhanced shareholder approached recognises only the long term interests of the shareholders. This means that certain decision might be against the short term interests of the shareholders as long as they are in line with long term welfare. Another point is that interests of the stakeholders have to be considered while making corporate decisions. This does not mean that (like in the stakeholder approach) all the interests of the different corporate constituencies have to be taken into account and balanced against each other. However, this entails that if the long term shareholder value could be achieved through satisfaction of certain interests of different stakeholders (and inducing the short term loss for the shareholders), then this is the way that decisions should be made and implemented. Thus, the enlightened shareholder value approach promotes the long term shareholder value as a benchmark to value the interests and performance of the company, while at the same time recognising the interests of other corporate constituents.

Taking into account the arguments provided above, it should be agreed that from a normative perspective every branch of law (including corporate law) should serve the interests of the society as a whole[431]. Therefore, if it would be presumed that company law is to be organized as to serve only the interests of the shareholders (if these interests are understood *sensu stricto*), the conclusion would be that company law serves only the interests of a small group of corporate constituents – shareholders. Thus, the author's views on this debate align with the views offered by the prominent scholars of corporate law

[431] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 28.

– company law should be organized and structured to advance the enlightened shareholder value model[432]. This approach is also upheld by certain international organizations. For example, the OECD principles of Corporate Governance state that '[c]orporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating cooperation among stakeholders. The governance framework should recognise that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation'[433]. The formulation of such an approach suggests that enlightened shareholder value model is supported. Stakeholders are viewed not as an end themselves but as an important partners along the way of enhancing the long-term success of the company[434].

The theoretical stakeholders versus shareholders debate carries over into the practical application of the law through the concept of the 'interests of the company'. As it is stated throughout this dissertation the legal concept of separate corporate personality implies that different corporate constituents interact with each other, as a general rule, through the company and not directly (they do not have direct contractual legal relationships with each other[435]). In terms of the stakeholders versus shareholders debate, this means that the term 'interests of the company' usually manifests in itself either the

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[432] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition.* Oxford: Oxford University Press, 2009, p. 28-29.

[433] Organisation for Economic Co-Operation and Development. OECD Principles of Corporate Governance, 2004 [interactive]. [Accessed on 2012-06-18] Available online at: <http://www.oecd.org/dataoecd/32/18/31557724.pdf>, p. 46.

[434] This approach exists in certain other jurisdictions as well, for example, USA. Although the USA follows and promotes the shareholder primacy model, the New York Stock Exchange has sponsored a commission on corporate governance that has adopted ten core principles. See: New York Stock Exchange Commission on Corporate Governance. Report, 2010 [interactive]. [Accessed on 2012-06-18] Available online at: <http://www.nyse.com/pdfs/CCGReport.pdf>. The first principle emphasizes the need to build long-term sustainable shareholder value. The long-termism and sustainability aspects of the values creation for the shareholders should be viewed as enhanced shareholder value approach.

[435] Although it should be remembered that agency theory presumes that there are direct agent-principal relations between different corporate constituents.

interests of the shareholders or the broad interests of various stakeholders. In other words, different laws dealing with regulation of companies usually do not state directly whether interests of shareholders or stakeholders should be taken into account. Laws usually use the term ‘interests of the company’.

Lithuanian CC stipulates that members of the management board should avoid situation when their personal interests conflict (or there is a potential conflict of interests) with the interests of the company[436]. Lithuanian ABI states that the management board of the company has to act according to the interests of the company and its shareholders[437]. Although from the mentioned provisions of the laws it is hard to conclude whether shareholder or stakeholder approach is dominant in the Republic of Lithuania, the Lithuanian case law recognises that the duties of directors arise to the company (as an entity with separate interests other than that of the majority shareholder)[438] and in some cases these duties arise to third parties, particularly to creditors[439].

Similar provisions exist in the UK and in Belgium. For example, W.Venn. mandates the disclosure of conflicts of interest if the interests of the member of the management board are not aligned with the interests of the company[440]. Moreover, in the Belgian company law theory it is stated that

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[436] Article 2.87(3) of the CC.

[437] Article 19(8) of the ABI.

[438] ‘The company and its management bodies are linked by fiduciary relationships, *id est*, relationships based on mutual trust; therefore, all the management bodies of the company must operate exclusively in the interest of the company. A management body of the company must vote against any decision contrary to the interests of the company. In cases where a member of the management body of the company is also a shareholder of the company, his interests as the shareholder and as the member of the management body of the company may differ. The interests of the company and of its shareholders may also vary. In the event of a conflict of interests, the principles of good faith, fairness and prudence require a member of the management body of the company to notify other management bodies of the company in this regard. However, personal interests, whatever they may be, do not release the member of the management body of the company from his fiduciary duty to act exclusively in the interest of the company’. See: SCL civil case No. 3K-3-383/2000, 2000 March 29, *Vilniaus miesto valdyba v. UAB “Sangreta”, S. J.*

[439] The SCL position is that civil liability of the head of the company may arise both to the company where the head of the company acts contrary to the interests of the company and to third persons where the head of the company violates the restrictions establishing certain guarantees of such persons. See: SCL civil case No. 3K-7-266/2006, 2006 May 25, *K. J. J. v. V. K. et al.*; SCL civil case No. 3K-3-228/2011, 2011 May 5, *uždaroji akcinė bendrovė "Vajalio medienos gaminiai“ v. R. K., N. K.*

[440] Article 523(1) of the W.Venn.

misuse of power exists when 'the power of a representative body or the power of a majority at the general meeting, is being used to sacrifice the interest of the company for private interests which are outside the company structure'[441]. In other words, it means that the interests of the company are valued more than interests of separate groups of corporate constituents. This approach is justified as the stakeholder theory in Belgium is valued more than shareholders' approach[442]. On the other side of the Atlantic Ocean's arm, called the English Channel, Article 175(1) of the UK CA 2006 stipulates that a director of a company must avoid a situation in which he has, or might have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The CA 2006 also states that members of the management board must act in good faith to promote the success of the company for the benefit of its shareholders. But in doing so the management board has to regard, among other things, the consequences of the decisions in the long term, interests of the company's employees and even impact on the community and the environment[443]. The rules stipulated in the CA 2006 reflect the enlightened shareholder value model[444], although the UK upheld the shareholder primacy approach up until the modifications made in the CA 2006[445].

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[441] GEENS, K.; CLOTTENS, C. Corporations and Partnerships. Belgium. In *International Encyclopaedia of Laws*. Hague: Kluwer Law International, 2006, p. 118, para. 224.

[442] At least the doctrinal view in Belgium is that the management board has to serve interests not only of the shareholders of the company but of employees, markets and even public authorities. WYMEERSCH, E. A Status Report on Corporate Governance Rules and Practices in Some Continental European States. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1086.

[443] Article 172(1) of the CA 2006.

[444] Companies Act 2006. Explanatory notes [interactive]. [Accessed on 2012-07-03] Available online at: <http://www.legislation.gov.uk/ukpga/2006/46/notes/contents>, p. 50, para 325. Enhanced shareholder value approach is evident in the Netherlands as well. Under the Dutch Corporate Governance Code the company should be managed 'with a view to ensuring the continuity of the enterprise, while the company endeavours to create long-term shareholder value'. See: Corporate Governance Code Monitoring Committee. Dutch corporate governance code Principles of good corporate governance and best practice provisions, 2008 [interactive]. [Accessed on 2012-06-18] Available online at: >http://www.commissiecorporategovernance.nl/page/downloads/DEC_2008_UK_Code_DEF__uk_.pdf>, p. 6, para 7.

[445] According to the Hampel Report '[t]he single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders' investment'. See: The Committee on Corporate Governance. Final

The above arguments suggest that as the debate over the interests of shareholders versus stakeholders in actual application of laws translates into the interests of the company. Thus, national laws (and case law) of every state play a determining role in establishing whose interests (shareholders', creditors', employees' or general interest) will be considered through the lens of interests of the company[446].

Stakeholders versus shareholders debate is relevant to the analysis of the shareholders' agreement as a contractual tool to mitigate possible conflicts of interest in as much as (as it will be analysed below in this dissertation) shareholders' agreement in certain cases has to be in the interests of the company (otherwise it might infringe rules regulating shareholders' agreements)[447]. Therefore, it is important to understand what is meant by the interests of the company as none of the jurisdictions analysed in this dissertation provide for a clear definition.

3.4. The role of the shareholders

3.4.1. Shareholders as a group and voting rights

The contractarian theory (closely related to the shareholder-primacy approach[448]) currently still dominates the discourse of corporate law[449].

Report, 1998 [interactive]. [Accessed on 2012-07-03] Available online at: <http://www.ecgi.org/codes/documents/hampel.pdf>, p. 11, para 1.16.

[446] For a comparative view on how interests of the company are understood in different European states see: WYMEERSCH, E. A Status Report on Corporate Governance Rules and Practices in Some Continental European States. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1079-1087.

[447] See Part II, Chapters 3.1.2. and 4.1.2.

[448] See Part I, Chapter 3.3.

[449] It should be remarked that contractarian theory (as almost all the theories) has never been an accurate description of reality. However, it serves as a good conceptual starting point for analysis of company law. See: KLAUSNER, M. The Contractarian theory of Corporate Law: A Generation Later, *Journal of Corporation Law*, 2006, Vol. 31, No. 3, p. 781; BRADLEY, M. *et al.* The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads. *Law and Contemporary Problems*, 1999, Vol. 62, No. 3, p. 34. It has been also suggested that '[c]ontractarianism is analogous to Newtonian physics, which no longer claims to be an accurate representation of the laws of physics, but yet provides a simple model that adequately explains a large

According to this theory, which is based primarily on the works of Coase[450], a company (or more broadly a firm) is viewed as a nexus of contracts[451] through which different corporate constituents act and exercise their rights. Scholars supporting the contractarian theory state that corporate laws should provide only a set of default rules that can be changed according to the needs and interests of a particular company and its constituents[452]. The main argument provided by the contractarians is that company does not have a separate legal personality on its own, but is influenced and dependent on shareholders, managers and other corporate constituents, and thus voluntary contracting and market forces should be relied upon in order to align the conflicting interests of different constituents active in the company[453].

From economic perspective (the nexus of contracts theory), shareholders cannot enter into a final contract[454] with the company as the success of the company is not clear at the moment of contract. Shareholders do not have "fixed" claims against the company (like creditors or employees) and are paid last which means that they have a residual claim, *id est*, they get only what is left over[455]. For example, shareholders not only take all the risk for the failure of the company, but their claims for distribution of profit are also satisfied lastly (only if company has profit). Therefore, it is believed that

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and important set of physical phenomena'. See: BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 4.

[450] See Part I, Chapter 2.2.

[451] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure. *Journal of Financial Economics*, Vol. 3, No. 4, 1976, p. 311.

[452] The opposing communitarianism theory favours more stringent and mandatory regulation applicable to different constituents of the company. *See* FORT T. L., SCHIPANI C. A. Corporate Governance in a Global Environment: The Search for the Best of All Worlds, *Vanderbilt Journal of International Law*, 2000, Vol. 33, No. 4, p. 829-879; KLAUSNER, M. The Contractarian theory of Corporate Law: A Generation Later, *Journal of Corporation Law*, 2006, Vol. 31, No. 3, p. 779-797.

[453] BRADLEY, M. *et al*. The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads. *Law and Contemporary Problems*, 1999, Vol. 62, No. 3, p. 34.

[454] The definition of contract in terms of law and economics differs. See Part I, Chapter 3.5. Also see: HART, O. An Economist's Perspective on the Theory of the Firm, *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1764.

[455] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 11.

shareholders have the appropriate incentives and are well suited to maximise the value of the company[456], and thus they have the control rights which are exercised through voting rights attributed to the shares.

Furthermore, shareholders, as suppliers of finance, have a unique relationship with the company. Their whole investment is put at risk once the company is incorporated. At the same time shareholders are considered to be the only voluntary constituency whose relations with the company are not reviewed and renegotiated periodically (unlike the creditors, suppliers and employees)[457]. According to Easterbrook and Fischel, shareholders receive votes in the general meeting of the shareholders rather than explicit promises that debt investors get[458]. This implies that equity investors are paid last (only after the debt investors, employees and all other claimants of the company) and have a residual claim – they are entitled only to what is left over[459].

As investments of the shareholders are not associated with any particular assets of the company (they have only ownership rights of the shares of the company), it is hard for them to protect their interests. For example, the shareholders cannot have collateral on the assets of the company to guarantee their claims arising from the shares. In the words of Williamson 'a governance structure of broad scope [should be] somehow devised'[460] in order to protect the interests of the shareholders. Company law recognises the weak position of the shareholders and grants them voting rights that can be exercised through the general meeting of shareholders. In certain cases shareholders are even given the right to choose the most appropriate governance structure of the

[456] EASTERBROOK, F. H.; FISCHEL, D. R., Voting in Corporate Law, *Journal of Law and Economics*, 1983, Vol. 26, No. 2, p. 403-406.

[457] WILLIAMSON, O. Corporate Governance. *The Yale Law Journal*, 1983-1984, Vol. 93, No. 7, p. 1210.

[458] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 6.

[459] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 10-11.

[460] WILLIAMSON, O. Corporate Governance. *The Yale Law Journal*, 1983-1984, Vol. 93, No. 7, p. 1210.

company[461]. As voting is a central feature of any corporate governance regime[462], shareholders have direct (by voting at the general meeting of the shareholders) or indirect (through the actions and decisions of the appointed members of the management) power over the company. In large publicly listed companies the most essential right of the shareholders is to vote on the appointment and dismissal of the members of the management bodies[463]. In this way shareholders can indirectly control the activities and policy of the company.

The importance of the voting rights of the shareholders is also confirmed by the fact that the most important decisions can only be adopted by the general meeting of the shareholders, for example, the change of the articles of association or approval of major transactions[464]. As Easterbrook and Fischel put it: '[t]he right to vote is the right to make all decisions not otherwise provided by contract'[465] and this right is conferred to the shareholders of the company as they are the only ones with the not complete contracts and residual risks[466].

However, the theoretically granted control rights (voting rights) should not be confused with what is actually happening in practice. The so called 'shareholder democracy' is usually an illusion with most of the important

[461] For example, Lithuanian ABI allows shareholders to choose in the articles of association either one-tier or two-tier structure of the company (article 19(2)).

[462] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 63-72.

[463] ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: the Interests of Shareholders as a Class. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 56-62.

[464] For example, see: Lithuanian ABI, articles 27 and 28.

[465] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 66.

[466] Voting rights follow the residual claims. For example, when the company faces financial difficulties, shareholders lose their incentives as residual claimants which are transferred into the hands of the creditors. See: EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 69.

decisions of the company adopted by the controlling shareholder[467]. Thus, although all the shareholders have voting rights that grant them power to control the company, only the shareholders that have a critical mass of these rights can actually influence the management and policy of the company[468].

In this context, shareholders' agreement could be viewed as a tool that, from one point of view, helps shareholders to acquire that critical mass and, from the other point of view, allows minority shareholders to bargain with the majority shareholders for a better protection of the interests of the former. Although it is argued that concentration of voting power amongst the shareholders of a particular publicly listed company is considered to be unlikely due to presumed high costs of contracting or management entrenchment[469], to the best knowledge of the author, there have been no evidence presented in academic works that shareholders of listed companies do not enter into shareholders' agreements in practice. On the contrary, as the results presented in this dissertation show, shareholders are willing to contract among themselves for various reasons, including concentrating their voting rights in order to have more efficient control over the company.

During the normal operation of business corporate law confers control rights (including voting rights) to shareholders, therefore shareholders' agreement in this context can be understood as facilitating shareholders to exercise their control rights over the company more effectively and to better protect their interests. Shareholders' agreement can enable shareholders to change the default corporate law rules according to their interests and to regulate legal civil relations within the company to suit their needs.

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[467] PACCES, A. M. *Featuring Control Power: Corporate Law and Economics Revisited*. Rotterdam: Rotterdam Institute of Law and Economics, 2007, p. 69.

[468] SHLEIFER, A.; VISHNY, R. W. A Survey of Corporate Governance. *The Journal of Finance*, Vol. 52, No. 2, 1997, p. 764.

[469] PACCES, A. M. *Featuring Control Power: Corporate Law and Economics Revisited*. Rotterdam: Rotterdam Institute of Law and Economics, 2007, p. 73.

The view that shareholders are one of the most important groups who have very significant control rights is reflected in the laws of the jurisdictions analysed in this dissertation[470].

3.4.2. Legal nature of the voting right

The historical foundations of voting rights in Europe and in the USA are quite similar, although their development timeframe is somewhat different[471]. At the start of incorporation boom of new companies in 19th century the standard rule in managing companies was one vote per person (it did not matter how much shares such person held)[472]. Later a graduated voting scale was introduced, which allowed to scale voting rights as the ownership rights in shares increased. At first voting rights were capped at a fixed maximum number[473], but later gradation was permitted without any ceiling[474]. Thus, historically the right to vote was attached to the owner of the shares as a person. Nowadays, voting right is attached not to a person, but to a share. Common law countries are using the so called one share – one vote principle, while member states in the EU have different approaches with a tendency to converge towards one share – one vote[475]. For example, multiple voting shares and non-voting shares

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470 Articles 14-18 of the Lithuanian ABI; WYMEERSCH, E. Belgium. In BAUMS, T.; WYMEERSCH, E. (eds.) *Shareholder voting rights and practices in companies in Europe and the US*. London: Kluwer International, 1999, p. 21-56; DAVIES, P. The United Kingdom. In BAUMS, T.; WYMEERSCH, E. (eds.) *Shareholder voting rights and practices in companies in Europe and the US*. London: Kluwer International, 1999, p. 331-366.

471 DUNLAVY, C. A. Corporate Governance in Late 19th-Century Europe and the U.S. The Case of Shareholder Voting Rights. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 5-39.

472 DUNLAVY, C. A. Corporate Governance in Late 19th-Century Europe and the U.S. The Case of Shareholder Voting Rights. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 12-13.

473 HANSMANN, H.; PARGENDLER, M. *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption*, 2013 [interactive]. [Accessed on 2013-11-23] Available online at: <http://ssrn.com/abstract=2219865>.

474 DUNLAVY, C. A. Corporate Governance in Late 19th-Century Europe and the U.S. The Case of Shareholder Voting Rights. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1729.

475 FERRARINI, G. A. *One Share - One Vote: A European Rule?* 2006 [interactive]. [Accessed on 2013-06-25] Available online at: <http://ssrn.com/abstract=875620>, p. 14-23.

(excluding the preferred shares) are not permitted both in Lithuania and in Belgium, while allowed in the UK (though they are not common in listed companies)[476]. Furthermore, majority of the investors in the EU also perceive deviations from the one share – one vote principle negatively[477]. The movement towards one share – one vote principle is based on the claim that voting power should be matched by the economic incentives (cash flow rights) attributed to the ownership of the share[478]. Legal scholars and economists provide both advantages and disadvantages of such regime[479]. In general, it is agreed that certain types of deviations from one share – one vote rule might not create substantial impediments to economic growth, and thus should be allowed[480].

Following paragraphs will briefly address the concept of voting right under the Lithuanian law. The starting point for analysis is that under article 2.45 of the Lithuanian CC a shareholder is considered a person who has certain duties and obligations towards the company[481]. The share itself, according to article 1.102 of the Lithuanian CC, is a security which grants its owner a right to participate in the management of the company (unless laws provide otherwise). The most important pecuniary duty (and the only one) of shareholders towards the company is to pay for the shares[482]. This entails that the status of a shareholder in a company is gained by contributing capital and investments. All the pecuniary and non-pecuniary shareholder rights are gained

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[476] Report on the proportionality principle, p. 15.

[477] Report on the proportionality principle, p. 96.

[478] KRAAKMAN, R.; BLACK, B. A Self Enforcing Model of Corporate Law. *Harvard Law Review*, vol. 109, 1996, p. 1942-1943.

[479] FERRARINI, G. A. *One Share - One Vote: A European Rule?* 2006 [interactive]. [Accessed on 2013-06-25] Available online at: <http://ssrn.com/abstract=875620>, p. 6-13.

[480] BURKART, M. C.; LEE, S. The One Share - One Vote Debate: A Theoretical Perspective. *ECGI - Finance Working Paper No. 176/2007*, 2007 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=987486>, p. 37-42.

[481] This also includes the duty to act in line with the principles of fairness and reasonableness. MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 119.

[482] Article 14(2) of the Lithuanian ABI.

only after the shares are fully paid up. For example, the right to vote can be exercised only if the shares conferring such right have been paid in full[483]. It can be observed that Lithuanian legislature directly links the right to vote with the duty to contribute money towards capital of the company. Thus, under Lithuanian law shareholder is entitled to vote only if such vote is backed up by monetary contribution (or contribution in kind).

Furthermore, Lithuanian ABI contains a strict one share – one vote requirement. Under article 17(2) all shares of the same nominal value must confer the same amount of voting rights. If there are shares that have different nominal value, then their voting rights are calculated in proportion to the lowest nominal value shares, which are presumed to confer one vote[484]. The only deviation from this rule is the preference shares, which might have no votes attached[485].

Shareholders influence management and other issues related to the company by exercising their voting rights in the general meeting of shareholders. The most important decisions, which influence the existence and functioning of the company, are decided by the general meeting[486]. Therefore, it is natural that the right to vote in the general meeting can arise only from the share[487]. Voting right is the only right that allows shareholders to protect their investments into the company and other interests by making decisions that have impact on the company, for example, to appoint members of the management board. Without the voting right shareholders have very limited resources (other rights) to protect their interests.

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[483] Article 17(1) of the Lithuanian ABI.

[484] This provision does not apply to ordinary shares, which according to article 42(1) of the Lithuanian ABI have to be of the same nominal value. Thus, only preference shares could have different nominal value.

[485] However, in certain cases even such shareholders are allowed to vote. For example, article 42(11) confers voting rights to shareholders of preference shares if no dividends were distributed in two consecutive years.

[486] Article 20 of the Lithuanian ABI. It is interesting to note that while voting right in its essence is a non-pecuniary right, it is the only right that can have direct impact on the pecuniary rights of the shareholders, as well as the value and assets of the company.

[487] Article 16(1.3) of the Lithuanian ABI.

It should also be noted that majority of the rights conferred by the share are either direct or indirect expression of the right to vote. For example, the right to dividends can be realized only by exercising voting right. While the right to ask for information is based on the assumption that such information is required when voting at the general meeting. Thus, it might be argued that voting right is the most valuable right that shareholder has. Without such right the shares become just an empty shell and shareholder just another name in the company's register.

The conclusion is that under the Lithuanian law one share – one vote principle is promoted by the legislature. Voting rights are conferred to shareholders proportionally to their investments into the company and any deviations from this rule are strictly limited. Shareholders are conferred decision making power in the general meeting of shareholders in proportion to their contributions to the capital of the company. The right to vote is fundamental shareholder's right, which is directly linked to the status as a shareholder. Person who has ownership, but does not have the right to vote can be hardly called a shareholder[488] as his power to influence management of the company and ability to participate in its activities is severely limited.

3.4.3. Minority shareholders

As it was argued above, company is a collective group of individuals who are joined together to pursue a purpose that is likely to satisfy their interests (although interests may vary among individual shareholders). Furthermore, in company law shareholders are conferred the power to decide on the most vital and significant issues related to the functioning of the company. Shareholders make their will and intentions known to the company and management bodies by passing decisions through the general meeting of shareholders. However, the collective decision making requires rules as to how such decision are

[488] In case of preference shares, they have a lot of similarities to bonds. See: BODIE, Z.; KANE, A.; MARCUS, A. J. *Investments. Ninth edition*. McGraw-Hill, 2010, p. 43-44.

passed and who is bound by them. As a general rule, the decisions of the general meeting of shareholders are passed by a simple majority vote of the members[489] and all the shareholders of the company are bound by such decisions (even those shareholders who voted against). Such regulation is justified and has its advantages. Firstly, it is the only rule that enables a continuous and smooth functioning of the company. The activities and functions of the company are not stopped merely because there is no unanimous decision at the general meeting of shareholders. Secondly, the presumption for implementing this rule is that interests of majority shareholders will in most of the cases correspond to the interests of the company. However, the majority rule in itself means that majority shareholders can decide whatever they want, even if it is against the interests of other shareholders who have voted in the general meeting of shareholders against the adoption of a particular decision. In order to compensate for possible discrimination by the majority (and to mitigate unjust consequences of possible abusive behaviour by majority shareholders[490]) company law usually provides for certain mechanisms in order to protect minority shareholders or to provide them with rights that would allow them to protect themselves against possible abusive behaviour by the majority shareholders.

3.4.4. Rational shareholder apathy

The rational shareholder apathy hypothesis (sometimes referred to as collective action problem or shareholder passivity) states that individual shareholders are generally not interested in exercising their voting rights effectively[491]. This is more likely to be true in companies with highly dispersed ownership structures

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[489] Statutory provisions or articles of association of the company might require qualified majority or even unanimous consent from the shareholders of the company. For example, article 28 of the Lithuanian ABI; article 558 of the Belgian W.Venn.; articles 21 and 283 of the CA 2006.

[490] ITALIA, S. Italy. In CAMPBELL, D.; BUCKLEY, S. (eds.) *Protecting Minority Shareholders*. London: Kluwer Law International, 1996, p. 372.

[491] See: BLACK, B. S. Shareholder Passivity Reexamined. *Michigan Law Review*, 1990, Vol. 89, No. 3, p. 526-529; GORDON, J. N. The Mandatory Structure of Corporate Law. *Columbia Law Review*, 1998, Vol. 89, No. 7, p. 1575-1577.

where there are a lot of shareholders owning just a fraction of total voting rights. In these companies the costs incurred by the shareholders in obtaining the information needed to cast an informed vote exceed the benefits that shareholders might gain because of their active actions[492]. A large block owner might still find positive returns from his investment in acquiring the needed information. But in these situations he would have to inform all other shareholders to vote in his way in order for voting at the general meeting to be decisive (that entails additional costs). This creates a free-rider problem where other non-block holders benefit from the investments and efforts of the large shareholder[493]. In both situations individual shareholders choose to remain uninformed and agree with the proposals on the agenda (and do not invest their time and money in order to exercise their voting rights intelligently), although collectively rational choice would be to acquire the necessary information in order to cast votes in a manner that is in the best interests of all the shareholders[494].

In context of this dissertation, research and data on the availability of shareholders' agreements in listed companies might reveal whether shareholders are indeed passive or whether there are certain situations when they actively protect their interests and exercise voting rights. Data and empirical analysis provided below in Part III suggest that there are situations when shareholders actively protect their interests. However, active participation of shareholders by entering into shareholders' agreements is considered to be subject to the following factors. As the rational apathy hypothesis suggests, shareholders do not take any action if the costs incurred are greater than the benefits gained. This might mean that shareholders are less

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[492] BLACK, B. S. Shareholder Passivity Reexamined. *Michigan Law Review*, 1990, Vol. 89, No. 3, p. 527.

[493] GORDON, J. N. The Mandatory Structure of Corporate Law. *Columbia Law Review*, 1998, Vol. 89, No. 7, p. 1575-1576. BLACK, B. S. Shareholder Passivity Reexamined. *Michigan Law Review*, 1990, Vol. 89, No. 3, p. 527-528.

[494] GORDON, J. N. The Mandatory Structure of Corporate Law. *Columbia Law Review*, 1998, Vol. 89, No. 7, p. 1576.

likely to enter into shareholders' agreement if the extra rights and control over the company, gained through such contractual relationships, do not outweigh the costs incurred. In most of the cases this involves large block holders who can enhance their position in the company by coordinating their actions with other shareholders (that can be either small or large). Thus, later shareholders cannot be considered as being passive as they enter into shareholders' agreements and strengthen their position and voting rights.

On the other hand, small shareholders are presumed to be less interested in contracting as they need to accumulate more voting rights than large block holders (this means that there must be more contracting parties in order to gain effective level of control over the company). Thus, the rational apathy hypothesis might hold water when dealing with small shareholders. Despite this, from the theoretical point of view, minority shareholders might be motivated to contract even without gain of substantial voting blocks in the company. For smaller shareholders it might be enough to coordinate their voting rights up to a level where they can gain certain rights that require a voting right threshold or acquire possibility to veto the decisions of the general meeting of shareholders (the costs for entering into contract should be lower than the benefit gained by the contracting shareholders).

Overall, it might be argued that shareholders' agreement (as a pure form of collective action of shareholders) might serve not as a barrier but as a catalyst in avoiding some of the problems suggested by the rational apathy hypothesis. As there is no compulsory cost-sharing mechanism for shareholders to share the costs of acquiring information and casting votes in an informed way (taking into account the fact that on a collective level rational choice of the shareholders should be to vote in a way that best suits their interests), shareholders' agreement might function as a tool that helps shareholders to overcome these problems. The contractual long term commitments (and initial unavoidable costs of contracting) would serve as a certain cost-sharing mechanism. For example, if there is a voting agreement where some of the shareholders agree to vote in the same manner as the large block holder all the contracting parties benefit. The block holder insures that he will not incur any more information sharing costs as all other shareholders will vote according to him. On the other hand, the smaller shareholders also are in better position as they know that the larger block holder will not infringe their interests if he expects them to vote according to the voting agreement in the future.

3.4.5. Coordination costs

In all the cases where shareholders want to improve their position within the company by forming an alliance (for example, using shareholders' agreement) they are faced with a problem of coordinating their actions and with costs that are associated with such coordination[495]. Although shareholders might be driven by a common purpose (for example, to gain more control over the company), their individual goals for achieving the common purpose may differ (for example, one shareholder might want to gain control to change the management body of the company, while the other might want to gain private benefits of control)[496]. Thus, shareholders incur various coordination costs: acquiring of information costs, communication costs, costs related to reaching an agreement, monitoring and enforcement of the agreement costs.

Moreover, it is argued that 'the mechanical difficulties of achieving consensus amongst thousands of decision makers impede shareholders from taking an active role <…> [and that] active shareholder participation in corporate decision-making would still be precluded by the shareholders' widely divergent interests and distinctly different levels of information'[497]. The

[495] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 36-37.

[496] OLSEN, M. *The Logic of Collective Action: public goods and the theory of groups*. Cambridge: Harvard University Press, 1965, p. 8. It is further elaborated by Olsen that in large companies with dispersed shareholding structure shareholders are less likely to act collectively as each individual contribution is less likely to achieve the desired results. *Ibid*, p. 55-56.

[497] BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 8.

interests of different shareholders are also likely to vary due to different strategies and reasons for their investments in the company. Shareholders that own shares for speculative reasons are mainly interested in the short-term value of the company, while long-term investors are likely to opt for maximizing the value of the company in the long term. There are likely to be disagreements on the policy and strategy of the company between these two groups of shareholders.

Shareholders are also more likely to participate in the decision making process only if the expected benefits of doing so will outweigh the costs[498]. If the shareholders see that the company is purely managed and they do not have the critical mass of the control rights in order to benefit from the decision making process, they will opt to exit rather than fight (also known as the Wall Street Rule)[499]. Thus, it is hard for the shareholders to coordinate their actions and that is why they choose to delegate the control to a smaller group that would be capable of effectively exercising control over the company, namely the members of the management bodies.

In context of shareholders' agreements, it might be argued that coordination costs might preclude shareholders from contracting amongst each other. However, the theoretical assumptions are that coordination costs pose a problem only in situations when they are higher than the benefits gained from coordinated actions. Thus, shareholders' agreements are more likely to be concluded when the benefits for shareholders of entering into shareholders' agreement are higher than the costs incurred.

3.4.6. Incomplete contracts

Shareholders who coordinate their actions through a contract are presented with another important issue, namely that contracts are necessarily

[498] CLARK, R. Ch. *Corporate Law*. Boston: Little, Brown & Co., 1986, p. 391.

[499] BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 8.

incomplete[500]. This means that contract at some point will be unable to provide clear direction for the parties on how to manage their relationships either because parties were unable to foresee a particular situation or because the costs for drafting a clear rule into the contract were too high and the risk for the situation to arise was very low. According to Williamson, bounded rationality also precludes comprehensive *ex ante* contracting, and thus all contracts are incomplete[501]. It is argued that among the reasons why contracts cannot be complete are information asymmetries, transaction costs, outright fraud, the ambiguities in language inadvertence, unforeseen circumstances, and disputes concerning observability, parties' pre-contracting intentions, measurability, and verifiability of contract terms and outcomes[502].

As shareholders' agreements are understood as explicit contracts both in the sense of law and of economics, it should be agreed that it is almost impossible to draft an agreement that would foresee all the possible disputes among the contracting parties and would contain necessary clauses that would deal with such situations. However, the question is whether parties to the agreement (in this case shareholders) should rely only on the gap-filling role of the company law and hope that statutory amendments and judicial decisions will be in their favour, or take active role in protecting their interests and agreeing at least on the most common and foreseeable problems that could arise in the not so distant future. The author is of the position that shareholders would be better positioned, if they would have a shareholders' agreement in place that would deal with most likely situations and problems that have been

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500 ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 23.

501 WILLIAMSON, O. Transaction Cost Economics. In SCHMALENSEE, R.; WILLIG, R. D. (eds.) *Handbook of Industrial Organization. Volume 1*. Oxford: Elsevier, 1989, p. 139-140. Furthermore, Williamson provides a classification of contracts according to their focus in time: classical, neoclassical and relational contracts. WILLIAMSON, O. Transaction-Cost Economics: The Governance of Contractual Relations. *Journal of Law and Economics*, 1979, Vol. 22, No. 2, p. 236-238.

502 BRADLEY, M. *et al.* The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads. *Law and Contemporary Problems*, 1999, Vol. 62, No. 3, p. 38-39.

identified in the past in the same company or in other companies. In other words, it would be beneficial for the shareholders to learn from the past mistakes (either their own or of those who were in the same position). Thus, the fact that shareholders' agreement could be viewed as an incomplete contract does not preclude from making an argument that shareholders would be better off with the shareholders' agreement in place than without it.

Another argument for concluding a shareholders' agreement despite the fact that it will be necessarily incomplete is that it is enough for the shareholders to agree only one subject matter, *id est*, the coordinated exercise of the voting rights. As it was explained above[503], shareholders exercise their control over the company through voting rights conferred to them by the shares of the company. Thus, the most essential matter that they have to agree is the coordination of voting in the general meeting of shareholders. If this is agreed upon, they can settle most of the disputes and conflicts through voting according to the procedure set in the shareholders' agreement. Therefore, the incomplete nature of shareholders' agreements does not always pose a threat for the conclusion of the contract.

3.5. Theoretical difficulties for a legal scholar

When dealing with corporate governance issues legal scholar is usually faced with fundamental theoretical difficulties in applying concepts that have one meaning in legal terms and quite another when viewed through the lens of the economist. This issue becomes evident when applying agency theory as a litmus paper to identify problems that exist in company law. Due to these reasons below two different concepts will be explained that are important for the research: agency and contract.

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[503] See: Part I, Chapter 3.4.

3.5.1. Agency

Economic concept of agency suggests that agency relationships arise when one or more persons engage another person to perform some service on their behalf[504]. The main emphasis from economic point of view is on the agency costs that arise to the principal due to possible misbehaviour of the agent. The economic theory does not provide any insights into the authority of the principal, and thus it is silent upon any fiduciary or any other duties of the agent to the principal. Due to these reasons it is said that agency relations 'arise out of purely factual dependency'[505]. This wide concept includes all the situations when one person (principal) is dependent upon the actions of another (agent) who does not necessarily have a legal duty to act in the interests of the principal. Thus, for economists, the agent must act for the interests of the factual principal and all possible measures should be taken to mitigate agency costs.

From a legal standpoint, however, agency is a narrower and stricter concept. It is primarily focused on: 1) the delegation of power to the agent to act in the name of the principal; 2) the authority of the agent to legally bind the principal by entering into contracts with third parties (or in any other way)[506]; and 3) fiduciary duties of the agent towards the principal. Sometimes this legal concept is describes as 'the creation of legal authority and power, often in a hierarchical form'[507].

From the arguments provided above, it could be concluded that the legal notion of the agency is focused more on the legal obligation of the agent to act in the name and interests of the principal. The economic concept of agency is based on the factual dependency of the principal on the actions of the agent

[504] JENSEN, M. C.; MECKLING, W. H. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 1976, Vol. 3, No. 4, p. 305-360.

[505] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 111.

[506] For example, articles 2.132-2.139 of the Lithuanian CC.

[507] ORTS, E. W. Shirking and Sharking: Agency Law, Agency Costs, and Dual Theory of the Firm. *Yale Law & Policy Review*, 1998, Vol. 16, No. 2, p. 272.

(especially emphasising the costs that might arise to the principal). The distinction between legal and economic concepts is best seen in the example of relations between the shareholders, company and members of the management body. Under the legal concept of agency, members of the management body are the agents of the company and only they can bind the company by entering into legal relations with third parties[508]. On the other hand, economic theory suggests that agency costs arise to the shareholders (who are the residual claimants) and not the company, and therefore the agency relations exist between the shareholders and the members of the management body[509]. Due to this, from the legal point of view agency problems exist neither between shareholders and management board, nor between minority and majority shareholders. However, from the perspective of economics, agency relations (and conflicts of interest) exist directly between the majority and minority shareholders.

3.5.2. Contract

As some of the legal commentators have noted the term 'contract' in both the nexus of contracts and agency theories is 'somewhat unfortunate'[510]. This statement is justified due to the confusion that the term brings to lawyers when it is used in context of the economic theories of the firm. The difference, as with the agency, is quite clear.

In legal terms contract is usually understood as a legally enforceable undertaking or agreement (promise)[511]. Two fundamental principles define the

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[508] The differences between the legal and economic concepts of 'agency' are also recognized by the practitioners who observe that from the legal perspective the primary duties of the management board and its members are towards the company itself and not to the shareholders or any other party (employees, creditors, etc.). See: GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 189.

[509] CHEFFINS, B. R. *Company law: theory, structure and operation*. Oxford: Clarendon press, 1997, p. 45.

[510] BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 10.

[511] EISENBERG, M. A. The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm. *The Journal of Corporation Law*, 1998-1999, Vol. 24, No. 4, p. 822. It should be

law of contracts: the freedom of contract and the binding force of contract[512]. These principles outline the general framework that everybody is free to choose whether to enter into legally binding contractual relationships or not. However, once such relations are established they have the same binding force to the parties as the law. Thus, the main concerns from the legal perspective are the validity[513], binding force and enforceability of the contract[514].

The economic approach, on the other hand, has a much wider meaning of contract and refers to 'long-term relationships characterized by asymmetric information, bilateral monopoly, and opportunism'[515]. The economists are primarily concentrated on the efficiency of contract. Therefore, terms as implicit, non-binding, incomplete and costless contracts are dominating the economic literature[516]. Economists presume that all contracts are Pareto efficient[517] and should not be interfered with, unless there is a market failure[518]. This means that contract is viewed as a mechanism that allows parties to gain certain benefits. However, if the costs for using this mechanism are too high, the market participants might look for other means to achieve their aims.

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emphasised that the meaning of contract in legal terms differs depending on the jurisdiction. The distinction is especially evident between the civil and common law countries. See: MOOR, de A. Contract and Agreement in English and French Law. *Oxford Journal of Legal Studies*, 1986, Vol. 6, No. 2, p. 275, 281; BEALE, H. G. (ed.). *Chitty on Contracts. Volume 1. General Principles. 31st edition*. London: Sweet & Maxwell, 2012, p. 13-15.

512 BEALE, H. G. (ed.). *Chitty on Contracts. Volume 1. General Principles. 31st edition*. London: Sweet & Maxwell, 2012, p. 20.

513 Validity of the contract depends on whether certain tests have been satisfied. For example, if there was an offer and acceptance. See: FURMSTON, M.; TOLHURST, G. J. *Contract Formation: Law and Practice*. Oxford: Oxford University Press, 2010, p. 1-2.

514 These aims of contract law remain true throughout most jurisdictions. See: BEALE, H. *et al. Cases, Materials and Text on Contract Law. 2nd edition*. Oxford: Hart Publishing, 2012, p. 39-76.

515 BAINBRIDGE, S. M. The Board of Directors as Nexus of Contracts. *Iowa Law Review*, 2002, Vol. 88, No. 1, p. 10.

516 KORNHAUSER, L. A. The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel. *Columbia Law Review*, 1989, Vol. 89, No. 7, p. 1449-1460.

517 Pareto efficiency is when there are no ways of making certain thing or people better off without making anybody or anything else worse off. See: VARIAN, H. R. *Intermediate Microeconomics: A Modern Approach. 8th edition*. New York: W. W. Norton & Company Inc., 2010, p. 15.

518 JOHNSTON, A. *EC Regulation of Corporate Governance*. Cambridge: Cambridge University Press, 2009, p. 23.

The economic and legal meaning of contract clearly differs and for a lawyer it might seem that the economists use a 'loose conception of contracts' that is 'imprecise form legal perspective'[519]. The following differences can be distinguished. First, the underlying idea behind the contract differs. For lawyers the contract is legally binding and enforceable tool, whereas economists see it as an efficiency maximising devise (not necessarily binding). Second, from a legal perspective there are no implicit contracts between different corporate constituents, whereas economic theories presume such contracts to be present. For example, as a general case, there are no legal contractual relations between shareholders and the members of the management body. However, according to agency theory such contracts do exist. Furthermore, incomplete, implicit and non-binding contracts have very limited legal value[520], while economic theories embrace these concepts and are mainly founded on them[521].

Although there is a clear conflict between the meaning of contract in legal and economic terms, the author's views are that economic theories could still be applied in analysing the problems between different corporate constituents. However, the differences between legal and economic notions should be always kept in mind.

3.6. Chapter conclusions

One of the most important functions of company law is to provide an efficiently functioning form through which different corporate constituents could act and cooperate. The internal organization of such form, called the company, is analysed by corporate governance discipline, which essentially

[519] ORTS, E. W. Shirking and Sharking: Agency Law, Agency Costs, and Dual Theory of the Firm. *Yale Law & Policy Review*, 1998, Vol. 16, No. 2, p. 292.

[520] ORTS, E. W. Shirking and Sharking: Agency Law, Agency Costs, and Dual Theory of the Firm. *Yale Law & Policy Review*, 1998, Vol. 16, No. 2, p. 291-292.

[521] WILLIAMSON, O. *The Mechanisms of Governance*. Oxford: Oxford University Press, 1996, p. 9-10.

studies how companies are managed and controlled. The interdisciplinary nature of corporate governance implies that various theories from different sciences, including law and economics, intersect in the process. As a consequence theories from one field are exposed to theories from other area of science. Sometimes this reveals the incompatibility of theories, other times shortcomings and defects of some of the theories are identified.

In the author's opinion, this happened with legal theories of the company that failed to explain internal relations that exist within companies. Legal theories did not analyse why shareholders are at the centre of a company and what relations they have with fellow shareholders or other corporate constituents. However, these questions have been addressed by some of the theories of the firm offered by the economists. On o these theories – agency theory – provides grounded explanations for internal relations between different corporate constituents and insights into possible defects of such relations. According agency theory, agency relations develop as a consequence of economic contract, under which one party undertakes to act in in the interests of the other. However, due to the nature of man these relations are not perfect and agency costs arise during time. Law in this regard is could be viewed as a discipline that can provide measures and tools for dealing with agency costs. Shareholders' agreements could be viewed as one of such tools.

The above chapter presented three agency problems that are evident in managing and controlling companies. Law in this regard has to provide sufficient legal measures to balance different conflicting interests and to reduce agency costs. Such legal measures provided by some of the legal scholars are overviewed in the next chapter.

Chapter 4. Legal strategies for reducing corporate agency costs

4.1. General remarks

An equally important function of company law (in addition to the one to provide a corporate form with core characteristics[522]) is to reduce the costs associated with carrying business through a company. In other words, it means that company law has an objective to provide legal means and tools in order to facilitate the complex relationships between different corporate constituents active in the company and to mitigate possible costs originating from such relationships[523]. In order to control opportunistic behaviour, safeguards (legal strategies) have to ensure that the costs for the agent to act opportunistically are higher than the expected benefits from such behaviour[524]. Thus, the increased costs for opportunistic behaviour in turn reduce the chances for the agent to act opportunistically. In addition, extra motivational tools (for example, remuneration according to performance) for the agent help aligning the interests of the principal with the ones of the agent.

The existence of publicly traded large corporations proves that the costs generated by the separation of ownership and control are outweighed by certain benefits. However, additional legal measures have to maintain such balance[525]. Laws, rules and institutions strengthen corporate governance,

[522] See Part I, Chapter 1.2.

[523] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 2.

[524] GHOSHAL, S.; MORAN, P. Bad for Practice: A Critique of the Transaction Cost Theory. *The Academy of Management Review*, 1996, Vol. 21, No. 1, p. 19.

[525] In addition to specific legal tools that are designed to counter agency problems, certain legal concepts help as well. For example, limited liability reduces the monitoring costs incurred by principals. See: EASTERBROOK, F. H.; FISCHEL, D. R. Limited Liability and the Corporation. *University of Chicago Law Review*, 1985, Vol. 52:1, p. 94.

reduce costly agency problems and provide a competitive playing field for all the corporate constituents[526].

This part of the dissertation introduces available legal strategies that help reduce the negative consequences of the agency problem. This allows to better determine where shareholders' agreements stand among different legal tools available for dealing with agency problems. The classification of legal strategies provided below is based upon Armour, Hansmann and Kraakman[527]. This classification of legal strategies is the most complete currently available in the academic literature. Some authors have attempted to provide a different classification of strategies, but, in the author's view, they are incomplete and partly overlap with the classification provided below. For example, Becht, Bolton and Roell have argued that central problem of corporate governance is the collective action problem among investors, and in order to mitigate it they provided for five alternative mechanisms: i) partial concentration of ownership and control in the hands of one or a few large investors; ii) hostile takeovers and proxy voting contests, which concentrate ownership and/or voting power temporarily when needed; iii) delegation and concentration of control in the board of directors; iv) alignment of managerial interests with investors through executive compensation contracts; and v) clearly defined fiduciary duties for CEOs together with class-action suits that either block corporate decisions that are against investors' interests, or seek compensation for past actions that have harmed their interests[528]. Although it could be established that shareholders' agreements would fall under i), as a mechanism concentrating the ownership

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[526] World Bank. Corporate Governance: a framework for implementation, 2000 [interactive]. [Accessed on 2012-08-03] Available online at: <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/09/08/000094946_00082605593465/Rendered/PDF/multi_page.pdf>, p. 7.

[527] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 35-53.

[528] BECHT, M.; BOLTON, P.; RÖELL, A. A., Corporate Governance and Control. *ECGI - Finance Working Paper No. 02/2002*, 2002 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=343461>, p. 1, 12.

and control in the hands of shareholders[529], this classification due to its limited scope will not be used.

4.2. Regulatory strategies

Regulatory strategies perform a normative function and through substantive regulation influence the relationships between the principal and the agent[530]. These strategies are aimed at either constraining the behaviour of the agent (setting a framework for agent's behaviour) or stipulating certain requirements before the agent-principal relations are formed. As regulatory strategies are based upon the intervention of the legislature, their effectiveness is solely dependent on the enforceability of stipulated requirements and the identification of compliance with the prescribed normative behaviour.

4.2.1. Rules and standards

Rules and standards are the most important and common tools of law. Majority of all the legal acts (including company law) are drafted in a way as to set either certain rules that must be complied *ex ante* or standards that set a framework for evaluating the behaviour of different parties in civil legal relationships *ex post*. Due to this difference it is often argued that 'the only distinction between rules and standards is the extent to which efforts to give content to the law are undertaken before or after individuals act'[531].

In context of agency relations rules and standards are also often used in order to prevent the unwanted behaviour and to stimulate behaviour that would negate possible agency costs. An example of a rule would be the requirements

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[529] In some cases the effect of shareholders' agreement is opposite so it would be impossible to categorize absolutely all agreements under this category.

[530] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 38.

[531] KAPLOW, L. Rules versus Standards: an Economic Analysis. *Duke Law Journal*, 1992, Vol. 42, No. 3, p. 560.

for distribution of dividends[532] and an example of a standard would be a requirement for the agent to act in good faith[533]. It can clearly be seen that rules are used to protect certain types of corporate constituents (depending on the rule and its aims) and are usually used when there is a clear and precise requirement that must be satisfied by the agent (although such requirement must be known to the legislature and accurately formulated)[534]. On the other hand, standards have a broader range of applicability as they only provide guidelines on what kind of behaviour is expected from the agent (for example, fiduciary duties[535]). In this regard the agent must be aware not only of the formulation of the standard but also of its actual applicability (usually by the courts) in order to coordinate his behaviour. Overall, rules and standards are a very broad category of measures available to the legislature and in most cases these two legal strategies overlap with other regulatory or governance strategies to mitigate agency problems.

4.2.2. Entry and exit

The next two strategies that deal with agency problems are aimed at establishing the terms under which the relations between the agent and the principal are formed and when and under what conditions such relationships can be terminated[536].

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532 For example, under article 831 of the CA 2006 a public company may only make a distribution if the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves, and if, and to the extent that, the distribution does not reduce the amount of those assets to less than that aggregate.

533 For example, article 2.87(1) of the Lithuanian CC requires all the members of the management body to act in good faith in relation to the company and the shareholders.

534 DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 114-115; 149.

535 See: WEINRIB, E. J. The fiduciary obligation. *The University of Toronto Law Journal*, 1975, Vol. 25, No. 1, p. 1-22.

536 ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 40-42.

The entry strategy essentially deals with the disclosure of information requirements[537], which establish the duties of the agent to inform the principal on various issues which are detrimental for the principal to be able to decide whether to enter into relations with the agent[538]. For example, in context of the shareholder and management conflict this primarily includes mandatory requirements to disclose information regarding the company and its business[539]. The requirement for disclosure of information balances the position of the agent and the principal as it enables the principal to acquire the information that otherwise would be available only to the agent. It could be argued that on their own the disclosure requirements enable the principal to make decisions only on whether to enter into relations with the agent or not. However, most of the other legal strategies and especially the governance strategies that require action from the side of the principal are greatly influenced by the amount and quality of information available to the principal. Thus, disclosure of information is relevant not only to the entry strategy but to other legal measures as well.

As the name suggests the exit strategy in dealing with agency problems is used when principal wants to end the agent-principal relations. In broad terms legal scholars have distinguished two sets of exit rights[540]: 1) the right to withdraw the value of the investment when shareholders object to certain decision which, in their view, might reduce the value of the company (this is usually related to the merger and acquisition situations); 2) to transfer their

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[537] The information which is required to be disclosed usually includes the key financial figures and accounts, principal risks and uncertainties of business, structure of the management body (including remuneration of key personnel), information on major shareholders, related party transactions and other relevant information.

[538] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 115-120.

[539] For example, on the EU level the disclosure standards are regulated in the Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[540] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 41.

shares in the company. While the first type of exit rights is more circumstantial as well as depended on certain jurisdictions that allow for the exercise such right, the transferability of shares is a generally recognised characteristic of the company. The exit strategy could also be viewed as an *ultima ratio* means for the principal to avoid the agency problems as it permanently ends the principal-agent relations. The exit strategy is argued to be used in those situations where other strategies to reduce the negative consequences of agency problems are unavailable or their implementation is too costly[541].

4.3. Governance strategies

Governance strategies are aimed at enhancing the position of the principal by conferring him rights to better control the agent[542]. However, the discretion on the actual exercise of such control rights is left to the principal alone – he has the freedom to use them or not[543]. Thus, in order for these strategies to be successful and effectively deal with the agency problems, principal has to be willing and able to accept certain costs that he might incur in realizing the strategies discussed below.

4.3.1. Selection and removal

As it was discussed above[544], one of the main features of the modern company is centralized management. As public companies are usually very large and have more than a few shareholders, the actual management of such companies is entrusted with highly competent professionals (that, according to agency theory, are treated as agents of shareholders). Shareholders in this regard act as

[541] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 131-132.

[542] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 38.

[543] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 113.

[544] See Part I, Chapter 1.2.

decision makers to appoint and remove the members of the management body[545]. Appointment and removal can be viewed as opposite sides of the same coin and serve as a strong controlling mechanism for the behaviour of the agents[546]. If principals see that a certain person is fit to serve their best interests, they have the right to appoint such person as their agent. However, if the agent no longer acts in the interests of the principals or is seen as unfit to act in a particular way, the principals have full control to remove him from his office and duty. This situation prevents the agent from acting against the interests of the principal, if the principal(s) can actually control the appointment and removal process.

It should be mentioned that in context of shareholder-management conflicts of interest two types of board systems are usually distinguished: one-tier and two-tier[547]. However, despite of the actual board structure that is in place in a particular company shareholders always have the power to appoint and remove either the members of the supervisory body or the management body[548]. Theoretically, this allows them in a position to be able to manage certain conflicts of interest if they think that a particular agent might cause them.

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[545] In order to be able to effectively exercise the appointment and removal rights shareholders should be able to exercise other accompanying rights such as: have all the appropriate information, be able to submit their candidates for appointment as members of the management body and be able to convene general meeting of shareholders. All of these rights are dealt with in the Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ 2007 L 184/17-24).

[546] However, only if the collective action problems are overcome. See: ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: the Interests of Shareholders as a Class. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 62-63.

[547] For an analysis of one-tier system in the UK and two-tier system in Germany, see: JUNGMAN, C. The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems. *European Company and Financial Law Review*, 2006, Vol. 3, No. 4, p. 432-437.

[548] For example, under articles 31 and 33 of Lithuanian ABI shareholders have the right to appoint either the members of the supervisory body (which in turn appoints members of the management body) or the members of the management body if the supervisory body is not formed in the company.

4.3.2. Initiation and ratification

Strategies that allow principals to appoint and dismiss the agent requires certain decision making from the principals, however, such decision making does not involve direct business decisions relating to the company. The initiation and ratification, on the other hand, is directly related to principals being involved in the area where, under normal circumstances, the agent should be active[549].

As it was mentioned above, agents are appointed by the principals because of their competence and professionalism in making business decisions and managing the company. Due to this reason the majority of business decisions are taken by the agents. However, if principals have certain issues and they would like these issues to be included in the business of the company, they have a right to initiate certain decisions. For example, shareholders in the EU under the Directive 2007/36/EC have the right to put new items on the agenda of the general meeting of shareholders and to draft resolutions accordingly. This means that shareholders can take action themselves without the need for the management body to propose certain issues or questions that should be decided by shareholders.

Furthermore, principals are given even stronger influence on the most important decisions relating to the company, which might include changing articles of association, approving merger, distributing profit, etc. (this depends on the jurisdiction and provisions of articles of association of a particular company) on ratifying the decisions made by the agents[550]. Ratification means that certain types of decisions of the management body of the company must be approved by shareholders in order for such decisions to become effective.

Overall, both initiation and ratification strategies give more power to principals to act when they think that the agent is not acting in the best of their

[549] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 42.

[550] For example, article 28(1) of the Lithuania ABI presents a list of decisions that have to be made only by a qualified majority of shareholders present in the general meeting.

interests. Initiation allows principals to put their issue on the agenda of the general meeting of shareholders (this becomes in particularly important when dealing with conflicts of interest between majority and minority shareholders) while ratification guarantees that agents will not act in certain way without the approval of the principal.

4.3.3. Trusteeship and reward

Trusteeship and reward strategies are focused on aligning the interests of the agent and the principal. The first one introduces a third independent party that serves as a guardian of the interests of the principal and the second one rewards the agent according to his performance and actions.

The trusteeship strategy is primarily based on the idea that in order for principals to be able to control their agents certain inside information on how the company is being managed is required[551]. Under these circumstances the independent non-executive directors are mixed in the unitary boards in order to control how executive members of the management body carry over their functions as agents[552]. The independent non-executive directors have duties to report only to the shareholders and are free to indicate whether the interests of principals are taken into account while managing the company[553]. It is argued that independent directors are motivated not by the high-powered incentives (in contrast to reward strategy) but by the low-powered reputational incentives of public esteem and recognition to be able to do a good job[554]. Thus, it is less likely that they will start acting against the interests of the principal.

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[551] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 43.

[552] In two-tier systems it is usually stipulated in statutory acts that members of the supervisory body cannot at the same time be members of the management body of the company. For example, article 31(6) of the Lithuanian ABI.

[553] This strategy is also being promoted by the European Commission. See: Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (OJ 2005 L 52/51-63).

[554] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 194-195.

While the reward strategy is not new[555], it focuses primarily on the self-interested nature of the agent[556]. Rewards motivate the agent to act in the interests of the principal (and in turn demotivate them to act in their own interests disregarding the principal as they would risk losing the reward). Legal scholars recognise two basic mechanisms for rewarding the agents[557]. The so called sharing rule allows the agent to share any monetary returns that are attributed to the principal due to the actions of the agent. This motivates the agent to act in the interests of the principal as at the same time his gains are also directly influenced. The second mechanism – pay for performance regime – allows the agent to benefit despite the monetary returns to the principal, if he successfully advances the interests of the principal.

Chapter 5. Shareholders and EU initiatives

5.1. General remarks

The comparative aspect of the dissertation takes into account three jurisdictions all of which are part of the EU. Before starting to analyse the regulation of shareholders' agreements in each of the jurisdictions and results of the empirical research it is necessary to take into account relevant legislation and policies on the EU level. Therefore, the purpose of this part is to overview (but not to analyse extensively) reports, action plans and EU legislation that have been introduced in the field of company law and corporate governance with

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[555] Earlier in the twentieth century laws have even required the members of the management body to own a certain minimum number of shares. See: WYMEERSCH, E. A Status Report on Corporate Governance Rules and Practices in Some Continental European States. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1125.

[556] DAVIES, P. *Introduction to Company Law. 2nd edition*. Oxford: Oxford University Press, 2010, p. 204-205.

[557] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 43.

particular emphasis on shareholders' rights and shareholders' agreements[558]. This will help to better understand the place of this research in context of company law problems and possible reforms in the EU[559]. It is expected that this short presentation of modernisation of company law and enhancement of corporate governance will also reveal certain insights and correlations between the initiatives on the European level and this dissertation (especially taking into account the Proportionality report that also presents some empirical data and insights on shareholders' agreements).

5.2. EU legislation

There are no legal acts on the EU level specifically dealing with shareholders' agreements. However, separate provisions on different rights of shareholders and transparency obligations to disclose the fact that there is shareholders' agreement concluded in the company are scattered throughout different EU legislative acts. First, disclosure requirements started with an obligation to disclose major shareholdings[560], which later were implemented into the Directive 2004/109/EC together with the requirements to disclose information on the joint exercise of voting rights. The disclosure requirements on the EU level relating to the shareholders' agreements are important as this dissertation relies on the information provided by the companies themselves. Second, a separate directive tries on the EU level to harmonize different rights of shareholders, which are in one way or another related to the exercise of voting rights. The results provided in this dissertation might give insights into whether this directive is effective (whether shareholders contract to gain voting rights

[558] It should also be noted that European Model Company Act project is nearing its completion. This new model act should provide some insights as to how prominent legal scholars in Europe view shareholders and their role in modern companies. For more information please see: <http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/>.

[559] This is especially true when EU regulation of company law is highly focused on the shareholders. See: HORN, L. Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation. *European Law Journal*, 2012, Vol. 18, No. 1, p. 83-107.

[560] Council Directive 88/627/EEC of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of (OJ 1988 L 348/62-65).

required to exercise rights regulated in the directive). Only relevant provisions of both of the directives are briefly presented below.

5.2.1. Transparency requirements regarding shareholders' agreements

The empirical part of this dissertation on the shareholders' agreements concluded in listed companies relies on the information provided by the companies themselves. Thus, it is important to analyse the transparency requirements in the EU to disclose any information related to shareholders' agreements.

The obligation to notify about the acquisition or disposal of voting rights (including shareholders' agreements regarding the exercise and/or transfer of voting rights) on the European level arises from articles 9-16 of the Directive 2004/109/EC[561]. These articles are supplemented by the Commission Directive 2007/14/EC[562] (articles 8 and 9 are the most relevant for the present analysis). These two directives lay down the requirements for the shareholders to inform the company (and in turn a relevant supervisory authority) when their voting rights cross a certain threshold. Directive 2004/109/EC establishes a presumption that voting rights of a particular shareholder also include 'voting rights held by a third party with whom that person or entity has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer in question'. Essentially this means that if there is a shareholders' agreement on the concerted exercise of the voting rights, then the shareholders have to notify the company that they have crossed a certain threshold established by in the national laws of the Member State. In their transparency

[561] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[562] Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

declarations they have to disclose that the threshold was cross due to concerted action. Thus, the shareholders are effectively obliged to disclose the presence of the shareholders' agreement. It should be stressed that the requirement to disclose on the concerted exercise of the voting rights is far reaching and encompasses all the situations that require the exercise of voting rights. For example, if shareholders conclude an agreement and do not explicitly state that in the general meeting of the shareholders they will vote in a particular way, but agree that they will nominate a certain number of members to the management body of the company, the obligation to disclose the crossing of the voting threshold still applies as the nomination and appointment of the members of the management body can be done only by exercising voting rights at the general meeting of the shareholders (even if not explicitly stated in the agreement).

A further obligation on the level of the European community to inform on issues related to shareholders' agreements is stipulated in article 10 of the Directive 2004/25/EC[563]. There are several transparency requirements for the listed companies that are significant in respect to shareholders' agreements stipulated in this Directive. The information that has to be disclosed includes: 1) any restrictions on the transfer of securities, such as limitations on the holding of securities or the need to obtain the approval of the company or other holders of securities; 2) the holders of any securities with special control rights and a description of those rights; 3) any restrictions on voting rights, such as limitations of the voting rights of holders of a given percentage or number of votes, deadlines for exercising voting rights, or systems whereby, with the company's cooperation, the financial rights attaching to securities are separated from the holding of securities; 4) any agreements between shareholders which are known to the company and may result in restrictions on the transfer of securities and/or voting rights; 5) the rules governing the appointment and

[563] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

replacement of board members and the amendment of the articles of association. It is evident that the requirements to disclose all of the above information are directly linked with the subject matter of the shareholders' agreement, and thus the author considers that companies listed on the regulated markets in the EU have the obligation not only to disclose the fact that there is a shareholders' agreement in place, but also disclose its subject matter as far as it is related to the information required according to the Directive 2004/25/EC.

5.2.2. Directive on shareholders' rights

Taking into account the results presented in the reports and the studies in context of the shareholder protection[564], the Council together with the European Parliament adopted Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies which had to be transposed into national laws of the Member Stated by the summer of 2009[565]. The Directive 2007/36/EC strengthens shareholders' rights, in particular through the extension of the rules on transparency, proxy voting, the possibility of participating in general meetings via electronic means and ensuring that cross-border voting rights are able to be exercised. The motivation behind this Directive was to enhance the control of the shareholders over the company[566].

The Directive 2007/36/EC is constructed from a number of key obligations of the listed companies and rights of shareholders. First, there is an obligation for the company to provide information and documents relevant for the upcoming general meetings in order to allow shareholders to cast informative vote. Second, shareholders are allowed to put new items on the agenda and ask questions about all items that are already on it. Third, in order

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[564] Please see the following chapters.

[565] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ 2007 L 184/17-24).

[566] There have been some doubts expressed whether the Directive is actually enhancing the control or just creating an illusion. See: MASOUROS, P. E. Is the EU Taking Shareholder Rights Seriously?: An Essay on the Importance of Shareholdership in Corporate Europe. *European Company Law*, 2010, Vol. 7, No. 5, p. 195-203.

to facilitate voting both by domestic and foreign shareholders, the Directive 2007/36/EC provides all the shareholders with a right to vote by proxy and allows listed companies to offer voting in the general meeting of shareholders using electronic means. All this bundle of rights and obligations is aimed at promoting the position of shareholders in listed companies and improving their control over the management.

The two rights that allow minority shareholders to influence the control of the company, in the view of the author, are the possibility to put items on the agenda of the general meeting and to table draft resolutions for items on the agenda. The exercise of these two rights according to article 5 of the Directive 2007/36/EC requires not more than 5 % of total voting rights. The empirical data on the shareholders' agreements might reveal whether minority shareholders consider these two rights important enough to contract for joint exercise of voting rights in order to gain the required threshold.

5.3. Action plans of the European Commission

At the date of writing of this dissertation there were two action plans in the field of company law and corporate governance issued by the European Commission. The first one was based on the proportionality principle that later led into Report on the proportionality principle, which dealt with shareholders' agreements and there usage in the EU. A comparison of the findings in the Report on the proportionality principle and this dissertation is provided in Part 3, Chapter 2.1.1. The second most recent action plan emphasized the need for shareholders to engage and take action themselves, which is in line with the concept of shareholders' agreement. It is an act of will of contracting parties and therefore relies solely on the ability of shareholders to engage in control of the company themselves. However, empirical results presented in Part 3 suggest that such engagement in control is likely possible only for the medium sized shareholders, while minority shareholders rarely engage in control of the company using shareholders' agreements.

5.3.1. Action plan 2003

Action plan 2003 highlighted the path that the Commission was willing to take in modernising the company law in the EU during the first decade of the twenty-first century.

One of the key polices indicated in the Action plan 2003 was to ensure 'effective and proportionate protection of shareholders'[567] which had to be achieved through enhancement of the rights of shareholders[568]. This shareholder empowerment strategy has been followed by most of the influential continental European countries which have significantly improved their laws relating to shareholder protection[569]. In addition, the Action plan 2003 is based on the shareholder democracy[570], which essentially is the proportionality principle suggested by the High Level Group[571]. Furthermore, the European Commission heard the recommendations of the High Level Group and proposed at that time new disclosure standards that included disclosure on 'the shareholders holding major holdings, and their voting and control rights as well as key agreements'[572].

The Action plan 2003 was amongst other things primarily oriented on the protection and empowerment of shareholders as the most important actors in corporate governance. In relation to this dissertation, it should be noted that shareholders have ever since played an important role in the policy agenda of the EU. Thus, the dissertation on the right of shareholders to contractually

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[567] Action plan 2003, p. 8.

[568] This policy eventually manifested itself in the form of a directive. See: Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ 2007 L 184/17-24).

[569] ENRIQUES, L.; VOLPIN, P. Corporate Governance Reforms in Continental Europe. *Journal of Economic Perspectives*, 2007, Vol. 21, No. 1, p. 131-134.

[570] Action plan 2003, p. 14.

[571] HORN, L. Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation. *European Law Journal*, 2012, Vol. 18, No. 1, p. 97.

[572] Action plan 2003, p. 12.

protect their interests is in accordance with the European initiatives in this field.

5.3.2. Action plan 2012

Action plan 2012 should be considered as a subsequent policy document following not only Report of the Reflection Group[573], but also other policy formulating documents issued by the Commission and the European Parliament. First, the Green Paper of the Commission on the EU corporate governance framework[574], which addressed, amongst other things, issues regarding the lack of appropriate shareholder engagement and short-termism. Second, the European Parliament Resolution on a corporate governance framework for European companies, which stipulated 'that shareholders' engagement with the company should be encouraged by enhancing their role, but that this involvement should be a discretionary choice and never an obligation'[575]. These earlier views and statements regarding shareholder participation in the companies have been carried through into the Action plan 2012.

Together with the above mentioned policy formulating documents Action plan 2012 emphasizes the role of shareholders. It states that 'shareholders have a crucial role to play in promoting better governance of companies. By doing this they act in both the interest of the company and their own interest'[576]. In light of the present dissertation, it is important to note that one of the main aims of the Action plan 2012 is promotion of engaging shareholders. In contrast to previous initiatives, the emphasis is no longer on the enhancement or empowerment of rights but on the actual exercise of such

[573] The Reflection Group. Report on the future of EU company law [interactive]. [Accessed on 2012-12-17] Available online at: <http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf>.

[574] European Commission. Communication from the Commission Green Paper - The EU corporate governance framework, COM(2011) 164 final.

[575] European Parliament. Resolution of 29 March 2012 on a corporate governance framework for European companies, P7_TA(2012)0118, see point 29.

[576] Action plan 2012, p. 3.

rights. According to the European Commission shareholders should be: 1) more active in controlling members of the management board by voting on their remuneration policy; 2) should provide more oversight over the related party transactions which primarily include the transactions with controlling shareholder. Another of the commitments of the European Commission presented in the Action plan 2012 is related to this dissertation. The Commission recognized that there is a problem with the concept of acting in concert and that this problem should be dealt with on the European level[577]. As it will be argued further in this dissertation the concept of acting in concert is directly related to the disclosure on shareholders' agreements.

5.4. Report on the proportionality principle

The study initiated by the European Commission in order to identify the actual situation and the use of various control enhancing mechanisms (including shareholders' agreements) in companies listed in different EU jurisdictions followed the reasoning provide in previous reports[578]. The main aim of this study was to identify and show existing diversions from the proportionality principle. The definition of proportionality principle[579] was taken from the Report of the High Level Group where it was described as follows: 'proportionality between ultimate economic risk and control means that share capital which has an unlimited right to participate in the profits of the company

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[577] Action plan 2012, p. 11.

[578] Reports of the High Level Group and Action plan 2003. See: The High Level Group of Company Law Experts. Report on issues related to takeover bids [interactive]. [Accessed on 2011-01-27] Available online at: <http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf>; The High Level Group of Company Law Experts. Report on a modern regulatory framework in the EU for company law [interactive]. [Accessed on 2011-01-27] Available online at: <http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf>. It should be mentioned that Report on the proportionality principle was followed by a Report of the Reflection Group. See: The Reflection Group. Report on the future of EU company law [interactive]. [Accessed on 2012-12-17] Available online at: <http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf>. For an overview see: HORN, L. Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation. *European Law Journal*, 2012, Vol. 18, No. 1, p. 83-107.

[579] Also known as one share – one vote principle.

or in the residue on liquidation, and only such share capital, should normally carry control rights, in proportion to the risk carried. The holders of these rights to the residual profits and assets of the company are best equipped to decide on the affairs of the company as the ultimate effects of their decisions will be borne by them'[580].

According to the Report on the proportionality principle, shareholders' agreement is a type of control enhancing mechanism, namely a coordination device[581], which is one of the most popular control enhancing mechanisms in European jurisdictions (together with pyramid structures and multiple voting rights)[582]. It is legally available in all the jurisdictions that were analysed in the report and is factually used in practice in 69 % of the member states[583]. Furthermore, according to the research a total of 8 % of European companies have at least one shareholders' agreement in place[584]. Institutional investors viewed shareholders' agreements as being almost neutral contractual tools[585] (which are important in taking investment decisions[586]), and thus not designed by their nature to infringe the principle of proportionality.

It has been established in the report that control enhancing mechanisms (and the way that they are regulated in each of the jurisdictions) have significant influence on the capital structures and ownerships patterns of listed companies. However, the difficulty of finding the balance of power between majority shareholders, minority shareholders and the management body has also been clearly pronounced: 'empowering blockholders mitigates the agency conflict between managers and shareholders but aggravates the conflict between large and small shareholders. Conversely, a mandatory one share –

[580] Report of the High Level Group on takeovers, p. 3.

[581] Report on the proportionality principle, p. 5.

[582] Report on the proportionality principle, p. 22.

[583] Report on the proportionality principle, p. 16.

[584] Report on the proportionality principle, p. 35.

[585] Report on the proportionality principle, p. 84.

[586] Report on the proportionality principle, p. 85.

one vote rule that erodes blockholder influence protects small shareholders against private benefit extraction by large shareholders but also leaves managers with more discretion to pursue their own goals'[587]. Thus, each of the devices must be weighed carefully before introducing new or changing existing legislation.

5.5. Debate on the power of the shareholders in the EU and the US

At this point of the dissertation it is interesting to briefly point out that the position of the shareholders in the EU greatly differs from their fellows in the US. It is argued that historically the position of the shareholders in the EU and the US has been greatly influenced by three factors: the role of ownership, the focus of company law and corporate governance, and federalism[588]. Firstly, as it has already been argued in this dissertation, the ownership structures in the US and in continental Europe differ greatly. Dispersed ownership structure is dominant in the US, while voting rights tend to be concentrated in the hands of a few shareholders in continental Europe. Secondly, the company law and corporate governance policy in the EU is promoting not only the rights of the shareholders, but it tries to balance them against the rights of other stakeholders[589], while in the US the regulation is focused primarily on the shareholders and their rights against the management body of the company. Thirdly, in the US the federal rules and their historical application allowed states to adopt different statutory acts in the field of company law. This had the effect that states started to compete between each other in order to attract more

[587] Report on the proportionality principle, p. 10. This statement was based on the theoretical study carried out for the report. See: BURKART, M. C.; LEE, S. The One Share - One Vote Debate: A Theoretical Perspective. *ECGI - Finance Working Paper No. 176/2007*, 2007 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=987486>.

[588] PINTO, A. R. The European Union's shareholder voting rights directive from an American perspective: some comparisons and observations. *Fordham International Law Journal*, 2009, Vol. 32, No. 2, p. 587-623.

[589] The German employee codetermination is the prime example. See: PLESSIS, J. J. *et al. German Corporate Governance in International and European Context.* 2nd edition. Berlin: Springer-Verlag, 2012, p. 149-196.

companies and provide most optimal company law rules, which resulted in the dominance of Delaware. Meanwhile in the EU, the European institutions have the power to harmonize company laws in the Member States. Although the later can deviate to a certain degree from the requirements imposed by the directives (but not by the regulations), so far there has been no evident competition between the Member States and none of them can be considered a European Delaware.

Furthermore, some legal scholars have stressed the importance of the differences in the legal distribution of powers in the US and continental Europe[590]. Cools argues that in the US the management body of the company has more powers over the company (both in terms of the decision-making and the initiation rights that lead to the decision-making). Coupled with the enabling character of the US company laws[591] the management body has even greater influence on the initial (or later) distribution of powers in, for example, articles of association of the company[592]. In contrast, in continental Europe company law provisions on the distribution of powers between the bodies of the company are of a mandatory nature (and, with some exceptions, cannot be changed in the articles of association of the company) and the shareholders are attributed with the most powerful rights over initiation and decision-making.

All of the above differences lead to a conclusion that shareholders are more important actors in the decision-making of the modern company in

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[590] COOLS, S. The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers. *Delaware Journal of Corporate Law*, 2005, Vol. 30, No. 3, p. 738-750.

[591] For example, the Delaware General Corporation Law (all acts effective as of September 24, 2012), section 141(a).

[592] Naturally the dispersed ownership structure presupposes the sharpest agency conflict between shareholders and the management body, which in the US can be usually observed in proxy fights. See: BEBCHUK, L.; HART, O. Takeover Bids vs. Proxy Fights in Contests for Corporate Control. *Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series*. Paper 336, 2001 [interactive]. [Accessed on 2013-04-06] Available online at: <http://lsr.nellco.org/harvard_olin/336>.

continental Europe than they are in the US[593]. In context of shareholders' agreements, it might be observed that the distribution of powers together with distinct ownership structures presupposes that shareholders' agreements are more likely to be concluded in continental Europe than in the US. First, in continental Europe voting rights of the shareholders contribute much more power, and thus there is perfectly valid rationale to concentrate such power in order to gain the control over the company. Second, the dispersed ownership structure in the US might be an important contributor to the passivity and coordination problems of shareholders. Thus, shareholders' agreements might be less likely in the US. Third, the initiation rights held by shareholders might motivate them to contract in order to reach the minimum threshold required to exercise such rights. Considering these points it is more rational to expect that shareholders' agreements are more often concluded in continental Europe than in the US.

5.6. Chapter conclusions

A brief inquiry into the legislative policy in the European Union has revealed that shareholders, their position and their rights have been on the agenda since the first attempts to modernize the regulatory framework of the company law in the EU. Although during the first decade of twenty-first century there have been legislative changes concerning the rights of shareholders in listed companies, there have been no attempts to regulate shareholders' agreements as such (with a very limited exception of disclosure requirements). This dissertation in the context of European initiatives fits in a way that it highlights a very important contractual part of relationships among shareholders and provides some insights that not only regulatory initiatives, but also the will and

[593] Some authors have even suggested that it is time to change the distribution of powers in the US and bring shareholders in to the game. See: BEBCHUK, L. A. The Case for Increasing Shareholder Power. *Harvard Law Review*, 2005, Vol. 118, No. 3, p. 833-914.

action from the part of shareholders is required in order to strengthen and protect their position in the company.

All the above policy documents and legislative acts repeatedly show that shareholders in continental Europe are an important part of the company and their involvement in corporate governance issues should be encouraged. It is argued that 'relying wholly on private contracting to produce governance mechanism is unrealistic'[594]. However, it is similarly naive to expect that all of the regulatory and governance strategies available to principals can be efficiently utilized without the help of a contract. Therefore, the path in the future should rely on a systematic approach encompassing both the regulative and contractual views.

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[594] DAVIES, P. *Introduction to Company Law*. *2nd edition*. Oxford: Oxford University Press, 2010, p. 112.

PART II: SHAREHOLDERS' AGREEMENT: THEORETICAL AND COMPARATIVE APPROACH

Chapter 1. Theoretical aspects of shareholders' agreements

Free market[595] means that persons have a choice whether to become shareholders of a particular company or to refrain from any investments in securities. If the decision has been made to become part of the company through the ownership of shares, it should be carefully evaluated and weighed what are the conditions and consequences of becoming a shareholder. Future shareholders must always consider not only the rights that will be conferred by the shares, but also whether they will be able to practically exercise these rights. This is especially true for the minority shareholders. The standard law and economics view suggests that minority shareholders can bargain for protection against opportunism by controlling shareholders[596]. Shareholders cannot rely only on the mandatory or default rules[597] as they might not suit their needs and interests. Thus, one of the possibilities is to bargain with each other and by entering into shareholders' agreement stipulate additional rights towards each other, contract around the default rules or agree to control the company in a way that satisfies the interests of all the contracting parties[598]. Before starting the country specific analysis of shareholders' agreements regulation, some theoretical aspects of shareholders' agreements will be addressed in this chapter.

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[595] The free market cannot be relied unconditionally as it is never perfect due to the information asymmetry which might cause 'the democracy of free foxes in a free hen house'. See: MONGIN, O. *Instability of Value* [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.eurozine.com/articles/2009-01-22-mongin-en.html>.

[596] For a review of literature on this point see: MEANS, B. A. Contractual Approach to Shareholder Oppression Law. *The Fordham Law Review*, 2010, Vol. 79, No. 3, p. 1162-1163.

[597] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition.* Oxford: Oxford University Press, 2009, p. 20-23.

[598] A good example would be the shareholders' agreement which is entered upon the completion of the acquisition of the company. In this case the shareholders who are selling large part of their shares make guarantees that their interests as the new minority shareholders will not be infringed by the new shareholder. If the new shareholder declines to sign the shareholders' agreement, the shareholders can decline to sell the shares altogether.

1.1. Shareholders' agreements and publicly listed companies

Almost all the legal research and discussions relating to shareholders' agreements are centred upon private companies[599]. This focus only towards the privately held companies is usually justified by the fact that the private company is the dominating form of organizing a business, there is no market for shares of the private companies[600] and that in practice shareholders' agreements are present only in small companies as large number of shareholders in large or public companies prevents them from contracting effectively[601]. Some scholars have also suggested that, from a theoretical point of view, shareholders of listed companies are better protected by various high standard rules that apply only to the listed companies, the shares are tradable on the regulated market and due to large numbers of shareholders the shareholders' agreements are usually impractical[602]. Other researchers argue that shareholders' agreements are rarely found in publicly listed companies (but do not provide any empirical evidences to support their arguments) and claim that one of the main reasons for this is the free transferability of shares of publicly listed companies[603]. Although it is true that there are more privately owned companies as compared to publicly listed ones and that shareholders of listed companies are better positioned to sell their shares through the regulated

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[599] For example, CADMAN, J. *Shareholders' Agreements. 4th ed.* London: Sweet & Maxwell, 2004; THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009; MEANS, B. A. Contractual Approach to Shareholder Oppression Law. *The Fordham Law Review*, 2010, Vol. 79, No. 3, p. 1161-1211; LACAVE, I. S.; GUTIERREZ, N. B. Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses. *European Business Organization Law Review*, 2010, Vol. 11, No. 3, p. 423-458; KULMS, R. A Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany. *European Business Organization Law Review*, 2001, No. 2, p. 685-701; MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 5-27.

[600] Some authors provide this justification for the scope of their research. For example, KULMS, R. A Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany. *European Business Organization Law Review*, 2001, No. 2, p. 688; 698-699.

[601] For example, STECHTER, M. *et al*. General report. In STECHTER, M. (ed.) *Protection of Minority Shareholders*. London: Kluwer Law International, 1997, p. 12.

[602] For example, CADMAN, J. *Shareholders' Agreements. 4th ed.* London: Sweet & Maxwell, 2004, p. 1.

[603] THOMAS, K. R.; RYAN, Ch. The Law and Practice of Shareholders' Agreements. 3rd edition. London: LexisNexis, 2009, p. 2.

market, there are no arguments why research of shareholders' agreements should be limited only to privately owned companies[604]. Theoretical arguments and empirical results provided in this research suggest that shareholders' agreements can not only be entered among the shareholders of the listed companies, but also can be (and are) used to solve various conflicts of interest among the contracting shareholders.

As it has already been mentioned[605] shareholders' agreements are not regulated on a separate level of the European Union law and are addressed only sporadically in a few directives[606]. However, the laws of most of the EU member states permit shareholders' agreements, for example, the UK, Germany, France[607], Belgium and Lithuania. Shareholders' agreements are also quite actively concluded in practice[608] and should be regarded as an often

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[604] Some of the jurisdictions even have legislation regarding shareholders' agreements that from their wording and scope of application are primarily centred on the private limited liability companies. For example, article 7.32 of the United States Model Business Corporation Act. American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005. Other jurisdictions have gone even further and enacted provisions that render shareholders' agreements unenforceable. For example, article 82 of the Danish Companies Act stipulates that 'Shareholders' agreements are not binding on the limited liability company, or with regard to resolutions passed at general meetings'. See: Act No. 470 of 12 June 2009 on Public and Private Limited Companies (Companies Act) (in Danish: *Selskabsloven*).

[605] See Part I, Chapter 5.

[606] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[607] SIEMS, M. *Convergence in Shareholder Law*, Cambridge: Cambridge University Press, 2008, p. 54-56.

[608] For example, legal practitioners in different jurisdictions argue that shareholders' agreements are common in listed companies in Belgium, Denmark, Germany, Italy and Spain. See: VERMEERSCH, K. Belgium In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=EA53B41D-BBD4-4821-8068-DE2F5F12EAFC>; BIGAARD, S. Denmark. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=0863715E-EFD5-41FD-A553-3D24E0268D2B>; GESELL, H. Germany. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=63D9B6E1-A039-4842-881C-71010F44AB98>; RUIZ, X.; GUEMES, L. Spain. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=6FA09A75-1FDF-4000-9B23-78E031E28943>; NUNZIANTE, G. Italy. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at:

used[609] legal tool to address and regulate relationships among the shareholders of a particular company (usually in order to enhance the control over the company). However, legal doctrine has been limited in providing analysis and comparison of legal regimes on shareholders' agreements in different member states. This analysis, in the author's view, is required in order to understand whether shareholders' agreements can be used as a tool to mitigate conflicts of interest arising in the context of corporate governance between different constituents.

1.2. Concept of the shareholders' agreement

In the broadest sense an agreement is the meeting of the minds of two or more persons who are contracting in order to establish rights and duties amongst each other[610]. The principle of freedom of contract presupposes that natural and legal persons are free to decide whether to contract, with whom to contract and on what terms to agree in their contract[611]. The principle of freedom of contract also entails that parties can enter into contract that is not explicitly regulated or allowed by the statutory provisions established in different laws. However, in these cases it is agreed that the contract must be in line with the mandatory provisions set in the laws, general principles of law, moral norms and public policy[612]. Otherwise, it is presumed to be null and void.

Due to these reasons the shareholders of any company are free to contract and to enter into shareholders' agreement in order to establish rights

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<http://www.ibanet.org/Document/Default.aspx?DocumentUid=F16AECA1-542E-4367-9AA2-19F91F8CA428>.

609 Around 8 % of the listed companies in the European Union have shareholders' agreements in place. See: Report on the proportionality principle, p. 35.

610 MIKELĖNAS, V. *Lietuvos Respublikos civilinio kodekso komentaras*. Šeštoji knyga. Prievolių teisė I. Vilnius: Justitia, 2003, p. 192.

611 VON BAR, Ch.; CLIVE, E.; SCHULTE-NOLKE, H. (eds.). Study Group on a European Civil Code and Research Group on EC Private Law (Acquis Group). *Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference*. Munich: Sellier. European law publishers, 2009, p. 62-70.

612 MIKELĖNAS, V. *Sutarčių teisė*. Vilnius: Justitia, 1996, p. 40 – 41.

and duties towards each other[613]. Although it is sometimes argued that in jurisdictions without any statutory provisions on the shareholders' agreements, they are not legally binding contracts but more of a 'gentlemen's agreement' type of relations between contracting parties[614], the author does not agree with such position. The fact that shareholders agreements are rarely regulated by the legislature and most of the times left to the general principles of contract law and the will of contracting parties does not make such contracts non-binding (unless they are against the mandatory statutory provisions). On the contrary, the biggest advantage of private civil law is that parties are free to contract and regulate their relations as long as their actions do not infringe mandatory provisions and norms. Shareholders' of any company (including public and private ones) are also free to regulate their relations by creating legally binding duties and enforceable rights towards each other. In other words, shareholders' agreement should be considered as a perfectly valid contractual tool that helps regulating relationships inside the company and should not be regarded as a merely 'gentlemen's agreement'.

From the theoretical legal perspective, the definition of the shareholders' agreement is identical whether the agreement is concluded between the shareholders of a listed public company or a private firm, although it is true that the content, bargaining rights and actual provisions of the agreement differ depending on various variables, including the type of the company. In the light of contractual freedom, the shareholders' agreement can

[613] Similar reasoning can be seen in some of the company laws where legislature just confirms the freedom of contract principle and the right of shareholders to enter into agreements. For example, article 15(7) of the Companies Act of the Republic of South Africa stipulates that 'the shareholders of a company may enter into any agreement with one another concerning any matter relating to the company, but any such agreement must be consistent with this Act and the company's Memorandum of Incorporation, and any provision of such an agreement that is inconsistent with this Act or the company's Memorandum of Incorporation is void to the extent of the inconsistency'. See: Companies Act, 2008 No. 71 of 2008 (as amended by Companies Amendment Act, No. 3 of 2011).

[614] NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. (eds.) Het Gewijzigde Vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991. Antwerpen: Maklu Uitgevers, 1992, p. 255.

be defined as *a written or oral contract*[615] *between the shareholders of a company (at least one of the shareholders has to be a party*[616]*) that is governed by the general principles of contract law*[617]*. The subject matter of the agreement must be related to 1) the company; 2) the shares of the company, and; 3) rights, duties and obligations of shareholders' towards each other or towards the company.* It is a relatively broad definition but it cannot be narrowed down as it would limit the freedom of shareholders to deal with their own interests in a way that they see it fit. This definition of shareholders' agreement encompasses other agreements between shareholders that are rather limited in scope. For example, voting agreements[618], relationship agreements[619], transfer of voting rights agreements[620] and securities' lending agreements[621] fall within the definition of shareholders' agreement.

Shareholders' agreements (as any other agreements concluded according to contract law) are binding to the parties and have the same

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[615] Oral shareholders' agreements are indeed concluded in practice. See: Financière de Tubize SA, *Annual Report 2010* [interactive]. [Accessed on 2012-01-28] Available online at: <http://www.financiere-tubize.be/en/rapport_ca_6.html>. Despite this, oral shareholders' agreements raise some questions of enforceability and even doubts whether parties to the contract will be able to remember and perform what they have agreed as the time passes.

[616] The one shareholder requirement is intended to capture the relationship agreements under the concept provided in this dissertation. However, agreements between shareholders and creditors do not fall under the definition of shareholders' agreement. Only one shareholder can be a party to the securities lending agreements as well.

[617] This definition is also supported by other legal scholars. See, for example, CADMAN, J. *Shareholders' Agreements*. London: Sweet & Maxwell Limited, 2003, p. 3; MADELON, C.; THOMSEN, S. Contracting Around Ownership: Shareholder Agreements in France. In *Modern Firm, Corporate Governance and Investment*. Cheltenham: Edward Elgar Publishing Limited, 2009, p. 255.

[618] By entering into voting agreement shareholders agree to jointly exercise their voting rights in the general meeting of shareholders and vote according to the procedure set in the agreement. See: Picanol Group NV, *Press release of April 16, 2009* [interactive]. [Accessed on 2012-01-28] Available online at: <http://www.picanolgroup.com/NR/rdonlyres/A855A8F1-EAA2-43F9-ACB2-E08C1AE04B82/0/PR16042009Eng.pdf>.

[619] Relationship agreements are usually entered into by the majority shareholder and the company and are mostly found in the UK. See: Part II, Chapter 4.3. These agreements insure that all the transactions between the company and majority shareholder are to be at an arm's length. In context of fraudulent behaviour they guarantee that the management of the company remains independent from the influence of the majority shareholder. See: Avis Europe plc., *Annual report and accounts 2010* [interactive]. [Accessed on 2012-01-28] Available online at: <http://www.annualreports.com/HostedData/AnnualReports/PDF/ave2010.pdf>.

[620] See: Part II, Chapter 2.2.

[621] See: Part II, Chapters 3.2. and 4.2.

mandatory effect as any statutory law[622], although it has to be admitted that the character of shareholders' agreements tends to be more of private and confidential nature[623]. Thus, any disputes arising from the shareholders' agreements are usually settled in privacy, either by mutual agreement of the parties or with the help of any alternative dispute resolution system (arbitration being the most common one)[624].

Depending on the interests of the contracting parties, the aims that they want to achieve and on the actual voting rights that contracting parties can exercise, the shareholders' agreements can deal with the following[625]:

- Strategy, common policy and main activities of the company[626];
- Structure of the company[627];
- Rights and duties of the shareholders[628];

[622] For example, Article 6.189(1) of the Lithuanian CC stipulates that any valid agreement concluded in accordance with the laws has a mandatory effect on the parties to this agreement.

[623] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 2.

[624] ROOS, C. M. Comparative Notes on Shareholders' Voting Agreements. *Scandinavian Studies in Law*, 1971, No. 15, p. 165.

[625] The clauses of shareholders' agreements can be categorized as follows: 1) Voting provisions that deal with the exercise of voting rights in the general meeting of shareholders, coordination of actions and formulation of general policy and strategy of the company; 2) Management provisions that deal with the composition of the management and the distribution of powers and control in the company; 3) Financial provisions that are related to the restrictions of share transfer, pre-emptive rights and share capital of the company; 4) Boilerplate provisions – termination, confidentiality and other general clauses. See: BELOT, F., Shareholder Agreements and Firm Value: Evidence from French Listed Firms. *AFFI/EUROFIDAI, Paris December 2008 Finance International Meeting AFFI – EUROPIDAI*, 2008 [interactive]. [Accessed on 2012-01-28] Available online at: <http://ssrn.com/abstract=1282144>, p. 6; MADELON, C.; THOMSEN, S. Contracting Around Ownership: Shareholder Agreements in France. In *Modern Firm, Corporate Governance and Investment*. Cheltenham: Edward Elgar Publishing Limited, 2009, p. 255; RYDER, R. D. *Corporate and commercial agreements: drafting guidelines, forms and precedents*. Universal Law Publishing Co., 2005, p. 295-315; THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 2.

[626] For an example see: Ascencio SCA. *Jaarverslag 2010* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.ascencio.be/fileadmin/user_upload/rapport-annuels/Ascencio-Rapport-annuel-2010-web-NL.pdf>, where parties agreed on the common policy and strategy of the company.

[627] For an example see: Bannimo NV. *Rapport annuel 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.banimmo.be/01/MyDocuments/Banimmo%20Rapport%20annuel%202009.pdf>. In this case shareholders agreed to keep the same structure of the management body of the company and not to vote for any changes.

[628] For an example see: Fluxys NV. *Annual report 2009* [interactive]. [Accessed on 2011-03-20] Available online at:

- Relationships among shareholders', including protection of minority shareholders[629];
- Relationships between shareholders and management, including the power and functions of management[630];
- Relationships between shareholders and the company[631];
- The exercise of voting rights, including concerted actions, veto rights and voting ceilings[632];
- Acquisition of shares and pre-emptive rights, including any restrictions on the transfer of voting rights (tag-along or drag-along rights)[633];

<http://www.fluxys.com/en/Financial%20info/AnnualFinancialReports/~/media/Files/Financial%20info/Annual%20Reports/EN/Fluxys_RA_2009_UK_web%20pdf.ashx>. One of the shareholders undertook an obligation to own at least 24 % of the shares of the company.

[629] For an example see: Moneysupermarket.Com Group plc. *Annual report 2010* [interactive]. [Accessed on 2011-06-28] Available online at: <http://www.investis.com/mony/financial/results/2011/annual_reportxyz_10.pdf>, where the majority shareholder agreed on the composition of the board of directors and on the procedure to avoid conflicts of interest.

[630] For an example see: SANITAS, AB. Neaudituotų tarpinių sutrumpintų konsoliduotųjų ir atskirų 2010 m. birželio 30 d. finansinių ataskaitų rinkiniai, parengti pagal tarptautinius finansinės atskaitomybės standartus, priimtus taikyti Europos Sąjungoje, ir tarpinis konsoliduotasis 2010 m. šešių mėnesių pranešimas [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/san/2010_q2_lt_ltl_con_ias.pdf>, where parties to the shareholders' agreement agreed on the number of members of the management body that they have a right to appoint. They also agreed not to vote for any amendments of the articles of association which might change the number of board of directors.

[631] For an example see: Accumuli plc. *Annual report and accounts 2010* [interactive]. [Accessed on 2011-03-27] Available online at: <http://www.accumuliplc.com/pdf/Accumuli%20plc%20Annual%20Report%20and%20Accounts%202010.pdf>. The contracting shareholders agreed to act in the best interests of the company and to deal with the company in line with the arm's length principle.

[632] For an example see: Henex SA. *Rapport de Gestion 2010* [interactive]. [Accessed on 2011-06-22] Available online at: <http://www.henex.be/Pdf/Etats%20financiers%20IFRS%202010.pdf> where shareholders agreed to vote in the general meeting of shareholders in such a way as to block any attempts of takeover of the company. For another example of shareholders agreeing on voting ceilings see: British Sky Broadcasting Group plc. *Annual report 2010* [interactive]. [Accessed on 2011-06-26] Available online at: <http://corporate.sky.com/documents/pdf/1ffb247d89b6490c9cd3dc7a4f24f4eb/2010/Annual_Report_2010>. For another example see: ROKIŠKIO SŪRIS, AB. *2010 m. šešių mėnesių tarpinės konsoliduotos finansinės ataskaitos ir tarpinis konsoliduotas pranešimas* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/rsu/2010_q2_lt_ltl_con_ias.pdf>, where parties entered into voting agreement for the sole purpose of concentrating control and gaining simple majority in the general meeting of the shareholders.

- Transfer of voting rights[634];
- Distribution of dividends[635];
- Deadlock situations;
- Succession issues[636];
- Liability for breaching the shareholders' agreement including the nullification of voting rights cast in the general meeting of shareholders;
- Confidentiality, termination and dispute resolution.

As shareholders' agreement is a manifestation of the freedom of contract principle, it can deal with one or more of the above mentioned issues. Thus, in most of the cases shareholders' agreements deal with a number of the issues listed above, and only in rare cases are they limited to only one of the issues.

1.3. Aims of the shareholders' agreement

By entering into shareholders' agreement, as in any other contractual relationships, the parties usually aim to create, modify or terminate their rights and duties[637]. Due to the fact that the shareholders' agreement is a special type

[633] For an example see: Floridienne NV. *Annual report 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.floridienne.be/images/biblio/biblio-1-288.pdf>, where parties agreed to offer shares to other parties of the agreement before selling them to third parties.

[634] For an example see: GUBERNIJA, AB. *2010 m. šešių mėnesių tarpinis pranešimas ir tarpinė finansinė atskaitomybė (neaudituota)* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/gub/2010_q2_lt_ltl_solo_ias.pdf>. In this case shareholders of the company transferred their voting rights without transferring their shares to other shareholders of the company.

[635] For an example see: Bannimo NV. *Rapport annuel 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.banimmo.be/01/MyDocuments/Banimmo%20Rapport%20annuel%202009.pdf>. In the agreement shareholders stipulated rules on the policy of dividend distribution.

[636] For an example see: Service Flats Invest NV. *Annual report 2010* [interactive]. [Accessed on 2011-04-22] Available online at: <http://www.sfi.be/docs/jaarverslag2010.pdf>. Shareholders agreed that the shareholders' agreement should be binding also to any successors of the present shareholders. Therefore, any transfer of shares must be accompanied by the shareholders' agreement.

[637] MIKELĖNAS, V.; TAMINSKAS, A.; VILEITA, A. Lietuvos Respublikos civilinio kodekso komentaras. Pirmoji knyga. Bendrosios nuostatos. Vilnius: Justitia, 2001, p. 157.

of contract, parties pursue special aims[638] some of which will be discussed below[639].

1.3.1. The aim to concentrate control

If there are no controlling shareholders in the company (in other words, ownership structure of the company is dispersed or at least relatively dispersed), shareholders' agreement can be used to concentrate voting power and strengthen the influence and control of the contracting shareholders in the company[640]. From a theoretical standpoint, the initiative to contract in this case might be presumed to rest with the relatively large shareholder who has most of the voting rights conferred by the shares (however, this shareholder should not have the controlling package). Smaller contracting shareholders also benefit, as they are assured that their interests will be taken into during the business of the company. The fact that shareholders' agreements are used to empower the contracting shareholders or otherwise enhance their position to influence the governance of the company is also recognised by practitioners[641].

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[638] In general, shareholders‘ agreements are attributed to the category of cooperation agreements, therefore the aims are always directed at joint interests of the contracting parties. *See* MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 14.

[639] Some authors argue that all the aims of the shareholders' agreements can be classified into three major groups: 1) agreements used to concentrate control of the corporation in as small group of shareholders as possible; 2) agreements with the purpose to distribute the control among as many shareholders as possible; 3) agreements used in order to transfer the control from one group of contracting parties to another. See: ROOS, C. M. Comparative Notes on Shareholders' Voting Agreements. *Scandinavian Studies in Law*, 1971, No. 15, p. 166; DUFFY, M. J. Shareholders Agreements and Shareholders' Remedies. Contract Versus Statute? *Bond Law Review*, 2008, Vol. 20, No. 2, p. 4. Other authors do not attribute special attention to the purpose and aims of the shareholders' agreements, but provide a general list of such aims. See: BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 432.

[640] Shareholders of the KBC Group NV, a company listed on the NYSE Euronext Brussels stock exchange, have agreed to coordinate the exercise of the voting rights. In this case the relatively large shareholder held 23 % while others held 12,9 %, 7,3 % and less of the voting rights conferred by the shares. After concluding the shareholders' agreement the contracting shareholders held more than 30 % of total voting rights in the company. See: KBC Group NV. *Annual report 2009* [interactive]. [Accessed on 2011-01-31] Available online at: <https://multimediafiles.kbcgroup.eu/ng/published/KBCCOM/PDF/COM_RVG_pdf_jaarverslag_KBC_Groep_2009_EN.pdf>.

[641] GARRATT, B. *The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition*. London: Profile Books, 2010, p. 14.

Under this scenario, on the one side of the table are the shareholders, who have relatively large block of shares in the company[642]. They are presumed to have a relatively large block of voting rights (compared to other contracting parties) and accordingly to be interested in influencing and controlling the company. The motivation to contract for larger shareholders rests in the expectations to get bigger returns as their investments are relatively large and more voting rights might lead to more control over the company (for example, through appointment of managers). Shareholders' agreement allows relatively large shareholder to attain the required level of controlling rights by influencing or even exercising the votes of the contracting smaller shareholders. Increased voting power in the hands of the relatively large shareholder confers more control over the management of the company, which in turn justifies the costs incurred while contracting with smaller shareholders.

On the other end of the table are the small shareholders who, due to their small stake in the company and relatively high costs of monitoring the management bodies, are not in a position to monitor and control the management of the company on their own[643]. If the minority shareholders are interested in the long term ownership of the shares and participation in the activities of the company, they can bargain with the relatively large shareholder for better protection of their interests and some extra rights (for example, to nominate a member of the management body or to require voting for dividend distribution). By entering into shareholders' agreement smaller shareholders can expect that all the decisions (both by the general meeting of the shareholders and the board of directors) are likely to be passed with their interests in mind (as there will be a monitoring shareholder with powerful voting rights package). If smaller shareholders think that the relatively large

642 The more voting power is concentrated in one hands, the more control can be exerted over the company. Thus, the controlling shareholder in the company enjoys the most private benefits of control. See: DYCK, A.; ZINGALES, L. Private Benefits of Control: An International Comparison. *The Journal of Finance*, 2004, Vol. LIX, No. 2, p. 540-541.

643 The same line of thought on the shareholders' agreements in listed companies has also been provided by some other legal scholars. See: BAGLIONI, A. Shareholders' Agreements and Voting Power: Evidence from Italian Listed Firms. *Applied Economics*, 2011, Vol. 43, No. 27, p. 4044.

shareholder is expropriating them or acting against their interests, they can always invoke the provisions of the agreement protecting their interests or even terminate shareholders' agreement (if all the mandatory requirements stipulated in the contract are met)[644]. The relatively large shareholder should be aware of this situation and is presumed not to expropriate minority shareholders as he might lose all the control powers (together with any private benefits of control) over the company vested to him. However, all the small contracting shareholders should be aware of the fact that they are giving all the control powers to the relatively large shareholder and should avoid falling victims of the larger shareholder by inserting appropriate contractual mechanisms for protecting their rights.

Without the cooperation between the relatively large shareholder and small shareholders the control of the company (and in turn the private benefits gained from such control) would be very hard to achieve. Shareholders' agreement is a way of furthering the interests of all the contracting parties under the conditions provided above. Thus, relatively large shareholder is allowed to control the company as long as he is doing it with the interests of smaller contracting shareholders in mind.

The above argumentation also holds water in cases where there are few relatively large shareholders[645]. In these cases the costs of contracting are even lower as there are fewer parties involved. Under this premise, the parties are equally interested in exercising control over the company but are not able to do so without the assent of the other shareholder. Thus, all relatively large shareholders are concerned with finding a way to exert their control over the

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[644] It could be argued that this will worsen the position of the minority shareholders. However, this mechanism should be considered as an insurance policy for minority shareholders in cases when relatively large shareholder is breaching his contractual obligations. Under the hypothesis provided in this chapter the relatively large shareholder needs minority shareholders to attain controlling rights of the company.

[645] For example, two shareholders of the Henex SA, a company listed on the NYSE Euronext Brussels stock exchange, having 20,17 % and 21,32 % of the voting rights, have agreed on concerted exercise of their voting rights in the general meeting of the shareholders. See: Henex SA. *Rapport de Gestion 2010* [interactive]. [Accessed on 2011-06-22] Available online at: <http://www.henex.be/Pdf/Etats%20financiers%20IFRS%202010.pdf>.

company. Shareholders' agreement under these circumstances can provide for a solution by allowing shareholders to concentrate their voting power and gain benefits of control which would not be possible to gain if the relatively large shareholders acted separately.

There are also evidences that small shareholders, driven by the interest to concentrate control and their voting power, without a clear leader (who would have a relatively large shareholding package) are also prone to enter into shareholders' agreement[646]. This can be explained by the fact that accumulation of votes in the general meeting of shareholders allows contracting parties to exercise rights that would not be available to them if they were acting alone. Certain rights become available to shareholders only after a certain minimum threshold of voting or ownership rights is crossed (for example, the right of inquiry under Lithuanian law[647]). Thus, shareholders gaining more voting rights in the general meeting of the shareholders can enjoy more rights that enhance their position in the company.

Concentration of power and voting rights is also possible in situations when shareholders lack knowledge and experience in monitoring management bodies of the company or do not have access to specific information, which is needed in order to decide on the strategy and policy of a particular company. In these cases shareholders are presumed to be better off if they would contract with the shareholders who have the required knowledge or experience. However, this seems to be possible only in situations when the shareholders

[646] For example, some of the shareholders of the company listed on the NYSE Euronext Brussels stock exchange have agreed to concentrate their control over the company by agreeing on concerted exercise of their voting rights in the general meeting of the shareholders. It is important to mention that a total number of 28 shareholders with voting rights ranging from 0,03 % to 5% were parties to the agreement. See: Picanol Group NV. *2009-04-16 Press Release* [interactive]. [Accessed on 2011-04-22] Available online at: <http://www.picanolgroup.com/NR/rdonlyres/A855A8F1-EAA2-43F9-ACB2-E08C1AE04B82/0/PR16042009Eng.pdf>.

[647] Articles 2.124-2.131 of the Lithuanian CC. For an analysis of the right of inquiry under Lithuanian law see: MILIAUSKAS, P. Right of Inquiry in Corporate Law. In *Contemporary Private Law* (ed. S. M. Kierkegaard). IAITL, 2012, p. 349-363.

having the knowledge or experience do not have a controlling block of the shares in the company and need voting rights that other shareholder possess[648].

1.3.2. The aim to protect the interests of the minority shareholders

The second aim (which is alternative to the first) of the shareholders' agreement in the context of corporate governance is to protect the interests of minority shareholders[649]. This purpose should prevail when there is a majority shareholder (or a group of controlling shareholders) entering into shareholders' agreement with minority shareholders. This prevents the diktat of the majority shareholder and allows minority shareholders to express their intentions and expectations through discussions and possible consensus in the general meeting of shareholders[650].

At this point the question arises whether the majority shareholder is willing to limit himself (and as a result his controlling power in the company together with his ability to extract private benefits of control) by contracting with minority shareholders. There are several situations when it could be presumed that majority shareholder is willing to contract with the minority shareholder. Firstly, in a situation when a listed company is increasing its capital and there are investors willing to provide the required capital, the majority shareholder will sometimes be asked to enter into shareholders' agreement if the monetary contribution is huge (although such contribution might only confer 5 % or even less of the total voting rights). Thus, majority shareholder will be forced to contract with a new minority shareholder who provides capital to the company[651]. A similar situation occurs, when the

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[648] Under the condition that no mandatory bid rules are triggered.

[649] Some jurisdictions even have similar purpose set in the laws. For example, in article 2341-bis of the Italian Civil Code it is stipulated that shareholders' agreements might have 'the purpose of stabilizing the relationships among shareholders'. See: BELTRAMO, M. *et al. The Italian Civil Code and Complementary Legislation. 3rd edition*. New York: Oxford University Press, 2010.

[650] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 1, 23-24.

[651] For an example see: Įmonių grupė "ALITA", AB. *Circular of the mandatory non-competitive tender offer to buy the remaining voting shares in Įmonių grupė "ALITA"*, AB, 2011-11-02

company acquires shares of a target company and as a consideration for the acquisition (or part of it) issues new shares, a shareholders' agreement might be signed with a new minority shareholder[652]. In this case shareholders of the company which is being acquired might sell their shares only upon condition of entering into shareholders' agreement. Thirdly, protection of certain interests of minority shareholders can also be guaranteed by the relationships agreement between the company and the majority shareholder[653]. Finally, shareholders' agreement can be concluded with minority shareholders when they can influence the balance of power between two competing block holders. This happens in cases where two relatively large block holders compete for the control of the company (and do not coordinate their actions as it was suggested in previous paragraphs) and minority shareholder can effectively determine which one of them will be assume control of the company.

In all the aforementioned situations, minority shareholders are in place to bargain for better protection of their interests in the company. If the majority shareholder refuses to contract, shareholders' agreement can still be concluded among minority shareholders[654]. In this case, the concentration of voting rights grants minority shareholders more rights (for example, to initiate the general meeting of shareholders or to put items on the agenda and other rights that

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[interactive]. [Accessed on 2012-04-18] Available online at: <http://www.alita.lt/wp-content/uploads/2012/03/Circular-of-the-mandatory-ALITA-02-11-2011.pdf>. The new majority shareholder entered into shareholders' agreement with the minority shareholder of the company. The terms of the contract were especially beneficial to the minority shareholder.

652 For an example see: Amiad Filtration Systems Ltd, *Press release of April 29, 2010* [interactive]. [Accessed on 2011-04-22] Available online at: <http://www.amiad.com/files/Amiad_completes_acquisition_of_Arkal_29_04_10_(2).pdf>. In this case a majority shareholder (45,58 %) entered into shareholders' agreement with three minority shareholders (14,5 % of voting rights in total).

653 Relationship agreements are usually entered into by the majority shareholder and the company and are mostly found in the UK. See: Part II, Chapter 4.3. These agreements ensure that all the transactions between the company and majority shareholder are to be at an arm's length. In context of fraudulent behaviour they guarantee that the management of the company remains independent from the influence of the majority shareholder. This is certainly to the benefits of the minority shareholders. See: Avis Europe plc. *Annual report and accounts 2010* [interactive]. [Accessed on 2011-06-25] Available online at: <http://www.annualreports.com/HostedData/AnnualReports/PDF/ave2010.pdf>.

654 Similar position has been stated by Belgian scholars as well. See: NYSSENS, Harold. *Stemovereenkomsten: Surrogaat voor certificering?* 1991-1992 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/28n3/nyssens.pdf>, p. 171.

require certain voting block) and better position to protect their interests in case of expropriation by majority shareholder.

Despite of the above, it should be agreed that in cases where the majority shareholder is strong and has a block of shares that allows him to dominate in the general meeting of the shareholders, the minority shareholders should be considered as being in a position that does not allow them to bargain for their interests. However, there is a reason why companies go public and usually this reason is to raise funding. If the minority shareholders are expropriated, they will not be willing to pay any premiums for the shares of that particular company. This situation is likely to lower the price that investors are willing to pay for the shares and in turn reduce the wealth of the controlling shareholder. This should be considered one of the reasons why companies listed in the UK enter into relationship agreements[655] (it is considered as a type of shareholders' agreement) with their controlling shareholders. This sends a signal to the minority shareholders that the majority shareholder is not likely to expropriate them in order to satisfy his private interests. Although minority shareholders are not parties to such relationship agreements, it should still be considered as being beneficial to their interests.

1.3.3. Other aims

Other aims of shareholders' agreement could be identified as well. Contractual relationships between shareholders can be used to maintain the *status quo* situation in the company[656]. In this regard, shareholders can agree not to change articles of association of the company and not to alter structure of the governance system, *id est*, the number of members and responsibilities of the management body, supervisory body or committees. It should be noted that an agreement of the shareholders regarding the change of the articles of

[655] See: Part II, Chapter 4.3.

[656] For an example see: Bannimo NV. *Rapport annuel 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.banimmo.be/01/MyDocuments/Banimmo%20Rapport%20annuel%202009.pdf>. In this case shareholders agreed to keep the same structure of the company and not to vote for any changes.

association of the company, the number, appointment and dismissal of the members of the management bodies of the company should be understood as a type of voting agreement. All of the above actions can be realized only by exercising voting rights during the general meeting of the shareholders. Only by voting can the articles of association be changed and members of the management body appointed. For example, in a situation when majority shareholder is contracting with relatively small shareholders (who at the same time are the members of the management board)[657] regarding the appointment of the members of the management body, the contractual right of the relatively small shareholder most of times[658] depends on the exercise of voting rights by the majority shareholder. Minority shareholders can occupy the position in the management as long as majority shareholder approves of this. Thus, minority shareholder can contractually enhance his position by contracting for *status quo*.

Another aim of the shareholders' agreement could be to avoid deadlock situations. The deadlock situation exists when shareholders (or their appointed members of the management bodies) cannot agree on a particular matter related to the management of the company. The deadlock is presumed to exists when the power of shareholders is distributed evenly and no decision can be adopted or in situation when a veto right is being exercised[659]. Deadlock situations are likely to occur in private non-listed companies and are highly unlikely in listed companies due to the wide distribution of the shareholdings. Nevertheless, a deadlock situation (at least temporarily) could occur in listed companies as well if two major block holders would disagree on the course of

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[657] The example is adopted according to a real world case. See: Bannimo NV. *Rapport annuel 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.banimmo.be/01/MyDocuments/Banimmo%20Rapport%20annuel%202009.pdf>.

[658] The fact whether cumulative voting system is in place should be at all times taken into account. For example, in Lithuania the cumulative voting system is mandatory when appointing members of the management and supervisory bodies. See: articles 31(3) and 33(3) of the Lithuanian ABI.

[659] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 110-111.

action or strategy of the company[660]. Shareholders' agreement might provide possible solutions to any possible future deadlock situations, however, such clauses will not be analysed in this dissertation.

If the company itself or members of the management body are parties to the shareholders' agreement, then certain supplementary duties can be agreed upon, for example, certain information disclosure duties (that members of the management board are obliged to disclose information which would not normally be required to disclose under statutory provisions). Most of the times this would mean that company has to be a party to the shareholders' agreement as certain duties of the members of the management bodies have to be transposed in to the internal documents of the company[661].

Dividends are the main form of shareholder compensation if the company is successful and profitable. Therefore, it is to the interests of the shareholders to agree on the dividend distribution policy. This could be considered as another aim of the shareholders entering into the shareholders' agreement[662]. Shareholders can agree not only on the rules or exercise of voting rights in order to distribute the profits of the company, but also on the investments (when, under what financial indicators, into what sectors and etc.) that can be made from the accumulated profit of the company.

When natural persons are parties to the shareholders' agreement, the agreement can regulate succession issues. The aim of these provisions is to ensure the continuity and enforcement of the shareholders' agreement upon the

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660 Despite the fact that shareholders of the listed companies have access to stock markets, it is still difficult to sell bigger blocks of shares and exit the company in cases of deadlock.

661 For example, Telenet Group Holding NV (a public limited liability company that is listed on NYSE Euronext Brussels stock exchange) shareholders agreed in the shareholders' agreement on the composition of the board of directors, on the way resolutions should be passed and on the existence and functioning of the committees of the board of directors. These provisions were transferred into the corporate governance charter and articles of association of the company. See: Telenet Group Holding NV. *Corporate Governance Charter* [interactive]. [Accessed on 2011-07-14] Available online at: <http://telenet.be/media/fs/1/others/pdf/investor/Charter%20clean%20EN%20310506.pdf>.

662 For an example see: Bannimo NV. *Rapport annuel 2009* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.banimmo.be/01/MyDocuments/Banimmo%20Rapport%20annuel%202009.pdf>. In the agreement shareholders stipulated rules on the policy of dividend distribution.

future shareholders. Generally, the agreement is binding only to the parties and does not have any effects to the rights and duties of third parties that might later become shareholders of the company[663]. In terms of succession law the nature of obligations should always be taken into account before deciding whether the new shareholder could be bound by such obligations. In certain situations the provision in the shareholders' agreement could be regarded as personal, and thus not applicable to the successor of the shareholder (for example, the right of a particular shareholder to be appointed as a member of the supervisory board). Legal persons who are shareholders might also be subject to an obligation regarding the continuity of the shareholders' agreement. The parties can agree that in case of sale, transfer of shares or merger of the shareholder (in cases it is a company), the company acquiring ownership rights of the shareholder is mandated to sign the shareholders' agreement before the ownership rights are transferred[664].

In order to avoid possible future disputes among the shareholders, shareholders' agreement can regulate the rights of the shareholders when one of them decides to exit the company[665]. The shareholders' agreement can deal with pre-emptive[666], tag along[667] or drag along[668] rights. All of these clauses in

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[663] This is contrast to the articles of association which is officially registered document available to the public for inspection. All the future shareholders are bound by the existing articles of association.

[664] For example, Metals exploration plc. *Subscription and Shareholders‘ Agreement* [interactive]. [Accessed on 2011-03-12] Available online at: <http://www.metalsexploration.com/pdf/Subscptn-Sharhldrs_Agreement/MTL_Sbscrptn_Shrhldrs_Agrmnt.pdf>. Article 19.2 of the agreement stipulates that 'in the event of any sale or transfer of any Shares <…> prior to completion of any such sale or transfer, the buyer or transferee shall first enter into a deed of adherence in a form and content reasonably acceptable to the Company'.

[665] For example, shareholders of Pinguin Lutosa NV (a public limited liability company that is listed on NYSE Euronext Brussels stock exchange) agreed on the pre-emptive rights and tag along rights in cases of sale or transfer of the shares. See: Pinguin Lutosa NV. *Annual report 2009* [interactive]. [Accessed on 2011-04-22] Available online at: <http://www.pinguinlutosa.com/files/finances/rapports%20annuels/uk/Annual%20report%202009%20Commercial_ENG.pdf>; Pinguin Lutosa NV. *Annual report 2010* [interactive]. [Accessed on 2011-07-14] Available online at: <http://flipflashpages.uniflip.com/2/41091/92745/pub/document.pdf>.

[666] For comparison: articles 15(1.4), 46 and 47 of the Lithuanian ABI. Statutory pre-emptive rights in Lithuania are conferred only to the shareholders of private non-listed companies. However, there are no limitations for the shareholders of listed companies to agree on such rights. For more on pre-emptive rights in Lithuania see: RIMAS, J. *Privataus kapitalo sandoriai: bendrovių teisės aspektai (daktaro disertacija)*. Vilnius: Vilnius University, 2010, p. 247-262.; BITĖ, V.; KIRŠIENĖ, J. Akcininkų išankstinio atsisakymo pirmumo teisės įsigyti parduodamas akcijas teisinis vertinimas.

the shareholders' agreements are aimed at providing solutions for possible legal disputes if one of the contracting parties decides to sell or transfer the shares of the company and allow the parties either to buy the shares of the exiting shareholder or to exit the company together. These rights are essential as there might be situations when the shareholdings of one particular shareholder are dependent upon the other person being a shareholder (due to his expertise, investments, connections, etc.).

Shareholders' agreements can be entered upon before the incorporation of the company or before the initial public offering[669]. The founders can conclude the shareholders' agreement in order to strengthen their position in the company before selling part of the shares to the public and in this way diluting their shareholdings in the company[670]. In these cases shareholders' agreement serves as tool to concentrate control over the company.

It should be noted that there is no finite list of aims that shareholders may have while entering into contractual relationships and the attempt to provide detailed list falls outside the scope of this dissertation. However, it should be emphasised that from the perspective of agency theory, shareholders' agreements can serve two main aims: concentrate control of the shareholders in order to mitigate the shareholder-management conflicts of interest or to protect minority shareholders in order to solve the agency problem amongst the majority and minority shareholders.

Jurisprudencija, 2008, No. 5 (107), p. 61-71. For the UK see: ROCK, E.; DAVIES, P.; KANDA, H.; KRAAKMAN, R. Fundamental Changes. In *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*, Oxford: Oxford University Press, 2009, p. 195 – 196.

[667] CHEMLA, G.; HABIB, M. A.; LJUNGQVIST, A. An Analysis of Shareholder Agreements. *Journal of the European Economic Association*, 2007, Vol. 5, No. 1, p. 94.

[668] CHEMLA, G.; HABIB, M. A.; LJUNGQVIST, A. An Analysis of Shareholder Agreements. *Journal of the European Economic Association*, 2007, Vol. 5, No. 1, p. 117-119. See also: BIENZ, C.; WALZ, U. *Venture Capital Exit Rights* [interactive], 2010. [Accessed on 2011-01-15] Available online at: <http://ssrn.com/abstract=1140128>, p. 5.

[669] For example see: Hansen Transmissions International NV. *Annual report 2011* [interactive]. [Accessed on 2011-06-09] Available online at: <http://ir.hansentransmissions.com/Website/pixportal.nsf/pGen00/CORL-8HDAV8/$FILE/0.%20Hansen%20Annual%20Report%20FY%202011.pdf>.

[670] However, listing requirements of every stock exchange should be taken into account as they might contain certain restrictions to the use of shareholders' agreements.

1.3.4. Confidentiality

Shareholders' agreement is a privately negotiated contractual instrument, and thus parties can agree to keep the whole document or part of it confidential. Unlike the articles of association, the shareholders' agreement is not automatically subject to public disclosure. Shareholders willing to regulate their relations in managing the company and not willing to disclose their full obligations to the public can do so by entering into the shareholders' agreement. This line of thought is perfectly valid when talking about private non-listed companies. However, the situation with listed companies is more sensitive and controversial. Listed companies are required to disclose at least some information which could be in the shareholders' agreement, especially any restrictions on voting rights or transfer of shares[671]. Voting agreement (as a type of shareholders' agreements) in this regard could be treated as creating certain restrictions on the exercise of the voting rights. For example, if shareholders agree to vote under instructions of other contracting shareholders, then their voting rights are restricted (they cannot exercise them as they see it fit). This information should be regarded as essential for other shareholders and future investors as it creates possible deviations from the one-share one-vote principle[672]. Furthermore, shareholders' agreements have important consequences on the structure of the ownership of the company[673], and hence should be disclosed if they are likely to change the balance of control powers in the company. A situation when such distribution of power within the listed

[671] On the European level such obligation is established to the member states by the Directive 2004/109/EC. See: Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57); Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

[672] FERRARINI, G. A. *One Share - One Vote: A European Rule?*, 2006 [interactive]. [Accessed on 2013-06-25] Available online at: <http://ssrn.com/abstract=875620>.

[673] See Part II, Chapter 1.5.

company is not disclosed solely on the ground of contractual confidentiality is against the transparency principle under which regulated markets operate. Thirdly, as discussed above, the disclosure requirements are mandatory for shareholders' agreements dealing with coordinated exercise of voting rights. The confidentiality clause cannot be used to avoid mandatory provisions. Fourthly, disclosure of relevant information on the concerted action might reduce agency problems[674]. Due to the above reasons, the author is of the opinion that any rules on the exercise of the voting rights in the general meeting of the shareholders agreed amongst the shareholders of listed companies should be disclosed in the annual reports of the company[675]. Listed companies should not be allowed to hide behind the veil of contractual confidentiality in order to avoid the disclosure of actual structure of the shareholdings in the company[676]. Therefore, confidentiality of the shareholders' agreements in listed companies should be limited.

1.4. Qualifying characteristics of the shareholders' agreement

Taking into account the concept and aims of the shareholders' agreement discussed above, qualifying characteristics of the shareholders' agreement are provided in the following paragraphs, including general characteristics, subject-matter, parties and form of the agreement.

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[674] ENRIQUES, L.; VOLPIN, P. F. Corporate Governance Reforms in Continental Europe. *Journal of Economic Perspectives*, 2007, Vol. 21, No. 1, p. 126.

[675] However, most of the times this is not the case and companies tend to indicate that shareholders have agreed on the concerted action and exercise of the voting rights, but fail to indicate how and on what matters the shareholders have agreed to act together. For example, see: Compagnie Financière de Neufcour SA. *Rapport Annuel 2009* [interactive]. [Accessed on 2011-06-23] Available online at: <http://www.neufcour.com/images/catalogue/id_1/images/576_Rapport_annuel_2009.pdf>.

[676] If shareholders want privacy and confidentiality they should form private companies.

1.4.1. General qualifying characteristics

The nature of the shareholders' agreement presupposes that most of the times it is entered upon by multiple parties acting in their own interests[677]. Thus, in most of the cases shareholders' agreement is a multiparty agreement with more than two contracting parties. However, in certain cases, shareholders' agreement can be entered between two parties or between two groups of parties.

The question whether shareholders' agreement should be qualified as a unilateral or bilateral[678] contract is a more complex one[679]. Parties to the shareholders' agreement usually have reciprocal rights and duties towards each other (the so called bilateral or synallagmatic contract), but there are cases when a unilateral contract can be concluded as well. This depends on the nature and subject-matter of the contract. For example, a voting agreement when one shareholder obliges himself to vote according to the instructions of another without any consideration or reciprocal duty of the first shareholder is a unilateral contract. In this case one party has a duty to vote according to the instructions of another shareholder, who has a correlative right to require for such performance. At the same time voting agreements can be constructed as

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[677] This means that most of the times there are more than two parties involved. For example, the shareholders' agreement of SANITAS, AB. See: SANITAS, AB. *Neaudituotų tarpinių sutrumpintų konsoliduotųjų ir atskirų 2010 m. birželio 30 d. finansinių ataskaitų rinkiniai, parengti pagal tarptautinius finansinės atskaitomybės standartus, priimtus taikyti Europos Sąjungoje, ir tarpinis konsoliduotasis 2010 m. šešių mėnesių pranešimas* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/san/2010_q2_lt_ltl_con_ias.pdf>.

[678] If the shareholders' agreement is qualified as either bilateral or unilateral contract, it still means that at least two parties are required to enter into the contractual relationships.

[679] Theoretically the fact that different jurisdiction have a different understanding of unilateral and bilateral contracts and contracts in general (especially this distinction is seen when comparing common and civil law jurisdictions) also poses some difficulties. Under the UK law a contract is binding only if there is a consideration for the promise or obligations. In Belgium there is a requirement for cause of contract, *id est*, why the parties are entering into contractual relations. Under Lithuanian law only the meeting of the minds and the will of the contracting parties is required for the contract to become binding. For more comparative analysis see: HERBOTS, J. H., Belgium. In *International Encyclopaedia for Contracts*. Hague: Kluwer Law International, 1998, p. 49-50; BEALE, H., *et al. Cases, Materials and Text on Contract Law.* Oxford: Hart Publishing, 2002, p. 13-16; TIKNIŪTĖ, A.; DAMBRAUSKAITĖ, A. Understanding Contract under the Law of Lithuania and other European Countries. *Jurisprudencija*, 2011, No. 18(4), p. 1389-1415; MIKELĖNAS, V. *Lietuvos Respublikos civilinio kodekso komentaras. Šeštoji knyga. Prievolių teisė I.* Vilnius: Justitia, 2003, p. 192; MIKELĖNAS, V.; MIKELĖNIENĖ D., Lithuania. In *International Encyclopaedia for Contracts*. Hague: Kluwer Law International, 2004, p. 48-49.

bilateral contracts where all the shareholders agree to vote according to the rules provided in the shareholders' agreement. Thus, every shareholder has both a right to require performance from other contracting shareholders and at the same time a duty to vote in accordance with the voting rules provided in the contract (synallagmatic relationships are formed between the parties of such contracts). Due to the complex nature of shareholders' agreement, the same contractual arrangement can sometimes create both bilateral (synallagmatic) and unilateral contracts to different parties[680]. In other cases shareholders' agreement might not create reciprocal obligations as contractual intentions of the parties are oriented into achieving the same goal, for example, to have a common policy and strategy of the company. Thus, shareholders' agreement might be similar to the joint venture agreement[681] in a way that both agreements might have coordination of actions (collaboration) of contracting parties as a primary purpose[682].

Furthermore, shareholders' agreements can be characterized as consensual contracts since they come into force by the will of the parties and do not require delivery of property (as in contrast to real contracts)[683]. However, in certain cases (especially where a transfer of shares is involved, for example, exit rights in the agreement) the coming into force of the

[680] The differences of civil law countries and common law countries should be kept in mind. See: HERBOTS, J. H., Belgium. In *International Encyclopaedia for Contracts*. Hague: Kluwer Law International, 1998, p. 49-50; MIKELĖNAS, V.; TAMINSKAS, A.; VILEITA, A. *Lietuvos Respublikos civilinio kodekso komentaras. Pirmoji knyga. Bendrosios nuostatos*. Vilnius: Justitia, 2001, Art. 1.63; BEALE, H. *et al. Cases, Materials and Text on Contract Law*. Oxford: Hart Publishing, 2002, p. 13-16; CORBIN, A. L. *Corbin on Contracts*. Matthew Bender & Company, Inc., 2007, p. 85-92, § 1.23.

[681] For more about the joint venture agreements see: MIKALONIENĖ, Lina. Jungtinės veiklos (partnerystės) sutarties teisinė kilmė ir samprata. *Mokslo darbai: Teisė*, 2010, No. 75, p. 81-92; CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 96-159. Some authors claim that joint venture agreement is a type of shareholders' agreements. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 17-18.

[682] However, as it was explained in the introduction of this dissertation, joint venture agreements are not considered to be a type of shareholders' agreements in context of listed companies. Therefore, the goal to coordinate actions in shareholders' agreement might be expressed through mutual exercise of voting rights.

[683] Again, the differences between civil law and common law countries have to be borne in mind. See footnote 625 above.

shareholders' agreement might be associated with the transfer of the shares. However, in case of change of shareholders, who are parties to the shareholders' agreement, the agreement should be still qualified as consensual contract. The transfer of shares in this case is usually possible only after the new shareholder has agreed to be bound by shareholders' agreement. Thus, the transfer of shares is made after (or at the time of) the shareholder agrees to be contractually bound.

Another question is whether shareholders' agreement should be qualified as an onerous (for valuable consideration) or gratuitous contract[684]. While some agreements can be treated as onerous (for example, if there are provisions for performance contractual duties for pecuniary consideration), others are treated as gratuitous (for example, to transfer voting rights without any consideration[685]). However, it should be presumed that entering into shareholders' agreement creates value for all contracting shareholders as they can exercise their influence over the company more effectively or regulate their internal relations in order to minimize conflicts of interest. Otherwise, economic logic suggests that shareholders would not contract in the first place.

Shareholders' agreements can be concluded for a fixed term or for an indeterminate period of time depending on the aims that shareholders have at the time of entering into contractual relationships. However, the term of the shareholders' agreement most of the times depends on the applicable law as well. In Belgium it is required that shareholders' agreements would have a fixed term, but maximum term is not stipulated[686]. In contrast, Lithuanian legislature has set a maximum term of 10 years for transfer of voting rights

[684] For a discussion on onerous and gratuitous contracts see: MOOR, de A. Contract and Agreement in English and French Law. *Oxford Journal of Legal Studies*, 1986, Vol. 6, No. 2, p. 281-283.

[685] However, a contract without consideration would be unenforceable under English law. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 32-34.

[686] Article 551 of the Belgian W.Venn. This requirement is sometimes questioned by the legal scholars. See: CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 204.

agreements[687], but there is no general rule for all the shareholders' agreements. The UK does not have any rules for limiting the term of the shareholders' agreement. It is interesting to note that different countries have rules that vary greatly, for example, in Italy fixed term shareholders' agreements cannot be entered for a period longer than 5 years. After this period they have to be reviewed and renegotiated[688]. All the agreements that are entered for a longer period are presumed to be valid only for 5 years. Similar provision existed in Belgium (1991-1995), but was later abolished by the legislature and only a requirement that voting agreements must be concluded for a fixed term was left. Thus, depending on the jurisdiction there might be a restriction on the maximum term of the shareholders' agreement and parties might be not allowed to enter into contractual relationships for an indefinite period of time.

1.4.2. Subject matter of the shareholders' agreement

The most essential condition for entering into shareholders' agreement is for the parties to agree on the subject matter of the contract. It is self-evident that if there is no meeting of the minds, the contract cannot be concluded. In order for a contract to constitute the shareholders' agreement, parties have to agree on certain matters the presence of which is essential for the validity and qualification of the contract as a shareholders' agreement.

The author is of an opinion that the subject matter of the shareholders' agreement must be related to all of the following[689]:

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[687] Article 2.89 of the Lithuanian CC.

[688] BAGLIONI, A. Shareholders‘ Agreements and Voting Power: Evidence from Italian Listed Firms. *Applied Economics*, 2011, Vol. 43, No. 27, p. 4045; BELTRAMO, M. *et al. The Italian Civil Code and Complementary Legislation. 3rd edition*. New York: Oxford University Press, 2010, Article 2341-bis.

[689] Although none of the jurisdictions analysed in this dissertation have legislation covering shareholders' agreements in general (including their subject matter), the analysis of the concepts stipulated in some of the laws of other countries strengthen the position that shareholders' agreement must always be related to the relations among shareholders and the company. For example, article 5(6) of the Danish Companies Act states that shareholders' agreement is 'an agreement governing the ownership and management of the company entered into between the shareholders'. See: Act No. 470 of 12 June 2009 on Public and Private Limited Companies (in Danish: *Selskabsloven*). Another example, article 32.1 of the Russian Companies Act stipulates that 'a shareholders' agreement shall be an agreement on the exercise of rights conferred by shares and (or) on particular considerations relating to the exercise of rights in shares. Under a shareholders' agreement the parties to that

1) the company (usually regarding the management, policy and strategy setting issues of the company);

2) the shares of the company (this includes all the pecuniary and non-pecuniary rights of the shareholders and the way they are exercised)[690], and;

3) rights, duties and obligations of shareholders' towards each other (for example, exit rights of the shareholders) or towards the company (for example, contractual duty of the shareholder to transact with the company at an arms' length principle).

Rights, duties and obligations of persons other than the shareholders can also be a part of the subject matter of the shareholders' agreement, but only if they are related to the functioning of the company (for example, obligation of the members of the management to acquire consent of the shareholders before passing certain decisions).

The subject matter of the agreement can be expressed through all types of obligations[691]: to do (for example, to vote in the agreed form), refrain from doing something (not to transfer the shares of the company) or in some cases even to transfer the ownership of a thing (for example, transfer the shares of

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agreement shall undertake to exercise rights conferred by shares and (or) rights in shares in a particular manner and (or) to refrain from exercising those rights'. See: Federal law No. 208-FZ of the Russian Federation of December 26, 1995 Concerning Joint Stock Companies (in Russian Закон об Акционерных обществах); Federal law No. 115-FZ of the Russian Federation of June 3, 2009 the Introduction of Amendments to the Federal Law "Concerning Joint Stock Companies" and article 30 of the Federal Law "Concerning the Securities Market". Subject matter of the shareholders' agreements is also dealt with in article 2341-bis of the Italian Civil Code. See: BELTRAMO, M. *et al.* *The Italian Civil Code and Complementary Legislation. 3rd edition*. New York: Oxford University Press, 2010. Article 7.32 of the Model Business Corporation Act and its commentary state that: 'the subject matter of [shareholders' agreements] includes governance of the entity, allocation of the economic return from the business, and other aspects of the relationships among shareholders, directors, and the corporation which are part of the business arrangement'. See: American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005.

690 Some authors do not distinguish this point and claim that the subject matter of shareholders' agreements is related to 'both the relationship between the shareholders themselves and that between the shareholders and the company'. THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. V.

691 MIKELĖNAS, V. *Prievolių teisė. Pirmoji dalis*. Vilnius: Justitia, 2002, p. 48; HERBOTS, J. H., Belgium. In *International Encyclopaedia for Contracts*. Hague: Kluwer Law International, 1998, p. 41-42.

the company if the heir does not enter into the shareholders' agreement). Therefore, all types of obligations can be undertaken in shareholders' agreement. Nevertheless, every obligation of the contract should still satisfy the general criteria: it should be clearly defined, legally binding and possible to perform[692].

The subject matter of the shareholders' agreement is relatively broad, but cannot be limited due to the prevailing freedom of contract principle. Legislators usually do not stipulate in statutory acts what the scope and subject matter of shareholders' agreement should be. For example, there are no subject matter restricting provisions in France[693], Germany[694], Canada[695], the Netherlands[696], Sweden[697] and other countries. Despite this fact, there should be at least broadly defined common denominator to distinguish shareholders' agreements from various service and sale-purchase agreements, which could be concluded between the company and shareholders or amongst shareholders. For example, joint venture agreements depending on their subject matter could be regarded as shareholders' agreements or as separate cooperation

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[692] MIKELĖNAS, V. *Prievolių teisė. Pirmoji dalis*. Vilnius: Justitia, 2002, p. 49-54.

[693] ICHAY, F. France. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2013-11-23] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=F7E7F4B3-A308-498E-8218-BEB66C0F6B7E>.

[694] GESELL, H. Germany. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=63D9B6E1-A039-4842-881C-71010F44AB98>.

[695] BERTRAND, D.; LYSTER, G.; POWERS, G.; STEVENS, S. Canada. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2013-11-23] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=A24EC5D2-26B8-4EA0-9FBC-097576A967F3>.

[696] GREEVEN, C.; AGHINA, T.; SLOTTJE, F. The Netherlands in respect of private companies with limited liability. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2013-11-23] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=B16CD41A-C817-499D-A930-39D0C474AF52>.

[697] KOKKO, C.; PANNIER, M. Sweden. In *IBA Guide on Shareholders' Agreements*, 2012 [interactive]. [Accessed on 2013-11-23] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=249CA754-886F-4CF4-94CE-1FD2F28226E9>.

agreements[698]. This Qualification would depend on whether the joint venture agreement is related to a company, its shares and rights and duties of the shareholders. If the agreement is missing at least one of the above features it should not (at least theoretically) be regarded as a shareholders' agreement[699].

1.4.3. Parties to the shareholders' agreement

As the name of the agreement suggests, at least one shareholder[700] (be it natural or legal person) of the company, to which the shareholders' agreement is related to, must be a party to the contract. Shareholder is the most important party without which qualification of the contract as shareholders' agreement would be impossible. Some authors also argue that shareholders' agreement is possible only between shareholders (with a possibility for a company to be a party as well)[701]. The maximum number of the parties is unlimited. However, if there are no shareholders as parties to the agreement, it cannot be qualified as shareholders' agreement. In most of the cases this problem does not arise as there are two or more contracting shareholders[702]. Nevertheless, certain types of shareholders' agreements (the relationship agreements) usually are entered between one controlling shareholder and the company itself.

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698 MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 13-17.

699 The author understands that such conception could be regarded as a floating concept. However, each of the shareholders' agreements is unique and it would against the nature of such agreement to artificially limit the subject matter.

700 The author believes that under normal circumstances at least two shareholders should be parties to the shareholders' agreement. The only exception is the so called relationship agreement where majority shareholder contracts with the company and undertakes certain obligations towards the company. For example, Moneysupermarket.Com Group plc. *Annual report 2010* [interactive]. [Accessed on 2011-06-28] Available online at: <http://www.investis.com/mony/financial/results/2011/annual_reportxyz_10.pdf>.

701 THOMAS, K. R.; RYAN, Ch. The Law and Practice of Shareholders' Agreements. 3rd edition. London: LexisNexis, 2009, p. v.

702 For an example see AKTA PLC, a company that is listed on the NASDAQ OMX Helsinki which has a shareholders‘ agreement among 36 shareholders in place. AKTIA PLC. *2009 information regarding shareholders' agreements* [interactive]. [Accessed on 2011-06-25] Available online at: <http://www.aktia.fi/ownership/agreements>.

Other persons can be parties to the agreement as well. This depends on the aims, subject matter of the contract and applicable legal regime[703]. There might also be specific parties depending on the type of the listed company. For example, shareholders of the listed financial institutions (usually banks) might be required to sign a governance memorandum (bank protocol) with the banking authority where they oblige themselves not to abuse their controlling rights and power.

In certain cases members of the management could be made parties to the shareholders' agreement in order for them to individually undertake obligations to comply with its terms[704]. This can be done in order to bring attention of the members of the management to certain provisions of the shareholders' agreement or to give a right to the shareholders to require for specific performance, for example, provide certain information which is not required to provide under the laws of jurisdiction in question[705]. Thus, the members of the management bodies are personally bound by the shareholders' agreement and have to act in accordance with its terms. Furthermore, members of the management can be parties to the shareholders' agreement acting as shareholders rather than managers[706]. Nonetheless, their position as a contracting party should be clearly defined in the agreement (whether they act as shareholders or as members of the management body).

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[703] Spouses of shareholders can sign the agreement if shares are considered to be their common property. For example, under articles 3.87 and 3.92 of the Lithuanian CC all the property that has been acquired after the marriage under general rule is considered to be common property of both spouses. Thus, in order to avoid disputes regarding the validity of the shareholders' agreement it is recommended that both spouses are made parties to the agreement.

[704] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 4.

[705] However, this might be subject to requirement of unanimous agreement among shareholders which is practically impossible in case of listed companies. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 70.

[706] For an example see: Zenitel NV. *2006-11-09 Press Release* [interactive]. [Accessed on 2011-04-22] Available online at: <http://www.zenitel.com/Documents/_Global/Investor%20relations/Financial%20press%20releases/2006/Pressrelease_09112006_english.pdf>. In this case three members of the board of directors were parties to a shareholders' agreement. They were acting as shareholders.

The company itself can be a party to the shareholders' agreement[707]. Usually this occurs for the following reasons[708]:

1) When there is an aim of the shareholders to commit the company to additional obligations (other than are stipulated in the articles of association), the company will be most likely a party to the agreement. For example, to set the remuneration policy for the members of the management board appointed by the contracting shareholders. Most of the times for such obligations to be valid and enforceable they have to be transposed into the internal documents of the company, for example into corporate governance charter[709];

2) When not all of the shareholders are parties to the agreement the inclusion of the company as a party to the agreement might be viewed as a way of making shareholders (as a group) undertake certain obligations[710];

3) The company might be made a party to the shareholders' agreement in order to indirectly bind members of the management bodies of the company to act in accordance with the principles and rules stipulated in the shareholders' agreement;

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[707] However, depending on the jurisdiction shareholders' agreement might not be always binding to the company. For example, article 82 of the Danish Companies Act states that 'shareholders' agreements are not binding on the limited liability company'. See: Act No. 470 of 12 June 2009 on Public and Private Limited Companies (Companies Act) (in Danish: *Selskabsloven*).

[708] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 3.

[709] For an example see: Telenet Group Holding NV. *Corporate Governance Charter* [interactive]. [Accessed on 2011-07-14] Available online at: <http://telenet.be/media/fs/1/others/pdf/investor/Charter%20clean%20EN%20310506.pdf>.

[710] This is more likely in the common law jurisdictions. See: CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 3-4. In the civil law countries this is highly unlikely as contract cannot bind third persons who are not parties to the agreement. There is also a strict statutory division of powers, which cannot be changed by contract, for example, article 19(5) of the Lithuanian ABI. In addition, the most important decisions in the company require the exercise of the voting rights in the general meeting of the shareholders. For example, article 37(3) of the Lithuanian ABI regulates that in cases when there are no collegial supervisory and management bodies formed in the company, the general meeting of the shareholders decides on the remuneration of the director. Thus, shareholders who are not parties to the agreement would not be obliged to vote according to the shareholders' agreement, if the remuneration policy would be stipulated in that agreement. Without voting agreement in place all shareholders can exercise their voting rights without any constraints.

4) If the company has subsidiaries (the company is the parent company (or one of the shareholders) of the subsidiaries), the shareholders' agreement can regulate the management and policy forming principles of such subsidiary companies;

5) When a company owns its shares and contracts as a shareholder[711] it can be a party to the agreement;

6) The company is usually a party to the shareholders' agreement when relationship agreements (sometimes also called the controlling shareholder agreements) are concluded. In these cases the majority shareholder undertakes to deal and enter into all commercial transactions with the company in accordance with the arm's length principle[712]. Thus, minority shareholders that are not parties to the agreement are assured that the majority shareholder is not using the company in order to expropriate them (for example, by entering into transactions with the company at a different than market price or at commercially unacceptable terms)[713].

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[711] For example, Etn. Fr. Colruyt NV. *Annual report 2009 – 2010* [interactive]. [Accessed on 2011-03-20] Available online at: <http://www.colruytgroup.com/colruytgroup/static/assets/financieel/jaarverslag_09-10/jaarverslag_09_10_e.pdf.zip>. Company possessing 5.87 % of its own shares entered into a voting agreement and agreed to vote with other contracting shareholders unanimously. However, such provisions are also dependent on the applicable law. Under article 54(7) of the Lithuanian ABI the company that has acquired its own shares does not have a right to use any of the pecuniary or non-pecuniary rights (including the right to vote).

[712] The arm's length principle in this regard is used in order to test the fairness of the related party transactions (majority shareholder or other companies controlled by him transacting with the company). Minority shareholders, being the shareholders of the company, are also entitled to the benefits that the company generates from its activities. Thus, the arm's length principle ensures that the majority shareholder treats minority shareholders equally and does not benefit at their expense. See: SCHON, W. Transfer Pricing – Business Incentives, International Taxation and Corporate Law. In SCHON, W.; KONRAD, K. A. (eds) *Fundamentals Of International Transfer Pricing in Law and Economics*. Berlin: Springer, 2012, p. 59-62. However, in certain cases the arm's length principle is used for avoiding double taxation. Thus, the controlling shareholder while entering into the relationship agreement can have tax benefits as well. See: MARKHAM, M. *The Transfer Pricing of Intangibles*. The Hague: Kluwer Law International, 2005, p. 18-21.

[713] For example, Reliance GeneMedix plc. (a company listed on the London stock exchange) entered into the relationship agreement with the majority shareholder. The agreement formalises the relationships between the company and the majority shareholder and, *inter alia*, emphasises the need for the company to deal with majority shareholder on an arm's length basis and on normal commercial terms at all times. See: Reliance GeneMedix plc. *2010-12-16 Press Release* [interactive]. [Accessed on

It should be noted that in continental European jurisdictions company can be a party to the shareholders' agreements mostly for informational purposes. For example, to inform the company and members of the management bodies about the undertakings that shareholders have assumed in terms of management of the company[714]. This means that rarely will the company assume certain obligations to the contracting shareholders as this might be considered as discrimination against other shareholder of the company (for example, if the company would undertake to provide certain information only to shareholders, who are parties to the agreement).

Moreover, not only private natural and legal persons can be parties to the shareholders' agreement, but also the state, municipality and other governmental institutions, for example the Government of the Republic of Lithuania[715] or the Minister for Communications of the Government of The Republic of South Africa[716]. In this regard it is important to establish that the state or other governmental institutions are contracting as shareholders of the company and not as institutions that are responsible for public administration[717].

2011-06-29] Available online at: <http://www.genemedix.com/pdf/rgmx_interims%202010_pressrelease_15122010.pdf>.

714 For example, shareholders of AB Lietuvos Dujos have entered into shareholders' agreement in order to regulate how the company will be managed. The shareholders agreed to ensure that that their nominees elected to the Board of the Company will vote in order to achieve the objectives established in the shareholders' agreement. If the company would have been made a party to this agreement it would already have information and about obligations of shareholders regarding the management. Arbitration Institute of the Stockholm Chamber of Commerce. Final award made on July 31, 2012, Arbitration No.: V (125/2011). *OAO Gazprom v. Ministry of Energy of the Republic of Lithuania* [interactive]. [Accessed on 2012-11-07] Available online at: <http://arbitrations.ru/files/articles/uploaded/Gazprom_v_Lithuania_Final_Award_SCC.pdf>, p. 8-9.

715 For an example see the shareholders' agreement between the Government of the Republic of Lithuania and UAB „NDX Energija" [interactive]. [Accessed on 2011-01-17] Available online at: <http://www.ndxenergija.lt/files/dokumentai/Sutarties_Priedas_Nr_12.pdf>.

716 TELKOM SA LIMITED. Shareholders' agreement in relation to TELKOM SA LIMITED [interactive]. [Accessed on 2012-10-11] Available online at: <https://secure1.telkom.co.za/apps_static/ir/pdf/financial/pdf/exhibit10_10.pdf>.

717 For example, in Lithuania there has been a recent study on how the state should exercise its control over the state controlled enterprises (as some of them are also listed). See: Ministry of Economics of the Republic of Lithuania. Study on the exercise of the ownership rights in the state owned enterprises, Ministry of Economics of the Republic of Lithuania, 2011[interactive]. [Accessed on 2012-08-11] Available online at: <http://vvi.ukmin.lt/index.php?r=document/view&id=1069>.

Other, than the above mentioned, persons can be parties to shareholders' agreement as long as the subject matter of the agreement is related to the functioning of the company, its shares and legal relationships between the shareholders and their rights and duties towards each other or the company. The question at this point is whether some third parties can be parties to the agreement if it regulates their relationships with the company or its shareholders (for example, when shareholders (as a group) contract with a creditor (a bank) regarding the management of the company). The author is of an opinion that in cases where an agreement stipulates that contracting shareholders (as a class) have to vote or to exercise other pecuniary or non-pecuniary rights conferred to them by the shares in accordance with the instructions of the outside (third) party, the contract should not be qualified as shareholders' agreement[718]. This is due to the following reasons. A contract to vote in accordance with third party's instructions that does not contain any provisions regarding legal relationships between shareholders (if they do not obtain any rights and duties towards each other) or with the company has other subject matter than shareholders' agreement. Namely, these obligations are undertaken in order to protect third party's interests[719] and not to regulate legal relationships arising between different constituents within the company. The shareholders neither agree on a common policy and management strategy of the company, nor do they undertake any obligations towards each other or

[718] Other scholarly opinion suggests that shareholders can undertake an obligation to vote in accordance with the instructions of any other party, *id est* outsider. For arguments from the UK see: CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 27. Some scholars from the Netherlands and Belgium argue that shareholders' agreements can include contractual relations where creditors can require shareholders to exercise their voting rights in order to satisfy their claims against such shareholders. See: KOELEMEIJER. M. Aandeelhouders en (stem)overeenkomsten. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 211-212.

[719] For example, a provision in a financing agreement requiring company not to change its articles of association can only be enforced by shareholders voting in the general meeting of shareholders. Still, this does not make the financing (or loan) agreement into a shareholders' agreement as the aim of the mentioned provision is to protect interests of the creditor. The other issue is whether shareholders are also parties to the said agreement. If the financing contract is between the company and the creditor, such agreement cannot be enforced against the shareholders of the company.

towards the company. Usually these types of provisions are inserted into the contracts with the creditors (that are financing operations of the company) in order to protect their interests. In the agreements with third parties the exercise of rights conferred by the shares is usually oriented at satisfying interests of third parties. For example, if the third party is a creditor of the company, then the agreement will usually stipulate certain duties of the shareholder or the company in order to repay debt. In other words, the creditor is not interested in the management and well-being of the company beyond that point.

The above analysis suggests that parties to the shareholders' agreements can be not only shareholders, but also other parties, whose rights and duties might be influenced by the agreement. The presence of other parties is dependent upon the subject matter and aims of the agreement. Nevertheless, in order for the contract to be qualified as a shareholders' agreement at least one shareholder must be party to the agreement, and the agreement must be related to the functioning of the company, its shares, legal relationships between the shareholders and (or) their rights and duties towards each other or the company.

1.4.4. Form of the shareholders' agreement

Shareholders' agreements can be either written[720] or oral[721] contracts. Despite this, most of the times shareholders' agreements are concluded in written form.

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[720] The requirement of written form usually depends on the jurisdiction. For example, article 32.1 of the Russian law on Joint Stock Companies requires all shareholders' agreements to be in writing and to be in single document. See: Federal Law No. 208-FZ of the Russian Federation of December 26, 1995 Concerning Joint Stock Companies (in Russian *Закон об Акционерных обществах*); Federal law No. 115-FZ of the Russian Federation of June 3, 2009 concerning the Introduction of Amendments to the Federal Law "Concerning Joint Stock Companies" and article 30 of the Federal Law "Concerning the Securities Market".

[721] Although orally concluded shareholders' agreements are rare and have enforceability problems, there are examples when shareholders of listed companies agree on certain matters orally. For example, Financière de Tubize SA. *Annual Report 2010* [interactive]. [Accessed on 2011-06-23] Available online at: <http://www.financiere-tubize.be/en/rapport_ca_6.html>. Legal practitioners from certain European countries also acknowledge that oral shareholders' agreements are as binding as written ones. For example, in Norway. See: KVAM, J.; HAUGSTVEDT, J. Norway. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=AB4A6E00-5BE3-4D99-947C-4424FDE40965>.

Shareholders' agreements cannot be concluded by voluntary conduct or tacit consent (in Latin *per facta concludentia*)[722]. For example, it is impossible to give tacit consent regarding any additional rights granted to the shareholders of the company (for example, right of inquiry for minority shareholders), regarding the competence of general meeting of the shareholders or supervisory and management bodies, regarding the solution of deadlock or exit rights of the shareholders, pre-emptive rights, voting right ceilings and other important issues. All of the above mentioned situations are either relatively rare (they do not happen often enough in order to establish some kind of pattern) in order to form any kind of practice between the shareholders or are so complicated and complex that cannot be resolved by tacit consent of the shareholders. The only case when it would be theoretically possible to give consent tacitly (the author is not aware of any practical examples of such cases) is regarding the concerted voting in the general meeting of the shareholders. If the shareholders have a long standing practice to vote in a certain way, theoretically it would be possible to argue that the shareholders have tacitly (with their voluntary conduct) agreed to vote in that certain way in the future. However, the burden of proof and enforceability of such shareholders' agreement would be a very questionable issue.

Depending on the jurisdiction, applicable law and the subject matter of the shareholders' agreement in certain cases the requirement for written or even notarized form might be triggered. For example, the transfer of shares under the Lithuanian law must be concluded in a written form[723]. However, if the laws do not specifically require for a written form or that the contract has to be notarized by the public notary, both written and oral contracts can be

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[722] Although some authors claim that there are court decisions where a 'course of dealing' among the parties was regarded as a shareholders agreement. See: LOWRY, J.; REISBERG, A. *Pettet's Company Law: Company Law & Corporate Finance. 4th edition*. Essex: Pearson Education Limited, 2012, p. 96. For an analysis of the case see: BURRIDGE, S. J. Wrongful Rights Issues. *The Modern Law Review*, 1981, Vol. 44:1, p. 40–67 (especially p. 48-49). The court ruled that the plaintiff agreed to become minority shareholder only on the condition that the ownership structure of the company remains the same. There was no written or oral agreement regarding this issue among the shareholders.

[723] Article 46(3) of the Lithuanian ABI.

concluded. For example, the voting rights agreement under Lithuanian and Belgian laws are not required to be entered upon in written form[724].

Although in most of the countries there are no requirements regarding the registration of the shareholders' agreements in the public registrar (for example, Lithuania, Belgium and the UK do not require the registration of the shareholders' agreements) some European jurisdictions require such registration (for example, Italy and Spain)[725].

1.4.5. Shareholders' agreement as a sui generis contract

Taking into account all the arguments provided above (and emphasising the freedom of contract principle, on which shareholders' agreement is based), it could be stated that shareholders' agreement is a *sui generis* contract[726]. It falls neither in the classical category based on individual party autonomy, where the contract is a compromise of conflicting adversarial interests, nor in the conception that the contract is based on the cooperation of the parties[727]. On the one hand, parties entering into shareholders' agreement have their individual interests, which they seek to protect using contractual means, for example, they might want to be represented at the board. On the other hand, the parties also have a common goal, thus are forced to cooperate (they most likely seek effective management of the company and return on their

[724] Article 551 of the Belgian W.Venn. and article 2.88 of the Lithuanian CC.

[725] RUIZ, X.; GUEMES, L. Spain. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=6FA09A75-1FDF-4000-9B23-78E031E28943>; NUNZIANTE, G. Italy. In *IBA Guide on Shareholders' Agreements*, 2011 [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.ibanet.org/Document/Default.aspx?DocumentUid=F16AECA1-542E-4367-9AA2-19F91F8CA428>.

[726] This conclusion is also based on the fact that shareholders' agreements in most jurisdictions are not regulated as a separate institute. However, certain types of agreements are defined in the statutory acts of some countries.

[727] SEFTON-GREEN, R. Duties to inform versus party autonomy: reversing the paradigm (from free consent to informed consent)? – a comparative account of French and English law. In HOWELLS, G.; JANSSEN, A.; SCHULZE, R. (Eds.), *Information Rights And Obligations: A Challenge For Party Autonomy And Transactional Fairness*. Aldershot: Ashgate, 2005, p.172-173.

investment). The cooperation element of the agreement should not be understood as undermining private interests of each contracting shareholder[728].

The author is of an opinion that the underlying characteristic is based on the individual interests of each contracting shareholder and the cooperation occurs as a consequence. Thus, the purpose to cooperate should not be interpreted as a common denominator for all the shareholders' agreements. For example, in a voting agreement, where parties agree to vote according to instructions of one of the contracting shareholders, the cooperation is based on the private interests of the shareholders, who agree to vote in a certain way in order to protect their rights and interests[729]. In this situation shareholders contractually bind themselves to vote in a certain way, and thus there is not room for cooperation after the agreement is concluded – shareholders have to abide by the rules stipulated in the contract. While in a voting agreement, which stipulates a duty for contracting shareholders to meet before each general meeting and agree on voting on each item in the agenda, should be regarded as an agreement to cooperate. Another example might be the transfer of voting rights agreement or the securities lending agreement, where parties might even have different interests[730]. Shareholder lending the shares might not know the purpose for which the voting rights are going to be used in the upcoming general meeting by the person acquiring the shares. Thus, by entering into contract they must ensure that their rights and interests in the company will not be infringed.

The freedom of contract principle and the broad scope of subject matter of the shareholders' agreement also suggests that there might be various types of shareholders' agreements concluded in practice. Limiting such agreements

[728] Similar position is also reflected by Lithuanian scholars. See: MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 21.

[729] Obligations to vote in a certain way might be an outcome of a cooperation agreement, as well as of a standard agreement based on party autonomy. For example, minority shareholders undertaking to vote according to the instructions of majority shareholder might be making a compromise and for their voting rights gaining a representative at the board of the company.

[730] It depends on the interpretation, whether securities lending agreements and transfer of voting rights agreements have to be in the interests of the company or should be regarded as commercial contracts.

only to the cooperation contracts, as it is suggested by some legal authors[731], might be considered as constraining the freedom of shareholders to agree on the exercise of their rights as they sit it fit. A possible common feature for all types of shareholders' agreements could be identified (although there might be certain exceptions) as the use of voting right attached to the share. In certain cases this is direct use of voting right (for example, voting agreements) and in other cases the exercise of voting right might be hidden under other types of duties and obligations (for example, to contract only in accordance with the arm's length principle[732]). However, the subject matter must at all times be as described in Part II, Chapter 1.4.2.

There are also practical reasons for qualifying transfer of voting rights agreement, securities lending agreement and relationship agreement as shareholders' agreements. Firstly, it is argued in this dissertation that shareholders' agreements should be concluded in the interests of the company. All of the above mentioned types of contracts might be used in abusive ways, and thus it is necessary to restrict their usage to only what is in the interests of the company. Secondly, listed companies have a duty imposed by the EU and national legislation to disclose shareholders' agreements. Taking into account that all types of shareholders' agreements might influence the balance of power in listed companies, it is necessary to classify them under shareholders' agreements to maintain the disclosure requirements[733].

1.4.6. Classification of shareholders' agreements

Classification of shareholders' agreements is important not only from the theoretical point of view as it allows easier and more coherent discussions among the legal scholars, but also from practical side as it allows legislature,

[731] MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 22-23.

[732] Which in turn means that general meeting of shareholders should not approve contracts that are against the interests of the company.

[733] All of the agreements presented in Part II, Chapter 1.4.6 are related to the restrictions on transfer of securities, the restrictions on voting rights or grant special control rights over the company.

courts and legal practitioners to draft, interpret and apply specific rules for each type of shareholders' agreement. The classification is also important as in most of the European countries shareholders' agreements in general sense are not regulated in statutory laws and are left for the discretion of the parties, while at the same time certain types of the shareholders' agreements are explicitly regulated by the legislature[734]. Although the qualifying characteristics analysed above are common to all types of shareholders' agreements, the aims, subject matter and (in certain cases) applicable rules for different types of agreements vary. A non-exhaustive list of types of shareholders' agreements is provided below[735]:

1) *Voting agreement*. The empirical research carried out by the author has revealed that voting agreements are the most popular type of shareholders' agreements in listed companies in Lithuania, Belgium and the UK[736]. Voting agreements are concluded amongst the shareholders in order to establish a better and more effective control over the company and its management or in order to form a group of controlling shareholders by agreeing to exercise their voting rights in concert[737]. The author is of an opinion that in all cases the voting agreement is possible only among the shareholders of the company because they are the only ones that have the right to vote in the

[734] For example, article 551 of the Belgian W.Venn. and article 2.88 of the Lithuanian CC stipulate specific rules regarding the voting agreements. From the wording of the statutory provisions it is evident that these restrictions do not apply to other types of shareholders' agreements.

[735] Some authors provide for a slightly different list of types of shareholders' agreements: 1) joint venture agreements (that are not relevant for the analysis of shareholders' agreements in public companies); 2) investment agreements (that are more typical for start-up companies); 3) minority protection agreements; 4) pooling agreements (also known as voting agreements); 5) voting trust agreements. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 17-27.

[736] See Part III, Chapter 2.5.

[737] It is interesting to note that from a historical comparative perspective voting agreements have been treated differently. For example, in Italy and France during 1970-1980 voting agreements and limitations on free exercise of voting rights were generally treaded as null and void. However, currently the situation has changed dramatically as French and Italian shareholders are amongst most active in entering into shareholders' agreements and laws treat them to be valid and enforceable. See: IMMENGA, U. Company systems and Affiliation. In CONARD, A.; VAGTS, D. (eds.) *International Encyclopedia of Comparative Law*. Tubingen: Mohr Siebeck, 2006, Chapter 7, p. 28.

general meetings of shareholders[738]. In certain cases voting agreements can be used in order to enable the contracting shareholders to exercise certain non-pecuniary rights that require a certain number (a threshold) of voting rights. For example, shareholders in Lithuanian companies can access confidential information of the company only if they hold more than ½ of all the shares of the company[739].

Voting agreements usually stipulate rules on how to exercise voting rights in each meeting of the shareholders, for example, on what decisions to vote in favour or that shareholder X in all the general meetings of shareholders will vote the same as shareholder Y. Voting agreement can also establish a preliminary voting procedure among contracting shareholders. Preliminary voting is usually done in a separate meeting in which contracting shareholders unanimously (or by majority of votes) decide how they will vote on the decisions on the agenda of the next general meeting.

Some authors classify voting agreements into: i) agreements between shareholders and the company; ii) agreements among shareholders; iii) agreements between shareholders and third parties[740]. However, this classification reflects only the persons that are parties to the voting agreement. Other authors provide for a more

[738] From the Lithuanian regulation perspective, it would be possible for a person who has acquired voting rights by entering into the transfer of voting rights agreement to enter into a voting agreement. After the transfer of voting rights person acquiring voting rights is the only one who is able to exercise such rights. However, author is not aware of any such cases in practice. For an analysis on transfer of voting rights agreement under Lithuanian law, see: Part II, Chapter 2.2.

[739] Article 18(1) of Lithuanian ABI. Another example is the right of the shareholders to initiate the inquiry proceedings. Only shareholders holding at least 1/10 of the shares representing the share capital of the company are allowed to initiate these proceedings. See: article 2.125 of the Lithuanian CC.

[740] KOELEMEIJER. M. Aandeelhouders en (stem)overeenkomsten. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 206-207.

detailed classification of voting agreements[741]. Voting agreements are classified into : 1) agreements to vote in a particular way; 2) agreements limiting the power to vote; 3) agreements whereby parties agree on appointment rights of the members of the management board; 4) agreements requiring approval of certain decisions by the contracting shareholders; 5) agreements providing for rules on how to vote for distribution of profit; 6) agreements providing restrictions on removal of certain members of the management body; 7) agreements relating to the management of the company.

Most of the time voting agreements are also accompanied by undertakings of the shareholders not to transfer their shares without consent of other contracting shareholders or other similar restrictions on the transferability of shares. These restrictions ensure that contracting shareholders will not try to avoid their obligations arising out of voting agreements by transferring their shares.

2) *Restriction on transfer of shares agreement*. Using contractual means shareholders can agree to put certain limitations on their right to freely transfer shares that are owned by them. Although restriction on transfer of shares agreement is rarely found in its pure form, other types of shareholders' agreements are often enriched with such provisions. Especially this is true in cases of voting agreements, which almost always contain certain rules on restrictions on transfer of shares (be it pre-emptive right clauses or other type of restrictions). This could be explained by the fact that voting agreements create rights and duties only against the shareholders,

[741] FERON, B. *Les Conventions D'actionnaires Apres la Loi du 13 Avril 1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.nautadutilh.com/publicationfiles/26-11-97_Les%20conventions%20d'actionnaires%20apr%C3%A8s%20la%20loi%20du%2013%20avril%201995_feron_b.pdf>, p. 47-55.

who are parties to such agreements. Therefore, shareholders wanting to easily escape the provisions of voting agreements could just sell their shares before the general meeting of shareholders. In order to prevent such behaviour (and also as a kind of enforceability mechanism) provisions regarding restrictions on the transfer of shares are stipulated in the voting agreements[742].

Despite of their usage, this type of agreement also raises certain legality questions as there are requirements imposed by the EU law that all the shares that are admitted to trading on a regulated market should be freely negotiable[743]. From the author's point of view, the requirement for the shares of the company that is going public to be freely tradable on the market is imposed only on the company. As shareholders and company are different subjects (due to the fact that company has its own legal personality), the requirement should not be extended to shareholders as long as they are dealing with restrictions of transfer of shares that are owned by them (and are not trying to impose such restrictions to all shareholders by changing articles of association of the company). Thus, agreements that provide certain restrictions on the transferability of shares (even if the company is publicly listed one) should be regarded as legal and valid agreements[744]. This assumption should be considered valid as long as restrictions on the transferability are personal (depend solely on the will of the contracting shareholder).

[742] For example, shareholders of KBC Group NV (company listed on NYSE Euronext Brussels stock exchange) have a shareholders' agreement in place that has very detailed rules on how the transfer of shares of contracting shareholders should be handled (rules on pre-emptive rights). See: KBC Group NV. *Annual report 2009* [interactive]. [Accessed on 2011-01-31] Available online at: <https://multimediafiles.kbcgroup.eu/ng/published/KBCCOM/PDF/COM_RVG_pdf_jaarverslag_KBC_Groep_2009_EN.pdf>.

[743] Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (OL 2001 L 184/1-66), article 46.

[744] Extended argumentation on this question is provided in Part III, Chapter 1.1.

3) *Transfer of voting rights agreement*. From the analysed jurisdictions this type of agreement is regulated only in the Republic of Lithuania[745]. By entering into transfer of voting rights agreement shareholders transfer their rights to vote in the general meeting of shareholders without transferring the ownership rights of the shares. Thus, it allows the decoupling of voting rights from the ownerships rights of the shares. Although the functionality of this type of agreement is similar to the proxy or voting trust, it bars the shareholder from exercising the voting rights for the term of the agreement. The subject matter of the agreement must always include clear instructions and rules on the exercise of the voting rights so that the person acquiring the voting rights would not abuse them or use them to the detriment of the shareholders or the company. Furthermore, the main purpose and aim of this contract is not to enable the separation of voting rights from economic interests for its own sake, but to allow shareholders to have as many contractual tools as possible to effectively implement their control over the company and to exercise their voting rights. For example, voting rights can be transferred to a professional intermediary who is specialising in the analysis and governance of companies. In this way the shareholder remains entitled to all the monetary benefits that shares confer to him, but the decision making power is transferred to a competent professional.

4) *Securities lending agreement*[746]. As a general rule, securities lending agreements are used as financial instruments in order for the market participants to be able to profit from the fluctuations in the market

[745] Please see Part II, Chapter 2.2.

[746] For an extensive analysis on the securities lending see: CLOTTENS, C. *Proportionaliteit van stemrecht en risico in kapitaalvennootschappen*. Doctoral thesis. Katholieke Universiteit Leuven, 2011.

by selling shares they do not own and then giving them back before the settlement day. Depending upon jurisdiction securities lending agreement can be understood as a type of loan[747] or as two interrelated sale of shares agreements[748]. Securities lending agreement can be qualified as a type of shareholders' agreement only when the purpose and aim of the contracting parties is not to use it as a financial instrument for trading stocks, but to transfer voting rights without transferring the ownership rights of the shares to the acquirer. In these cases the functionality of the securities lending agreement is similar to the transfer of voting rights agreements as it allows persons who do not have ownership of the shares (or long term economic interest in the company) to vote in the general meeting of shareholders of particular companies.

5) *Relationship agreement*. This type of shareholders' agreement is most common in the UK. Despite the fact that parties to the relationship agreement are usually the company and the majority shareholder (in most of the cases there are no undertakings amongst the shareholders of the company) it is still agreed by the UK scholars that such agreement should be qualified as a type of shareholders' agreement[749]. Under the relationship agreement majority shareholder undertakes to act or abstain from action in relation to the company (for example, he might undertake to appoint only independent members of the management body, to enter into transactions with the company only at an arm's length and on normal commercial terms) or limits his rights and role in controlling the company for the

[747] This understanding is prevailing in Belgium. See Part II, Chapter 3.2.

[748] For example, this is the case in the UK. See Part II, Chapter 4.2.

[749] ANDENAS, M. *Shareholders' Agreements: Some EU and English Law Perspectives*, 2007 [interactive]. [Accessed on 2012-10-19] Available online at: <http://www.lawschool.tsukuba.ac.jp/pdf_kiyou/tlj-01/tlj-01-andenas.pdf>, p. 143.

benefit of minority shareholders (for example, agreement might provide for voting caps or other restrictions on voting rights, limit the right of the majority shareholder to compete with the company, require the approval of certain transactions of independent directors). The principal purpose of the relationship agreement usually is to ensure that the company and its subsidiaries are capable of carrying on their business independently from the controlling shareholder. Relationship agreements are usually entered after the initial IPO of the company as a reassurance to the markets and all future shareholders that company is being managed in accordance with the best corporate governance principles.

While gathering empirical data, no relationship agreements were identified in Lithuania and Belgium. However, this does not mean that such agreements cannot be concluded between the company and controlling shareholder in continental European jurisdictions[750]. In addition to statutory mechanisms to protect minority interests[751], relationship agreement could cover additional undertakings from the controlling shareholders, which might fall in the soft law category, for example, to nominate only independent members for the management board, not to compete with the company, to promote best corporate governance practices in management of the company. Thus this would send a clear message to the minority shareholders of a listed company that the majority shareholder is not there to expropriate them.

[750] The enforceability of such agreements might be highly questionable and would require a separate in depth study. Therefore, this question is not addressed in the dissertation. General principle should be that if the agreement is not against imperative statutory provisions, it should be enforceable in courts.

[751] For example, *ultra vires* doctrine or the right to question the validity of decisions of the general meeting.

6) *Joint venture agreement*. Classification of joint venture agreement as shareholders' agreement is subject to certain reservations[752]. First, joint venture agreement is a form of collaboration between contracting parties and does not always manifest itself as shareholders' agreement[753]. Joint venture could be carried out through partnership or even contractual co-operation agreement, but shareholders' agreement is only possible if joint venture is implemented by incorporating a limited liability company. Secondly, even in cases where joint venture is based on an incorporated legal entity it should also be mentioned that the scope of such agreement is far reaching and usually is not appropriate for listed companies due to stricter rules that apply to them[754]. The author is not aware of any publicly listed companies that would be subject to joint venture agreements as a type of shareholders' agreement. However, such agreements could be in place in companies that are controlling shareholders of a listed company (and in some of the cases analysed in this dissertation are). In other words, this type of shareholders' agreement is more common in private non-listed companies.

1.4.7. Closing remarks

The analysis of the qualifying characteristics of the shareholders' agreements allows defining shareholders' agreement as a multiparty contract entered among the shareholders of the company (and possibly between other additional parties), the subject matter of which is related to the functioning of the

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752 Although some authors generally state that joint venture agreements is a type of shareholders' agreement. THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 17-18.

753 For example, article 6.969(1) of the Lithuanian CC states that by entering into joint venture agreement 'two or more persons (partners), co-operating their property, work or knowledge, undertake to act jointly for a certain common goal or certain activities which do not infringe any law'. See also: MIKALONIENĖ, Lina. Jungtinės veiklos (partnerystės) sutarties teisinė kilmė ir samprata. *Mokslo darbai: Teisė*, 2010, No. 75, p. 81-92.

754 For example, articles of association cannot contain any rules restricting free tradability of shares.

company, its shares, legal relationships between the shareholders and (or) their rights and duties towards each other or the company. This is a complex and complicated contractual tool that allows a lot of freedom for the contracting parties to agree on the matters and issues that would best suit the needs of the shareholders.

The peculiarities of the subject matter of the shareholders' agreement and the exclusivity of the parties that can be bound by such an agreement allow making two conclusions about the validity of the contract. First, if the company is liquidated, the shareholders' agreement should also be presumed to be terminated and no longer binding to the parties. This conclusion stems from the reasoning that the existence of the company is directly associated with the validity of the shares. Once the company is liquidated and is no longer considered to be a legal person, the shares no longer confer any rights to the shareholders regarding the company. This means that neither the company exists, nor the shareholders have any rights or duties towards each other or to the company[755]. In other words, the object (company, shares and rights stemming from the shares) of the shareholders' agreement no longer exists, and thus the contract should be considered to be terminated from the moment the company was liquidated. The second conclusion is regarding the validity of shareholders' agreement once the contracting shareholder stops being a shareholder (due to sale or any other transfer of the shares). This is a more complicated matter as the validity of the shareholders' agreement towards the contracting party who is no longer a shareholder depends on the provisions of the contract. For example, if the shareholders' agreement grants contracting shareholders a right of pre-emption and one of the contracting shareholders transfers his shares in breach of such provision, then it should be considered that the contract is enforceable for the shareholder in breach and he should face all legal consequences for the breach of the agreement. However, in other cases

[755] It should be pointed out that in certain cases shareholders might have liability related duties to third persons (creditors), especially when it concerns fraudulent bankruptcy.

former shareholder might be not bound by the contract if he no longer owns the shares of the company. For example, a voting agreement stipulating the exercise of the voting rights in the general meeting of the shareholders would be presumed to be terminated against a shareholder, who has sold his shares. This is explained by the fact that voting agreement can be concluded only amongst the shareholders of the company and only persons with voting rights can exercise them. Thus, once the contracting party stops being a shareholder of the company, the agreement stops being valid to that party. Hence, the validity of the shareholders' agreement and its provisions towards the contracting party, who is no longer a shareholder of the company, usually depends on the subject matter of the agreement and should be treated on a case by case basis.

1.5. Shareholders' agreement and the impact on the relations among shareholders

It is very important to stress the impact of the shareholders' agreement on the structure of the company and the relationships among the shareholders. The analysis of the shareholding structure of the company allows assessing whether the company has a controlling shareholder capable of influencing majority or even all of the most important decisions passed within the company or whether the shareholdings are dispersed without a dominant shareholder present in the company. However, this analysis might be complicated by the fact that shareholders of the company have entered into the shareholders' agreement. Without disclosure of the agreement the structure of the shareholders might look entirely different as when the provisions of the shareholders' agreement are known to the public.

For an illustration of such impact an analysis of the shareholders' agreement among shareholders of AB "SANITAS", a company incorporated in the Republic of Lithuania and listed on the NASDAQ OMX stock exchange will be presented below[756]. AB "SANITAS" was established in 1922 and is one of the oldest and biggest pharmaceutical companies in Lithuania primarily active in the field of manufacturing and trading of pharmaceutical products.

According to the financial reports for the financial year 2010 submitted by AB "SANITAS"[757], there were four shareholders that held more than 10 % of the voting rights in the company: AB "INVALDA" – 23,42 %, Baltic Pharma Limited – 20,30 %, Citigroup Venture Capital International Jersey Limited – 17,56 % and Amber Trust II SCA – 12,70 %. From preliminary analysis of the shareholding structure it is evident the AB "INVALDA" is the largest shareholder that has the most influence over the control of the company. However, a more detailed analysis reveals that the control rights, cash flow rights and transferability of shares is influenced by the contractual obligations among different shareholders of AB "SANITAS".

Two of the shareholders (Baltic Pharma Limited and Citigroup Venture Capital International Jersey Limited) are acting in concert, and thus together control 37,86 % of the voting rights of the company[758]. This entails that the factual ownership structure of the company differs from the one that is not subject to contractual relationships. A further analysis shows that a shareholders' agreement between Amber Trust II SCA, Citigroup Venture Capital International Jersey Limited, Baltic Pharma Limited, AB "INVALDA"

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[756] It should be mentioned that after the analysis presented in this dissertation has been carried out, the factual situation and shareholdings of the company have changed and the shareholders' agreements has been terminated. The shares of the previous shareholders has been acquired by a new shareholder who has also initiated the squeeze out procedure and currently holds 99,4 % of all the share of AB "SANITAS". See: AB „SANITAS". *Konsoliduotųjų ir atskirų 2011 m. metinių finansinių ataskaitų rinkiniai, parengti pagal tarptautinius finansinės atskaitomybės standartus, priimtus taikyti Europos Sąjungoje, ir konsoliduotasis 2011 m. metinis pranešimas pateikiami kartu su nepriklausomo auditoriaus išvada* [interactive]. [Accessed on 2012-09-25] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/san/2011_ar_lt_ltl_con_ias.pdf>.

[757] SANITAS, AB. Neaudituotų tarpinių sutrumpintų konsoliduotųjų ir atskirų 2010 m. birželio 30 d. finansinių ataskaitų rinkiniai, parengti pagal tarptautinius finansinės atskaitomybės standartus, priimtus taikyti Europos Sąjungoje, ir tarpinis konsoliduotasis 2010 m. šešių mėnesių pranešimas [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/san/2010_q2_lt_ltl_con_ias.pdf>.

[758] *Ibid*, p. 29.

(all of the major shareholders of the company) and other shareholders[759] is in place. The agreement limits the right to transfer the shares of the company if it is against the provisions stipulated in the shareholders' agreement[760]. In addition to this, the agreement gives a right for each of the three largest shareholders of the company (Amber Trust II SCA, Citigroup Venture Capital International Jersey Limited, Baltic Pharma Limited) to appoint one member to the management body (the total number of members of the management bod is five). The contracting shareholders have also agreed not to initiate or vote for any changes of the articles of association of the company, if such changes are related to the number of the members of the management body[761]. These provisions of the shareholders' agreement clearly influence the allocation of control in AB "SANITAS" as two of the biggest shareholders (Baltic Pharma Limited and Citigroup Venture Capital International Jersey Limited) are acting in concert and have the right to appoint two out of five members of the management body. The below provided table shows insights on how the shareholding structure of AB "SANITAS" looks with and without shareholders' agreement in place.

[759] Other shareholders are not taken into account at this point, but are reflected in Annex 1 provided below.

[760] SANITAS, AB. Neaudituotų tarpinių sutrumpintų konsoliduotųjų ir atskirų 2010 m. birželio 30 d. finansinių ataskaitų rinkiniai, parengti pagal tarptautinius finansinės atskaitomybės standartus, priimtus taikyti Europos Sąjungoje, ir tarpinis konsoliduotasis 2010 m. šešių mėnesių pranešimas [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/san/2010_q2_lt_ltl_con_ias.pdf>, p. 29.

[761] *Ibid*, p. 30.

Without shareholders' agreement	With shareholders' agreement
The largest shareholder has 23,42 % of voting rights in the general meeting of shareholders.	Two of the largest shareholders are acting in concert and together hold 37,86 % of the voting rights. This should trigger the mandatory bid requirement under the Lithuanian law[762].
The rights of the shareholders to transfer their shares are not restricted.	Shareholders' agreement stipulates rules and limits the transfer of shares among the contracting shareholders.
The members of the management board are appointed according to general rules provided in the company laws.	Three of the shareholders (two of which are acting in concert) are entitled to appoint one member of the management body each. This provision is implemented by voting in the general meeting of shareholders.
Initiation and change of articles of association of the company are made according to the general rules provided in the company laws.	Shareholders' agreement imposes a duty on the contracting shareholders to abstain from initiating or voting for any changes of articles of association related to the change in number of the members of the management body.

Table 1: The influence of shareholders' agreement on the ownership and control structure of AB "SANITAS"

It should be pointed out that while shareholders' agreement has great influence upon the relations of the contracting shareholders and even the ownership structure of the company, the contractual relations are created as binding only amongst the parties and should not create any negative or positive effects to other persons, including the company. There are two implications of this reasoning. First, shareholders' agreement should not be against the interests of the company, for example, it cannot limit the statutory powers of the different bodies of the company. Second, even if shareholders' agreement creates certain beneficial consequences to the company, company itself cannot enforce the obligations of the contract unless it is a party to the agreement[763].

The conclusion from the above example is that shareholders' agreements are very important contractual legal tools that can have influence on the ownership structure of the company (that might be significantly different from the official ownership structure without the agreement taken into account), the distribution of control rights amongst the shareholders, the

[762] See: Article 31 of the Lithuanian Law on Securities.

[763] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 37.

peculiarities of the transfer of the shares and the rights of the shareholders regarding the management and corporate structure of the company. In addition, this example suggests that all research that deals with identifying ownership structure peculiarities of listed companies in different countries have to take into account the influence and role that shareholders' agreements have and how they can shift and impact the shareholding structure of the company[764].

1.6. Chapter conclusions

Theoretical assumptions and arguments provided in this chapter suggest that shareholders' agreement, as a conflict management tool, can be effectively used in listed companies. In this context shareholders' agreement might be defined as a multiparty contract entered among the shareholders of the company (and possibly between other additional parties), the subject matter of which is related to the functioning of the company, its shares, legal relationships between the shareholders and (or) their rights and duties towards each other or the company. The complexity of this tool allows freedom for the contracting parties to agree on the matters and issues that would best suit their needs as shareholders, as long as subject matter is in the lines of the boundaries of the definition of the shareholders' agreement and its qualifying characteristics.

Two main alternative aims can be theoretically distinguished that might dominate shareholders' agreements in listed companies: to concentrate control of contracting parties or to protect the interests of minority shareholders. These

[764] Although there is quite a lot of academic research in the field of ownership structure of listed companies, not all authors include or mention that shareholders' agreements have a significant influence while determining the ultimate controller of the company. Usually only pyramiding is included in determining the ownership structure of the company. See: LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A. Corporate Ownership Around the World. *The Journal of Finance*, 1999, Vol. 54, No. 2, p. 471-517; FACCIO, M.; LANG, L.H.P. The Ultimate Ownership of Western European Corporations. *The Journal of Financial Economics*, 2002, No. 65, p. 365-395. VAN DER ELST, Ch. Shareholder Mobility in Five European Countries. *ECGI – Law Working Paper No. 104/2008*, 2008 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=1123108>.

two aims may also be accompanied by other reasons that stimulate shareholders to enter into contractual relations.

The impact of shareholders' agreement to the ownership structure of the company also allows concluding that it should be taken into account at all times when analysing the influence and control rights of shareholders of a particular company. Furthermore, it suggests that rules requiring full disclosure of shareholders' agreement on the impact of shareholding structure of the company are necessary in order to allow other shareholders and possible investors to gain information about the controlling shareholders of the company.

Chapter 2. Regulation of shareholders' agreements in Lithuania

As is true with almost all of the European member states, in Lithuania the right of the shareholders to enter into agreements among themselves and to regulate matters concerning their relationships with the management body of the company has been recognized by Lithuanian legal scholars[765], and is being derived from the principle of contractual freedom.

Though shareholders' agreements have been explicitly regulated in the previous wording of the Law on Companies[766], the current wording of the law only indirectly suggests that such agreements are permitted to be concluded among shareholders[767]. The old wording of the Law on Companies contained some restrictions as to the parties and content of the shareholders' agreements.

[765] BOSAITĖ, A.; BUTOV, S. Juridiniai asmenys kaip civilinės teisės subjektai. In MIZARAS V. (ed.), *Civilinė teisė: Bendroji dalis*. Vilnius: Justitia, 2009, p. 260.

[766] Article 14(6) of the Law on Companies of the Republic of Lithuania (old wording) (Valstybės žinios, 1994, No 55-1046). The law stipulated that in order to implement their pecuniary and non-pecuniary rights, two or more shareholders had the right to conclude a shareholders' agreement. The agreement had to specify the following: 1) contracting shareholders (full names, names of legal persons) and their addresses; 2) company's name; 3) obligations of the shareholders concluding the agreement relating to voting on all or individual items on the agenda of the general meeting, related to the implementation of non-pecuniary rights or resolutions adopted by the meeting; 4) liability of the parties for failure to perform their obligations; 5) the procedure for settling disputes between the shareholders-parties to the agreement; 6) the period of validity of the agreement.

[767] Article 5(4.2) of the Lithuanian ABI.

For example, only two or more shareholders were able to enter into shareholders' agreement, and thus it was not possible to conclude relationship agreements with the company. At the date of writing of this dissertation, there were no legal rules in Lithuania that would regulate shareholders' agreements as such in general[768] as was discussed in the previous chapter. However, there are statutory provisions regarding certain types of shareholders' agreements, namely the voting agreement and transfer of voting rights agreement.

Although it is argued in Lithuanian legal doctrine that the most common agreements among shareholders are the voting rights agreement, the transfer of voting rights agreement and the shareholders' agreement[769], the author does not fully agree with such classification. A more logical and legally convenient classification would be to consider all of the above agreements as shareholders' agreements with the voting agreement and transfer of voting rights agreement being a more detailed version of a general shareholders' agreement[770].

Empirical analysis of the companies listed in the NASDAQ OMX Vilnius stock exchange revealed that of a total of 37 listed companies 10 shareholders' agreements have been concluded in 7 companies. This number of companies that have shareholders' agreements in place is well above the average of 8 % in the EU[771] and amounts to 18.9 %[772] of all the listed

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[768] In contrast, relatively recent changes in the company laws of Russian Federation have introduced the concept of the shareholders' agreement. See: article 32 of the Federal law No. 208-FZ of the Russian Federation of December 26, 1995 Concerning Joint Stock Companies (in Russian *Закон об Акционерных обществах*).

[769] BOSAITĖ, A.; BUTOV, S. Juridiniai asmenys kaip civilinės teisės subjektai. In MIZARAS V. (ed.), *Civilinė teisė: Bendroji dalis*. Vilnius: Justitia, 2009, p. 260-261.

[770] For a classification of the shareholders' agreements see Part II, Chapter 1.4.5.

[771] Report on the proportionality principle, p. 35. Additionally, it could be added that, for example, in France even a 1/3 of all the listed companies have a shareholders' agreement in place which is in average 6 pages long (among the 749 listed companies on Euronext Paris, 268 companies had at least one shareholders' agreement between 1997 and 2007). See: MADELON, C.; THOMSEN, S. Contracting Around Ownership: Shareholder Agreements in France. In *Modern Firm, Corporate Governance and Investment*. Cheltenham: Edward Elgar Publishing Limited, 2009, p. 256-257.

[772] The percentage was calculated according to the number of companies which shareholders entered into the agreements. For a detailed analysis see Annex I.

companies. This clearly shows that shareholders of the Lithuanian listed companies see contractual means as an important tool to protect their interests.

The following paragraphs of this chapter analyse available Lithuanian regulation and lows on the voting agreement, transfer of voting rights and some other issues related to shareholders' agreements.

2.1. Voting agreement

2.1.1. General comments

Article 2.88 of the Lithuanian CC explicitly allows shareholders to conclude agreements on the exercise of voting rights at the general meeting of shareholders. According to the drafters of the CC, voting agreements can only be concluded among shareholders as only they have voting rights conferred to them by the shares[773]. The author is in accord with this interpretation and is of the opinion that an agreement where shareholders as a class undertake against the creditor of the company not to change articles of association or not to take additional financial undertakings cannot be qualified as a voting agreement. As mentioned in the previous chapter, such an undertaking should not be qualified as a shareholders' agreement as it is not related to legal relationships among shareholders (if they do not obtain any rights and duties towards each other) or with the company and has other subject matter than shareholders' agreement – to protect the interests of the third party.

Although the general rule is that shareholders are allowed to enter into voting agreements, there are some restrictions stipulated in the CC as to what kind of undertakings of the shareholders are not permitted. Article 2.88(1) of the CC provides a list of exceptions from the general rule which make voting agreements null and void[774]. At this point it has to be mentioned that voting agreements that do not conform to the prohibitions in Article 2.88 of the CC

[773] MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys.* Vilnius: Justitia, 2002, p. 195.

[774] The wording of the article states that such agreements are 'invalid'.

are considered unlawful (as conflicting to the mandatory rules), and therefore null and void *ab initio*. This conclusion is in line with Articles 1.80 and 6.225 of the CC which stipulate that all the contracts that are against the mandatory provisions of the laws are null and void *ab initio* and cannot be approved by the parties at any stage[775]. Other than the above interpretation of the restrictions would enable agreements among the shareholders that are contrary to the statutory provisions[776] (for example, until the decision of the court to invalidate the contract, shareholders would be able to vote in the general meeting of the shareholders according to the instructions of the management body). The author is of an opinion that these situations are unacceptable from the legal point of view as they would allow shareholders to overcome the restrictions stipulated in the CC against the intentions of the legislature (at least temporarily).

Thus, voting agreements are explicitly allowed in Lithuania. However, they have to conform with certain restrictions, which will be analysed below in this chapter.

2.1.2. Special proxy

Listed companies usually have numerous shareholders, and it might be economically inefficient or practically impossible for them to convene before a general meeting of shareholders and to determine amongst themselves how they are planning to exercise their voting rights (if a more detailed voting procedure is not stipulated in the voting agreement). For example, shareholders might be from different countries and the actual meeting might sometimes be more costly than the benefits from concerted voting. Lithuanian CC provides a solution for such a situation.

According to article 2.88(2) of the CC, parties to the voting agreement may grant a special proxy to another party or to any third person to exercise

[775] In contrast, agreements that can be invalidated only by the court are not considered to be null and void *ab initio*.

[776] Or even legitimize them if the courts would decide so.

voting rights according to the provisions of the agreement. There are no limitations as to who such a proxy might be and all the parties to the voting agreement might appoint the same proxy to vote in their name. In order for the parties of the voting agreement to be able to issue a special proxy, the voting agreement itself has to provide for such a possibility. Furthermore, the special proxy may be revoked only under circumstances and rules provided by the voting agreement. This is to prevent parties to the voting agreement that have already issued a special proxy from starting revoking their proxies separately as this can undermine the enforcement and actual execution of the voting agreement.

However, the issue of the special proxy constrains the voting rights of the parties to vote on their own. Article 2.88(3) of the CC explicitly states that shareholders who agreed to issue a special proxy in the voting agreement do not have the right to vote on their own or to issue any other proxies to vote in their name (this also entails that all the proxies that have been issued before entering into voting agreement should be revoked or automatically lose any enforceability). In order to regain the right to vote, shareholders have to first terminate the special proxy (and this is possible only in accordance with the provisions set in the voting agreement). Thus, the shareholder who issued a special proxy in the voting agreement cannot exercise his voting rights, unless he terminates such proxy[777]. On the one hand, this provision facilitates the exercise of voting rights according to the provisions of the voting agreement[778]. The contracting shareholders cannot vote themselves and cannot issue instructions to the special proxy that are against the provisions of the voting agreement. This strengthens the implementation of the voting agreement and limits the risk of possible breaches of the duties of the contracting parties. On the other hand, it deprives shareholders from exercising their voting rights on

[777] As a general rule the special proxy is valid for the term of the voting agreement. However, shareholders are free to agree that special proxy is issued for one particular general meeting.

[778] This is especially true if there are a lot of parties to the agreement.

their own[779]. It should be stressed that shareholders are not allowed to exercise their voting rights (or to issue additional proxies) only as to the subject matter and questions related to the voting agreement. For example, if the voting agreement deals only with the exercise of votes regarding the appointment and dismissal of the members of the management body of the company, the shareholders are not allowed to exercise their voting rights or to issue proxies only regarding the appointment and dismissal of the management. However, shareholders are free to vote and issues proxies on all other issues that they are entitled to vote according to the Lithuanian ABI.

The author is of an opinion that the special proxy should contain detailed rules and instructions (which have to be in line with the provisions of the voting agreement) for the proxy to exercise the voting rights. Additionally, in all cases these instructions should be in the interests of the shareholder and should not cause conflict of interests[780]. The need for rules and instructions for the special proxy could be explained by the limited nature of such proxy. The validity of the special proxy is restricted only to issues regulating voting agreement. Therefore, there have to be clear rules and instructions for the proxy to vote only according to the provisions of the voting agreement.

Overall, the possibility to issue a special proxy is regarded as positive due to four reasons. Firstly, the special proxy can facilitate and help shareholders to practically exercise their voting rights, when it is economically or practically not feasible to do it themselves. Secondly, the issue and revocation procedure has to be stipulated in the voting agreement, which prevents shareholders from avoiding their obligations to vote in accordance with the agreement[781]. Thirdly, the voting rights are exercised by one proxy

[779] The possibility to exercise voting rights is essential when voting agreement provides for a procedure of preliminary consultation before each general meeting.

[780] Article 2.135 and 2.137(2) of the Lithuanian CC.

[781] This is especially relevant due to the lack of court law on the enforceability of voting agreements in Lithuania. The special proxy can be issued to bank or any financial intermediary, which would act as a representative of all the parties to the voting agreement and would vote only according to the rules stipulated in the contract. In case of a dispute, the contracting shareholders would not be able to exercise their voting rights in the general meeting of the shareholders as this is explicitly prohibited by

and this limits the chance of duplication of votes. Lastly, the decision whether to grant a special proxy is left for the parties to decide according to their needs and in compliance with the provisions of the agreement. Parties can always agree not to issue the special proxy.

2.1.3. Statutory restrictions on voting agreements

Although voting agreements are generally allowed to be concluded amongst shareholders of Lithuanian companies, the CC provides some restrictions that limit the scope of voting agreements. These restrictions will be discussed in the following paragraphs.

The first restriction on the subject matter stipulates that all voting agreements, where shareholders undertake to vote according to the instructions received from the management bodies of the company in question (this includes both collegial management body – the board of directors and the sole management body – the executive director), are null and void. This prohibition can be explained by the fact that under Lithuanian law different functions can only be held by the different bodies of the company[782]. The management body and the general meeting of shareholders have different powers and competences vested in them by the law and articles of association. There is an explicit prohibition for the general meeting of the shareholders not to transfer its competences and functions to other bodies of the company[783]. If it would be allowed for the shareholders to vote according to the instructions of the management body, the balance between the separation of powers would be undermined and all control of the company could fall in the hands of the

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the CC, and thus the special proxy would act as an enforcer of the provisions of the voting agreement. This would also stimulate the parties to settle their disputes peacefully.

[782] Under Lithuanian law the competence of the general meeting of the shareholders, board of directors and other bodies of the company are clearly stipulated in the ABI. It is considered that each body of the company has its own prescribed functions and cannot transfer them to other bodies. In contrast, under the UK law shareholders usually have the power to decide on the functions and power of each of the bodies of the newly formed company.

[783] Article 19(5) of the Lithuanian ABI. The law states that ‘the General Meeting of Shareholders may not delegate other bodies of the company to address the issues assigned to its competence’.

members of the management. This would not only be against mandatory provisions of ABI, but also would go against the theoretical foundations of the Lithuanian company law, according to which the law (and not the shareholders) regulates the balance of power and competences of different bodies in companies.

In contrast, Belgian W.Venn. also provides for a similar restriction on the subject matter of the voting agreement. However, the restriction includes not only the management bodies of the company, but also the company itself, all of its subsidiaries and any other bodies formed within the company[784]. In other words, the scope of application of the Belgian provision is much broader. From a comparative perspective it should be noted that in the UK there is no clear separation of powers between different bodies of the company (especially between the general meeting of the shareholders and the management body) stipulated in company laws, and thus there are no statutory restrictions related to the voting agreements[785].

In the view of the author, Lithuanian rule is too narrow and allows the parties to the voting agreement to escape its field of application. For example, if the shareholders agree to vote according to the instructions of the subsidiary of the company, the strict interpretation of the article 2.88(1.1) would suggest that they are allowed to do so. However, subsidiaries, as a general rule, are coordinated by the management body of the company, and thus the management body would be the ultimate instruction giver. Moreover, the situation above is clearly against the intentions of the Lithuanian legislature, as it is expressly stipulated in the ABI that general meeting of the shareholders is not allowed to delegate its powers. Another argument is that voting rights are the most valuable non-pecuniary rights of the shareholders', and the exercise of these rights is directly related to the exercise of control and power over the company. Due to the above reasons the author proposes to interpret the

[784] Article 551 of the Belgian W.Venn.

[785] LOWRY, J.; REISBERG, A. *Pettet's Company Law: Company Law & Corporate Finance. 4th edition*. Essex: Pearson Education Limited, 2012, p. 112-114.

provision stipulated in article 2.88(1.1) of the CC as encompassing also the situations when shareholders undertake to vote under instructions of the company itself, its subsidiaries or any other bodies formed in the company (including the supervisory and management bodies). This interpretation ensures that in cases where voting agreements are in place amongst shareholders the separation of the functions and competences of different bodies of the company will not be altered and the voting rights conferred to the shareholders will not be exercised by other bodies of the company. Essentially, the interpretation would be in line with article 19(5) of the Lithuanian ABI and would eliminate the uncertainty that exists now[786].

The second statutory bar prohibits shareholders from agreeing to vote for all the proposals made by the management body of the company. Under Lithuanian law the agenda of the general meeting of the shareholders is prepared by the management body[787]. Due to this statutory provision, members of the management body have the power to put any items and proposals on the agenda that they deem to be relevant to the functioning of the company. However, at the moment of entering into voting agreement shareholders are not in the position to foresee what proposals will be made by the management body in the future. In other words, shareholders are encouraged to use their voting powers wisely and not to blindly follow and accept everything that management body of the company proposes them. Before exercising their voting rights shareholders have to take into account their interests and the interests of the company. Accordingly, this exception is closely related to the first one and clearly distinguishes between the powers of the board and the general meeting of shareholders. In order to exercise their powers in most efficient way, shareholders have to weigh the proposals offered by the management and only then come up with a decision. They cannot agree to vote

[786] Legal uncertainty exists in situations when shareholders agree to vote for the instructions of other bodies of the company. This is not expressly prohibited by article 2.88(1.1) of the CC, but is against the mandatory provision of article 19(5) of the Lithuanian ABI.

[787] Article 25 (1) of the Lithuanian ABI.

for the proposals that have not been made yet and that will be put on the agenda of the general meeting of shareholders only in the undefined future[788]. Nevertheless, there might be *de facto* situations when shareholders actually vote for every proposal or item put on the agenda by the management, for example, all the proposals of the management body are for the benefit of the company and the shareholders. However, in order to avoid uncertainty and entrenchment of the management this cannot be agreed in advance in the voting agreement. The shareholders have to keep their independence from the will of the management body of the company. Again, the provision stipulated in article 2.88(1.2) of the CC should be interpreted broadly as including not only the management body of the company, but also other bodies (including supervisory body), the company itself and all its subsidiaries. For example, shareholders should not be allowed to undertake to vote for all the proposals submitted by the audit or remuneration committees if such are formed in the company.

Thirdly, agreements to vote or to abstain from voting according to the instructions of any person (including shareholders and third parties) for consideration are considered to be null and void[789]. Consideration in this regard

[788] From comparative perspective it is interesting to note that not all countries have implemented such restrictions. Shareholders of companies listed on the New York Stock Exchange are allowed to vote according to the instruction of the management body. For example, shareholders of Blackrock inc. (PNC and Barclays) agreed to vote all of their voting shares in accordance with the recommendation of BlackRock's board of directors in accordance with the provisions of their respective shareholders' agreements with BlackRock. As a consequence, if the shares held by PNC and Barclays constitute a substantial portion of the outstanding voting shares, matters submitted to a stockholder vote that require a majority or a plurality of votes for approval, including elections of directors, will have a substantial number of shares voted in accordance with the determinations of the BlackRock board of directors. This arrangement has the effect of concentrating a significant block of voting control over BlackRock in its board of directors. Blackrock inc. *Annual report 2010* [interactive]. [Accessed on 2011-06-26] Available online at: <http://media.corporate-ir.net/media_files/irol/11/119943/2010AR_Final/pdf/FullBlackRockAnnualReport2010.pdf>, p. 82.

[789] From comparative perspective it should be noted that some countries have very strict rules regarding the exercise of voting rights for consideration. For example, article 59 of Greek law 2190/1920 provides that any person, who intentionally and for illegal cause receives special benefits or promises, in order to vote in a specific way in the general meeting of the shareholders of the company or in order to be absent from such general meeting of the shareholders shall be punished with up to one year imprisonment and a monetary punishment of 1,000 euro at least. See: Institutional Shareholder Services Europe, European Corporate Governance Institute and the law firm Shearman & Sterling. *Report on the Proportionality Principle in the European Union, Comparative Legal Study, Exhibit C (Part 1)*, 2007 [interactive]. [Accessed on 2012-10-12] Available online at:

is understood as any direct benefit for the shareholder who exercises his voting rights[790]. This is a clear ban on vote buying which might be considered to be originating from the doctrine formulated by the CCL (constitutional case No. 14/2012)[791]. In this way Lithuanian legislature prohibits the separation of voting power and economic benefit constituted by the shares (but, as it is explained in the next part of this chapter, this proposition is only true when voting rights are separated from ownership rights for consideration). Thus, the view of Easterbrook and Fischel that the separation of shares from votes introduces a disproportion between expenditure and reward is upheld in Lithuania[792]. It is also argued that distortion arises when voting rights are placed in the hands of one who lacks an economic interest in the business (which might happen in cases of vote buying)[793]. Despite this, the discussions in the academic field regarding empty voting and vote buying are controversial, with some authors[794] arguing against vote buying, some saying that vote buying should be allowed and there are no statutory bans on them[795],

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<http://ec.europa.eu/internal_market/company/docs/shareholders/study/study-exhibit_c_part1_en.pdf>, p. 191 – 192. Even more severe consequences for voting or abstaining from voting for consideration are stipulated in article L242-9(3) of the French Commercial Code. Under this article both the shareholder who votes or abstains and the person buying such votes are subject to an imprisonment for two years and a fine of 9,000 euro. See: RAWORTH, Ph. *The French Commercial Code in English*. New York: Oxford University Press, 2010. Vote buying is also prohibited in Germany. See: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 73.

790 MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 196.

791 The governance of the company is usually carried out by the management body of the company, which in turn is a representative of all the shareholders. This representative democracy element could be also viewed as a reason why vote buying is not allowed in the general meeting of shareholders. An analogy could be drawn from vote buying prohibitions during parliament elections. See: CCL, constitutional case No. 14/2012, 2012 October 29, *Dėl Seimo rinkimų rezultatų vienmandatėje apygardoje pripažinimo negaliojančiais*.

792 EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991, p. 74.

793 THOMPSON, R. B.; EDELMAN, P. H. Corporate Voting. *Vanderbilt Law Review*, 2009, Vol. 62, No. 1, p. 160-166.

794 EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Cambridge: Harvard University Press, 1991.

795 LAN, L. L.; HERACLEOUS, L. Negotiating the Minefields of Corporate Vote-Buying. *Corporate Governance: An International Review*, 2007, Vol. 15, No. 5, p. 969-978. There are some countries which explicitly allow vote buying and selling, for example, Australia. See: FRIDMAN, S;

whilst others are taking a somewhat neutral position (especially taking into account various financial derivatives that allow for similar legal effects as vote buying)[796].

The position to prohibit vote buying under Lithuanian law is also based on the notion of voting right analysed above[797]. A different approach, which would suggest that transfer of voting rights (without the ownership of the shares) for monetary consideration is a simple commercial contract, cannot be upheld for the following reasons. Firstly, the economic interests and the voting interests should be aligned at all times. Economic interests stem from the ownership of the shares and capital contributed to the company. Voting interests follow such economic interests and reflect the position of the shareholder to get returns on the investment. If the right to vote is sold, the economic interests are detached from the ownership of the share. It should be presumed that the person buying votes has different (and even adversarial) interests as those of shareholder. If the person interested in buying votes would have the same or similar interests as the shareholder, payment for voting would not have any economic logic. Shareholder would be free to cast votes as he sees it fit and such voting would be in the interests of the previously mentioned person. Thus, vote buying is feasible only when interests of the shareholder and person buying the votes are different. By allowing to buy votes, the legislature would allow for inherently programmed conflicting situation, which would result in increased litigation. Secondly, in order to avoid above mentioned situations Lithuanian legislature insures alignment of such interests by requiring to back each share with capital contributions and allowing to exercise voting rights only when the shares are fully paid up. If the votes were

LUMSDEN, A. J. Proxy Voting and Vote Selling. *Keeping Good Companies Journal of Chartered Secretaries Australia Ltd*, 2009, Vol. 61, No. 6, p. 332.

[796] HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811-908; HU, H. T. C.; BLACK, B. Equity and Debt Decoupling and Empty Voting II: Importance and Extensions. *University of Pennsylvania Law Review*, 2008, Vol. 156, No. 3, p. 625-739.

[797] See Part I, Chapter 3.4.2.

allowed to be bought, the person buying such votes would not have any capital contributions to the company. Lack of economic interest in efficient management of the company would also increase risk that sold votes would be cast in a way that is against the interests of the company. It can also be added that the person buying the votes incurs costs (pays for the votes) and it should be assumed that such costs are expected to be covered by exercising voting rights. This presumption strengthens the position that interests of the company might suffer, if the votes are sold. Thirdly, the one share – one vote approach adopted in Lithuanian ABI strongly suggests that voting rights should at all times be attached to the share. Thus, exercise of voting rights should always depend on the will of the owner of the shares. If vote buying would be allowed, voting rights would be exercise independent of the will of the original shareholder. Fourthly, reasoning that there are more ways to decouple voting rights from the shares is not well founded and should not be upheld. It should be considered that the concept of vote buying is sufficiently broad to encompass various voting manipulation techniques identified in recent scholarship[798]. If vote buying is prohibited than all contracts with the primary purpose to sell votes (whether they are entered into as security lending or buyback agreements) should fall under prohibition to sell votes. Fifthly, as presented in this dissertation[799], the EU promotes long term ownership and investment in the company. Buying shares would disrupt this policy as person owning shares could be identified as the same person who casts votes[800]. All of the arguments provided above do not mean that vote buying under certain

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[798] For example, in case of date capture agreement the acquirer of the shares (and voting rights) does not bear any economic consequences of the vote since the impact of the vote on the value of the company takes place after the share is returned to the original shareholder.

[799] See Part I, Chapter 5.

[800] Recent policy proposed by the European Parliament supports this argument. See: European Parliament's Committee on Economic and Monetary Affairs. *The use of shareholder voting rights during the general assembly of company shareholders* [interactive]. [Accessed on 2013-11-24] 2009. Available online at: <http://www.europarl.europa.eu/document/activities/cont/201103/20110324ATT16407/20110324ATT16407EN.pdf>.

circumstances could not be allowed or should be banned *per se*[801]. However, this cannot occur by simply abolishing the restriction to buy votes. Vote buying should be regulated separately in order to prevent any possible abuse (at least by providing that votes sold cannot be cast against the interests of the company). Thus, if the legislature decides to allow vote buying, the new legislation should guarantee that above mentioned obstacles are avoided.

The author is of the position that under Lithuanian law vote buying is explicitly prohibited and should also be extended to situations involving financial derivatives that are used for vote buying[802]. The prohibition for vote buying also encompasses prohibition to exercise (or to abstain from exercising) other special rights held by the shareholder, for example, a veto right. Although the Lithuanian CC allows to decouple voting rights from economic interests (by the way of transfer of voting rights agreement discussed below), the author holds a position that such transfer cannot occur for remuneration and the transferred voting rights cannot be used against the interests of the transferee shareholder or the company[803].

2.1.4. Voting agreement and the interests of the company

Unlike in Belgium (where W.Venn. explicitly states that voting agreements have to be in the interests of the company) and the UK (where case law has formulated the rule that exercise of voting rights cannot breach the interests of the company and minority shareholders), the concept of interests of the company in context of voting agreements in Lithuania is controversial. There

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[801] For possible benefits of allowing vote buying see: CLARK, R. Vote Buying and Corporate Law. *Case Western Reserve Law Review*, Vol. 29, 1979, p. 797-799.

[802] This strong view is supported by the fact that there is a lack of regulation regarding the vote buying and especially the techniques using financial derivatives that have similar consequences as vote buying. The author is of an opinion that vote buying could create instability in the financial markets and could create unforeseen consequences. Therefore, without the support from the legislature (and at least general guiding principles) the vote buying should be limited. The author is aware of various ways that financial derivatives are used to achieve the same consequences as vote buying and understands that prevention of their use would be hard to achieve.

[803] For more analysis on this issue in the light of the transfer of voting rights agreement see Part II, Chapter 2.2.

are no statutory provisions in Lithuanian CC that would emphasise the interests of the company or minority shareholders when voting in accordance with the voting agreement. The Lithuanian legislature has not stressed in any way[804] that breach of interests of the company or of the minority shareholders is ground enough to invalidate the voting agreement or decisions of the general meeting of the shareholders[805] that were adopted in accordance with such voting agreement.

From the analysis of Lithuanian case law it could also be concluded that only the fact that a certain resolution of the general meeting of shareholders (as a consequence of exercise of voting rights) is against the interests of certain shareholders is not enough to invalidate such resolution or the votes cast in the general meeting of shareholders[806]. It has been stated by the courts that there are two interests that must be balanced, while deciding upon the validity of the resolutions of the general meeting of shareholders. Firstly, the interests of persons who might be adversely affected by adoption of the resolutions at the general meeting of shareholders (including public interests) must be protected by allowing them to dispute the resolutions. Secondly, the interests of the company and shareholders who have voted for the adoption of a particular resolution are to be protected[807]. Despite the declaration of balancing of

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[804] It is noteworthy that there is a special procedure for private limited liability companies whereby shareholders have a right to require court to enforce the sale of shares of the shareholder or shareholders, whose actions are against the purpose of the company and it is unreasonable to expect that such harmful behaviour is likely to change in the future. However, this procedure cannot be applied to public companies. See articles 2.115-2.123 of the Lithuanian CC.

[805] It should be mentioned that enforcement of the voting agreement and the validity of the resolutions of the general meeting of shareholders are closely related. According to standard voting agreement, shareholders agree to exercise their voting rights in the general meeting of shareholders. Thus, the actualisation of the voting agreement is by adoption of certain decisions. The statutory provisions and case law on the validity of the resolutions is directly related to the enforceability question of voting agreements. Voting agreements that stipulate voting for adoption of such resolutions that are considered to be invalid according to statutory provisions or case law should be considered as unenforceable or even null and void in certain cases.

[806] SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras"*; SCL civil case No. 3K-3-878/2002, 2002 June 19, *UAB "Vilnamisa" v. AB "Šeškinės Širvinta"*; SCL civil case No. 3K-3-315/2010, 2010 July 8, *J. J. v. AB „Lankava"*.

[807] It is interesting to note that courts regard interests of the company and interests of the shareholders that voted for the adoption of the resolution in the same group of interests (that must be balanced against other shareholders who are against the adoption of the decision). However, such division of

interests, the courts have ruled that ‘shareholder who controls 91.95 per cent of the shares of the company can adopt any resolution he likes and is not bound by the opinion or interests of the minority shareholders’[808]. In other words, this means that there is no question about balancing different interests if controlling shareholder is involved in the case. A simplified version of the argument would be that while deciding the case courts are counting of voting rights that were cast for and against particular resolution[809]. The reasoning behind the Lithuanian case law is that minority shareholders do not have any influence on the adoption of the resolutions in the general meeting of shareholders, and if the voting on the issues would be repeated the outcome would be the same (majority shareholders would adopt only such decisions that are in their best interests). Furthermore, the courts have formulated certain rules as to when decisions of the general meeting of shareholders might be invalidated: 1) only when mandatory rules of Lithuanian ABI are breached; 2) such breach causes negative consequences to the interests of the claimant (or to the public

interests is logically not justified. The interests of the company might be breached even by the majority shareholder, who has voted for the adoption of a particular resolution in the general meeting of shareholders (for example, to sell all assets of the company below market price). Thus, from the author’s point of the view, the interests of the company must be balanced against all other interests that shareholders or any stakeholders might have.

[808] SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras“*. It should be mentioned that the reasoning of the court was not always like that. In one of the earlier resolutions the SCL ruled that the number of voting rights at the general meeting of shareholders should not be interpreted as a sole qualifying ground for the validity or invalidity of the resolutions of the general meeting of shareholders. However, this reasoning, in the author’s view was lost somewhere along the way. See: SCL civil case No. 3K-3-613/2001, 2001 May 28, *UAB “Vilnamisa” v. AB “Šeškinės Širvinta”*. Also see: MIKALONIENĖ, L. Akcininko Locus Standi dėl visuotinio akcininkų susirinkimo sprendimų pripažinimo negaliojančiais. *Teisės problemos*, 2012, No. 77, p. 17-18.

[809] For example, SCL civil case No. 3K-3-171/2008, 2008 March 17, J. K. (J. K.) v. UAB „Vilties vaistinė“. This case involved a resolution of the general meeting of shareholders to change articles of association which resulted in deprivation of the shareholder-claimant of the right to initiate audit of the company. The decision of the court was that interests of this shareholder had been breached as he was deprived from one of the rights that he could previously enjoy. However, the decisive factor in this case was that shareholder-claimant had more than 30 % of the voting rights and he could have influenced the adoption of the resolution (change of articles of association requires qualified majority). The question is, what would be the outcome of this case, if the shareholder in question would have had only 10 % of the voting rights. Systemic analysis of the relevant case law would suggest that his claim would be dismissed. However, it should be considered whether only the number of voting rights is sufficient criteria to determine validity of decisions of the general meeting of shareholders.

interest); 3) no other legal measures are possible to remedy the situation[810]. It could be seen that the test is particularly strict and greatly limits the invalidation of decisions of the general meeting of shareholders[811].

In the author's view, the reasoning of the Lithuanian courts provided above is flawed[812]. Although they officially declare that one of the purposes to invalidate resolutions of the general meeting of shareholders is to protect the interests of all interested shareholders (who are adversely affected by such decisions), the interests that are actually protected are only of the majority or controlling shareholders. The main argument in concluding the breach of interests, in the view of Lithuanian courts, is the number of voting rights in the general meeting of shareholders (this is not expressly stated in the cases, but the argumentation and reasoning of the court allows for such a conclusion[813]). The above discussed case law would allow making a deduction that voting agreements could be considered valid and enforceable even if they would oblige shareholders to vote against the interests of the company or their fellow shareholders. This would be true as long as contracting shareholders would retain control over the company and a decisive block of the voting rights in the general meeting of shareholders. However, this reasoning cannot be supported. Firstly, the interests of majority or controlling shareholder are not identical to the interests of the company[814]. A clear distinction at this point reveals that

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[810] SCL civil case No. 3K-3-315/2010, 2010 July 8, *J. J. v. AB „Lankava“.*

[811] However, a broader interpretation is provided in Lithuanian legal doctrine. See: MIKALONIENĖ, L. Akcininko Locus Standi dėl visuotinio akcininkų susirinkimo sprendimų pripažinimo negaliojančiais. *Teisės problemos*, 2012, No. 77, p. 20-24.

[812] Majority of the SCL cases involve procedural breaches for allowing shareholders to vote in the general meeting of shareholders, for example, the shareholder is not provided with the date and time of the general meeting. However, if the shareholder is prevented from exercising his voting rights, he is prevented from expressing his will regarding one or the other aspect of company's activities. The author is of a position that in all cases that involve procedural breaches, the court should also analyse material and subjective rights of the shareholder. This is supported by the above argumentation that the shareholder is prevented from exercising his rights.

[813] With an exception of single case. SCL civil case No. 3K-3-613/2001, 2001 May 28, *UAB "Vilnamisa" v. AB "Šeškinės Širvinta".*

[814] At this point the question arises whether shareholders have a duty to take interests of the company into account while voting at the general meeting of shareholders. There are no direct statutory acts or case law that would formulate such a duty. However, shareholders have indirect obligations to act in the interests of the company. For example, they cannot act against good faith to the detriment of the

majority shareholders could be voting at the general meeting of shareholders and their votes might be cast in a way that is to the detriment of the interests of the company. Interests of the company should be understood as interests of the shareholders as a class[815] and not as interests of the shareholders who are controlling the company. Secondly, the interests of the minority shareholders should be protected despite the fact they do not have decisive voting rights (this is precisely the reason why they are called minority shareholders). One of the aims of corporate governance and company law is to protect the interests of a weaker shareholder constituent – minority shareholder[816]. Therefore, the number of voting rights should not be considered as a decisive factor in determining the validity of the decision of the general meeting of shareholders, as in almost all the situations minority shareholder will be considered as a party that has no influence on the outcome of voting[817]. Thirdly, the impact on the interests of the company and minority shareholders should be the most crucial factor in determining the validity of voting arrangements and resolutions of shareholders passed in relation to the voting agreement (even when voting is in line with all mandatory provisions of company law[818]). There

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interest of creditors of the company. See: SCL civil case 3K-3-124/2004, 2004 February 18, *UAB "Göllner spedition" v. S. B. and J. B.* Furthermore, the courts have formulated a rule that majority shareholders cannot infridge pecuniary rights of the minority shareholders. See: SCL civil case 3K-7-471/2002, 2002 May 23, *UAB „Baltic fund securities" v. AB „Geonafta".*

[815] If the enlightened shareholder value principle (or shareholder value approach) is adopted. See Part I, Chapter 3.3.

[816] ENRIQUES, L.; HANSMANN, H.; KRAAKMAN, R. The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 89-90.

[817] A more broader approach is applied in Belgium where it is state that not only the amount of votes that were cast in breach of the voting agreement have to be taken into account, but also the influence of the shareholder (minority) on the discussions and debates in the general meeting. See: BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 434-435.

[818] According to article 2.82(4) of the Lithuanian CC the resolutions of the bodies formed in any legal entity (including resolutions of the general meeting of shareholders) can be invalidated on the ground that they are not in line with the principles of fairness and reasonableness. From this provision of the law follows a conclusion that decisions of the general meetings of shareholders can be invalidated also in cases when such resolution is not against the mandatory rules of law. The same position has been expressed by other Lithuanian legal scholars. See: MIKALONIENĖ, L. Bendrovės visuotinio akcininkų susirinkimo sprendimų negaliojimas. *Mokslo darbai: Teisė*, 2012, No. 83, p. 94.

are numerous situations where decisions adopted by the controlling shareholders (in accordance with the voting agreements) are against the interests of the company and/or minority shareholders[819]. In all these situations minority shareholders are powerless to change the resolutions because they do not have significant number of voting rights. This is the reason why they are making a claim to the court (if they could change the decision of the general meeting of shareholders they wouldn't go to court, they would call another meeting and change the resolution). Therefore, courts should on a case by case basis decide whether the interests of a company (or minority shareholders) were infringed, and whether such infringement would justify the annulment of the decisions of the general meeting of shareholders[820]. One of the grounds for invalidity might be considered the *raison d'être* of such decision. If the decision is adopted for the sole purpose of satisfying the interests of controlling shareholders at the cost of the interest of the company or minority shareholders, or is adopted only to deprive minority shareholders from the rights that were conferred to them by the articles of association, such decision (and in turn voting agreements) should be declared invalid despite the number of voting rights that is held by the minority shareholder[821]. At the same time, if the decision adopted has other purpose and only as a consequence the company

Furthermore, this also suggests that the conclusion of the case should not be determined solely upon the number of voting rights that particular shareholder has.

[819] Tunnelling assets from the company to other companies owned by the controlling shareholders or deprivation of certain rights from minority shareholders (by change of articles of association) are just a few examples.

[820] Similar (although not the same) approach is also provided by other scholars. See: MIKALONIENĖ, L. Akcininko Locus Standi dėl visuotinio akcininkų susirinkimo sprendimų pripažinimo negaliojančiais. *Teisės problemos*, 2012, No. 77, p. 24.

[821] From a comparative approach similar rule is stipulated in article 243(2) of the Stock Corporation Act of Germany. It states that '[a] contesting action [to set aside a resolution of the general meeting of shareholders] may also be based on the grounds that a shareholder has attempted by exercising voting rights to attain special benefits for himself or another person to the detriment of the company or other shareholders and that the resolution is apt to serve such purpose'. See: Norton Rose LLP. Stock Corporation Act (Translation as at 1 December 2011) (in German *Aktiengesetz*) [interactive]. [Accessed on 2012-10-12] Available online at: <http://www.nortonrose.com/files/german-stock-corporation-act-2010-english-translation-pdf-59656.pdf>. However, abusive claims should be prevented as much as possible. See: VERMEULEN, E. P. M., ZETZSCHE, D. A. The Use and Abuse of Investor Suits: An Inquiry into the Dark Side of Shareholder Activism. *European Company and Financial Law Review*, 2010, Vol. 7, No. 1, p. 23-36.

or minority shareholders experience certain negative consequences, there is no reason to invalidate such decision[822]. As voting agreements are entered into in order to vote according to their provisions in the general meeting of shareholders, the same argumentation as to the validity of such agreements could be applied.

Following the reasoning provided above, the conclusion of this section would be that voting agreements whereby shareholders agree to vote in such a way that undermines the interests of the company and/or interests of the minority shareholders should be treated as unenforceable in Lithuania.

2.1.5. Breach of voting agreements and available remedies

According to article 2.88(4) of the CC in case of breach of the voting agreement, the court has a right to: 1) re-calculate the results of voting at the general meeting of shareholders in compliance with the voting agreement; 2) to declare the decision of the general meeting of the shareholders null and void, unless the votes cast in breach of the voting agreement did not in any way effect the validity of the resolutions taken[823]. This provision entails two situations. First, in cases where the votes were cast against the undertakings of the shareholders and due to this the distribution of voting rights in the general meeting of shareholders was different than it would have been if the shareholders had voted in accordance with the voting agreement, the court can recalculate and redistribute the votes in accordance with the voting agreement. Second, if the votes cast in breach of the voting agreement were decisive and conclusive in adopting or rejecting the resolution of the general meeting of the

[822] An example might be the increase of the share capital of the company. If a company is in need of new financial injection for continuation of its business or for implementation of its strategy, the adoption of the decision to increase share capital is justified even if it might dilute the interests of minority shareholders. On the other hand, if the purpose of increasing the capital is only to dilute minority shareholders, the decision (and any associated voting agreements) should be invalidated.

[823] SCL stated that there are two purposes of invalidating decisions of the general meeting of shareholders. First, to protect interests of the shareholders, whose rights were infringed, and the public interest. Second, to protect interests of the company and shareholders, who voted for the adoption of the decision. See: SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras“*;SCL civil case No. 3K-3-650/2003, 2003 June 4, *S. A. et al. v. akcinė bendrovė “Mažeikių nafta”*.

shareholders, the court is entitled to declare the resolution of the shareholders to be null and void. The question at this point is whether the remedies provided by the CC are effective in these cases and whether the voting agreement (as a type of shareholders' agreement) can be enforced in courts.

At the time of writing of this dissertation there were only a few cases dealing with a breach of duty to vote according to the voting agreement. This prevents the author from making generalizations on what is the position of the courts on the breach and enforcement of voting agreements question in Lithuania. However, there are two possible interpretations on application of the above remedies.

1) *The first interpretation* is that the plaintiff is allowed to choose between the remedies and ask the court either to recalculate the results of voting on the particular resolution or to require the annulment of the resolution (this choice would be available only if the cast votes were decisive on the adoption of the decision[824]). This can be illustrated by some examples. In the first example there is a voting agreement concluded among 5 of the shareholders of a listed company (1st has 7 %, 2nd – 15%, 3rd – 5 %, 4th – 6 % and 5th has 19 % of the voting rights and together they hold 52 % of all the voting rights in the company), which stipulates that they should vote against any decisions that would change the number of the members of the management body. In order to change the number of the members of the management body, the change of the articles of association is required under Lithuanian law[825], which can be made only by the qualified majority of the shareholders (which cannot be less than 2/3 of all the shareholders present at the general meeting of the shareholders). Under this example there is a motion to change the articles of association and to decrease the number of the

[824] MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 196.

[825] Articles 28(1.1) and 33(2) of the Lithuanian ABI.

members of the management body. Institutional shareholders of the company (holding the rest of the shares – 48 %) are voting in favour of this motion. Four of the contracting shareholders (33 % of the votes) are voting against the motion, but the 5th (having 19 % of the votes) decides to breach the voting agreement and votes for the motion. Thus, a situation occurs, where the breach of the voting agreement is conclusive on whether the resolution of the general meeting of the shareholders is adopted or not[826]. If the breach is remedied, the motion would not be passed. This means that the number of the members of the management body would remain the same. The fact that the breach of the voting agreement is decisive on the adoption of the decision means that the four remaining shareholders (who are the parties to the voting agreement) can choose either to ask the court for recalculation of the votes or for the annulment of the decision. In both cases the situation would be remedied, and the number of the members of the management board would not be decreased. If the votes are recalculated, the motion is rejected. If the resolution is annulled, the number of members of the management body remains the same. Thus, in the example above both choices remedy the situation in case one of the shareholders' breaches the voting agreement.

The situation in the second example is a little bit different. There are two groups of shareholders each holding 1/3 of the total voting rights in the company. The institutional shareholder is also present and holds 1/3 of the voting rights respectively. The essential difference from the first example is that the contracting shareholders

[826] In order to pass the resolution regarding the change of the number of the members of the management body a qualified majority is required. In the example above, all the shareholders are present in the general meeting of the shareholders, and thus the decision can only be passed by the 66.66 % majority of the votes. The 5th shareholder in such case can cast the decisive vote as 48 % of the votes held by the institutional shareholders and 19 % votes of the 5th shareholders equal to 67 % of all the voting rights.

undertook contractual obligations not to abstain or vote against something, but to vote in favour of all the motions that are proposed by one of the shareholders from the first group. The shareholder from the first group of contracting shareholders is a very experienced investor with long term practice and knowledge in controlling public companies and this seems to be a good reason for the other shareholders to enter into the voting agreement. In order to achieve long term financial goals, the shareholder from the first group instead of distributing dividends to the shareholders proposes to increase the capital of the company. The institutional shareholder is against such motion and is voting 'no' for increasing the capital and 'for' the distribution of the dividends (1/3 of all the votes). The first group of shareholders keep their obligations under the voting agreement and are voting 'for' increasing the capital of the company and 'no' on the distribution of dividends. However, the second group of shareholders decided that they actually need dividends and in breach to their obligations under the voting agreement opted to vote 'against' the increase of capital and 'for' distributions of dividends. The shareholders from the first group file a claim and have a choice on how to remedy the situation. If the shareholders choose to recalculate the votes, then the capital would be increased and the dividends would not be distributed[827]. If they choose to annul the decision of the general meeting of the shareholders, neither the capital would be increased, nor the dividends distributed[828]. As the first option would have the same consequences, as if the second group of shareholders had voted in accordance with the voting

[827] Recalculation of votes in this situation would mean that the 1/3 of the voting rights held by the second group of shareholders would be included in the voting for the increase of share capital of the company. In other words, the votes would be recalculated in accordance with the provisions of the voting agreement.

[828] This is due to the reason that the decision of the general meeting of the shareholders would be declared null and void and would not have any legal effect. The shareholders in this case would have to vote again in order to have a valid decision of the general meeting of shareholders.

agreement, the first group of shareholders would likely choose to ask the court to recalculate the votes. Thus, the situation would be remedied and the consequences would be the same, as if there was no breach of the voting agreement[829].

2) *The second interpretation* is that the plaintiff is not allowed to choose between the remedies and the court always chooses the first remedy (recalculation of votes), if the breach of the voting agreement does not have decisive influence on the decision of the general meeting of the shareholders, and always declares the resolution null and void otherwise (if the voting has decisive influence on the adoption of the decisions). If we were to analyse two of the examples above from the perspective of this interpretation, we would find considerably different results. In the first example, the contracting shareholders decided to vote against the change of the number of the members of the management body. In case of breach of the voting agreement under the second interpretation, the court would automatically choose to annul the resolution of the shareholders as the breach had decisive consequences upon the adoption of the resolution. The results would be similar as in the case of the first interpretation, and the situation would be remedied as the number of the members of the management body would remain the same. However, a different story is with the second example, where the shareholders agreed to vote in favour of the motions proposed by one the shareholders (who accordingly proposed not to distribute the dividends, but instead to increase the share capital of the company). Due to the reason that the

[829] This is in line with the fundamental principle for remedies for the breach of contract (including performance *in natura* and damages), which is to put the injured party into the same position he would have been in had the contract been properly performed. See: BEALE, H., *et al. Cases, Materials and Text on Contract Law.* Oxford: Hart Publishing, 2002, p. 659-689; 811-816.

votes cast in breach of the voting agreement had decisive role on the adoption of the decision, the court can only annul the decision. Controversially, this means that neither dividends are distributed, nor the share capital is increased. In other words, the claimants cannot require for a recalculation of the cast votes, and thus the situation cannot be remedied into one which would have exist, if the shareholders in breach had voted in accordance with the contract. Consequently, the remedy available to the court for the breach of the voting agreement seems to be incapable of remedying the situation and bringing parties to a position as if the agreement was executed properly. The annulment of the resolution of the general meeting of the shareholders is neither in the interests for the shareholders requiring the increase of capital, nor for the shareholders who voted for distribution of dividends.

The author's view regarding the two possible interpretations of applying remedies for the breach of the voting agreement is that the first interpretation should be upheld. There are several grounds for this conclusion. First, under both views situations when the breach of the voting agreement is not decisive are dealt with in the same manner. The plaintiffs have only the right to require the recalculation of the votes and the court accordingly can grant only such remedy. Second, there is no difference between the two views in cases where shareholders agree to vote 'against' or abstain from voting. Both remedies (recalculation of votes and annulment of the resolutions of the general meeting of shareholders) would have the same consequences under both interpretations – the decision would be either annulled or not passed. Which means that situation would be remedied and the consequences would be the same as if there was no breach of the contract. Third, the main difference between the two possible interpretations is evident in situations when shareholders agree to vote in accord in favour or 'for' certain resolutions.

Under the first view the shareholders are granted the choice to ask for a suitable remedy in order to put them into a position as if the contract would have been performed without a breach. In other words, the recalculation of the cast votes causes legal consequences as the decision of the general meeting of shareholders is considered to be valid and passed in accordance with the provisions of the voting agreement. In contrast, under the second interpretation the breach of the voting agreement is not remedied as the resolution is just annulled and essentially the situation is kept in *status quo*. This means that voting against the provisions of the voting agreement under the second view would have no negative consequences to the shareholders who are in breach of agreement. This, in the opinion of the author, is not justified from the legal point of view.

Furthermore, restrictions on voting rights and transfer of shares in accordance with EU directives have to be disclosed by all listed companies. This entails that voting agreements amongst shareholders have to be disclosed in annual reports. This forms legal expectations of other shareholders of the company and possible investors. Therefore, breach of such contractual obligations might have legal impact not only on the shareholders, who are parties to the voting agreement, but also to the company and other shareholders. First interpretation provided above would allow courts to remedy such situation and would be in line with the case law and position provided in the Lithuanian legal doctrine that annulment (or change in this case) of the decision of the general meeting must be in the interests of all the shareholders of the company[830]. Thus, in every case interests of all the shareholders and interests of contracting shareholders should be considered separately.

The author is of an opinion that *pacta sunt servanda* principle also entails that in case of breaches of the agreement the injured party has a right to

[830] MIKALONIENĖ, L. Bendrovės visuotinio akcininkų susirinkimo sprendimų negaliojimas. *Mokslo darbai: Teisė*, 2012, No. 83, p. 93-94; SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras“*;SCL civil case No. 3K-3-650/2003, 2003 June 4, *S. A. et al. v. akcinė bendrovė "Mažeikių nafta"*. It should be noted that other jurisdictions adopt slightly different approach. For example, in France resolutions of the general meeting can be invalidated if they are against the interests of either majority or minority shareholders' interests. See: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 296-297.

expect that the court in applying the available remedies will bring him into such a situation as if the voting agreement had not been breached[831]. This line of thought corresponds to the 'performance interest' approach, according to which the main reason why contracts are entered into is for them to be performed[832]. In cases the obligations arising from the contract are breached, the court should try to apply remedies that compel the party in breach to perform his obligations under the contract[833] or, as argued above, to allow claimants to choose between the available remedies in order to protect their interests in most efficient way.

It should be noted that remedy to recalculate votes does not entail that decision making power is transferred from the general meeting of shareholders to the court. This remedy is possible only when voting agreement contains clear and precise undertakings to vote, which in turn are breached. The court does not replace the will of the shareholder in breach, but instead it remedies the situation by restoring the will, which was expressed in the voting agreement.

All the further interpretations provided in this dissertation regarding the enforcement of voting agreements in Lithuania will rely on the first interpretation of the choice between the available remedies.

2.1.6. Enforcement of voting agreements

The question whether voting agreements are enforceable in the Lithuanian courts is closely related to the question on applicable remedies discussed above, but at the same time is more complicated. As discussed in the previous part of this chapter, the courts have the power to re-calculate the results of

[831] This is only possible in situations where the voting agreement provides for clear obligations to vote in certain way. However, if there is a general obligation to convene in order to decide on how to vote in the general meeting of shareholders, the shareholders cannot expect the court to enforce such provision.

[832] ROWAN, S. *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance*. Oxford: Oxford University Press, 2012, p. 1-2.

[833] ROWAN, S. *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance*. Oxford: Oxford University Press, 2012, p. 17-20.

voting at the general meeting of shareholders in compliance with the voting agreement or to rule that the resolution adopted at the general meeting is invalid, unless the voting in violation to the provisions of the voting agreement was not decisive. However, the problem remains whether the court can order specific performance and require the contracting shareholders to cast their votes in accordance with the provisions of the voting agreement or to abstain from voting against the provisions stipulated in the agreement.

Although case law regarding this question is very scarce, the author in the following paragraphs will analyse a decision by one of the regional courts[834] in Lithuania and will provide comments on the enforceability of voting agreements, *id est*, ordering specific performance to vote or to abstain from voting in the general meeting of the shareholders.

Vilnius regional court analysed a case where the dispute between the shareholders of a company (private limited liability company) arose regarding the enforcement of shareholders' agreement provisions on voting in the general meeting of shareholders and the annulment of the resolutions that were adopted in breach to the shareholders' agreement. The decision at hand was adopted regarding the application of interim measures, more specifically, regarding the injunction to vote in the general meetings of the shareholders in a way that would be against the provisions of the shareholders' agreement[835]. The local court (acting as first instance court) granted the interim measures and prohibited the defendants from voting in a way that would be contrary to the obligations undertaken in the shareholders' agreement. The appeal was filed and Vilnius regional court ruled that such interim measures are impossible to be applied in cases when voting agreement should be enforced. Court's arguments were as follows. First, the court argued that article 16(3) of the ABI

[834] For clarification purposes it should be noted that there are five regional courts in Lithuania, which serve as first instance for the cases assigned to their jurisdiction by law and as appeal instance for judgements, decisions, rulings and orders of local courts. In the case analysed below the regional court was acting as an appeal instance for a decision adopted by one of the local courts.

[835] Vilnius regional court civil case No. 2S-1987-823/2011, 2011 September 9, *I. M.* v. *V. B. and UAB „Baltijos ir Amerikos terapijos ir chirurgijos klinika"*.

states that shareholder's right to vote in the general meeting of the shareholders can be prohibited or restricted only in cases where it is stipulated by the ABI or other laws, as well as in situations when the dispute is regarding the ownership of the shares. From this argument the court concluded that the dispute is not related to ownership of the shares. In addition, the laws of the Republic of Lithuania do not expressly stipulate that the voting right can be restricted in cases where the dispute is regarding performance of the shareholders' agreement. Second, the court stated that voting right is a personal non-pecuniary right of the shareholder, and thus specific performance (in this case to prevent the shareholder from voting against the provisions of the shareholders' agreement) is not possible. The court stated that in case of breach of shareholders' agreement the parties are allowed to claim for damages[836], but cannot require specific performance. Third, the court presented an argument that Lithuanian CC explicitly stipulates[837] that courts are allowed either to re-calculate the results of voting at the general meeting of shareholders in

[836] The topic on compensation of damages for the breach of shareholders' agreements falls outside the scope of this dissertation. However, the author will very briefly touch upon this topic. The author is of an opinion that damages caused by breach of voting agreement would be very hard to prove, unless parties would agree for a minimum amount of damages in case of any breach of voting agreement . For example, how should the damages be calculated for a resolution to increase the share capital of the company by issuing new shares that was adopted due to voting against the provisions in the voting agreement? This resolution might increase the value of the shares and there might be no direct (and even indirect) damages to the parties to the voting agreement caused by the breach. Another situation can also be considered. For example, in case where the resolution of the general meeting of shareholders is adopted in order to approve large transactions with members of the management body below the market price of that particular transaction. Under these circumstances it might be presumed that shareholders who are in breach of the voting agreement might have caused damages to the company (and indirectly to other shareholders) that are equal to the difference between the market value and the transaction price. It is evident that the question on damages depends on the resolution that is being passed (or not passed) in the general meeting of shareholders. Thus, the author assumes that only compensation of damages without the possibility to enforce the voting agreement or to recalculate the votes of the general meeting of shareholders is not sufficient in order to remedy the situation that appears after the breach of voting agreement. See: SHAVELL, S. Specific Performance Versus Damages for Breach of Contract. *The Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 532*, 2005 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.harvard.edu/programs/olin_center/papers/pdf/Shavell_532.pdf>. From comparative perspective, Belgian scholars also argue that in case of breach of the voting agreement the calculation of damages would be very difficult, and therefore ineffective. See: HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 199.

[837] Article 2.88(4) of the Lithuanian CC.

compliance with the voting agreement or to rule that the decision taken at the general meeting is invalid, unless voting in violation to the provisions of the voting agreement was not decisive in adopting that decision. The court stated that a remedy to enforce the shareholders to vote in a particular way is mentioned in neither the CC, nor in the Lithuanian ABI. Furthermore, although it is not prohibited for the shareholders to enter into voting agreements, court can neither impose an obligation for the shareholder to vote in certain way, nor to restrict him from voting in a way that is against the provisions of the shareholders' agreement. From all these arguments the court concluded that voting agreements under the Lithuania law cannot be enforced in courts.

The author does not agree with the conclusion and arguments provided by the court. The first argument of the court is rather short sighted as the formulation stipulated in the ABI that voting rights can be restricted in cases when it is provided by the laws also entails that the general contract remedies (and in particular specific performance remedy) are also available and can be applied in case of breach of the voting agreement[838]. Thus, from the author's point of view, the specific performance remedy and the restriction on voting rights that it may cause is also available to shareholders, who want to remedy the breach of the voting agreement. The laws in Lithuania do not explicitly state that the court has a right to order specific performance in cases related to voting agreements. However, this does not mean that they are prohibited from doing so.

Secondly, the author does not dispute that voting right is a non-pecuniary (in other words, non-monetary) right[839]. However, the question in the case at hand is whether such right should be considered as of an exceptionally personal nature. Only if voting right is considered as of an exceptionally personal nature, the specific performance remedy would not be

[838] The author assumes that the intentions of the legislature to provide restrictions on the voting rights in other laws were not intended to be applied only when voting rights were explicitly mentioned in the law. Thus, remedy provided in article 6.213(2) of the CC should be applicable in cases regarding the performance of the voting agreement.

[839] This is clearly established in article 16(1.3) of the Lithuanian ABI.

possible[840] as obligations or undertakings arising out of such right would not be enforceable. The author strongly supports the position that the right to vote, as a type of non-pecuniary right, stems not out of the shareholders as such (in other words, not from the shareholder as a person) but out of the share[841] as a specific financial instrument[842]. This is true due to several reasons. Firstly, all the rights (including non-pecuniary voting right) are attached to the share and follow it in cases of transfer[843]. Thus, the person who holds the share is entitled to exercise the voting right. If he sells the share, he loses the right to vote in the general meetings of the shareholders. It entails that the voting right is not a personal right. Secondly, as it was analysed above[844], historically voting rights were attached to the persons, who were the owners of the shares. This, however, meant that despite the actual number of shares each shareholder had only one vote. In modern time this concept of democratic voting changed into one share – one vote rule, where each share conferred one vote. Thirdly, the

[840] For a comparative analysis on this point please see: BEALE, H., *et al. Cases, Materials and Text on Contract Law*. Oxford: Hart Publishing, 2002, p. 698-700. Article 6.213(2.5) of the Lithuanian CC restricts specific performance of purely personal obligations.

[841] This position has been also expressed in Lithuanian doctrine. See: MIKALONIENĖ, L. Bendrovės visuotinio akcininkų susirinkimo sprendimų negaliojimas. *Mokslo darbai: Teisė*, 2012, No. 83, p. 83.

[842] It has been suggested that securities (including shares) are neither property, nor obligations. They are considered to be tangibles into which the rights they represent have materialised into. See: MICHELER, E. The legal nature of securities: inspirations from comparative law. In GULLIFER, L.; PAYNE, J. (eds) *Intermediated Securities: legal problems and practical issues*. Oxford: Hart Publishing, 2010, p. 131-150. Some scholars also propose that '[a] shareholder does not merely acquire a contractual, personal claim against the corporation, but rather acquires a right *in* the corporation'. See: RINGE, W-G. Hedge Funds and Risk-Decoupling – The Empty Voting Problem in the European Union. *Oxford Legal Studies Research Paper No. 52/2012*, 2012 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=2135489>, p. 31. Both of the views presented here support the position that voting rights bundled in the share together with all the other rights should not be considered as of an exceptional personal nature. Therefore, all the duties arising from the exercise of such rights should also be considered as inseparably attached to the share and not to the shareholder as a person.

[843] Comparison of the non-pecuniary rights attached to the share with non-pecuniary rights of authors stemming out of publication of a book could be made. The fact that the book is sold in the bookstore does not mean that the reader who bought the book also acquired all the non-pecuniary rights associated with the authorship of the book. There is a very clear distinction as the non-pecuniary rights of writing and selling the book are exceptionally related to the author of the book and cannot be transferred to other persons by merely selling the book. Whereas the sale of shares means that all pecuniary and non-pecuniary rights are transferred as well. In other words, the legal regime is entirely different in these cases.

[844] See Part I, Chapter 3.4.2.

voting right can be held by a legal person who owns shares in a particular company, and hence it cannot be regarded as personal[845]. The above arguments suggest that the right to vote is a non-pecuniary right which is attached to the share and not to the shareholder as a person. Fourthly, the shareholder exercising his voting rights expresses his own will. The author does not argue that courts should take over the process of voting at the general meeting *per se*. Enforcement should be allowed only when the will is already clearly and unambiguously expressed in the shareholders' agreement. Clear and precise expression of the will should also eliminate any possible arguments regarding personal nature of such obligation.

The question on application of specific performance can be now addressed. There are restrictions for applying the specific performance remedy provided in the Lithuanian CC. One of them states that specific performance is not possible in cases when the obligation is of an exceptionally personal nature[846]. The drafters of the CC have commented that this exception applies only to natural persons and only when performance is related to their specific professions (for example, an artist, an architect and etc.)[847]. Shareholders are neither artists, nor architects[848], and as it has been argued the right to vote is not of a personal nature. Due to these reasons all the obligations stemming from the voting right should be considered as of non-personal nature. In other words, there are no restrictions provided in the Lithuanian legal acts to order specific performance of voting agreements (to require the parties to vote or to abstain from voting according to the provisions of the agreement).

The fact that the neither the CC, nor the ABI explicitly mention that shareholders might be forced by the court to vote in certain way does not mean

[845] Under the Lithuanian law, obligations of an exceptional personal nature (also known as personal service contracts) can only be attributed to natural persons. Legal persons cannot have such obligations. See: MIKELĖNAS, V. *Lietuvos Respublikos civilinio kodekso komentaras. Šeštoji knyga. Prievolių teisė I.* Vilnius: Justitia, 2003, p. 287.

[846] Article 6.213(2.5) of the Lithuania CC.

[847] MIKELĖNAS, V. Lietuvos Respublikos civilinio kodekso komentaras. Šeštoji knyga. Prievolių teisė I. Vilnius: Justitia, 2003, p. 287.

[848] Although they can be, this would not be their qualifying characteristic as a shareholder.

that the court cannot apply the specific performance remedy (which is a general remedy available for the breach of contract). However, a more interesting question in this regard is the connection between the recalculation of votes remedy and the specific performance. Recalculation of votes entails that the breach of the voting agreement is remedied by distributing or adjusting the results of voting in the general meeting of shareholders as if the voting agreement had not been breached. In other words, it is assumed that the shareholder in breach of voting agreement voted according to the provisions of the agreement. In case of specific performance it is not presumed that the shareholder voted in accordance with the provisions of the voting agreement, but the shareholder is obliged by the court to vote or to abstain from voting in a manner that is against the voting agreement. From the author's perspective, these two legal remedies have identical consequences as both remedies enforce the voting agreement. The only difference is the moment of their application. The recalculation of votes is relevant after the general meeting of shareholders has passed the decision and is aimed at remedying the past event. Specific performance, on the other hand, comes into play before the general meeting of shareholders, and is aimed at preventing the shareholders from deviating from the provisions of the voting agreement. As both of the remedies are essentially restricting the voting rights of the shareholders to vote in a manner that is not consistent with the voting agreement, it should be concluded that the claimants should be allowed to choose whether to ask for specific performance or for recalculation of the votes.

Furthermore, the resolution adopted in the general meeting of shareholders and the exercise of voting rights is strongly related and the decision cannot be passed without the exercise of voting rights (the resolution is the consequence of the exercise of voting rights[849]). Therefore, voting rights cast in breach of the voting agreement cannot result in a valid resolution of the

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[849] CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 218.

shareholders (as it would be in breach of legal principle *ex injuria jus non oritur*), and court should be allowed to require specific performance of the voting agreement. It is noteworthy that this conclusion is in line with the requirements imposed on listed companies to disclose any restrictions on the exercise of voting rights. This allows both the company and other shareholders to expect how the voting rights will be exercised in the general meetings of shareholders.

Both Lithuanian case law[850] and legal scholars[851] agree that decision adopted in the general meeting of shareholders is not a contract. Thus, voting agreement should not be regarded as preliminary agreement to conclude a contract in the future. Due to this reason concept of the voting agreement as a preliminary agreement will not be analysed in this dissertation.

Overall, it should be concluded that arguments provided by the court regarding the non-enforceability of the voting agreements are not well-founded. Obligations undertaken in the agreement should not be considered as being exceptionally of personal nature as they stem from the voting rights, which are attached to the share and not personally to the shareholder. Thus, the order by the court to perform the obligations under the voting agreement should be considered as not only possible, but also as encouraged. As for the compensation of damages, the author believes that this remedy would not be appropriate to remedy the breach of a voting agreement and upholds the view provided in the United States Model Business Corporation Act[852].

At this point it should also be noted that voting agreements might not always stipulate precise procedure for voting, and it might be difficult or even impossible to require the contracting shareholder to act according to the terms

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[850] SCL civil case No. 3K-3-135/2008, 2008 March 3, *UAB „Kriptonika“ v. UAB „Penki kontinentai“*.

[851] MIKALONIENĖ, L. Bendrovės visuotinio akcininkų susirinkimo sprendimų negaliojimas. *Mokslo darbai: Teisė*, 2012, No. 83, p. 89-90.

[852] Article 7.31(a) of the Model Business Corporation Act and its commentary explicitly state that voting agreements are subject to specific performance remedy. See: American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005.

of the contract. For example, a voting agreement, where shareholder A obliges himself to vote exactly the same way as contracting shareholder B, is precise and court can easily determine how the shareholder A in breach of voting agreement should vote – his votes should be cast in the same way as the shareholder B. However, if the voting agreement does not state clearly how the votes should be cast and, for example, stipulates only that shareholders have to consult with each other prior the general meeting, he court is not in a position to order specific performance because: 1) the agreement in this case leaves some room for the shareholder to decide on how to cast his voting rights; 2) the court cannot make such a decision for a shareholder; 3) the court order to convene a prior meeting according to the voting agreement would be without a purpose as shareholder would still be free to decide on how to vote. In these situations the author agrees that specific performance is either impossible or would not remedy the situation. Thus, award of damages instead of specific performance for the breach of voting agreement would be preferable[853].

Taking into account all of the arguments above, specific performance of voting agreement should be considered as one of available remedies in cases of breach of contractual obligations to vote in certain way. However, it should not be considered as applicable in every case and situation. Specific performance should be awarded only on a case by case basis, for example, attempt to obtain specific performance in cases where multiple breaches of voting agreement had already taken place might not be optimal[854].

Up until this point the question on the enforceability of a valid voting agreement has been dealt with. But what about the agreements that contain provisions that are restricted by article 2.88(1) of the CC. As it was mentioned above, these agreements are considered to be null and void *ab initio*, and thus

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[853] The award of damages in this case would be in line with the principles stemming from Roman law where the failure or impossibility of specific performance was remedied by the obligation to pay damages. See: ZIMMERMANN, R. *The Law of Obligations: Roman Foundations of the Civilian Tradition*. Oxford: Clarendon Press, 1996, p. 4-10.

[854] DUFFY, M. J. Shareholders Agreements and Shareholders' Remedies. Contract Versus Statute? *Bond Law Review*, 2008, Vol. 20, No. 2, p. 13-14.

unenforceable in the courts. However, the law is silent on the validity of the decisions of the general meeting that have been passed according to the invalid voting agreements. Systematic analysis of the CC presupposes that the mentioned decisions of the general meetings of shareholders are not necessarily invalid *per se*. The legal consequences to the validity of the decisions of the general meeting of shareholders that were adopted by exercising votes in accordance with an invalid voting agreement should be similar to the consequences arising out of the breach of voting agreement. This indicates that the court has a right to recalculate the votes cast in the general meeting of shareholders and not necessarily to declare the decision null and void. The decisions could only be ruled as invalid if voting according to the null and void voting agreement had decisive consequences upon passing the decisions at the general meeting[855]. While judging upon the invalidity of the decisions of the general meeting of shareholders, the competence of the general meeting upon the particular issues passed (whether it requires majority or qualified majority) and the number of voting rights held by the parties to the invalid voting agreement are of significant importance[856].

Shareholders' agreements are enforceable in other European countries as well, for example, in the Netherlands, Italy and France[857].

2.1.7. Closing remarks

In light of the arguments provided above, the voting agreement under Lithuanian law should be considered as an effective contractual tool for the shareholders to concentrate their voting power in the general meeting of

[855] The courts uphold the same view as well. *See* SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras“*.

[856] It should also be kept in mind that prescriptive period for claims for invalidating the resolutions of the shareholders' meeting under Lithuanian law is 30 days. See article 1.125(4) of the Lithuanian CC and article 19(10) of the Lithuanian ABI.

[857] ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 110; 127-128; BERNARD, G. Shareholders' Lawsuits against the Management of a Company and its Shareholders under French Law. *European Company and Financial Law Review*, Vol. 6, No. 2-3, 2009, p. 205-218.

shareholders and to coordinate their actions in order to have more influence on the governance of the company. From the author's point of observation, Lithuanian legislature has rightly chosen not to regulate the subject matter of the voting agreements in general, but to provide broad guidelines and specific restrictions, when such agreements are considered to be null and void. The restrictions on the subject matter of the voting agreements are considered to be necessary in order to avoid abuse of the voting agreements and to prevent the reallocation of powers that could be against the Lithuanian company law principles. It should be noted that some of the restrictions still require certain adjustments from the side of the legislature (or from the side of the courts), as currently they can be circumvented to a certain degree[858]. Furthermore, the use of special proxy allows shareholders not only to prevent possible deviations from the voting agreements, but also enables voting agreements to be concluded among large number of shareholders (which is especially important in listed companies). The issue of the applicable remedies and enforceability of the voting agreements under Lithuanian law is quite controversial and the court law is very scarce. However, the author has argued that shareholders asking for remedies from the court should be allowed to choose whether they require recalculation of votes, annulment of the decisions of the general meetings of shareholders (only in cases where voting of the shareholders in breach had decisive influence on the passing of the decisions) or they want to protect their interests by specific performance. Only the choice of available remedies, in the

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[858] Drafters of the CC refer to the German Stock Corporations Act and statutory restrictions stipulated there as a basis for Lithuanian provisions. See: MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 196. However, current wording of article 136(2) of the German Stock Corporations Act stipulates as follows: 'An agreement whereby a shareholder undertakes to exercise voting rights in accordance with the instructions of the company, the management board or the supervisory board of the company or a controlled enterprise shall be null and void. An agreement whereby a shareholder undertakes to vote for the respective proposals of the management board or supervisory board of the company shall likewise be null and void'. See: Norton Rose LLP. Stock Corporation Act (Translation as at 1 December 2011) (in German *Aktiengesetz*) [interactive]. [Accessed on 2012-10-12] Available online at: <http://www.nortonrose.com/files/german-stock-corporation-act-2010-english-translation-pdf-59656.pdf>. This strengthens the position that Lithuanian provisions on the restrictions on the subject matter of the voting agreements are outdated.

author's view, would allow the court to actually remedy the situation as if the voting agreement had not been breached.

2.2. Transfer of voting rights agreement

2.2.1. General remarks

The peculiarity of Lithuanian law is that it not only allows shareholders to enter into voting agreements, but it also enables them to transfer their voting rights without transferring the ownership rights (or the title) of the shares[859]. Article 2.89 of the CC expressly allows shareholders of the company to transfer their voting rights to other shareholders of the company or to third persons. Transfer of voting rights agreement can also be used to transfer other non-pecuniary rights that are conferred to the shareholder by the shares[860], for example, the right ask for information from the company[861]. According to the rules on the transfer of voting rights agreement, shareholders of the company can transfer their voting rights attached to the shares without transferring the ownership rights. Taking into consideration the wording provided in the CC, transfer of voting rights is a unique type of agreement that, to the best knowledge of the author, is not found in any other European jurisdiction.

There are certain formal requirements to be complied with in order for the transfer of voting rights agreement to be valid. First, the agreement can enter into force not earlier than after the fact of conclusion of the agreement

[859] The issue whether the voting rights can be decoupled from the ownership rights is very controversial and has attracted quite a lot of international attention from legal scholars. See: HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811-908; HU, H. T. C.; BLACK, B. Equity and Debt Decoupling and Empty Voting II: Importance and Extensions. *University of Pennsylvania Law Review*, 2008, Vol. 156, No. 3, p. 625-739. In their articles American scholars Henry Hu and Bernard Black have coined the concepts of 'empty voting' and 'hidden ownership', which are relevant while discussing the decoupling of voting and ownership rights. For an European approach and proposal to amend EU legislation regarding this issue see: RINGE, W-G. Hedge Funds and Risk-Decoupling – The Empty Voting Problem in the European Union. *Oxford Legal Studies Research Paper No. 52/2012*, 2012 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=2135489>.

[860] Article 2.89(5) of the Lithuanian CC.

[861] Article 18 of the Lithuanian ABI.

and related information is disclosed to the company[862]. The information includes the number of the votes that are being transferred, the term of the agreement, the basis for the ownership rights of the shares, information about the shareholder who is transferring the voting rights (transferor) and person to whom the voting rights are transferred (transferee). Second, the company has to disclose (during the next general meeting of the shareholders) that certain voting rights have been transferred. This is related to the fact that after the transfer of voting rights all of the duties of the company regarding the convening of the general meeting of the shareholders should be exercised not towards the holder of the ownership rights of the shares, but towards the holder of the voting rights. Third, there is a limit to the term for how long the voting rights can be transferred. The maximum period is ten years. Commentary of the Lithuanian CC is silent upon the purpose for limiting the validity term of the transfer voting rights agreement. However, one of possible interpretations for such restriction might be that the ownership rights of the shares are separated from the voting rights (which is not ordinary). In order to limit possible negative consequences for such decoupling (and protect the interests of the share owner), the legislature has opted to restrict the validity term[863]. The fourth requirement, according to the author, is the most important one and it requires establishing a clear procedure and rules on the exercise of the transferred voting rights. This means that a person who has acquired voting rights cannot exercise them as he sees it fit. The transferee of the voting rights has to follow certain rules and procedures established by the transferor on how to vote in the general meeting, what goals and purposes to pursue while voting and what interests of the shareholder to represent.

The author holds a position that though voting rights are separated from the ownership rights of the shares, the actual use of them is limited to the

[862] Article 2.89(2) of the Lithuanian CC.

[863] Another interpretation might be related to the nature of the transfer of voting rights agreement. This agreement has similarities to proxy, and thus similarly as proxy might be limited in time to protect the interests of the shareholder transferring his votes.

interests of shareholders who have made the transfer (transferors). If all of the requirements are adhered, the transfer of the voting rights agreement should be considered valid[864]. In addition, there are no restrictions limiting how many voting rights the shareholder can transfer. Taking into account the freedom of contract principle, it should be concluded the owner of the shares can choose, whether to transfer all of the voting rights conferred to him by the shares or only a part of them[865].

2.2.2. Transfer of voting rights and proxy

From a standpoint of the Lithuanian legal system, the transfer of voting rights agreement is similar to the proxy as in both cases the ownership rights of the shares remain with the shareholder, but the voting rights are exercised by third party (it could be said that the function of the proxy and transfer of the voting rights is similar). However, there are some legal differences between the two legal instruments, which will be briefly discussed below.

Firstly, in contrast to a proxy, the transfer of voting rights becomes effective only from the time of disclosure to the company of the number of transferred votes, the term, grounds of the transfer and parties to the agreement. Secondly, the transfer of voting rights agreement cannot be concluded for a longer period than ten years (whilst default term for the proxy is one year). Thirdly, the qualifying characteristic of the transfer of voting rights agreement is that it should stipulate specific rules and procedures for the transferee on how to exercise transferred voting rights. Author is of a strong opinion that in cases where the transfer of voting rights agreement does not stipulate the rules and voting procedure, the transferee cannot exercise the voting rights to the detriment of the company or against the interests of the shareholder who has transferred the voting rights.

[864] However, the restrictions on the subject matter of the voting agreement, discussed above, are applicable to the transfer of voting rights agreement as well.

[865] Considering the fact that article 40(5) of the Lithuanian ABI prohibits any division of the share, vote that is being transferred should also be prohibited to be divided in half or in any other manner. Only full vote can be transferred.

Systemic analysis of the transfer of voting rights agreement uncovers another significant difference between the proxy and the transfer of voting rights, *id est*, legal consequences. After the transfer of voting rights, for a period stipulated in the agreement the transferor can no longer exercise the transferred voting rights himself. This means that after conclusion of the agreement the shareholder also loses (as long as the agreement is valid) all other non-pecuniary rights associated with the voting rights: right to convey general meeting of the shareholders[866], right to put items on the agenda[867], right to table draft resolutions for items on the agenda[868] and other rights that require the exercise of voting rights attached to the shares. Thus, all the voting regarding different items on the agenda is carried out by the transferee and can no longer be influenced by the transferor. Legal consequences also arise for the company as well. It no longer owes duty to the transferor of the voting rights to notify him about upcoming general meetings of shareholders. This duty must be carried out towards the acquirer of voting rights because he is the one who will be actually exercising them. However, taking into account the nature and purpose of the voting rights[869], it should be stressed that the transferee cannot exercise them in a way that would be against the interests of the company or the shareholder who has transferred the rights[870] (the same is also true for all

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[866] Article 23(1) of the Lithuanian ABI.

[867] Article 25(3) of the Lithuanian ABI.

[868] Article 25(4) of the Lithuanian ABI.

[869] EASTERBROOK, F. H.; FISCHEL, D. R. *The Economic Structure of Corporate Law*. Harvard: Harvard University Press, 1996, p. 66-67; THOMPSON, R. B.; EDELMAN, P. H. Corporate Voting. *Vanderbilt Law Review*, 2009, Vol. 62, No. 1, p. 136-144.

[870] The position of the author is in line with the general conception of the company law that conflicts of interest between different corporate constituents should be limited, avoided or mitigated. See: ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. Agency Problems and Legal Strategies. In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 35-53. However, there is a view that the voting rights and ownership rights can be separated without the further influence of the shareholder (holding the ownership rights) over the person who has acquired the voting rights. This might create substantial conflicts of interest between these persons. The author believes that without at least general legal regulation of the decoupling of voting rights from ownership rights, the decoupling should be limited only to cases where the transferee is acting in the interests of the transferor. For more discussions see: HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811-908; LAN, L.

other non-pecuniary rights that might be transferred using the transfer of voting rights agreement).

The last difference between a proxy and the transfer of voting rights agreement is related to the entering into and termination of the civil legal relations. The proxy can be issued by a unilateral will of the principal (the agent has to show consent by accepting the proxy or by tacitly exercising the proxy). However, voting rights can only be transferred by a contract, which means that there has to be a meeting of the minds from both the transferee and transferor[871]. At the same time, different rules are applied in order to terminate the civil relations between the parties. By default, proxy can be revoked at any time by the unilateral will of the shareholder[872], whilst the transfer of voting rights is a contract and can only be terminated unilaterally if the other party fails to perform or the performance is defective, and thereof it constitutes an essential breach of contract[873]. In other words, the transfer of voting rights agreement can be terminated only in accordance with the general rules applied to contract law. There might be another interpretation as to the termination of the agreement. If the transfer of voting rights agreement is interpreted as more similar to proxy[874], it could be argued that the agreement can be terminated by unilateral will of the shareholder. However, this interpretation is less likely taking into account the position of the legislature that voting rights can be returned to the shareholder using compulsory transfer of shares procedure[875].

L.; HERACLEOUS, L. Negotiating the Minefields of Corporate Vote-Buying. *Corporate Governance: An International Review*, 2007, Vol. 15, No. 5, p. 969 – 978;

871 See article 6.154 of the Lithuanian CC. This also means that one of the parties to the transfer of voting rights agreement has the right to require other party to act in a way that is established in the agreement and the second party has a duty to act in such a way. This strengthens the position that transfer of voting rights agreement can be concluded only for the interests of the company and the shareholder who has transferred his voting rights.

872 Article 2.146(1) of the Lithuanian CC.

873 Article 6.217 of the Lithuanian CC.

874 In accordance with section XXXVI of the Lithuanian CC.

875 Article 2.122 of the Lithuanian CC.

As the above analysis suggests, although similar from functional approach (both instruments allow another person to exercise voting rights in the general meeting of the shareholders), the transfer of voting rights agreement and proxy under the Lithuanian law should be considered as two distinct legal instruments. The decisions of the general meeting of the shareholders passed while voting rights were exercised using either a proxy or transfer of voting rights agreement are valid, unless they violate mandatory requirements discussed in this chapter or are against any other mandatory requirements set in the law. Nevertheless, legislature, courts and shareholders who are dealing with the issues concerning exercise of voting rights should take a special note on the differences of these two legal instruments[876].

2.2.3. Aim and purpose of the transfer of voting rights agreement

The purpose of the transfer of voting rights agreement is to create a simple legal tool, which is available to all the shareholders of the company, allowing shareholders to exercise their non-pecuniary rights in a most efficient way. It also provides shareholders with more means to establish an effective and long lasting common policy towards the control of the company. Due to these reasons the transfer of voting rights is not intended to be used solely for the purposes of separation of ownership rights from voting rights without the aim of facilitating the exercise of voting rights[877]. Taking into account the aims of this legal instrument[878], the exercise of voting rights or the agreement itself,

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[876] However, shareholders entering into transfer of voting rights agreement do not always take into consideration the above explained differences. There are situations when transfer of voting rights agreement is used as proxy and the acquirer of voting rights is allowed to use such rights at his own discretion. See: GUBERNIJA, AB. *2011-10-26 notice regarding the acquisition of voting rights* [interactive]. [Accessed on 2012-10-31] Available online at: <https://csf.omxgroup.com/csf/DisclosureAttachmentServlet?messageAttachmentId=192742>.

[877] It can also be used to avoid certain mandatory legal duties, for example, instead of transferring the ownership of the shares parties might agree to transfer the voting rights and in this way they could avoid certain income taxes.

[878] The aims of the transfer of the voting rights agreement are revealed in the commentary by the drafters of the CC. See: MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 197. The drafters noted that unless specified otherwise in the contract, the transfer of voting rights agreement is subject to articles 4.236-4.252 of the CC that regulate the administration of the property

where it might be stipulated that the transferee can exercise voting rights in order to satisfy his own private interests (if they are not in line with the interests of the shareholders) without taking into account the interests of the company or the shareholders, should be treated as invalid[879]. For example, the competing company acquires the voting rights (without the ownership rights) of its competitor and in the general meeting proposes to liquidate the company or to sell its assets for a price that would mean financial difficulties to the competitor. This use of voting rights should be considered as unlawful.

The line of thought that transferred voting rights are to be used only in the interests of the company and its shareholders is strengthened by the fact that transferred rights might be transferred back to the shareholder, who has ownership rights, using compulsory transfer of shares procedure[880]. The essence of this procedure is that a shareholder: 1) who is prevented from exercising his rights conferred to him by he shares due to the wrongful (unlawful) behaviour of another shareholder; and 2) there are no indications that such wrongful behaviour of another shareholder will change in foreseeable future, can file a claim and require the court to order the misbehaving shareholder to transfer his shares[881]. The Lithuanian CC allows using this procedure in cases where voting rights have been transferred and they are

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of third persons (in Lithuanian *Kito asmens turto administravimas*). Article 4.242(2) explicitly states that the administrator must act in a reasonable manner and good faith, so that it serves the best interests of the principal. The courts have also embraced this reasoning and have applied the above standards to the transfer of voting rights agreement and to the duties of the transferee. See: Panevėžys regional court civil case No. 2A-552-198/2012, 2012 September 6, *UAB „Esveras"* v. *UAB „Jungtinis dujų centras"*. However, the problem is that article 2.89 of the CC does not mention that administration of the property of third persons rules are to be applied *mutatis mutandis*. Thus, the argumentation provided by the drafters might be stretched a little bit too far.

[879] However, the agreement should not be considered to be null and void *ab initio*, as fraudulent intentions would have to be proved in court. The author consents that in these cases it would not be easy to prove that transferee had intentions to act to the detriment of the company and its shareholders. However, in all the cases the aims and true intentions of the parties to the contract should be established.

[880] Articles 2.115-2.123 of the Lithuanian CC regulate this procedure. It should be noted that only shareholders of private companies (UAB) can use it. This means that shareholders of publicly listed companies (AB) have to rely on the market. Nevertheless, this legal instrument is important in explaining the true intentions of the legislature regarding the transfer of voting rights agreement.

[881] SCL civil case No. 3K-3-323/2008, 2008 June 13, Ž. N., K. T., J. T., A. T., Z. T., D. T., A. T. v. UAB „Grigiškių statyba".

being exercised against the interests of the company, and there are no well-founded reasons to expect that such undesirable behaviour will change in the foreseeable future[882]. In other words, this means that the Lithuanian legislature has explicitly stated its intentions that transferred voting rights cannot be used against the interests of the company. In cases where transferred voting rights are used to the detriment of the company, they have to be transferred back to the shareholder who holds the ownership rights.

Following the arguments provided above, the transfer of voting rights agreement can be entered into only for the interests of the company or its shareholders[883]. The separation of ownership and voting rights[884] creates an 'empty voting'[885] situation where one person holds 'empty' shares and the other holds only voting rights without equivalent economic interest in the company. Prominent legal scholars comment that '"empty voting" strikes everyone as undermining one of the fundamental assumptions of the company

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[882] Article 2.122 of the Lithuanian CC.

[883] There are cases in the Lithuanian courts regarding the transfer of voting rights agreements even among the shareholders of listed companies. For example, shareholders of the listed company AB "Gubernija" holding 6.01 % and 11.89 % of the voting rights transferred their voting rights to another shareholder (private company), who after the transfer acquired the majority of the voting rights (62.98 % in total). After the transfer, the transferee removed the board of directors and the general manager, and despite written protests from the transferor shareholders replaced them with other people. The newly appointed members of the management body started approving various transactions that transferred assets of the company to the majority shareholder below the market price or in other ways were beneficial only to the majority shareholder (for example, all the employees of the company received annual subscriptions to newspapers published by the majority shareholder). Additionally, against the written disapproval from the transferor shareholder, the majority shareholder voted for the increase of the share capital of the company. See: Court of Appeal of the Republic of Lithuania, civil case No. 2A-121/2010, 2010 February 25, *T. S., L. A.* v. *„Respublikos" spaustuvė, V. T.* Although the claim for interim measures in this case was dismissed in nevertheless shows that transferred voting rights can be used to the detriment of the company and other shareholders.

[884] It is interesting to observe that (as argued above) there already exists a separation between ownership and control (shareholders and managers). If another layer of separation is added in this context, the shareholders would not only be separated from the actual management and day to day control of the company, but they would also be stripped from the most important right that is given to them – the right to vote. In addition, legislature would have to deal not only with minority and majority shareholders, but also with two groups of quasi shareholders: one that has ownership and the other that has voting rights. This situation, form the perspective of the author, is unacceptable in modern company law as it creates too many possible conflicts of interest.

[885] This term was coined by the American scholars Henry Hu and Bernard Black. According to them, this term means a situation where voting rights are being exercised by any person whose voting rights substantially exceed his net economic ownership. See: HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811-908

paradigm, *id est*, that the shareholder is entitled to decide about the company's destiny, because, as the residual claimant, he is the ultimate risk bearer[886]. Due to the fact that the transfer of voting rights agreement can create 'empty voting' as the transferor remains with the 'empty' ownership rights, while the transferee obtains voting rights, every transfer of the voting rights should be judged on a case by case basis[887]. This creates controversial situations because the transferee is not exposed to the risks of company going bankrupt or to fraudulent management of the company. In addition, the person gaining only voting rights is not motivated by the distribution of the dividends, as he is not entitled to them[888]. The argument that transfer of voting rights can be qualified as an ordinary commercial contract can be countered with the same arguments as provided above regarding vote buying[889].

In order to prevent any misuse of the voting rights, it should be ensured that the interests of the shareholders and the company are not undermined only because of the fact that shareholders transferred their voting rights (and any other non-pecuniary rights that stem out of the voting rights). Thus, in order to avoid 'empty voting' the transfer of voting rights has to be accompanied by instructions, procedure and rules on exercising them as not to cause detrimental economic consequences to the transferor and the company. Precise and clear voting strategy stipulated in the agreement should limit the chances of the transferee to act against the interests of the company or the shareholders, who have transferred the voting right. Even in cases where voting instructions are not stipulated in the transfer of voting rights agreement, the transferee should

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[886] WYMEERSCH, E. Shareholders(s) matters(s). In GRUNDMANN, S. *et al.* (eds.) *Unternehmen, Markt und Verantwortung – Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. August 2010*. Berlin: Walter de Gruyter, 2010, p. 1573.

[887] Even in cases where the transferee is also a shareholder of the company, the extra voting rights give him more power that is disproportional to his economic interests.

[888] Article 60(1) of the Lithuanian ABI stipulates that dividends are distributed amongst the shareholders in proportion to their ownership rights and not voting rights in the company.

[889] See Part II, Chapter 2.1.3. Other European countries also prohibit separation of voting rights from ownership of the shares, for example, Germany. See: ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 72.

have a duty to act in the interests of the shareholders and the company or, as discussed above, the voting rights could be taken away by using compulsory transfer of shares procedure. In order to further avoid misuse of the transfer of voting rights agreement all the statutory limitations on subject matter of the voting agreement should also be applied to the transfer of voting rights agreement. This issue will be addressed below.

2.2.4. Legal consequences of the transfer of voting rights

The transfer of voting rights agreement causes quite a few legal consequences both to the shareholder transferring his voting rights, to the person acquiring these rights and even to the company. Most of the consequences are related to the ability of the shareholders-transferor to exercise certain rights conferred to him by the shares. The shareholder who keeps the ownership rights of the shares, but transfers the voting rights loses the possibility to exercise the following rights (and in turn the person gaining voting rights also gains the following rights):

1) to initiate the conveying of the general meeting of shareholders[890];
2) to add new items to the agenda of the general meeting of the shareholders[891];
3) to require for a secret voting in the general meeting of the shareholders[892];
4) to require for distribution of the dividends before the end of the financial year of the company[893];
5) to object the appointment of separate members of the supervisory board and require for a re-election of the whole board[894];

[890] Articles 23(1) and 23(4) of the Lithuanian ABI.

[891] Article 25(3) of the Lithuanian ABI.

[892] Article 27(7) of the Lithuanian ABI.

[893] Article $60^1(2)$ of the Lithuanian ABI.

[894] Article 31(11) of the Lithuanian ABI.

6) to require the court to appoint or to replace the liquidator of the company[895];
7) to initiate the general meeting of the shareholders regarding the reorganization of the company[896].

All of the rights listed above are essentially related to the voting rights and their exercise. However, these rights might be treated as being secondary in their nature. For example, the right to require re-election of whole supervisory board directly stems from the right to vote (as appointment and dismissal of members of different bodies of the company is possible only through the exercise of voting rights). It should be noted that under certain circumstances the exercise of these rights could have a direct effect on the value of the shares, and thus to the economic interests of the shareholder-transferor. For example, the re-election of the supervisory board or appointment of the liquidator of the company could be treated as affecting the economic interests of the shareholder. In addition, the exercise of some of the rights of the shareholder requires not a certain per cent of the voting rights but a share of the capital (in other words, ownership of the shares). Thus, their exercise is not restricted by the transfer of the voting rights. For example, the right to start the inquiry proceedings of the company can be exercised by shareholders holding at least 1/10 of the share capital of the company[897]. This means that this right can still be used by the shareholder who transferred his voting rights.

Legal consequences arise to the company as well. After the transfer of voting rights, the company no longer has a duty towards the shareholder-transferor to inform him about the upcoming general meetings of the shareholders. Instead, this duty must be performed towards the person who has acquired the voting rights.

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[895] Article 73(9) of the Lithuanian ABI and Articles 2.108(4) and 2.109(2) of the Lithuanian CC.

[896] Article 2.86(2.3) of the Lithuanian CC.

[897] Article 2.125(1.1) of the Lithuanian CC.

Certain consequences can arise to third persons as well. Although article 2.89(2) explicitly stipulates that transfer of voting rights agreement should be disclosed to the company, third parties might not be aware of such fact. Even in cases where shareholder is transferring his shares (the votes of which are transferred to another person), the acquirer of the shares might not be aware that the votes are no longer attached to the shares. Article 1.75(2) stipulates that in order for an agreement to be used against third parties, it has to be registered in the register. However, this provision is applied only when law explicitly provides that certain type of contract needs to be registered. There is no such requirement for the transfer of voting rights agreement. Therefore, it should be concluded that transfer of voting rights agreement remains valid after the transfer of the shares and it is the duty of the acquirer of the shares to verify whether voting rights are attached to the shares[898].

2.2.5. Restrictions on the transfer of voting rights

Neither the CC, nor the ABI provide for any restrictions on the subject matter of the transfer of voting rights agreement. However, taking into consideration the arguments provided above, systematic analysis of the Lithuanian CC suggests that the restrictions to the subject matter of the voting agreements stipulated in article 2.88 of the CC should be also applied to the transfer of voting rights agreements. This argument is grounded on the fact that both voting agreement and the transfer of voting rights agreement are classified as shareholders' agreements, which have a purpose of facilitating the exercise of voting rights and strengthening the position of shareholders related to the governing of the company. Hence, both of them are similar from the functional point of view[899]. Other reasoning might allow shareholders (or in certain cases

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[898] This can be easily done in the company's register.

[899] For example, two shareholders agree to vote in concert and enter into the voting agreement. This means that they have to vote according to the provisions stipulated in the agreement. On the other hand, one of the shareholders can transfer his voting rights to the other shareholder by entering into the transfer of voting rights agreement. In this case the votes would also be exercised in concert under the

even the management body) to misuse the transfer of voting rights agreement and avoid restrictions that are applicable to the voting agreement.

Firstly, the transfer of voting rights agreement should be treated as null and void *ab initio* if voting rights were transferred for consideration[900]. As in the case of voting agreements, consideration should be understood as any direct benefit or gain by the shareholder who is transferring his votes[901]. This means that not only monetary compensation, but other benefits or privileges gained by the shareholder-transferor should be prohibited. If this restriction would not be upheld, shareholders would be able to sell their voting rights by simply naming the agreement as transfer of voting rights instead of voting agreement. This situation is considered as unacceptable from legal standpoint as there is a clear restriction in the Lithuanian CC on buying and selling votes in the general meeting of shareholders. Despite of these arguments, Lithuanian courts have trouble in identifying the transfer of voting rights agreements entered into for consideration as being invalid[902]. For example, in one of the cases related to the validity of the decision adopted by the general meeting of shareholders it was established by the court that one of the shareholders had transferred his voting rights to the other shareholder for LTL 50 000 (~EUR 15 000) per year[903]. The validity of the transfer of voting rights agreement was not raised by the parties and the court did not exercise its right to invalidate such contract *ex officio*.

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rules and instructions provided in the contract. This clearly indicates that both types of agreements serve a similar function.

900 However, this does not mean that the transferee is not entitled to any kind of compensation. On the contrary, voting rights can be exercised as a service (for example, by professional financial intermediaries) and shareholder-transferor would have to compensate all the expenses that the transferee had in exercising transferred voting rights.

901 MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 196.

902 Even when article 1.78(5) of the Lithuanian CC requires courts to invalidate contracts that are contrary to the mandatory provisions of laws *ex officio*.

903 Kaunas regional court civil case No. 2S-1293-173/2008, 2008 December 8, *N. D.* v. *„Žaliakalnio turgavietė“*.

Secondly, voting rights cannot be transferred if they are to be exercised according to the instructions of the management bodies of the company, the company itself, all of its subsidiaries and any other bodies formed within the company. The transfer of voting rights agreement should be considered to be null and void if it stipulates that voting rights are to be cast for all the proposals of the management body or any other body formed within the company. Again, the separation of powers in the company must be maintained. In this regard, the author is of an opinion that voting rights cannot be transferred to any member of the management body[904] or of any other body formed in the company as it would be nearly impossible to prevent this person from exercising the voting rights in accordance with the restrictions provided in article 2.88 of the CC.

From the perspective of the author, if the subject matter restrictions are not applied to the transfer of voting rights agreement, then the restrictions to the voting agreement are rendered useless as shareholders can enter into the transfer of voting rights agreement in order to avoid statutory prohibitions to the voting agreement. In other words, shareholders would be able to contract around the mandatory provisions of the Lithuanian CC. Moreover, the power and competence of different bodies formed in the company are clearly divided and balanced in the Lithuanian ABI[905], and thus shareholders cannot derogate from these mandatory provisions. Due to these reasons, situations where shareholders would be able to avoid restrictions on voting agreements by entering into the transfer of voting rights agreement would not be justified from the Lithuanian company law perspective. The author believes that there

[904] However, there are situations in practice where voting rights are transferred to the members of the management body. For example, shareholders of a company listed in NASDAQ OMX Vilnius stock exchange (AB "GUBERNIJA") transferred more than 30% of all the voting rights to the general manager of the company. From the author's point of view, the general manager of the company could not have exercised these voting rights as it would have violated the restrictions on the subject matter of the contract. See: GUBERNIJA, AB. *2008-04-17 notice regarding the acquisition of voting rights* [interactive]. [Accessed on 2011-01-27] Available online at: <https://csf.omxgroup.com/csf/DisclosureAttachmentServlet?messageAttachmentId=173629>.

[905] Article 19(5) of the Lithuanian ABI stipulates that the general meeting of shareholders does not have a right to transfer its powers and competence in the company to other bodies.

are two ways how this situation should be treated: 1) Lithuanian case law should clearly establish that transfer of voting rights agreements are subject to the restrictions applicable to the voting agreements; 2) Lithuanian legislature should amend article 2.89 by including provisions that subject matter of the transfer of voting rights agreement is restricted in the same way as subject matter of voting agreement.

2.2.6. Transfer of voting rights and voting trust

An interesting position by the drafters of the CC has been expressed in the commentary, stating that the transfer of voting rights agreement is the same as the voting trust in the US[906] (and, probably, in the UK as well). However, this position holds water only with the reservations provided below. First, under the common law, trusts are usually governed by the laws of trusts and not of contract[907]. Under the US law, the general rule is that only shares are entitled to vote and non-shareholders cannot (in most of the cases) exercise voting rights[908]. Due to these reasons, a standard voting trust agreement stipulates that the shares have to be transferred to the trust and registered in the name of the trustee[909]. Shareholders usually get voting trust certificates (which in themselves are separate securities that can be traded on the market) in return for their shares. The certificate holders have a right to appoint trustees, who vote the deposited shares. It is also possible to put shares of several companies

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[906] MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 197.

[907] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 27.

[908] For example, article 7.21 (a) of the Model Business Corporation Act and its commentary. See: American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005.

[909] Article 7.30 of the Model Business Corporation Act and its commentary. See: American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005. Also article 218 of the Delaware General Corporation Law. See: Delaware Code (all acts effective as of September 24, 2012), Title 8, the Delaware General Corporation Law.

into the same voting trust[910]. This means that according to standard voting trust rules, the shares (together with all the rights) are transferred to the trustee and the shareholder holds neither the share, nor voting rights. In contrast, the transfer of voting rights agreement in Lithuania allows only for transfer of voting rights or other non-pecuniary rights, and the shareholders are left with the ownership of the shares. The author agrees that in some legal analysis voting trusts are analysed together with the voting agreements (but not the transfer of voting rights agreements) but even in these scholarly works it is stated that voting trust must be distinguished from the shareholders' agreement[911].

The author believes that the reasoning why drafters of the Lithuanian CC have commented that transfer of voting rights agreement is the same as voting trust is related to argumentation in the commentary that, unless specified otherwise in the contract, the transfer of voting rights agreement is subject to articles 4.236-4.252 of the CC that regulate the administration of the property of third persons[912]. The first problem is that the Lithuanian CC does not state in any of the statutory provisions that rules related to the administration of the property of third persons are to be applied *mutatis mutandis* to the transfer of voting rights agreement. In addition, systematic analysis reveals that the Lithuanian CC always provides for a relevant norm, if rules related to another legal instrument are to be applied *mutatis mutandis*[913]. Second and more theoretically fundamental problem is whether voting rights

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[910] BECHT, M.; BOLTON, P.; RÖELL, A. A., Corporate Governance and Control. *ECGI - Finance Working Paper No. 02/2002*, 2002 [interactive]. [Accessed on 2012-07-21] Available online at: <http://ssrn.com/abstract=343461>, p. 2-3.

[911] IMMENGA, U. Company systems and Affiliation. In CONARD, A.; VAGTS, D. (eds.) *International Encyclopedia of Comparative Law*. Tubingen: Mohr Siebeck, 2006, Chapter 7, p. 27-28. The Model Business Corporation Act also regulates voting trusts and voting agreement in separate articles (7.30 and 7.31). American Bar Association. *Model business corporation act annotated: official text with official comments*. Chicago: American Bar Association, 2005.

[912] MIKELĖNAS V., BARTKUS G., MIZARAS V., KESERAUSKAS Š. *Lietuvos Respublikos Civilinio kodekso komentaras. Antroji knyga. Asmenys*. Vilnius: Justitia, 2002, p. 197.

[913] For example, article 2.110 stipulates that in case of liquidation of a company the liquidator has all the rights and duties of the management body, and articles related to the management body are applied *mutatis mutandis*.

could be treated as property in the sense of norms applicable to administration of the property of third persons'. Article 4.240 allows the administrator to use the voting rights, but only in cases when the securities are subject to administration. Thus, the question remains whether voting rights separated from the ownership rights of the shares could be subject to administration of property rules[914].

From the above analysis the author makes a deductive conclusion that drafters of the CC intended that after the transfer of voting rights the transferee would be obliged to use them only in the interests of the shareholder and the company. However, the author believes that reference to administration of the property of third persons' provisions in this case is excessive. As argued above, the transfer of voting rights agreement must always include instructions and rules on the exercise of the voting rights. Thus, the shareholder-transferor is always in a position to protect his own interests by contractual means.

2.2.7. Closing comments

The debate over the separation of voting rights from the ownership rights of the shares is getting more and more attention from corporate scholars all around the world. In this regard legislature in Lithuania has foreseen this problem[915] and has provided shareholders with a right to enter into contractual relationships in order to divorce voting from ownership rights. Despite the fact that after the transfer of the voting rights, the shareholder-transferor loses the right to exercise transferred voting rights (and all other shareholders' rights that are based on the voting rights), the systematic analysis of the transfer of voting rights agreement reveals that the aim and purpose of this contractual tool should not be treated as only the decoupling of voting rights from economic interests of the shareholder. The opinion of the author is that the central part of the agreement analysed in this chapter is for the shareholder-

[914] As this question falls out of the scope of this dissertation, the author will not attempt to give an answer to it.

[915] However, the question remains whether this happened intentionally or by accident.

transferor to establish clear rules and instructions for the person acquiring the voting rights to exercise them in a manner that is in accord with the interests of the shareholder and the company. For this reason the restrictions that are applicable to the voting agreement should be by analogy applied to the transfer of voting rights agreement. Otherwise, the restrictions for the voting agreement might be contracted around by transferring the voting rights.

Although the functionalities of proxy and voting trust are similar to the transfer of voting rights agreement, these three legal instruments are different. Mostly they differ in the legal consequences that they create both to the shareholder who is transferring his votes and to the person who is subsequently entitled with the exercise of these voting rights. However, the transfer of voting rights agreement is the only instrument which directly allows for the separation of voting rights from the ownership of the shares in a way that shareholder is prevented from exercising voting rights for the duration of the agreement.

It should be mentioned that transfer of voting rights is not the only method to decouple voting rights from the ownership rights of the shares. Although they are not regulated by any laws, securities lending agreements[916] can be concluded in Lithuania[917], and they are actually entered into in practice[918]. Basically, securities lending agreements are understood similarly as in Belgium, as they are considered to be a loan of fungible things. After the conclusion of the contract, the ownership of the shares passes to the borrower

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916 The primary purpose of the security lending agreements is to allow for the short selling transactions in the regulated market and not to decouple the ownership rights from the voting rights.

917 Securities exchange commission of Lithuania has explained in one of its notes that although there are no specific provisions regarding the lending of securities, such transactions are possible and allowed under Lithuanian law. See: Securities exchange commission of the Republic of Lithuania (currently, the Central Bank of the Republic of Lithuania). Explanation note dated February 3, 2011 No. 13K-2 regarding the possibility to lend securities.

918 For example, shares of one of companies listed on the NASDAQ OMX Vilnius stock exchange were lent from the general manager of the company to one of the shareholders. See: ROKIŠKIO SŪRIS, AB. Notification dated August 24, 2012 about acquisition (disposal) of a block of shares [interactive]. [Accessed on 2012-10-15] Available online at: <https://csf.omxgroup.com/csf/DisclosureAttachmentServlet?messageAttachmentId=185792>; ROKIŠKIO SŪRIS, AB. Notification dated November 17, 2006 about acquisition (disposal) of a block of shares [interactive]. [Accessed on 2012-10-15] Available online at: <https://fp.lhv.lt/news/4408789?leadImgMaxHeight=130&locale=en>.

and at the specified date he has to return the same amount of the same type of securities to the lender. Thus, all of the financial risk associated to the securities that are being lent remains with the shareholder-lender, but the borrower gains the possibility to exercise voting rights that are attached to the lent securities (shares).

Taking into consideration the currently evolving financial instruments and the ever increasing possibilities for the shareholders and other persons to decouple voting rights from the ownership of the shares, the availability of the transfer of voting rights agreement in the Lithuanian CC should be viewed as an appropriate legislative approach in trying to control possible abuses of the voting rights. However, clearer provisions regarding the applicability of restrictions to the subject matter of the contract and establishment of clear duty for the transferee to act in a reasonable manner and good faith, so that it is in line to the best interests of the shareholder-transferor and the company, would be recommended to the Lithuanian legislature.

2.3. Some other aspects of legal regulation of shareholders' agreements in Lithuania

This section of the chapter briefly deals with some of the other areas of law and legal rules that might have impact or legal consequences upon the conclusion of shareholders' agreements. The author, in particular, has chosen to highlight some points on competition law and disclosure of shareholdings requirements[919].

First, shareholders should always take into consideration the rules applicable to competition. Shareholders' agreements cannot prevent, restrict or distort competition or allow the contracting shareholders to abuse their

[919] Both of these points are wide in their scope and require separate research. It is not the purpose of this dissertation to analyse them in depth but to note that such problems do exist.

dominant position in the market[920]. This is best illustrated by an example. Under one particular shareholders' agreement UAB "Fortum Heat Lietuva" and Municipality of Klaipėda – the shareholders of AB "Klaipėdos energija" (a company providing central heating services to the city of Klaipėda) – agreed that all the institutions and organizations, which are financed from the budget of Municipality of Klaipėda, are to remain the customers of the company as central heating provider[921]. In other words, the shareholders of the company (one of which is a municipality, which has to comply with public law regulations) agreed to act in a way that would restrict the choice of institutions and organizations controlled by the Municipality of Klaipėda to switch to alternative heating sources (for example, heating with gas) or to alternative central heating providers. The Council of Competition of Lithuania in its decision stated that provisions of shareholders' agreements that are against the mandatory provisions of competition law should be considered void, and ordered the shareholders of the company to change particular article of the shareholders' agreements so it wouldn't infringe the norms of competition law.

The above example clearly demonstrates that shareholders' agreements have to comply with competition law regulations. This applies not only to the public administration authorities, but also to private companies. Thus, a private company, which is a shareholder of another company, cannot enter into shareholders' agreements that would infringe competition law norms. Shareholders of the listed companies should especially be aware of the fact that conclusion of shareholders' agreements might trigger the prior-notification requirement regarding concentration to the Council of Competition of Lithuania[922] or even to the European Commission[923], and failure to notify

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[920] This is especially true when talking about legal entities. See: Law on Competition (Valstybės Žinios, 1999, Nr. 30-856; Valstybės Žinios, 2012, Nr. 42-2041), articles 5, 7, 9 and 12. This requirement flows directly from articles 81 and 82 of the Treaty Establishing the European Community. See: Treaty Establishing the European Community (OJ 2006 C 321 E/44-186).

[921] Decision No. 2S-13 of the Competition Council of the Republic of Lithuania dated May 13, 2010. Dėl Klaipėdos miesto savivaldybės tarybos 2009-05-28 sprendimo Nr.T2-196 atitikties Lietuvos Respublikos konkurencijos įstatymo 4 straipsnio reikalavimams.

[922] Articles 8 and 10 of the Law on Competition of Lithuania.

might cause the suspension of the validity of the agreement. In particular, this is the case for voting agreements or transfer of voting rights agreements, as the concentration occurs from the moment of acquisition of control and the ability to exercise voting rights. Thus, the acquisition of shares or assets in the company might not be required to attain control over the company[924].

Another very important requirement which should be complied with is the disclosure of the shareholders' agreements to the supervisory authority, to the company and other participants in the market. This requirement stems from the legislation of European Union, namely from articles 9-16 of the Directive 2004/109/EC[925], Commission Directive 2007/14/EC[926] (articles 8 and 9 are the most relevant for the present analysis) and article 10 of the 2004/25/EC Directive[927]. Shareholders and companies listed on the NASDAQ OMX Vilnius stock exchange must comply with disclosure rules and must reveal all the information regarding the conclusion of shareholders' agreement and related duties and rights, especially if such duties and rights are subject to restrict the transfer of the shares or the exercise of voting rights[928]. Thus, there is a requirement for the listed companies to disclose the presence of all types of shareholders' agreements about which the company is aware of and which can

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923 Articles 4 and 7 of the Regulation No. 139/2004. See: Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (OJ 2004 L 24/1-22).

924 Articles 3(2) and 3(3) of the Regulation No. 139/2004 and Commission Notice No. 139/2004 are especially important in this regard. See: Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (OJ 2008 C 095/1-48).

925 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

926 Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

927 Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

928 For a more detailed overview of Lithuanian legislation in this respect please see Annex 1.

restrict the exercise of voting rights or transfer of shares[929]. In this regard some of the presumptions stipulated in the Lithuanian securities laws are very important to note. For example, it is presumed that a shareholder, who has transferred his votes to another person, is still considered as the owner of the voting rights in light of the securities regulations[930]. Thus, all the duties from the relevant provisions of the securities regulations arise to the shareholder and not to the person who has acquired voting rights[931].

There are some other duties that might arise to the shareholders who are parties to the agreement, for example, tax related duties[932], but at this point suffice it to point out that shareholders should be always aware about the additional legal requirement and duties that might arise out of the conclusion of shareholders' agreement.

2.4. Chapter conclusions

By not specifically regulating shareholders' agreements and stipulating only the minimum standards and rules governing specific types of shareholders' agreements, Lithuanian legislature has followed the general trend that is

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[929] The author is of an opinion that a more stringent requirement to disclose the whole shareholders' agreement or the articles that restrict the exercise of voting rights or transfer of shares should also be considered by the legislature. This is explained by the argument that only the disclosure of the fact that there are certain restrictions on the voting rights of the shareholders is not enough as other shareholders and the company are not made aware of actual restrictions, consequences and changes that arise to the ownership structure of the company. For an example see: Part II, Chapter 1.5.

[930] Article 24 (1.3) of the Lithuanian Law on Securities. This provision is in line with the above presented arguments regarding the subject matter of the transfer of voting rights agreement as the shareholder-transferor has to provide clear instructions and rules on how the voting rights should be exercised. Nevertheless, there is a likelihood of confusion as the competition law norms treat the transfer of voting rights as one of ways to acquire control over the company (and thus implementing concentration), while security laws still consider that the shareholder-transferor is the ultimate holder of the voting rights (in other words, it is presumed that there was no acquisition of control).

[931] However, according to article 23(1), the duty to notify the supervisory authority about the acquisition of voting rights remains with the person who has acquired such rights.

[932] For example, article 7(1) of the Law on Corporate Income Tax. See: Law on Corporate Income Tax of the Republic of Lithuania (Valstybės Žinios, 2001, No. 110-3992); State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania. Commentary on article 7(1) of the Law on Corporate Income Tax [interactive]. [Accessed on 2012-10-16] Available online at: <http://mic.vmi.lt/documentpublicone.do?id=1000032030>.

prevailing in Europe[933]. The author is of a position that this approach should be upheld as it perfectly reflects the principle of freedom of contract which gives freedom to the parties to contract about everything that is not explicitly prohibited by the mandatory legal norms.

Shareholders of the listed companies should not be thrust into very strict legal frames on how they ought to exercise the rights conferred to them by the shares. The possibility to protect their interests[934], to attain more control over the company by concentrating voting rights or to exercise voting rights more effectively by transferring such rights should be attainable by contractual means. To this end legislature in Lithuania has provided with two legal instruments: the voting agreement and the transfer of voting rights agreement. Both of these tools are not perfect and require some intervention by the Lithuanian legislature or at least by the courts in order to improve their applicability and effectiveness.

Nevertheless, the conclusion is that shareholders of companies listed on NASDAQ OMX Vilnius stock exchange are allowed by the legislature to conclude shareholders' agreements that are in line with the mandatory rules applicable to each type of the agreement, provided that they are not in conflict with public order or public morals. This includes not only the voting agreements and the transfer of voting rights agreements, but all other types of shareholders' agreements that regulate relationships among shareholders. Thus, from theoretical point of view, shareholders' agreements in Lithuania could be treated as a legal tool capable of mitigating negative consequences of conflicts of interest amongst shareholders and between shareholders and management body of the company.

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[933] This is true with some exceptions. For example, Russia. See: article 32 of the Federal law No. 208-FZ of the Russian Federation of December 26, 1995 Concerning Joint Stock Companies (in Russian *Закон об Акционерных обществах*).

[934] Legal rules regulating the protection of minority shareholders and their interests are very important. But at the same time shareholders should be allowed to agree on other or more extensive means to protect their interests.

Chapter 3. Regulation of shareholders' agreements in Belgium

Company law in Belgium, in contrast to the Lithuanian company legislation, is codified in one single act called the *Wetboek van Vennootschappen* (W.Venn.)[935], which has been an outcome of long discussions about the fragmentation of legal regulations in the field of company law[936]. W.Venn. provides for a possibility (by not imposing any restrictions, except for the subject matter of the voting agreements) for the shareholders to enter into shareholders' agreement, which Belgian legal scholars define as a contract regarding the rights of shareholders[937].

As in Lithuania, the Belgian legislature has chosen not to regulate shareholders' agreements in general sense. Thus, there are no provisions in Belgian company law related to the definition, scope, parties or subject matter of the shareholders' agreements. However, one particular type of shareholders' agreements – the voting agreement – did not escape the legislative intervention and is briefly regulated in the W.Venn.[938]. Moreover, despite the fact that there are no legal tools for the shareholders to transfer their voting rights without transferring the ownership rights of the shares, the actual decoupling of economic interest from the ownership of the shares in Belgium occurs through the securities lending agreement. Accordingly, in the light of the principle of freedom of contract, shareholders of companies listed in NYSE Euronext Brussels stock exchange can enter into and regulate all their legal relationships and matters related to shares, rights and duties of the shareholders and the company using shareholders' agreements.

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[935] An older wording of the law is available in English. See: WARENDORF, H. C. S.; THOMAS, R. L.; WYMEERSCH, E. (eds.). *Belgian Company Law*. Hague: Kluwer Law International, 1997.

[936] Van Bael & Bellis. *Business Law Guide to Belgium*. *2nd edition*. Hague: Kluwer Law International, 2003, p. 25.

[937] VAN CANEGHEIM, L. Statuten en aandeelhoudersovereenkomsten, *Rechtskundig Weekblad*, 2006, Vol. 11, p. 471.

[938] Shareholders' agreement under the Belgian law is understood more broadly and also includes agreements on restrictions on transfer of voting rights. See: article 510(2) of the W.Venn. However, the next paragraphs of this dissertation will be mainly focused on the voting agreement.

Empirical study of the companies listed in NYSE Euronext Brussels stock exchange has shown that there are 50 shareholders' agreements concluded in 36 companies from 121 analysed[939]. This means that 29.5 %[940] of all the companies listed on the NYSE Euronext Brussels have at least one shareholders' agreement in place. Belgian shareholders conclude more shareholders' agreements than Lithuanian and the UK ones, and the number of the agreements is even four times the average among the EU countries[941]. Thus, shareholders of the Belgian companies are very active in protecting their interests and exercising control over listed companies[942].

The following sections of this chapter deal with the voting agreement, the securities lending agreement and some other issues regarding shareholders' agreements under the Belgian law.

3.1. Voting agreement

3.1.1. General remarks

Voting agreements have a long and complicated history in Belgium[943]. At the end of nineteenth century voting agreements were considered as a perfectly valid type of contract as neither civil, nor company law in Belgium had any restrictions regarding the exercise of voting rights in concert using contractual

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[939] See Part III, Chapter 2.1.

[940] The percentage was calculated according to the number of companies that had shareholders' agreement in place.

[941] Report on the proportionality principle, p. 35.

[942] This is a positive change compared to the end of the twentieth century practices. See: Commissie voor het bank – en financiewezen. *Vergelijkende studie over de informatie die de Belgische genoteerde vennootschappen publiceren inzake "corporate governance"*, 1999 [interactive]. [Accessed on 2011-06-10] Available online at: <http://www.fsma.be/~/media/Files/stu/NL/study10_NL_21710_pdf.ashx>, p. 16. European legislation on the disclosure of voting rights has also to taken into account as an important factor in disclosure practices.

[943] NYSSENS, Harold. *Stemovereenkomsten: Surrogaat voor certificering?* 1991-1992 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/28n3/nyssens.pdf>, p. 173.

means[944]. However, early in the twentieth century court law[945] changed the practice among the shareholders and, up until the changes in company law regulations in 1991, voting agreements among shareholders of Belgian companies were deemed to be illegal and void[946]. After the amendments to the company laws voting agreements were allowed to be concluded for (renewable) periods of five years[947], but only if they did not limit the responsibilities of the directors or were not used to create different classes of voting rights[948]. It is sometimes commented in the Belgian legal doctrine that the whole concept of shareholders agreeing on how to vote before the general

[944] HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 186. This position was formed by the case law dating even to 1938, where it was stipulated that voting agreements are allowed if they: 1) do not restrict the rights of the shareholders to participate in the decision making in the company; 2) are not contrary to the interests of the company; 3) are not fraudulent. See: FERON, B. *Les Conventions D'actionnaires Apres la Loi du 13 Avril 1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.nautadutilh.com/publicationfiles/26-11-97_Les%20conventions%20d'actionnaires%20apr%C3%A8s%20la%20loi%20du%2013%20avril%201995_feron_b.pdf>, p. 39-40.

[945] For an extensive list of court cases regarding this matter see: HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 187; NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991*. Antwerpen: Maklu Uitgevers, 1992, p. 267-268.

[946] WYMEERSCH, E. Belgium. In BAUMS, T.; WYMEERSCH, E. (eds.) *Shareholder voting rights and practices in companies in Europe and the US*. London: Kluwer International, 1999, p. 44.

[947] Currently, there is only a requirement that voting agreements have to be concluded for a fixed period of time, but there are no requirements in the laws for a minimum term of validity of the voting agreement. It should be noted that a fixed term period also entails that it should be expressly stipulated in the contract if it can be renewed and how many times it can be renewed. The requirement for a fixed minimum term was abolished due to strong objections from legal scholars and practitioners that the fixed 5 year period is much too short. However, the breach of the requirement for having a contract with a limited term of validity makes such contract invalid. See: HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 189-190. Other authors claim that the renewability of voting agreements should be considered as flexible. See: BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 433.

[948] BECHT, M.; CHAPELLE, A.; RENNEBOOG, L. Shareholding Cascades: The Separation of Ownership and Control in Belgium. In BARCA, F; BECHT, M. (eds.) *The control of corporate Europe*. Oxford: Oxford University Press, 2001, p. 79.

meeting of the shareholders in Belgium has undergone an evolution[949], and currently there are no disputes whether the voting agreements are possible to enter into under the Belgian law[950]. The legislative intervention and validation of voting agreements was based on one of the most important cases of the Supreme Court of Belgium[951]. Generally, voting agreements under the Belgian law are understood as agreements among shareholders to vote or abstain from voting in a certain way[952].

The wording of article 551(1)[953] of the W.Venn. suggests that voting agreements can be concluded only amongst shareholders (amongst persons who have control over the voting rights in the general meeting of the shareholders). The author holds a position that voting agreement under the Belgian law (similarly as under the Lithuanian law) cannot be concluded for the benefits of third persons, for example creditor[954]. This position is strengthened by the requirement stipulated in article 551 of the W.Venn. that all voting agreements must be concluded with the interests of the company in

[949] HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 185.

[950] VANHAUTE, P. A. A. *Belgium in international tax planning*. Amsterdam: IBFD, 2008, p. 24; NYSSENS, Harold. *Stemovereenkomsten: Surrogaat voor certificering?* 1991-1992 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/28n3/nyssens.pdf>, p. 173; HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 188-189.

[951] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 431; Hof van Cassatie [Supreme Court] decision dated April 13, 1989, No. F-*19890413*-16 2. *Arresten van het Hof van Cassatie 1988-89*, p. 920.

[952] NYSSENS, Harold. *Stemovereenkomsten: Surrogaat voor certificering?* 1991-1992 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/28n3/nyssens.pdf>, p. 170-171.

[953] 'The exercise of voting rights might be regulated by shareholders' agreements'.

[954] There is another opinion provided by some of the scholars. See: KOELEMEIJER. M. Aandeelhouders en (stem)overeenkomsten. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 206-207; CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 197.

mind. Thus, shareholders cannot agree to vote in the interests of the third party as this would clearly undermine the interests of the company.

Though the general rule under the Belgian company law is that shareholders are allowed to enter into the voting agreements, similarly as in Lithuania, there are some restrictions to the subject matter of the contract. Articles 551(1) and 551(2) of the W.Venn. provide a list of restrictions to the voting agreement.

3.1.2. Voting agreement and interests of the company

Although the W.Venn. explicitly allows shareholders to regulate their relationships with each other regarding exercise of voting rights using contractual legal tools, these agreements must be limited in time[955] (there has to be a fixed term agreement[956]) and have to be concluded in the interests of the company. In this context interests of the company are understood as related to its existence, continuity and development, including collective interests of both present and future shareholders[957]. The requirement for the voting agreement to

[955] The author is in accord with the Belgian commentators that the requirement of the W.Venn. for the voting agreements to be limited in time does not extend to all of the shareholders' agreements, and is applicable only to the agreements that are in one way or another related to the exercise of voting rights. NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991*. Antwerpen: Maklu Uitgevers, 1992, p. 268; HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 189. Some of the Belgian scholars do not agree with the wording of this provision and argue that even with limited term (but not expressly defined in law) shareholders' agreements can be concluded for indefinite time period as agreements can be automatically renewed or extended. See: CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 204. Other authors argue that the fixed term for the validity of shareholders' agreement has to be rational (and should be interpreted in light of the interests of the company for which the agreement is concluded). See: CLOTTENS, C. *Proportionaliteit van stemrecht en risico in kapitaalvennootschappen*. Doctoral thesis. Katholieke Universiteit Leuven, 2011, p. 123.

[956] From a comparative point of view, in France voting agreements cannot result in shareholder permanently giving up his voting rights. Thus, agreements should also be limited in time. See: BOMBRUN, N. France. In CAMPBELL, D.; BUCKLEY, S. (eds.) *Protecting Minority Shareholders*. London: Kluwer Law International, 1996, p. 217.

[957] NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A.

be in the interests of the company originates from the decision of the Supreme Court of Belgium, where it stated that voting agreements that are against the interests of the company (or are otherwise fraudulent) should be considered null and void[958].

For example, there is a group of shareholders who are planning on exiting the company. These shareholders enter into a voting agreement and agree to vote in the general meeting of the shareholders for all the decisions regarding the sale of the assets of the company for less than market value. Clearly, the decisions for sale of assets under the market value are to the detriment and against the interests of the company. Hence, because the voting agreement is against the interests of the company, it should be considered as null and void. The interests of the company should prevail not only at the time of entering into contractual relationships, but during the whole validity period of the voting agreement[959]. It could be clearly seen that after the abolishment of the requirement for the voting agreements to be for a fixed five year term, legislature in Belgium has decided to link the period of validity of the agreement with the requirement for the agreement to be in the interests of the company. Therefore, the longer the period of validity, the more risk parties face that at certain period of time the agreement might become against the interests of the company.

In comparison to the Lithuanian legal rules (articles 2.88 and 2.89 of the CC), where the interests of the company are only implied, the Belgian legislature has established a clear statutory provision that shareholders' agreements regarding the exercise of voting rights have to be in the interests of

en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991. Antwerpen: Maklu Uitgevers, 1992, p. 269.

[958] Hof van Cassatie [Supreme Court] decision dated April 13, 1989, No. F-*19890413*-16 2. *Arresten van het Hof van Cassatie 1988-89*, p. 920.

[959] HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 191.

the company[960]. All agreements that conflict with this requirement are *ab initio* null and void. For example, an agreement by the shareholders of the company to vote for the sale of the property of the company for lower price than market value to other company (owed only by the contracting shareholders) would be deemed to have been concluded against the interests of the company (the other shareholders and possibly the employees of the company would suffer due to the consequences of the agreement).

Though the purpose of the shareholders' agreement by the Belgian legislature is defined in a positive way (to be in the interests of the company), courts have ruled that in practice it can also be applied in the negative sense, as not to be against the interests of the company[961]. Therefore, it is not necessary to prove the fact that shareholders' agreement is in the interests of the company (as it would be difficult to do), but it is enough to show that the agreement will not be detrimental to the company as a whole, and the intentions of the contracting shareholders are not to fraudulently benefit from the company[962]. It should be also pointed out that the interests of the company under the Belgian law are mostly viewed not from the shareholders' value model, but predominantly from the perspective of stakeholder theory[963]. Due to this, the interests of the company and the aims of the voting agreement could be interpreted not only from the standpoint of direct benefits to the shareholders,

[960] The French legal doctrine upholds the position that voting agreements cannot be exclusively made to satisfy interests of one shareholder (an example is given when majority shareholder tries to preserve his influence after the sale of the controlling block). See: BOMBRUN, N. France. In CAMPBELL, D.; BUCKLEY, S. (eds.) *Protecting Minority Shareholders*. London: Kluwer Law International, 1996, p. 217.

[961] Hof van Cassatie [Supreme Court] decision dated April 13, 1989, No. F-*19890413*-16 2. *Arresten van het Hof van Cassatie 1988-89*, p. 920. HELLEMANS, F. Stemovereenkomsten naar Belgisch recht. In KLUIVER, H. J.; WOUTERS, J. *Beginselen van vennootschapsrecht in binationaal perspectief: Vergelijkende beschouwingen naar Belgisch en Nederlands recht*. Tilburg: Intersentia, 1998, p. 192; CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 216.

[962] TILLEMAN, B.; CAPRASSE, O. (eds.) Wetboek vennootschapsrecht: geannoteerd wetboek van vennootschappen met bijzondere wetgeving, met inbegrip van de verenigingen en stichtingen. Brugge: die Keure, 2010, p. 383-384.

[963] For an overview of the debate see Part I, Chapter 3.3.

but also from the interests of other stakeholders (including employees, creditors and even customers or clients). To put it another way, voting agreements that have negative influence on the status of the employees in the company or the financial status of the company to repay debts to its creditors might be considered as being against the interests of the company[964].

The Belgian case law has provided some examples in this field. However, these cases are not particularly helpful in formulating a general approach or test to determine what kind of voting agreements (as a type of shareholders' agreement) are considered to be against the interests of the company. For example, according to the Belgian courts, shareholders' agreement whereby shareholders agree to exercise their voting rights as to appoint the former majority shareholder as a chairman of the board (or to agree upon their representation in the board) does not infringe the interests of the company[965]. Furthermore, courts allow shareholders to reach consensus in a voting agreement regarding the appointment of the heir of the controlling shareholder as a member of the management body, unless such an agreement restricts the removal rights of the shareholders or is in itself against the interests of the company[966]. The same reasoning applies to the voting agreements where shareholders agree to vote in favour for certain candidates to be elected as members of the management body or where minority shareholders are granted a right to provide a list of possible members of

[964] The author is of an opinion that the validity of the voting agreement has to be decided on a case by case basis.

[965] Rechtbank van eerste aanleg, Luik [Court of first instance] decision dated April 12, 1991 No. F-19910412-3, *Journal des tribunaux*, 1992, p. 81.

[966] Hof van Cassatie [Supreme Court] decision dated April 13, 1989, No. F-*19890413*-16 2. *Arresten van het Hof van Cassatie 1988-89*, p. 920. It is considered that shareholders should always have a choice at the general meeting of shareholders when voting upon appointment of members of the management body. The same reasoning applies for the removal of members of the management board. See: FERON, B. *Les Conventions D'actionnaires Apres la Loi du 13 Avril 1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.nautadutilh.com/publicationfiles/26-11-97_Les%20conventions%20d'actionnaires%20apr%C3%A8s%20la%20loi%20du%2013%20avril%201995_feron_b.pdf>, p. 47-48.

management bodies that general meeting could choose from[967]. Unless the right to choose from candidates is restricted or general meeting of shareholders is forced to elect certain members of the management body, these voting agreements are considered as not being against the interests of the company.

The above positions of courts could be considered as a clear signal to the shareholders that they can enter into voting agreements to agree on their representation in the management bodies of the company. Nonetheless, shareholders cannot deprive themselves from the right to remove the members of the board from their office. In other words, the fact that shareholders agree to appoint members of the management does not prevent them from removing such directors. Thus, the voting agreement cannot restrict the right of dismissal of the general meeting of shareholders[968]. Further examples that are considered to be against the interests of the company include limiting the competence of the general meeting of the shareholders to decide and determine the distribution of profit or discriminating minority shareholders of the company[969].

3.1.3. Statutory restrictions on the subject matter of the voting agreements

The Belgian legislation has embedded certain statutory restrictions regarding the subject matter of the voting agreements. Besides the requirement for shareholders' agreements related to the exercise of voting rights to be concluded in the interests of the company, the W.Venn. restricts agreements to

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[967] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 432-433.

[968] The right of the shareholders to dismiss the members of the management board under the Belgian law is considered to be a rule of public order. Thus, any agreement (including shareholders' agreements) or legal technique that would deviate from or infringe this mandatory rule is considered to be null and void. See: WYMEERSCH, E. A Status Report on Corporate Governance Rules and Practices in Some Continental European States. In HOPT, K. J. *et al.* (eds.), *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford: Clarendon Press, 1998, p. 1092-1093.

[969] NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991. Antwerpen: Maklu Uitgevers, 1992, p. 268-269.

vote according to the instructions of the company, its subsidiaries or any of the legal bodies formed within the company. In contrast to article 2.88 of the CC, the W.Venn. provides a more detailed list of subjects who are prohibited to issue voting instructions to the shareholders. According to the Lithuanian CC, the agreements amongst the shareholders are considered to be null and void only if they agree to vote according to the instructions of the management body, but the law is silent upon instructions from any other bodies, for example, a supervisory body if there is a two tier governance structure adopted in the company. Therefore, legal provisions in the W.Venn. provide for a more efficient legal regulation that more coherently reflects the actual situation, which might occur between the shareholders and the company. Reason for the restriction is similar to Lithuania – to clearly divide the competence of different bodies of the company and do not to allow management body (subsidiaries or other bodies formed in the company) to exercise the powers of the shareholders[970].

The third case wherein voting agreements are deemed to be null and void occurs when shareholders agree to vote for all the proposals made by the company or any of its bodies. From a comparative perspective, this provision is similar to the one in the Lithuanian CC[971], but again encompasses a wider range of subjects. Thus, it should be considered to be more effective as the proposals to the shareholders can be made not just by the management body, but also, for example, by audit or remuneration committees. As it has already been suggested when analysing the regulation in Lithuanian, shareholders have to consider proposals made by any of the bodies of the company only after such proposals are made, and they cannot undertake to vote for all the proposals that are not clear at the moment of contract. Contractual undertakings to vote for all the proposals could also be considered as

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[970] For example, articles 531 and 518(2) of the Belgian W.Venn. Also see: NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991*. Antwerpen: Maklu Uitgevers, 1992, p. 269.

[971] Article 2.88(1.2) of the CC.

restricting the competence of the general meeting of the shareholders to decide on the most important matters relating to the company[972].

Besides the restrictions on the subject matter of the voting agreement stipulated above, these agreements should be in line with the requirements provided in article 510(2). This article deals with the restriction of transferability of shares and clearly states that transferability of shares can be limited by the shareholders' agreement[973]. The same general criteria (as to the voting agreement) apply to the non-transferability clauses (if they are incorporated into the voting agreement or any other type of shareholders' agreement). Namely, the limitation of the transferability of shares has to be limited in time and justified in the interests of the company. Additional and more detailed requirements apply for the clauses related to the approval of transfer of shares and to the exercise of pre-emptive rights. The effect of these clauses cannot result in the non-transferability of the shares for more than six months after the date when these clauses were applied[974] (for example, the approval for the transfer of shares cannot be withheld for more than six months)[975]. This restriction under the Belgian law is based on the fact that the transferability of shares in the NV companies is one of the most essential characteristic of that company type[976].

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[972] Article 531 of the W.Venn. stipulates that the general meeting of the shareholders is regarded as the most important body of the company.

[973] For an in depth analysis of this article see: NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A. en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991*. Antwerpen: Maklu Uitgevers, 1992, p. 258-266; BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 496-499.

[974] FERON, B. *Les Conventions D'actionnaires Apres la Loi du 13 Avril 1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.nautadutilh.com/publicationfiles/26-11-97_Les%20conventions%20d'actionnaires%20apr%C3%A8s%20la%20loi%20du%2013%20avril%201995_feron_b.pdf>, p. 14.

[975] According to article 510(2), if shareholders' agreement provides for possibility to limit transfer of shares for more than six months, this term is automatically reduced to six months.

[976] GEENS, K.; WYCKAERT, M. Beginselen van Belgisch Privaatrecht IV. Verenigingen en Vennootschappen. Deel II: De Vennootschap. A. Algemeen Deel. Mechelen: Wolters Kluwer Belgium, 2011, p. 54-55.

Article 551 of the W.Venn. does not contain any restrictions concerning vote buying, *id est*, there are no direct prohibitions to vote or to restrain from voting for consideration[977]. However, a situation where shareholders agree to vote for consideration and their voting infringes the interests of the company should be considered as illegal. This reasoning stems from the legal requirement that all of the shareholders' agreements have to be in the best interests of the company. For example, if a competing company pays shareholders of the company in order for them to vote against any expansion of business or establishment of subsidiaries in the territory where the competing company is performing its activities, the voting agreement amongst these shareholders should be considered as null and void, as it is against the interests of the company. However, it should be noted that under Belgian legislation the fact that shareholders are exercising their voting rights for certain remuneration *per se* is not considered to be illegal. This has to be always accompanied by as analysis whether a particular voting agreement is against the interests of the company.

3.1.4. Legal consequences for breach of statutory restrictions

The breach of the above analysed restrictions causes legal consequences that are stated in article 551 – all the voting agreements are null and void. The W.Venn. uses the Dutch phrase *zijn nietig*, which translates into null and void *ab initio*. If the court identifies that the voting agreement does not comply with at least one of the restrictions, it has no other choice but to declare such contract null and void from the moment of conclusion. Furthermore, parties do not have any right to confirm the validity of such agreements later on[978]. It

[977] It is provided in Belgian doctrine that due to one share-one vote principle it is illegal to transfer voting rights without transferring the ownership of the share This approach was influenced by the case law which formulated a rule that voting agreements cannot be concluded as a result of fraud. See: CLOTTENS, C. *Proportionaliteit van stemrecht en risico in kapitaalvennootschappen*. Doctoral thesis. Katholieke Universiteit Leuven, 2011, p. 95-97, 125-127.

[978] NIEUWDORP, R. Overeenkomsten tussen aandeelhouders. In BRAECKMANS, H.; WYMEERSCH, E. Het gewijzigde vennootschapsrecht 1991: Het nieuwe recht van de N.V., B.V.B.A.

could be argued that the Belgian legislature intended for the subject matter restrictions to be of mandatory nature, and therefore the infringement of these rules invalidates the voting agreement.

Article 551 of the W.Venn. does not provide for a list of remedies that the court can apply in case of the breach of the voting agreement[979]. However, the W.Venn. stipulates legal consequences in cases where votes in the general meeting of shareholders where cast in accordance with null and void voting agreements. Furthermore, article 551(3) of W.Venn. states that all the votes that were cast according to the voting agreement that infringes imperative norms stipulated by the W.Venn. are void[980]. The decision of the general meeting of shareholders can also be declared null and void, unless the votes that were cast according to the unlawful voting agreement did not affect the validity of the decision[981] (they were not significant enough)[982].

From a comparative approach, both in Belgium and in Lithuania invalid voting agreements can affect the validity of the decisions of the general meeting of shareholders, but only if the votes cast according to the unlawful agreement had significant importance for passing the decision[983]. While in Lithuania this approach is straightforward and courts usually base the annulment of decisions of the general meetings of shareholders on the per cent or number of voting rights that were exercised[984], Belgian scholars provide a

en coöperatieve vennootschap na de wetten van 18 en 20 juli 1991. Antwerpen: Maklu Uitgevers, 1992, p. 269.

[979] In contrast, article 2.88(4) of the Lithuanian CC stipulates that courts are empowered to re-calculate the results of voting at the general meeting of shareholders in compliance with the voting agreement or to rule that the resolution taken at the general meeting is invalid.

[980] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 434.

[981] GEENS, K.; WYCKAERT, M. Beginselen van Belgisch Privaatrecht IV. Verenigingen en Vennootschappen. Deel II: De Vennootschap. A. Algemeen Deel. Mechelen: Wolters Kluwer Belgium, 2011, p. 608.

[982] The prescription period for such claims is set to six months.

[983] The rule for the nullification of the resolutions of the general meeting of shareholders is expressly formulated in the W.Venn. In Lithuania, on the other hand, this rule has been formulated by the courts. See: SCL civil case No. 3K-3-878/2002, 2002 June 19, *UAB "Vilnamisa" v. AB "Šeškinės Širvinta"*.

[984] SCL in all these cases emphasises the fact that exercise of voting rights in the general meeting of shareholders would not have any impact on the final decision of the shareholders. In other words, the

more subtle line of thought. Professor Braeckmans suggests that decisions of the general meeting are passed by shareholders and not just merely by abstract sums of voting rights that are attached to the shares. Therefore, when deciding upon the validity of the decisions of the general meeting of shareholders not only the amount of votes that were cast in breach of the voting agreement have to be taken into account, but also the influence of the shareholder (who breached the agreement) on the discussions and debates in the general meeting[985]. The author believes that this approach is justified as shareholders might be persuade to vote in a certain way that is acceptable to the shareholder in breach of contractual obligations. Moreover, this more flexible interpretation ensures that courts will be analysing the case at hand and examining the issues relevant to the factual situation, and will not act just as mathematicians, who based on addition and subtraction of voting rights rule on the validity of decisions of the general meeting of shareholders. It should be noted that this approach is feasible only if extensive minutes of the meeting are available, and the court is able to establish the influence of the shareholder in breach over the other shareholders. However, the case might be that the general meeting of shareholders is very formal and no discussions take place that could influence the decision of other shareholders. In these cases the court should take into account the interests of the company (voting agreements cannot be against the interests of the company). Thus, if there is a voting agreement whereby majority shareholders vote and pass a resolution that is detrimental to the company as a whole (which includes the interests of minority shareholders as well), the court should be in a position to remedy such situation.

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outcome of the cases is based purely on mathematical application of voting rights. However, none of the cases mention that not only the exercise of the voting rights but also discussions and negotiations in the general meeting of shareholders have impact on the final decision. SCL civil case No. 3K-3-856/2001, 2001 September 24, *V. S. and D. S.* v. *specialiosios paskirties akcinė bendrovė „Stumbras"*; SCL civil case No. 3K-3-650/2003, 2003 June 4, *S. A. et al. v. akcinė bendrovė "Mažeikių nafta"*; SCL civil case No. 3K-3-135/2008, 2008 March 3, *UAB „Kriptonika" v. UAB „Penki kontinentai"*.

[985] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 434-435. This approach was adopted from the case law. See: Hof van Cassatie [Supreme Court] decision dated April 4, 1975. *Rechtskundig Weekblad, 1974-75*.

3.1.5. Enforcement of voting agreement

The Belgian court law and legal doctrine (similarly like in Lithuania[986]) has been confronted with a question regarding the enforceability of voting agreements – can a court order specific performance for the breach of the voting agreement? It seems that at first both the Belgian courts and legal scholars were against the enforceability of the voting agreement by ordering specific performance, and only the award of damages was considered to be the most appropriate remedy[987]. However, after the enactment of the new Company law in 1991, which clearly stated that voting agreements are valid type of contract, the situation changed. Commenting the Supreme Court judgement dated April 13, 1989[988] professor Nelissen Grade has come to a conclusion that voting agreement under the Belgian law can be enforced[989]. According to him, the judge can order the shareholder, who is a party to the voting agreement, to vote according to the provisions stipulated in the contract. If the shareholder fails to do so, the judge can also grant damages. Currently, the approach that courts can order specific performance of the voting agreement is upheld by most of the legal scholars in Belgium[990].

Despite of the above, some Belgian legal scholars provide reservations as to when the voting agreement cannot be enforced by granting specific performance remedy. For example, Professor Nelissen Grade suggests that if the contracting shareholder has freedom to decide how to vote in the general meeting of the shareholders, then the court is not in a position to order specific

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[986] See Part II, Chapter 2.1.6.

[987] CROES, C. *Benoeming van bestuurders in een Naamloze Vennootschap 1994-1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/31n1/croes.pdf>, p. 96-97.

[988] Hof van Cassatie [Supreme Court] decision dated April 13, 1989, No. F-*19890413*-16 2. *Arresten van het Hof van Cassatie 1988-89*, p. 920.

[989] NELISSEN GRADE, J. M. De la validité et de l'exécution de la convention de vote dans les sociétés commerciales. *Revue Critique de Jurisprudence Belge*, 1991, Vol. 45, p. 253-254.

[990] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 435; CROES, C. *Benoeming van bestuurders in een Naamloze Vennootschap 1994-1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.law.kuleuven.be/jura/art/31n1/croes.pdf>, p. 96.

performance, as it is unclear what kind of performance would be required from the shareholder[991]. According to him, a clear and enforceable obligation, for example, is to vote in favour of a particular candidate to the management body or to vote as determined by the majority of the contracting shareholders. Another reservation, which is of a broader scope, is that courts should generally abstain from granting specific performance of the voting agreement if the request for performance is contrary to the principle of good faith[992]. It could be concluded that, according to Belgian commentators, the specific performance remedy should be applied on a case by case basis and the judge should in all cases determine whether specific performance is possible taking into account the nature of the voting agreement and the undertakings stipulated therein.

The possibility to re-calculate the votes cast in the general meeting of shareholders should also be mentioned. The re-calculation of votes has similar legal effects as the order for the specific performance of the voting agreement, *id est*, the court remedies the situation in order for the outcome of the general meeting of shareholders to be in line with the provisions of the voting agreement. However, the re-calculation of votes has a more retrospective application. For example, if a shareholder breached the voting agreement and the resolution of the general meeting was passed, the order of the court to vote in accordance with the voting agreement would not have the desired legal effect, unless the resolution of the general meeting of shareholders would be declared void. Even in this case shareholders would have to convene another general meeting in order to decide on the same issue. In case of re-calculation

[991] NELISSEN GRADE, J. M. De la validité et de l'exécution de la convention de vote dans les sociétés commerciales. *Revue Critique de Jurisprudence Belge*, 1991, Vol. 45, p. 253. The same reasoning is also provided by other Belgian researchers. See: FERON, B. *Les Conventions D'actionnaires Apres la Loi du 13 Avril 1995* [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.nautadutilh.com/publicationfiles/26-11-97_Les%20conventions%20d'actionnaires%20apr%C3%A8s%20la%20loi%20du%2013%20avril%201995_feron_b.pdf>, p. 46.

[992] In comparison, the Lithuanian legislature in article 1.5(1) of the CC stipulated that all the parties to the legal civil relationships must act in accordance with the principle of good faith (fairness). However, the Lithuanian courts are not always determined to apply this principle while deciding cases.

of votes the court would be able to change the resolution of the meeting and repeated voting procedure would not be required, and thus the resolution of the general meeting would reflect the provisions and undertakings of the shareholders according to the voting agreement. The author holds the view that the Belgian courts should be empowered to re-calculate the votes at the general meeting of the shareholders in cases where votes were cast in breach of the voting agreement. It should be noted that some of the Belgian scholars have also expressed similar points, stating that the court is able to declare that the execution of the voting agreement might result in certain resolution of the general meeting of shareholders, and the court might even consider that resolution to be adopted by the shareholders[993].

3.1.6. Closing remarks

In order to prevent possible abuses of the voting agreements, the Belgian legislature has stipulated that all the contracts among shareholders regarding the exercise of voting rights have to pass a test – these agreements have to always be in the interests of the company. Although this positive test has transformed into a negative one – the voting agreement cannot be against the interests of the company – the author views this is an essential part in order for the voting agreement to be valid. The test is applied on a case by case basis, and the final decision on what is against and what is line with the interests of the company is left for the courts to decide. This allows for a very broad scope test, and should be considered as an effective approach to preventing the misuse of voting agreements.

Voting against the statutory restrictions stipulated in article 551 of the W.Venn. may cause three different (albeit related) legal consequences: 1) the voting agreement might be considered to be null and void; 2) the votes cast in the general meeting of shareholders in accordance with the voting agreement

[993] CERFONTAINE, J.; VAN CANEGHEM, L. Nieuwe Regelen Inzake Aandelen. In BRAECKMANS, H.; WYMEERSCH, E. *Het gewijzigde vennootschapsrecht 1995*. Antwerpen: Maklu Uitgevers, 1996, p. 217-218.

might be considered to be null and void; and 3) the decisions of the general meeting of shareholders might also be declared null and void, unless the nullified votes had no effect on the validity of the decisions taken.

In this regard it should be pointed out that the Belgian legislature did not provide the shareholders with a possibility to issue a special proxy[994] (in contrast to the Lithuanian provisions). As it was argued above[995], the special proxy serves as an additional enforcement mechanism and prevents parties to the voting agreement from derogating from the provisions stipulated in the contract[996]. Despite of this, shareholders of Belgian companies use proxies according to general rules stipulated in the W.Venn.[997], and thus additional statutory rules are not required. The W.Venn. is silent upon the issue of re-calculation of votes in cases where the decision of the general meeting of shareholders was adopted by the votes cast in breach of the provisions of the voting agreement. The author views that Belgian company law would benefit from this rule, as it would make voting agreements and their enforceability more viable.

Despite all the discussions and uncertainties of the last century regarding the validity and enforceability of voting agreements in Belgium, the author can strongly conclude that currently voting agreements are valid and enforceable type of contracts. Shareholders of the companies listed on the NYSE Euronext Brussels stock exchange can enter into these agreements, and

[994] Recently (from January 1, 2012), there was a new article 547bis added to the W.Venn., which enables the shareholders of listed companies to appoint the same person as a proxy, who can exercise voting rights of different shareholders. The shareholders of listed companies were also limited to have only one proxy appointed at a time.

[995] See Part I, Chapter 2.1.2.

[996] Some Belgian commentators argue that the shareholders of listed companies can make use of proxies (especially through the proxy solicitation procedure) in order to ensure that the votes in the general meeting of shareholders are cast in accordance with the voting agreement. See: BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 407-408.

[997] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 405-406.

regulate their relationships or exercise control over the company more effectively.

3.2. Securities lending agreement[998]

3.2.1. General observations

Unlike the legislation in Lithuania, the Belgian legislature does not provide with a legal instrument for the transfer of voting rights. There are no provisions in the W.Venn. that would allow shareholders to separate their voting and ownership rights[999]. Although certain provisions of Belgian laws might be misleading in this regard and could even be (falsely) interpreted that votes are allowed to be legally transferred without the actual transfer of the shares. For example, article 7(1.1) of the Law on the disclosure of major shareholdings in companies whose shares are admitted to trading on a regulated market[1000] requires a notification to be made by both the party that is acquiring voting rights and the party that is disposing of such rights, if an agreement for the temporary transfer of voting rights for consideration is entered into. Similar provision can also be found in article 7(1.1) of the Royal decree on the disclosure of major shareholdings[1001]. Furthermore, according to the

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[998] The author would like to note that securities lending agreement forms a part of equity, bond and money markets. It is used as an instrument in order to sell shares that the market participant does not own or to borrow money against the lending of the securities. Thus, the primary function of the securities lending agreements is not to decouple voting rights from the economic interest of the shareholders. However, in this part of the dissertation the author will not analyse securities lending agreements as separate financial instruments, but will analyse them only from the functional perspective that allows similar legal consequences as the transfer of voting rights agreement. For an analysis of securities lending agreement as a financial instrument see: FAULKNER, M. C. *An Introduction to Securities Lending. 4th edition*, 2007 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.eseclending.com/pdfs/Data_Explorer_Intro_to_Sec_Lending.pdf>.

[999] Belgian scholars state that separation of voting rights from the shares is illegal in Belgium. See: CLOTTENS, C. *Proportionaliteit van stemrecht en risico in kapitaalvennootschappen*. Doctoral thesis. Katholieke Universiteit Leuven, 2011, p. 95-97.

[1000] Wet op de openbaarmaking van belangrijke deelnemingen in emittenten waarvan aandelen zijn toegelaten tot de verhandeling op een gereglementeerde markt en houdende diverse bepalingen (Belgisch Staadsblad, 12 June 2007, No. 2007/03215).

[1001] Koninklijk besluit op de openbaarmaking van belangrijke deelnemingen (Belgisch Staadsblad, 4 March 2008, No. 2008/03071).

Information vade mecum of the NYSE Euronext Brussels stock exchange '[s]ome specific cases of acquisition or transfer of voting rights are likely to result in the crossing of a threshold (whether legal or statutory as the case may be) for the transferor (decrease of its holding), but also for the transferee (increase of its holding). In such case, both to the transferor and the transferee are subject to a notification requirement in case a threshold is crossed'[1002].

All of the above mentioned acts mention not the transfer of the shares (in Dutch *overdracht van effecten*) or the transfer of ownership rights (in Dutch *eigendomsoverdracht*), but the transfer of voting rights (in Dutch *overdracht van stemrechten*). This creates confusion in the wording of the legislation, as it might be considered that the transfer of the voting rights without transferring the ownership title is possible in Belgium as it is in Lithuania. However, this is not the case. Belgian scholars argue that there are two ways for transferring voting rights without transferring the economic interest: either by selling securities with an option to buy them back[1003] or by concluding a securities lending agreement[1004].

In order for the acquirer of the voting rights to be able to vote at the general meetings of a particular company, the securities lending agreements are concluded. The reason why transfer of the voting rights (without transferring the ownership of the shares) would not cause the desired legal effects for the acquirer, *id est*, to be able to vote in the general meeting of shareholders, can be derived from article 547 of the W.Venn. It is stipulated in this article that shareholders in the general meeting can vote either in person or

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[1002] NYSE Euronext Brussels. Information vade mecum. Obligations of Information of the Companies Admitted to Trading on the Regulated Market Euronext Brussels, 2012 [interactive]. [Accessed on 2012-08-09] Available online at: <https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/vade_mecum_euronext_eng_apr2012.pdf>, p. 70.

[1003] CLOTTENS, C. De nieuwe transparantiewetgeving. In *Openbaar bod en transparantie 2007*. Kalmthout: Biblo, 2008, p. 227.

[1004] MARESCEAU, K. Commentaar bij art. 7 Transparantiewet. In WYMEERSCH, E.; STEENNOT, R. (eds.) *Financieel recht: artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Antwerpen: Kluwer, 2011, p. 7/1-7/26.

by proxy[1005]. There are no provisions that would allow any other person to vote according to, for example, the transfer of voting rights agreement[1006]. Thus, if the voting rights would be transferred using a transfer of voting rights agreement, the acquirer of the voting rights would not be able to exercise these rights as he is neither a shareholder, nor as a proxy. Due to these reasons Belgian scholars agree that in order for the acquirer of the voting rights to be able to exercise them, securities' lending agreement has to be concluded[1007].

3.2.2. Qualification of the agreement

Belgian scholars define the securities lending agreement as a transaction whereby one party (the shareholder) lends his shares to the other party (the borrower) for a specific period of time, and the borrower undertakes at the end of the term to return the same kind of securities, but not necessarily with the same identification number[1008]. It should be noted that the Belgian Civil Code distinguishes between two types of loans: a loan for use or *commodatum* (in Dutch *de bruiklening*) and loan for consumption or *mutuum* (in Dutch *de verbruiklening*)[1009]. There is a general agreement among the Belgian scholars

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[1005] BRAECKMANS, H.; HOUBEN, R. *Handboek Vennootschapsrecht*. Antwerpen: Intersentia, 2012, p. 404-406.

[1006] Article 536(2) of the Belgian W.Venn. is particularly important in this regard, as it stipulated that only registered shareholders (14 days prior to the meeting) can participate (and thus exercise their voting rights) in the general meetings of listed companies.

[1007] MARESCEAU, K. Commentaar bij art. 7 Transparantiewet. In WYMEERSCH, E.; STEENNOT, R. (eds.) *Financieel recht: artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Antwerpen: Kluwer, 2011, p. 7/1-7/26.

[1008] DE BACKER, G. *De gids voor vennootschappen editie 2007*. Mechelen: Wolters Kluwer Belgium, 2007, p. 55. DU LAING, B. Aandelenlening. In TILLEMAN, B.; DU LAING, B. (eds.) *Recht en Onderneming 3: Onderneming en effecten*, Brugge: Die Keure, 2001, p. 233. MUYLDERMANS, J.; WEYNANTS, F. De effectenlening. Een status quaestionis na de Wet van 10 maart 1999. *Algemeen fiscaal tijdschrift*, 1999 October, p. 337. CLOTTENS, C. *Proportionaliteit van stemrecht en risico in kapitaalvennootschappen*. Doctoral thesis. Katholieke Universiteit Leuven, 2011, p. 411-414; Belgian Commission of Accounting Standards also holds the same position. See: Commissie voor Boekhoudkundige Normen. Advies van de Commissie Boekhoudkundige Normen inzake effectenleningen, Advies 169/1, Bull. CBN 1995, No. 35.

[1009] FOSTER, T. *Dutch Legal Terminology in English. 3rd edition*. Alphen aan den Rijn: Kluwer Law International, 2009, p. 13-14. Commissie voor Boekhoudkundige Normen. Advies van de Commissie Boekhoudkundige Normen inzake effectenleningen, Advies 169/1, Bull. CBN 1995, No. 35.

that the securities lending agreement is qualified as a loan for consumption[1010]. Therefore, securities lending agreement under the Belgian law is qualified as a loan of fungible things (this applies only for dematerialised shares)[1011]. This means that all the shares of a particular company are considered to be interchangeable and substitutable for one another. In other words, the borrower of the shares (the acquirer of the voting rights) does not have to return particular shares that he had borrowed, as he only has an obligation to return the same number of shares of the same company.

After the securities' lending agreement is concluded, the ownership title of the shares automatically passes to the borrower together with the securities themselves[1012]. Ownership of the shares enables the borrower to exercise all the voting rights attached to the shares in the general meeting of shareholders[1013] as he sees it fit[1014]. The said agreements usually are concluded before the date of the general meeting. As a general rule, after the casting of votes at the general meeting, securities' lending agreement obliges the borrower to return the shares (with all the rights attached to them) to the rightful owner (the shareholder). Through the mechanism of the securities lending agreement shares are temporarily transferred to the borrower (together with voting rights), and the same functionality as with the transfer of voting rights agreement is achieved.

[1010] DU LAING, B. Aandelenlening. In TILLEMAN, B.; DU LAING, B. (eds.) *Recht en Onderneming 3: Onderneming en effecten*, Brugge: Die Keure, 2001, p. 248. MUYLDERMANS, J.; WEYNANTS, F. De effectenlening. Een status quaestionis na de Wet van 10 maart 1999. *Algemeen fiscaal tijdschrift*, 1999 October, p. 338.

[1011] Article 1892 of the Belgian Burgerlijk wetboek [Civil Code] Also see: MARESCEAU, K. Commentaar bij art. 7 Transparantiewet. In WYMEERSCH, E.; STEENNOT, R. (eds.) *Financieel recht: artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Antwerpen: Kluwer, 2011, p. 7/1-7/26.

[1012] In contrast, the ownership of infungible things (characterized by individual features) does not pass to the borrower with the conclusion of a loan or lending agreement.

[1013] DU LAING, B. Aandelenlening. In TILLEMAN, B.; DU LAING, B. (eds.) *Recht en Onderneming 3: Onderneming en effecten*, Brugge: Die Keure, 2001, p. 296. MUYLDERMANS, J.; WEYNANTS, F. De effectenlening. Een status quaestionis na de Wet van 10 maart 1999. *Algemeen fiscaal tijdschrift*, 1999 October, p. 338.

[1014] Unless securities lending agreement provides for instructions and rules on how to exercise voting rights in the general meeting of shareholders.

3.2.3. Securities lending and transfer of votes

From a comparative functional perspective it should be noted that there are some differences between the transfer of voting rights agreements (as they are regulated in Lithuania) and the securities lending agreements (as they are understood in Belgium). First, under the transfer of voting rights agreement the ownership rights of the shares are not transferred to the acquirer. Due to this reason only non-pecuniary rights can be transferred using the transfer of voting rights agreement, whilst the securities lending agreement allows passing the ownership title together with all the pecuniary rights conferred by the shares[1015]. Secondly, the securities lending agreement grants ownership title and subsequently the right to vote in the general meeting of the shareholders after the new shareholder has been registered as such with the company. In contrast, in case of the transfer of voting rights agreement is concluded the shareholder of the transferred shares remains the owner, and the acquirer of the voting rights is registered only as the owner of the voting rights or other non-pecuniary rights. Thirdly, the transfer of the voting rights is subject to clear and precise instructions for the acquirer on the exercise of such rights, while there is no such requirement in case of conclusion of the securities lending agreement. Lastly, there are no statutory restrictions relating to the securities lending, whereas transfer of the voting rights agreement is subject to certain restrictions set by the legislature.

The functional approach also allows some insights into similarities between the two instruments. First, both of them are of contractual nature, and their conclusion and termination depends solely on the will of the contracting parties. This also means that shareholders are allowed to regulate their relations as they see it fit, unless it is contrary to the mandatory requirements or norms. Secondly, both contractual instruments allow shareholders to acquire voting

[1015] It should be noted that the securities lending agreement should regulate the use and compensation of all the pecuniary rights and gains derived from the use of the shares of the acquirer. For example, the compensation of dividends should be expressly indicated in the agreement.

rights in a particular company without simultaneously acquiring long term economic interests in the company. Although, as it was mentioned above, the actual civil legal relationships between the parties differ in each instrument, the end result is the same – acquirer is entitled to use voting rights attached to the shares. Thirdly, after the conclusion of both agreements, the original shareholder loses his right to vote. In case of transfer of votes, only the acquirer is entitled to use voting rights. In case of the securities lending agreement, under the Belgian law the acquirer gains not only the voting rights, but also the ownership title of the shares. Thus, the shareholder lending the shares loses all the rights for the period of validity of the agreement.

3.2.4. Closing remarks

Considering the fact that transfer of voting rights under the Belgian law would not have the same legal effect as in Lithuania, the securities lending agreement is used not only as a financial instrument to trade on the markets, but also as a tool to decouple voting rights from the long term economic interest in the company. As the securities lending agreement is qualified as a loan of fungible things, the ownership of the shares passes to the borrower, and thus he is enabled to vote at the general meetings of shareholders. The question arises, whether the Belgian legislature should leave everything as it is (which means no legislative intervention) or should provide for some general guidance rules that would limit possible abuse of the securities lending agreements for the sole purpose of gaining voting rights at the general meeting of shareholders. From the perspective of Lithuania, for example, there are certain requirements and restrictions that apply to the transfer of voting rights agreement. The author is of an opinion that the securities lending agreement should not allow the borrower of the shares to use voting rights attached to the borrowed securities as he sees it fit. Certain requirements as to the mandatory instructions and rules on how voting rights should be exercised during the term of the agreement should always form a part of the contract. Hence, the conclusion is that the Belgian legislature should at least consider the possibility of introducing certain requirements to the subject matter of the securities lending agreement, if such agreement is intended to be used solely for the purposes of acquiring voting rights without the economic interest attached to the shares. These restrictions should be aimed at protecting the interests of the company and the shareholders.

3.3. Some other aspects of legal regulation of shareholders' agreements in Belgium

As it has been argued above, shareholders' agreements under the Belgian law are considered as a perfectly valid and enforceable type of contract. However, there are some more open questions left that need to be addressed. Do shareholders' agreements have to be always concluded in writing? When is the moment of conclusion of the shareholders' agreement? Are shareholders presumed to have entered into shareholders' agreement only when it has binding effect on the contracting parties?

From the perspective of transparency regulations in Belgium persons are presumed to be acting in concert (in Dutch *in onderling overleg handelende personen*) and have an agreement to act in concert, among other situations, when they have concluded[1016]: 1) an agreement to adopt, by concerted exercise of the voting rights they hold, a lasting common policy in the company; or 2) an agreement to hold, acquire or dispose of securities to which voting rights are attached[1017]. Thus, in context of shareholders' agreements, there is no requirement for the parties to have a written contract. This approach stems from the general rule in contract law that agreements do not necessarily have to be in written form in order to be biding. The fact that parties have expressed

[1016] CLOTTENS, C. De nieuwe transparantiewetgeving. In *Openbaar bod en transparantie 2007*. Kalmthout: Biblo, 2008, p. 224-225.

[1017] Wet op de openbaarmaking van belangrijke deelnemingen in emittenten waarvan aandelen zijn toegelaten tot de verhandeling op een gereglementeerde markt en houdende diverse bepalingen (Belgisch Staadsblad, 12 June 2007, No. 2007/03215), articles 3(13) and 3(14). In contrast, articles 2(47) and 24 of the Lithuanian Law on Securities.

their will and intentions to act in concert by exercise of the voting rights in order to adopt a lasting common policy of the company is enough, and no written agreement is required (in certain cases even tacit consent is enough to determine that the shareholders are acting in concert)[1018]. From the transparency regulation point of view, the signing of the shareholders' agreement is less important than the actual consent of the parties to act in certain way. Therefore, shareholders acting in concert after the conclusion of the shareholders' agreement have a duty to inform the supervisory authorities[1019], but only if the threshold of share ownership stipulated in the laws has been reached[1020]. The duty to inform remains despite of written or oral form of the shareholders' agreement.

Furthermore, it should be pointed out that the duty to inform about the fact that shareholders are acting in concert remains even if the shareholders' agreement does not provide biding obligations to exercise voting rights (the agreement itself has to be binding to the contracting parties). The former Banking, Finance and Insurance Commission analysed a situation[1021] where shareholders had contracted in shareholders' agreement to meet each time before the general meeting of shareholders in order to discuss the exercise of voting rights. Although parties to the shareholders' agreement had adopted a

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[1018] NYSE Euronext Brussels. Information vade mecum. Obligations of Information of the Companies Admitted to Trading on the Regulated Market Euronext Brussels, 2012 [interactive]. [Accessed on 2012-10-09] Available online at: <https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/vade_mecum_euronext_eng_apr2012.pdf>, p. 72.

[1019] Supervisory structure in Belgium was changed into two peaks model in 2011. The National Bank of Belgium is the principal prudential supervisor for the Belgian financial system and the Financial Services and Markets Authority is the supervisor for financial markets, investment products and of the rules of conduct that apply to financial institutions. See: DE BRUYCKER, J. VAN LANDEGHEM, K. GOLDSCHMIDT, E. *Reform of the Belgian financial supervisory structure, introduction of the Twin Peaks model in Belgium*, 2011 [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.worldservicesgroup.com/publications.asp?action=article&artid=3839>.

[1020] Wet op de openbaarmaking van belangrijke deelnemingen in emittenten waarvan aandelen zijn toegelaten tot de verhandeling op een gereglementeerde markt en houdende diverse bepalingen (Belgisch Staadsblad, 12 June 2007, No. 2007/03215), article 6.

[1021] Commissie voor het bank-, financie- en assurantiewezen. Verslag van het directiecomité 2007 [interactive]. [Accessed on 2011-06-10] Available online at: <http://www.fsma.be/nl/Doormat/arch/~/media/Files/publications/ver/nl/cbfa_dc_2007.ashx>, p. 58.

common lasting policy on the management of the company, the agreement did not create binding obligations to the parties to vote in certain way. The shareholders' agreement explicitly stated that contracting shareholders do not undertake to exercise their voting rights in accordance with the procedure established in the shareholders' agreement, and can decide to vote as they see it fit. In other words, the shareholders' agreement established a formal procedure that was directed at coordinating the interests of the contracting shareholders in setting a lasting common policy towards the company, but was not binding on the parties. The former Banking, Finance and Insurance Commission has decided that despite the fact that the shareholders' agreement did not provide binding obligations to the parties, they were still considered as acting in concert from the perspective of requirements under transparency regulation[1022]. This means that the fact that there is a non-binding obligation to vote in certain way shareholders' agreement amongst the shareholders of a company (or that not all the shareholders are actually performing their duties under the agreement) does not have any effect on the legislative presumption under the Belgian law that contracting shareholders are acting in concert. Thus, shareholders' agreements under the Belgian transparency rules create certain obligations of the contracting shareholders even in those cases where obligations to vote are not binding to the parties – shareholders have to disclose to the supervisory authority and to the market that they are acting in concert.

The author holds a position that the requirement to disclose about shareholders' agreement even in a situation when there are no binding obligations to vote is justifiable. This conclusion can be drawn from the fact that listed companies have influence not only to the corporate constituents that

[1022] Commissie voor het bank-, financie- en assurantiewezen. Praktijkgids CBFA 2008 16 dd. 9 december 2009. Transparantiewetgeving (Titel II van de wet van 2 mei 2007 en koninklijk besluit van 14 februari 2008) [interactive]. [Accessed on 2011-02-02] Available online at: <http://www.fountain.eu/images/cont/230_68150_file.pdf>, p. 12. Commissie voor het bank-, financie- en assurantiewezen. Verslag van het directiecomité 2007 [interactive]. [Accessed on 2011-06-10] Available online at: <http://www.fsma.be/nl/Doormat/arch/~/media/Files/publications/ver/nl/cbfa_dc_2007.ashx>, p. 58.

are directly interested in the success of the company, but also to the securities markets of the states and persons active in these markets. Even non-binding clauses of shareholders' agreement in listed companies should be viewed as capable of shifting the power of control in the company[1023], and thus should be disclosed to the public. Thus, the fact that certain provisions of shareholders' agreement are not binding does not prevent or limit the possible influence that it might have on other participants of the securities markets.

3.4. Chapter conclusions

Although the Belgian legislature decided not to regulate shareholders' agreements in general terms, the wording provided in article 551(1) of the W.Venn. suggests that shareholders' agreements are considered to be valid and enforceable types of contracts[1024]. Therefore, shareholders of companies listed on the NYSE Euronext Brussels stock exchange can enter into all types of shareholders' agreements and are not limited only to the voting agreements.

However, the voting agreement and restriction on transfer of shares agreement has attracted particular attention from the Belgian legislature. There are strict restrictions on the subject-matter of the voting agreement, violation of which result in severe legal consequences – nullification of the shareholders' agreement and even the decision adopted by the general meeting of shareholders. The most notable restriction or requirement for the voting agreements is for the subject-matter to be in the interests of the company. All of the voting agreements entered into amongst the shareholders of a particular company have to be in line with the interests of that company. Shareholders' agreements regarding the exercise of voting rights that are against the interests

[1023] For an example see: Part II, Chapter 1.5.

[1024] The wording is as follows: 'Aandeelhoudersovereenkomsten kunnen de uitoefening van het stemrecht regelen', which translates into: 'the exercise of voting rights can be regulated by shareholders' agreements'. It is clear that the legislature purposefully chose to use the word 'aandeelhoudersovereenkomsten' (shareholders' agreements) instead of just using 'stemovereenkomste' (voting agreements) in order to show that other types of shareholders' agreements are also possible to be concluded amongst the shareholders of the company.

of the company are considered to be null and void from the moment that they were concluded.

Securities lending agreements in Belgium are used not only as a financial instrument to profit from market fluctuations of prices of shares, but also as a contractual tool to gain voting rights without acquiring long term economic interest in the company. The lack of legislation regarding the use of the securities lending agreements only for the purpose of acquiring voting rights enables certain market participants to misuse these agreements and to abuse the right to vote. The author is of a strong opinion that the requirement for the voting agreements to be in the interests of the company should be also applied to the securities lending agreements in order to prevent possible abuse. This is explained by the fact that after the conclusion of the securities lending agreement, shareholder temporarily loses not only the ownership of the shares, but also the ability to exercise voting rights in his discretion. This loss of freedom should be, in the author's view, compensated by the obligation of the borrower to act in the interests of the company, while he is exercising voting rights attached to the lent securities.

Chapter 4. Regulation of shareholders' agreements in the UK

It has been argued in the previous chapters that the analysed jurisdictions belonging to the continental European tradition (Belgium and Lithuania) have a certain degree of regulation on the shareholders' agreements, *id est*, both jurisdictions regulate at least the voting agreements. Nevertheless, it has to be acknowledged that none of the analysed jurisdictions has a set of general legal rules designed especially for shareholders' agreements. The UK in this context (as a part of the common law system) relies solely on the general principles of contract law, legal doctrine and case law.

Shareholders' agreements are being concluded in practice among the shareholders of the companies listed on the London stock exchange, although they are not that popular as in Belgium or Lithuania (despite the fact that London stock exchange is one of the biggest stock exchanges in the world). The per cent of the traded companies that have at least one shareholders' agreement in place is lower than in the other two jurisdictions analysed and even falls below the EU average. From the analysed 302 companies listed on the London Stock Exchange and constituting the FTSE 350 index[1025] only 20 companies had at least one shareholders' agreement concluded by their shareholders. A total of 21 shareholders' agreements had been concluded in the sample companies. This means that only 6.6 per cent[1026] of the listed UK companies have a shareholders' agreement and it is lower than the EU average (which is 8 per cent[1027]).

As in Belgium, the UK has codified its company legislation into a single act – the Companies Act 2006. This is the longest codified legal act in the history of the UK that has been enacted after a long and coherent codification

[1025] Only companies that are incorporated in the UK and that have their primary listing in the London Stock Exchange were analysed. Thus, from the sample of 350 companies only 302 have been selected.

[1026] The percentage was calculated according to the number of companies that had at least one shareholders' agreement in place.

[1027] Report on the proportionality principle, p. 35.

process[1028]. However, even the longest codified act in the English history does not explicitly deal with shareholders' agreements. There are no provisions in the CA 2006 neither about shareholders' agreements in general or about voting agreements, transfers of voting rights or securities lending agreements. It is indirectly mentioned in some of the provisions of the CA 2006 that shareholders can in some cases enter into shareholders' agreements (for example, articles 820 and 824). Due to the lack of statutory legislation, in order to analyse shareholders' agreements in the UK, the legal doctrine and case law must be relied upon.

The UK scholars provide that shareholders' agreement 'is a contract between the persons who are parties to it and is enforceable in accordance with normal contractual principles'[1029]. The argument does not have to be in writing or signed by the parties[1030]. It is claimed in the English doctrine that shareholders' agreements are binding and influence the rights and duties only of those shareholders who are parties to the shareholders' agreement[1031]. It is also added that, under English common law, this contract is considered 'as a commercial contract without qualifying as a specific form of contract meriting special legal rules'[1032]. However, it is generally agreed that shareholders' agreements do not get a lot of attention and the UK case law as well as doctrine is relatively scarce on this subject[1033] (it could be added that similar situation exist both in Lithuania and in Belgium). Nonetheless, certain types of

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1028 ARMOUR, J. Codification and UK Company Law. In DELPLANQUE, C.; Association du Bicentenaire du Code de Commerce (ed.), *Bicentenaire du Code de Commerce 1807-2007: Les Actes des Colloques,* Paris: Dalloz, 2008, p. 287-310. It is interesting to note that from 80 sections in 1844 the CA has grown to 1300 sections in 2006.

1029 CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 3.

1030 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 26, 30.

1031 ANDENAS, M. *Shareholders' Agreements: Some EU and English Law Perspectives*, 2007 [interactive]. [Accessed on 2012-10-19] Available online at: <http://www.lawschool.tsukuba.ac.jp/pdf_kiyou/tlj-01/tlj-01-andenas.pdf>, p. 143-146.

1032 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 17.

1033 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 29.

shareholders' agreements are more common than others and require special attention and legal analysis.

4.1. Voting agreement

4.1.1. *General remarks*

Although voting agreements in the UK are not regulated by any statutory provisions, the possibility to enter into these contractual relationships is derived from the general principles of contract law, and especially the principle of freedom of contract[1034]. It has been established by the UK scholars that voting agreements are valid under the UK law and that shareholders are free to exercise their voting rights in any way they see it fit, including exercising them in coordination with other shareholders[1035]. The UK courts have also long since ruled that shareholders can vote in the general meetings of the shareholders in a manner that suits their interests[1036], and thus they can enter into agreements in order to agree on the exercise of their voting rights in a particular way[1037]. Hence, there are no legal obstacles in the UK law for the shareholders to agree on the exercise of the voting rights conferred to them by the shares. Essentially, this means that voting agreements, as a type of shareholders' agreement, are enforceable by the courts, for example, the court can order the shareholder to vote or to restrain from voting according to the terms of the voting agreement.

[1034] ANDENAS, M. *Shareholders' Agreements: Some EU and English Law Perspectives*, 2007 [interactive]. [Accessed on 2012-10-19] Available online at: <http://www.lawschool.tsukuba.ac.jp/pdf_kiyou/tlj-01/tlj-01-andenas.pdf>, p. 135.

[1035] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 8, 27. THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 1-3.

[1036] Chancery division. Decision dated March 22, 1974, *Northern counties securities LTD v. Jackson & Steeple LTD*. *The Weekly Law Reports*, 1974, p. 1133-1148. Some authors provide that pooling agreements (another name for voting agreements) were recognised by English law even a century ago. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 25.

[1037] Chancery division. Decision dated January 21, 1902. *Greenwell v. Porter*. *Chancery Law Reports*, 1902, p. 530-536.

Shareholders can agree to vote on a specific matter (the voting agreement in this case would be limited in time and scope) or may undertake to vote generally according to the rules and principles set in the voting agreement[1038]. Usually voting agreements contain provisions that set certain rules that the contracting shareholders agree to follow while voting in the future general meetings of the shareholders[1039]. Furthermore, voting agreements in the UK are contractually binding (provided that there was sufficient consideration), but only if they are not in conflict with the articles of association of the company, the applicable statutory provisions and do not unfairly prejudice or fraudulently affect the minority shareholders[1040].

As a general rule voting agreements (as a type of shareholders' agreement) create reciprocal obligations only to the contracting parties and are not *per se* binding to the company, other shareholders, who did not take part in the agreement, or to the future shareholders[1041]. Thus, obligations arising out of the voting agreements under the English case law are exceptionally of personal nature and are valid as long as contracting shareholder remains the owner of the shares (and of the voting rights) of the company. If the shares are transferred, shareholder no longer is in the position to fulfil his obligations under the voting agreement, as he does not have the right to vote at the general

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[1038] CADMAN, J. *Shareholders' Agreements, 4th ed.*, London: Sweet & Maxwell, 2004, p. 27.

[1039] For example, on 10 August, 2009 shareholders (jointly representing 16.04 % of the issued share capital) of Pilat Media Global plc concluded a shareholders' agreement. The agreement sets out the rules on how parties will cooperate with respect to their voting at the annual general meeting of the company. The parties to the agreement agreed to vote in a manner recommended jointly by two of the contracting shareholders. If these two shareholders do not agree on certain resolutions, then contracting shareholders are to vote as they wish. See: Pilat Media Global plc. *2009-08-11 Press Release* [interactive]. [Accessed on 2011-03-21] Available online at: <www.londonstockexchange.com>.

[1040] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 26; DAVIES, P. L.; WORTHINGTON, S. *Gower and Davies' Principles of Modern Company Law. 9th edition*. London: Sweet & Maxwell, 2012, p. 691-692.

[1041] House of Lords. Decision dated April 8, 1897. *Welton v. Saffery*. *Law Reports, Appeal Cases*, p. 331. Lord Davey in this case stated that 'individual shareholders may deal with their own interests by contract in such way as they may think fit. But such contracts, whether made by all or some only of the shareholders, would create personal obligations or an *exceptio personalis* against themselves only, and would not become a regulation of the company, or be binding on the transferees of the parties to it, or upon new or non-assenting shareholders'. ANDENAS, M. *Shareholders' Agreements: Some EU and English Law Perspectives*, 2007 [interactive]. [Accessed on 2012-10-19] Available online at: <http://www.lawschool.tsukuba.ac.jp/pdf_kiyou/tlj-01/tlj-01-andenas.pdf>, p. 147-151.

meeting of shareholders. This situation can be prevented either by limiting the transferability of shares or by requiring new shareholders to become parties to the voting agreement[1042].

4.1.2. Restrictions on the voting agreements formulated by the courts

As there are no provisions in the CA 2006 regarding the shareholders' agreements, there are no statutory restrictions on the subject-matter of the agreements stipulated by the legislature. However, in contrast to Belgium and Lithuania, the courts have established certain limitations to matters on which shareholders are allowed to agree. There is a general rule established by the UK case law that individual shareholders have full discretion as to the exercise of rights attached to the shares and 'the shareholder's vote is a right of property, and prima facie may be exercised by a shareholder as he thinks fit in his own interest'[1043]. However, this changes once shareholder is acting not individually but collectively as a majority shareholder[1044] (such cases also include shareholders' agreements), and thus he has to take into account not only his interests, but also interests of the company and minority shareholders.

The UK case law has formulated a rule that majority shareholder (or shareholders acting in concert through a shareholders' agreement) cannot exercise voting rights in a manner as to violate the interests of minority shareholders and of the company itself[1045]. For example, in *Cook v Deeks*[1046]

[1042] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 28; ANDENAS, M; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 140.

[1043] House of Lords. Decision dated March 15, 1937. *Carruth v ICI Ltd*, *Law reports, Appeal cases*, 1937, p. 765. The doctrinal approach in the UK is that shareholders are largely free to vote and adopt decisions which they like, but should not cause prejudice to the minority. See: DAVIES, P. L.; WORTHINGTON, S. *Gower and Davies' Principles of Modern Company Law. 9th edition*. London: Sweet & Maxwell, 2012, p. 687-691.

[1044] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 67.

[1045] CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 165-167. It should be noted at this point that earlier UK case law suggested that there was common view that each shareholder could exercise his voting rights despite the fact that it is against the interests of the company. See: Chancery division. Decision dated March 2, 1877. *Pender v Lushington. Chancery Division Law Reports*, p. 75-76. Lord Jessel MR stated that 'a man may be actuated in giving his vote the House of Lords ruled that majority shareholders are not entitled to benefit themselves at the expense of the company and minority shareholders. It was stated that 'a resolution that the rights of the company should be disregarded in the matter would amount to forfeiting the interest and property of the minority shareholders in favour of the majority, and that by the votes of those who are interested in securing the property for themselves'.

There were other similar cases where the House of Lords repeated the same rule. For example, it was ruled that the voting agreement to change the articles of association of a particular company to the detriment of the minority shareholders is unenforceable[1047]. This was the question in *Brown v. British Abrasive Wheel Company Limited* case. Some of the shareholders of the high capitalisation public company decided to buy shares from other shareholders, and afterwards to increase share capital of the company. They were successful in buying more than 90 % of the shares of the company. However, the remaining shareholders refused to sell their shares. In order to force the disagreeing shareholders to sell their shares, controlling shareholders changed articles of association of the company and stipulated that shareholders having 90 % or more of total shares of the company have the right to force other shareholders to sell their shares to the controlling shareholder. The court ruled in this case that unilateral change of rights of minority shareholders (especially taking into account the fact that the same result could not be reached by contractual means) was only for the interests of controlling shareholder of the company. The interests of the company and minority shareholders were not

by interests entirely adverse to the interests of the company as a whole. He may think it more for his particular interest that a certain course may be taken which may be in the opinion of others very adverse to the interests of the company as a whole, but he cannot be restrained from giving his vote in what way he pleases because he is influenced by that motive'.

[1046] House of Lords. Decision dated February 16, 1916. *Cook v. Deeks*. *Law reports, Appeal cases*, 1916, p. 554-565; SEALY, L. S. *Cases and Materials in Company Law*. London: Cambridge University Press, 1971, p. 391.

[1047] Chancery division. Decision dated February 24, 1919, *Brown v. British Abrasive Wheel Company Limited*. *Chancery Law Reports*, 1919, p. 290-297.

taken into account while changing the articles of association. Due to these reasons court did not upheld the claim of the majority shareholder[1048].

From the above examples it could be concluded that there are limits on how shareholders can protect their interests by exercising voting rights. The line of thought could also be stretched to other situations. For example, it is highly likely that unilateral decision by the controlling shareholder to change articles of association and to deprive minority shareholders of their previous right (both pecuniary and non-pecuniary) would constitute a breach of interests of the company and of minority shareholders[1049].

Moreover, it has been stated by the courts that the majority shareholder cannot exercise his voting rights unfairly in order to cause injustice to the minority shareholders. In particular, the increase of share capital of the company with a single purpose to further dilute the shareholdings of the minority shareholder (and in turn lower his power to object other decisions in the general meetings of shareholders) is against the interests of the minority shareholder, and is not considered as a fair exercise of voting rights by the majority shareholder[1050]. Although the right to vote is the most important right that shareholder of the company has (and even though full discretion on how to exercise such right belongs to the shareholder alone), the English case law is

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[1048] It is noteworthy that article 15 of the Directive 2004/25/EC regulates the situation that was decided by the English courts. The position in the Directive is entirely different and shareholders who have 90 % of the shares of the company can squeeze-out rest of the shareholders. Despite the fact that British Abrasive Wheel Company Limited was a public company there were no statutory provisions at that time enabling controlling shareholders to ouster minority shareholders by requiring selling their shares. Nevertheless, it could not be argued that the mentioned decision is not relevant nowadays. Directive 2004/25/EC and all national legal acts transposing this directive set certain minimum standards for the squeeze-out procedure. Due to this reason controlling shareholder cannot change the threshold for the squeeze-out in the articles of association of the company (or enter into voting agreement with such a purpose) as it would not only be contrary to the statutory provisions, but also would be against the interests of the company and minority shareholders.

[1049] However, not in all cases the breach of interests of the company can be established. See: Chancery division. Decision dated November 8, 1950. *Greenhalgh v. Arderne Cinemas*. *Chancery Law Reports*, 1951, p. 286-294. In this case the articles of association where changed and minority shareholder was deprived of a pre-emptive right. However, court ruled that this was not against the interests of the company as a whole.

[1050] Chancery division. Decision dated January 1, 1976. *Clemens v Clemens Bros Ltd*. *All England Law Reports*, 1976, p. 268-270.

clear that '[n]o right of a shareholder to vote in his own selfish interests[1051] or to ignore the interests of the company entitle him with impunity to injure his <…> fellow shareholders'[1052].

From the above arguments it could be concluded that shareholders are not allowed to agree on the exercise of their voting rights (and on the manner that they will vote in the general meeting of the shareholders) if such an agreement might undermine the interests of the minority shareholders[1053] or the company. In other words, the voting agreement cannot infringe interests of the company and minority shareholders. At this point the question arises what is meant by voting *bona fide* for the benefit of the company as a whole. In the English case law it has been established that 'the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole'[1054]. Another ambiguous terminology is encountered as to what is meant by company as a whole. The same authority gives an answer that it 'does not <…> mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit'[1055]. Thus, company as a whole is regarded from a purely shareholder value principle point of view as being collective body of

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[1051] However, this does not mean that the decision of the meeting of shareholders cannot result in certain shareholders being better-off than others. See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 153. The main criteria in such cases is whether majority shareholders are acting bona fide for the benefit of the company as a whole or abusing their voting rights in order to profit at the expense of the minority. See: CADMAN, J. *Shareholders' Agreements*, *4th ed.*, London: Sweet & Maxwell, 2004, p. 166.

[1052] Queen's Bench Division Decision dated September 18, 1981, *Estmanco (Kilner House) Ltd v Greater London Council. The Weekly Law Reports,* 1982, p. 2-16.

[1053] Minority shareholders cannot be discriminated in such a way as to give majority shareholders an unfair advantage in management of the company. See: BOURNE, N. *Bourne on Company Law. 5th edition*. New York: Routledge, 2011, p. 107.

[1054] Chancery division. Decision dated November 8, 1950. *Greenhalgh v. Arderne Cinemas. Chancery Law Reports*, 1951, p. 291.

[1055] Chancery division. Decision dated November 8, 1950. *Greenhalgh v. Arderne Cinemas. Chancery Law Reports*, 1951, p. 291. BOURNE, N. *Bourne on Company Law. 5th edition*. New York: Routledge, 2011, p. 107.

shareholders[1056]. Therefore, acting for the company as a whole cannot be interpreted as being beneficial for the majority shareholder only – it must not infringe the interests of the shareholders as a general body (including minority)[1057].

Nonetheless, the above approach does not mean that shareholders are prohibited from exercising their voting rights as they see it fit. They are allowed to vote in such manner as to disregard the objections or interest of other shareholders. For example, they can nominate and elect members of the management body whose views best reflect the views of the controlling shareholder[1058]. In addition, shareholders may act and vote in a way which promotes the interests of shareholders as a class, but might negatively affect interests of individual shareholders (or might enhance the position of certain shareholders even more)[1059]. The above analysed court decisions suggest that there should be a balance between the freedom to exercise the right to vote and the unfair treatment of the interests of the company and minority shareholders (when such interests are undermined for the benefit of controlling shareholders).

1056 This approach is strengthened by the fact that the CA 2006 does not mention company as a whole terminology and instead uses 'for the benefit of members as a whole'. For example, article 172 of the CA 2006 stipulates that 'director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'.

1057 DAVIES, P. L.; WORTHINGTON, S. *Gower and Davies' Principles of Modern Company Law. 9th edition*. London: Sweet & Maxwell, 2012, p. 698-700. However, it is argued that this test is not particularly useful when there is a conflict of interest between two groups of shareholders.

1058 Chancery division. Decision dated July 21, 1887. *North West Transportation Co LTD v. Beatty. Chancery Law Reports*, 1887, p. 589-601.

1059 High Court of Australia. Decision dated February 17, 1938. *Mills v. Mills. Commonwealth Law Reports*, 1938, Vol. 60, p. 150-188. In this case a resolution was passed which increased the voting power of the managing director (who was one of the majority shareholders) by providing the company's dividend distribution to be by way of bonus shares to ordinary shareholders. The decision was challenged on various grounds including on the basis that it was not in the best interests of the company. Judge Latham C.J. stated that 'question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair as between different classes of shareholders. Where such a case arises some other test than that of the 'interests of the company' must be applied'. This again confirms the conclusion that interests of shareholders should be balanced between each group of shareholders (be it ordinary and preference shareholders or majority and minority shareholders). See also HOLLINGTON, R. *Shareholders' rights. 6th edition*. London: Sweet & Maxwell, 2010, p. 62-63. He analyses the same point from the perspective of directors of the company.

From a comparative point of view, the Belgian W.Venn. has a similar rule that shareholders' agreements have to be in the interests of the company (which in practice has been interpreted as not to be contrary to the interests of the company). As it was argued above, the case law in the UK has formulated almost the same limitation to the subject matter of the voting agreement and all the agreements whereby shareholders agree to vote in a manner that is against the interests of the company or minority shareholders are deemed to be unenforceable. The CA 2006 has transposed these decisions into a statutory right for the shareholders of the company to apply to court if they think that they are treated unfairly[1060]. A different situation exists in Lithuania, where there are no statutory provisions or authoritative case law that voting agreements should always be concluded for the interests of the company (or not to violate the interests of minority shareholders). Thus, the approach in each of the analysed jurisdictions is different.

Furthermore, contrary to Lithuania and Belgium, the UK law does not provide any statutory or court formulated restrictions regarding the exercise of voting rights (for example, according to the instructions of the bodies of the company or for all the proposals of the management). The absence of these restrictions could be explained by the fact that as the CA 2006 does not provide for a clear distribution of powers among the management body and the general meeting of the shareholders[1061]. It is also argued that shareholders at any time have the right to instruct the directors to act or refrain from acting, and thus

[1060] Article 994(1) of the CA 2006 states that '[a] member of a company may apply to the court by petition for an order on the ground (a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial'. See: DAVIES, P. L.; WORTHINGTON, S. *Gower and Davies' Principles of Modern Company Law. 9th edition*. London: Sweet & Maxwell, 2012, p. 719-734.

[1061] Except for some cases where it is expressly provided that certain resolutions can only be adopted by special resolutions of shareholders. For example, articles of association of the company can only be amended by a special resolution (article 20(1) of the CA 2006).

they retain their powers as residual claim holders[1062]. From these arguments it could be argued that in the UK there is no need for restrictions on the subject matter of the voting agreements related to the instructions stemming from the management body, as shareholders decide on the distribution of powers in the company (distribution of power is not provided in the statutory provisions).

4.1.3. Company as a party to the agreement

The empirical research carried out during the course of this dissertation has shown that the UK companies are entering into a type of shareholders' agreement called the relationship agreement whereby majority shareholder provides certain undertakings towards the company to act or to refrain from acting in a certain way (the obligations of the majority shareholder are most of the time related to the exercise of his voting rights, for example, the appointment of members of the management body). However, a relatively high number of relationship agreements raises the question whether a company can be a party to such agreements and voting agreements in general[1063]. There is no single answer that would suit all the possible situations, but analysis of the most relevant UK case law reveals certain limitations for the company to bind itself with the use of shareholders' agreement.

In the famous case *Russell v. Northern Bank Development Corporation Limited*[1064] their Lordships stated that a company cannot validly contract out of its power to alter articles of association or to increase share capital[1065]. Under the factual situation of this case company and its shareholders entered into a

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[1062] CAHN, A.; DONALD, D. C. *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA*. Cambridge: Cambridge University Press, 2010, p. 303-304.

[1063] This doubt is strengthened even more due to the position of the House of Lords that shareholders' 'contracts, whether made by all or some only of the shareholders, would create personal obligations or an *exceptio personalis* against themselves only'. See: House of Lords. Decision dated April 8, 1897. *Welton v. Saffery*. *Law Reports, Appeal Cases*, p. 331.

[1064] House of Lords. Decision dated April 8, 1992. *Russell v. Northern Bank Development Corporation LTD*. The Weekly Law Reports, 1992, p. 588-595.

[1065] Article 617 of the CA 2006.

voting agreement and agreed not to change articles of association of the company or to increase its share capital without the written approval of all the contracting parties. The House of Lords stated that shareholders are free to vote as they please and can also exercise their voting rights using contractual means[1066]. However, this rule is only true in case of shareholders as owners of the shares of the company. When company is made a party to the agreement, it cannot deprive itself of powers that are conferred to it by the legislation. If the company would be allowed to be a party of such an agreement, it would mean that all the future shareholders of the company (or even the present shareholders that are not parties to the agreement) would also be bound by the contract, and such situation is not acceptable from the perspective of the UK law[1067].

From the *Russell v. Northern Bank* case it can be concluded that while shareholders are free to enter into voting agreements and to agree upon the exercise of their votes (and their undertakings towards each other are perfectly valid), the company cannot validly bind itself and override its statutory power solely by contractual means[1068]. In other words, as long as shareholders agree on how they will exercise their voting rights in the general meeting of shareholders, the agreement is a valid and binding contract. However, if the company is made part of such an arrangement, the contractual relationships between the parties go beyond the voting agreement and enter the area that

[1066] FERRAN, E. The Decision of the House of Lords in Russell v. Northern Bank Development Corporation Limited. *Cambridge Law Journal*, 1994, Vol. 53, No. 2, p. 344-347.

[1067] The court stated that 'a formal agreement not to exercise its statutory powers for a period which could, certainly on one view of construction, last for as long as any one of the parties to the agreement remained a shareholder and long after the control' of the company has passed to other shareholders. House of Lords. Decision dated April 8, 1992. *Russell v. Northern Bank Development Corporation LTD*. The Weekly Law Reports, 1992, p. 594.

[1068] In the words of the House of Lords, 'while a provision in a company's articles which restricts its statutory power to alter those articles is invalid an agreement dehors the articles between shareholders as to how they shall exercise their voting rights on a resolution to alter the articles is not necessarily so'. House of Lords. Decision dated April 8, 1992. *Russell v. Northern Bank Development Corporation LTD*. The Weekly Law Reports, 1992, p. 593.

might be regulated by the statutory provisions of the Companies Act[1069]. If this happens, shareholders' agreement (or part of it) that limits statutory powers of the company is not enforceable and not binding upon the parties[1070]. Thus, from the case law provided above it could be stated that voting agreements among shareholders are completely valid contractual arrangements. The company is also allowed to be a party to the shareholders' agreement and it does not make the agreement invalid *per se*. However, voting agreements with the company as a party should clearly state that provisions that might be considered as limiting statutory powers of the company are not binding to the company, but are valid only amongst the contracting shareholders.

The relationship agreements in this context serve a slightly different purpose. Although they sometimes include provisions related to the exercise of the voting rights, such agreements are intended to protect the interests of the company (and of minority shareholders) from possible misconduct and fraudulent behaviour by the majority shareholder. The company in these contracts usually acts as a party that has a right to require from the majority shareholder to act or to refrain from acting in certain way and not as a party

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1069 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 56.

1070 Some authors have argued that this decision is very formal as statutory powers of the company are exercised through the general meeting of the shareholders. Therefore, there is hardly any distinction as between the statutory powers of the company and the exercise of voting rights of the shareholders. Furthermore, it has been argued that shareholders should be allowed to sanction a fetter on the statutory powers of the company. See: FERRAN, E. The Decision of the House of Lords in Russell v. Northern Bank Development Corporation Limited. *Cambridge Law Journal*, 1994, Vol. 53, No. 2, p. 347, 365-366. The author does not agree with this position and believes that there is a clear distinction between the statutory powers of the company and the exercise of voting rights. Statutory powers of the company (even when they are exercised through the general meeting of shareholders) embody substantive rights of the shareholders that cannot be contracted out as they are provided by the law. Shareholders should always have them, unless the laws are changed. However, shareholders are left with a choice as to the exercise of such rights. Due to this reason, in the author's opinion, the court in *Russell v. Northern Bank* case ruled that company cannot contract out of its statutory powers but shareholders can agree among themselves how they are going to exercise their voting rights in the general meetings of shareholders. Furthermore, if it would be allowed for the company to contract out of its statutory powers (even with the sanctioning from the shareholders) it would create very confusing and uncertain situations. For example, questions would arise whether company that has contracted out of its statutory power with one creditor can still use such power against other creditors or stakeholders (as contract is binding only amongst the parties). Such a situation would allow different statutory powers of the company depending on the person that it contracts with (it would even be possible to argue for different articles of association for different creditors). In the author's view such situation would absurd and unacceptable from the perspective of company law.

that is required to limit its statutory powers in any way. Due to the purpose of the relationship agreement it is hardly possible that it might limit statutory powers of the company. However, if this happens, in light of the case law cited above, it should be considered that such provisions are unenforceable.

Overall, there is no general prohibition (statutory or made by courts) that would prohibit company from entering into shareholders' agreement as a party, unless the company undertakes to fetter its statutory powers[1071].

4.1.4. Enforcement of voting agreements

There are no disagreements among the UK scholars regarding the enforceability (by specific performance) of the voting agreements[1072]. English courts have also shown this by adopting decisions and ordering injunctive reliefs either not to vote in breach of the provisions of the voting agreement[1073] or, on the contrary, to vote according to the rules on the exercise of voting rights stipulated in the agreement[1074]. However, the voting agreements can be enforced only by the courts and company cannot require contracting shareholders to vote in accordance with the contract (even if it is against the interests of the company), and is bound to accept even the votes that were made in contravention to the voting agreement[1075]. This could be explained by the fact that contractual relationships exist only among the shareholders[1076] and

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1071 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 68-69.

1072 CADMAN, J. *Shareholders' Agreements. 4th edition*. London: Sweet & Maxwell, 2004, p. 8; FITZGERALD, S.; MUTH, G. *Shareholders' Agreements. 6th edition*. London: Sweet & Maxwell, 2012, p. 6; THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 196-198.

1073 Chancery division. Decision dated March 22, 1974, *Northern counties securities LTD v. Jackson & Steeple LTD*. The Weekly Law Reports, 1974, p. 1133-1148.

1074 Chancery division. Decision dated December 17, 1915, *Puddephatt v. Leith. Chancery Law Reports*, 1916, p. 530-536. SEALY, L.; WORTHINGTON, S. *Cases and Materials in Company Law. 8th edition*. Oxford: Oxford University Press, 2008, p. 202.

1075 CADMAN, J. *Shareholders' Agreements, 4th ed.*, London: Sweet & Maxwell, 2004, p. 28.

1076 THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 37-38.

remedies for breach of the contract lie only between the parties to the agreement.

Breach of the voting agreements might also entitle shareholders to claim damages from other contracting shareholders who violated certain provisions of the agreement. However, the author believes that in these cases it would be difficult to prove the amount of damages (or loss) caused by the breach of the voting agreement[1077]. The function of damages is to put the innocent party to the agreement into a situation which would have been if there had been no breach of contract.

4.1.5. Closing remarks

Conclusion at this point would be that English legislature has decided not to include any provisions regarding the voting agreements and restrictions on their subject matter in the lengthy CA 2006. Therefore, shareholders (this also includes shareholders of listed companies) are left to regulate their interests and exercise of voting rights during the general meetings of shareholders as they see it fit. However, the control of such broad freedom to contract is left to the UK courts that have formulated some of the restrictions on the voting agreements that are also known to be incorporated into statutory laws of other countries[1078]. The most important one is that voting agreements whereby shareholders agree to vote against the interests of the company or of minority shareholders are considered to be unenforceable in the UK courts.

[1077] Other authors have expressed similar views. THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 194.

[1078] For example, Belgium and Lithuania. Some mixed legal systems also have certain restrictions as to the subject matter of shareholders' agreements. See: article 15(7) of the Companies Act of the Republic of South Africa.

4.2. Securities lending agreement[1079]

4.2.1. General comments

The transfer of voting rights (or the separation of the voting rights from the ownership rights) is not regulated in the UK (although there are some recommendations[1080]). However, this does not mean that shareholders are unable to decouple the voting rights from the ownership rights of the shares. Thus, the situation is similar to the one in Belgium and the above purpose is achieved by the securities lending agreement. In the UK it is legally impossible to transfer voting rights without transferring the ownership of the shares in a way that is possible in Lithuania. The reason for this is that a person must be entered on the relevant register of securities of the company in order to have the right to attend or vote at the meeting (this has to be done not more than 48 hours before the general meeting of shareholders)[1081]. This means that a person who wants to exercise the voting rights must be in the register of the company as a shareholder. Due to these reasons voting rights have to be transferred together with the shares, and thus the securities lending agreements are used in order to achieve the same legal effects as with the transfer of voting rights agreement.

4.2.2. Qualification of the agreement

From a functional approach, it should be noted that although the name of the contractual tool is identical as in Belgium (securities lending agreement) in its essence another legal instrument is used. The word 'lending' from the UK

[1079] The author would like to note that the securities lending agreement in this part is analysed from a functional approach compared with the transfer of voting rights agreement as it is stipulated in the Lithuanian CC. Securities lending as an investment vehicle is not analysed in this dissertation.

[1080] Securities Lending and Repo Committee. *Securities Borrowing and Lending Code of Guidance*, 2009 [interactive]. [Accessed on 2012-01-28] Available online at: <http://www.bankofengland.co.uk/markets/gilts/stockborrowing.pdf>.

[1081] Article 113 of the CA 2006. See also: Her Majesty's Treasury. Uncertificated Securities Regulations 2001, No 3755. In comparison see article 21(1) of the Lithuanian ABI where it is expressly stated that person who has entered into the transfer of voting rights agreement (and acquired the voting rights) has the right to attend and vote in the general meeting of shareholders.

perspective is confusing and does not reflect the actual legal relations that are formed between the 'borrower' and the 'lender' of the shares. In fact, under the securities lending agreement an absolute transfer of title (sale) against an undertaking to return equivalent number and kind of securities occurs[1082]. Thus, the transaction consists of two separate sales. The first sale takes place when the 'borrower' buys the shares from the 'lender' with an agreement to replace the securities in due course on a specified future date and a subsequent sale happens when these shares are returned to the 'lender'[1083]. This means that the name 'securities lending' does not describe what actually happens during the transactions and is somewhat misleading[1084]. In practice two separate sales of shares take place and there are no legal lender-borrower relations between the parties.

The primary function of the securities lending in the UK is to enable investors to short-sell the shares of the company in order to make profit from the fluctuation of prices of the shares in the market. It is for this reason that the Securities Lending and Repo Committee maintains a position that 'securities should not be borrowed solely for the purpose of exercising the voting rights at, for example, an AGM or EGM'[1085]. The Committee insists that the corporate governance responsibilities should be considered before lending shares over a period when general meetings are expected to be held. As it was mentioned above, this dissertation does not deal with the securities lending agreements as investment instruments but analysis their functionality to

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1082 FAULKNER, M. C. *An Introduction to Securities Lending. 4th edition*, 2007 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.eseclending.com/pdfs/Data_Explorer_Intro_to_Sec_Lending.pdf>, p. 15.

1083 MANTYSAARI, P. *The Law of Corporate Finance: General Principles and EU Law. Volume II: Contracts in General*. Berlin: Springer, 2010, p. 346-347.

1084 Shareholder Voting Working Group. *Review of the impediments to voting UK shares*, 2004 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.bba.org.uk/download/4439>, p. 20.

1085 Securities Lending and Repo Committee. *Securities Borrowing and Lending Code of Guidance*, 2009 [interactive]. [Accessed on 2012-01-28] Available online at: <http://www.bankofengland.co.uk/markets/gilts/stockborrowing.pdf>, article 7.4.

transfer voting rights without transferring the economic interest in the company.

Nonetheless, the securities lending agreements are used for the record date capture purposes. In the date capture cases the borrower (who usually does not have any direct economic interest in the company or the interest is very small) contracts with the lender to buy the shares just before the expected date of the meeting of the shareholders and simultaneously undertakes to sell them back to the lender immediately afterwards[1086]. In this way the voting rights are transferred to the borrower without transferring ownership rights of the shares in the long term (though from formal legal perspective the ownership of the shares is 'transferred' two consecutive times). In this way the securities lending agreements in the UK create controversial situations as the borrower has the unrestricted power to use transferred voting rights as he sees it fit (usually solely for his private interests).

Empirical studies have shown that 4% of the shares in the UK are on loan when they convey votes[1087]. This means that lending of securities in order to acquire voting rights is an actual phenomenon in the UK. Furthermore, a study on the decoupling of the voting rights from the economic interests in the company has shown that there are many situations when interested persons buy votes (using securities lending agreements or other financial derivatives)[1088]. It has been concluded by Hu and Black in the mentioned study that vote buying (including securities lending) poses a threat and should be addressed on the legislative level. At this moment, however, there are no statutory acts or case

[1086] MANTYSAARI, P. *The Law of Corporate Finance: General Principles and EU Law, Volume III: Funding, Exit, Takeovers*. Berlin: Springer, 2010, p. 555.

[1087] CHRISTOFERSEN, S. E. K., *et al. Vote Trading and Information Aggregation*, 2006 [interactive]. [Accessed on 2011-02-24] Available online at: <http://ssrn.com/abstract=686026>, p. 35.

[1088] HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811-908.

law that would expressly invalidate the use of securities lending agreement only for the purposes of acquiring voting rights[1089].

The differences and similarities between securities lending agreement in the UK and transfer of voting rights agreement in Lithuania are similar to the ones explained in Part II Chapter 3.2.3. of this dissertation.

4.2.3. Closing remarks

The securities lending agreement allows separating control rights from the economic interests in the company. However, the use of the securities lending agreement for the sole purpose of acquiring voting rights in the UK is controversial and has attracted attention from both the legal scholars and from the authorities. An example of the British Land Company plc. is often given in order to illustrate the situation which arises when shares are lent for the purposes of exercising voting rights attached to them. One of the shareholders of British Land Company plc., Laxey Partners, owned a one per cent stake in the company. In order to remove the chairman of the company Laxey Partners raised its voting rights up to nine per cent by borrowing more than 40 million shares before the record date and securing the right to attend and vote at the next general meeting of shareholders[1090]. Thus, a situation occurred when a shareholder holding only one per cent of economic interest in the company was able to exercise around nine per cent of total voting rights at the general meeting of shareholders. Due to the fact that the securities lending agreements in the UK concluded for the single purpose of gaining voting rights without increased economic interest in the company are undermining the principle of proportionality between the economic interest in the company and respective control rights, they should be evaluated carefully and in a reserved manner. In this respect the author agrees with the opinion provided by the Shareholder

[1089] LAN, L. L.; HERACLEOUS, L. Negotiating the Minefields of Corporate Vote-Buying. *Corporate Governance: An International Review*, 2007, Vol. 15, No. 5, p. 971-972.

[1090] SCANNELL, K. How Borrowed Shares Swing Company Votes. In *The Wall Street Journal*, January 26, 2007.

Voting Working Group that 'a balance needs to be struck between the importance of voting and the benefits derived from stocklending'[1091].

One of the ways to achieve such balance, in the author's view, is to allow voting of lent shares but only in accordance with the instructions of the lender. In other words, securities lending agreements should contain additional provisions as to the exercise of the voting rights attached to the transferred shares. This position is line with both the scholars who argue against the vote buying[1092] and with the ones that take the position that votes should be allowed to be separated from the shares[1093]. Essentially, the instructions given by the lender would ensure that the securities lending agreement is not abused in the general meetings of the company (by exercise of the acquired voting rights) and at the same time it would not hinder the functionality of the said agreement as an investment instrument. However, similar restrictions as to the subject matter of the voting agreement should be applicable (the instructions should not be against the interests of the company).

4.3. Relationship agreement

Another type of shareholders' agreement that can be found among the UK listed companies is the relationship agreement. From the three jurisdictions analysed only the companies listed on the London Stock Exchange have used relationship agreements. In most of the cases relationship agreements are concluded between the company itself and the majority shareholder. This agreement is a reassurance for the market and for the minority shareholders

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[1091] Shareholder Voting Working Group. *Review of the impediments to voting UK shares*, 2004 [interactive]. [Accessed on 2012-10-18] Available online at: <http://www.bba.org.uk/download/4439>, p. 20.

[1092] Easterbrook and Fischel argue that '[a]ttaching the vote firmly to the residual equity interest ensures that an unnecessary agency cost will not come into being. Separation of shares from votes introduces a disproportion between expenditure and reward'. See: EASTERBROOK, F. H.; FISCHEL, D. R., Voting in Corporate Law, *Journal of Law and Economics*, 1983, Vol. 26, No. 2, p. 410-411.

[1093] MARTIN, S.; PARTNOY, F. Encumbered Shares. *University of Illinois Law Review*, 2005, No. 2005:3, p. 813; LAN, L. L.; HERACLEOUS, L. Negotiating the Minefields of Corporate Vote-Buying. *Corporate Governance: An International Review*, 2007, Vol. 15, No. 5, p. 969-978.

that the majority shareholder will not expropriate them and will not try to extract private benefits of control from the company at the expense of other corporate constituents and the company itself. The author presumes that the initiative to enter into this kind of agreement rests with the majority shareholder who takes certain obligations before the company, for example, that all trade, dealings and other commercial activities between the majority shareholder and the company will be carried in good faith and according to all the best practices dominating in the market. Relationship agreements are usually entered after the initial IPO of the company as a reassurance to the markets and all future shareholders that company is being managed without the unacceptable influence of the majority shareholder.

African Barrick Gold plc. offers a good example of the relationship agreement[1094]. During the IPO in 2010 the company and its majority shareholder Barrick Gold Corporation (that owns 73.9 per cent of the shares) have entered into the relationship agreement. Under this agreement the majority shareholder provides support to the company. The main purpose of the agreement is to ensure that the company is capable of carrying on its business independently of the majority shareholder and that transactions and relationships with the majority shareholder and all of its subsidiaries are conducted at an arm's length principle and on normal commercial terms. The agreement also contains a commitment by the Barrick Gold Corporation that it will ensure that the company is managed according to the UK Corporate Governance Code. Furthermore, the majority shareholder undertook not to exercise his voting rights or powers that might cause a breach of eligibility criteria for listing on the Main Market. Thus, the majority shareholder undertook to comply with the listing rules of the London Stock Exchange. In addition, the majority shareholder agreed not to compete with the company as long as it holds at least 30 % of the share capital or voting rights in the

[1094] African Barrick Gold plc. *Annual report and accounts 2010* [interactive]. [Accessed on 2011-06-25] Available online at: <http://www.fineclient.com/download/files_10028/ABG_Annual_Report.pdf>.

company. The agreement is valid as long as the company is listed on the stock exchange and Barrick Gold Corporation controls more than 15 % of the issued share capital. Similar agreements exist in other companies listed on the London Stock Exchange[1095].

The relationship agreement is a powerful voluntary tool which ensures that the interests of the company and minority shareholders will not be expropriated by the majority shareholder. From the example above it is clearly seen that the majority shareholder not only agreed to deal with the company only in accordance with the arm's length principle, but also decided to limit its voting rights for the benefit of the company and shareholders as a whole. This type of shareholders' agreement is a clear example of how legal contractual tools might be used for the mitigation of corporate conflicts of interest between majority and minority shareholders.

From a comparative perspective it is interesting to note that relationship agreements were found only in the UK. There were no Belgian or Lithuanian listed companies that would be parties to any similar agreements. Taking into account the fact that ownership structures in the continental Europe are largely concentrated and in the UK – dispersed, these findings are hard to explain. All the relationship agreements concluded in the UK listed companies analysed in this dissertation included a majority shareholder who had significant influence on the control of the company. Nonetheless, the controlling shareholder entered into contractual relationships with the company and bound itself to act in certain way that is more beneficial to the company and other shareholders. On the other side of the English Channel, however, companies with concentrated ownerships structure (with large controlling shareholders) were not using any contractual tools to assure financial markets and minority shareholders that they are not going to exercise their powers as controlling

[1095] Hansen Transmissions International NV. Annual report 2011 [interactive]. [Accessed on 2011-06-25] Available online at: <http://www.zf.com/media/media/document/corporate_2/company_4/corporate_news_1/offer/otherdocuments/0_Hansen_Annual_Report_FY_2011.pdf>. This company has been delisted after it was acquired by ZF Friedrichshafen AG on October 6, 2011.

shareholders in order to extract private benefits of control. One of the explanations for this phenomenon could be that companies that have concentrated ownership structure in the UK are trying to compete for available limited resources of investors and shareholders with listed companies with widely dispersed ownership structure. In order to reassure possible minority shareholders that there interests will be taken into account in management of the company, such agreements are entered into with the company. This also provides certain signals to the securities markets that company is intended to be managed according to the best corporate governance practices and should be considered as a good investment.

However, the question remains why there are no similar agreements in the continental Europe. Possible explanation could be that as there are very few listed companies with dispersed ownership structures, companies do not have to provide any reassurances to the market and minority shareholders as there are very few competitors with large number of dispersed shareholders. The reason for such divergence in the use of relationship agreements could also be explained by simple lack of information and knowledge on the use of contractual tools in order to provide for a higher stability in the management of the company. Nonetheless, the most likely reason is that controlling shareholders are unwilling to restrict themselves with additional undertakings to the company that would limit their freedom to exercise control over the company as they see it fit. Unless there is a strong pressure from the market or from minority shareholders, the author is of an opinion that relationship agreements are highly unlikely to be entered upon in the companies listed on the stock exchanges in the continental Europe.

4.4. Some other aspects of shareholders' agreements in the UK

In addition to the above provided legal rules that apply to the shareholders' agreements, some additional aspects that the author believes are worth mentioning will be provided below.

It is noteworthy that the UK is a common law country and certain elements regarding the validity of contract are necessary which would otherwise not be required in the continental Europe. For example, gratuitous promises are unenforceable under the English law and parties have to show that at the moment of the contract there was consideration which is considered to be a reason for enforcement of the contract[1096]. In addition, it is necessary to prove intentions of the contracting shareholders to create legal relations (which are usually presumed in agreements of commercial nature)[1097]. Therefore, in all cases where there is a shareholders' agreement amongst the shareholders of listed companies such agreement must be entered for respective consideration and shareholders should expressly provide their intentions to be bound by the provisions of the contract. If these requirements are not met, shareholders' agreement might be considered as unenforceable by the UK courts.

Another aspect of shareholders' agreements in the UK that is worth mentioning is related to the so called Duomatic principle[1098]. As it was argued above, the shareholders' agreement can be entered into both in written and in oral form. Using contractual means shareholders stipulate rules and regulations that govern the relations amongst them. It could be considered that these provisions are established only for the interests and benefit of the contracting shareholders. Due to this reason the question arises what happens if all the contracting shareholders decide to act in a way that is inconsistent with the formal procedure established in their agreement. For example, shareholders' agreement provides for a pre-meeting consultation amongst the contracting shareholders on how to exercise their voting rights in the general meeting of the shareholders. If all the contracting shareholders agreed not to consult in the pre-meeting, but in the next general meeting to vote in the same manner as one

[1096] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 32-34.

[1097] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 35-36.

[1098] The name of this principle is derived from the case which formulated it. See: Chancery division. Decision dated November 12, 1968. *Re Duomatic Ltd. Chancery Law Reports*, 1969, p. 365-377.

of them, could this be considered as a breach of shareholders' agreement, and whether shareholders would be entitled not to vote accordingly, because formal procedures stipulated in the contract have not been held?

Originally the Duomatic principle was adopted in context of the resolutions passed by the shareholders[1099]. The principle entails that formal requirements cannot be considered more important than the substance on which the shareholders agree[1100]. Thus, even if certain formal requirements are not followed, resolution of the shareholders cannot be invalidated if all the shareholders holding voting rights agree to it[1101]. The resolution of the shareholders in this case is considered as binding as if it was passed in the general meeting of the shareholders[1102]. By relatively recent case law this principle has also been extended to the contractual relationships. In *Monecor (London) Limited v. Euro Brokers Holdings Limited* case Lord Mummery stated that the Duomatic principle 'is a sound and sensible principle of company law allowing the members of the company to reach an agreement without the need for strict compliance with formal procedures, where they exist only for the benefit of those who have agreed not comply with them. What matters is the unanimous assent of those who ultimately exercise power over the affairs of the company through their right to attend and vote at a general meeting. It does not matter whether the formal procedures in question are stipulated for in the Articles of Association, in the Companies Acts or in a

[1099] THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 66.

[1100] From comparative perspective it is interesting to note that Lithuanian Supreme Court has argued that 'the expression and materialisation of the will of the body of the legal entity is determined not by the form and quantity of the documents, but by the subject matter and competence of the said organ which is stipulated in the articles of association of the company'. SCL civil case No. Nr. 3K-3-350/2010, 2010 July 30, *UAB „SEVEN entertainment" v. Klaipėdos miesto savivaldybės administracija*.

[1101] Chancery division. Decision dated November 12, 1968. *Re Duomatic Ltd. Chancery Law Reports*, 1969, p. 373. Lord Buckley in this case stated that 'where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be'.

[1102] MANTYSAARI, P. *Comparative Corporate Governance. Shareholders as a rule maker*. Berlin: Springer, 2005, p. 90.

separate contract between the members of the company concerned. What matters is that all the members have reached an agreement'[1103].

The above case law suggests that the Duomatic principle could be applied not only to the resolutions of the general meeting of shareholders, but also to shareholders' agreements. One point might be that shareholders' agreements in themselves could be considered as resolutions. However, this is highly unlikely in listed companies as case law suggests (that all shareholders that have voting rights in the company) have to be parties to such agreement. The other more likely consequence arising from the Duomatic principle might be that shareholders cannot dispute that formal procedure established in the shareholders' agreement has not been followed, and thus all the passed votes should be rendered illegal. The Duomatic principle in this case would suggest that if all the contracting shareholders have deviated from the provisions of the shareholders' agreement and such unanimous consent can be proven, their votes should not be rendered invalid only due to formal reasons.

The above principle provided by the UK case law is pragmatic in a way that it puts substance over form and formal requirements. The main idea behind the Duomatic principle is that unanimous consent of the contracting shareholders is put above the formal requirements stipulated in the agreement. Thus, infringement of formal requirements cannot be basis for a dispute amongst the shareholders if they have unanimously agreed on the substance of the issue. The Duomatic principle could be applied in context of shareholders' agreements in a way that it would prevent shareholders from challenging resolutions of the general meeting of shareholders adopted in breach of the formal provisions of shareholders' agreement (for example, requiring written form of consent or pre-meeting consultations), unless not all of the contracting shareholders agree to adopt such decision.

[1103] England and Wales Court of Appeal. Decision dated February 23, 2003. *Monecor (London) Limited v. Euro Brokers Holdings Limited* No. A3/2002/1098.

4.5. Chapter conclusions

The UK is the only one from the analysed jurisdictions that does not have any special statutory provisions regarding the shareholders' agreements. These agreements are regulated by the general principle of freedom of contract and are considered to be valid and enforceable by the courts. In addition, there are no issues regarding the enforceability of obligations undertaken by the shareholders in the agreement. Courts are entitled to order injunctive reliefs and to prevent contracting parties from acting in breach to the shareholders' agreement or to require party in breach to act in accordance with the provisions of the agreement. Thus, specific performance of the shareholders' agreement is allowed in the UK.

The gap in the statutory provisions relating to the restrictions on the subject matter of shareholders' agreements is filled with case law. Although there is general consent that individual shareholders are allowed to exercise their voting rights as they see it fit (even though in certain cases it might be against the interests of the company), this rule does not apply for collective exercise of voting rights. Courts have in numerous cases stated that shareholders' agreements (including voting agreements) cannot have their purpose as to violate the interests of the minority shareholders (or deprive them from certain rights) or of the company.

Furthermore, special status of the company, while entering into shareholders' agreements, provides that it cannot contract out of its statutory powers. This is justified by the fact that future shareholders can only be bound by the articles of association or by their own personal contractual obligations. Nonetheless, shareholders can agree to vote in a way that would effectively limit statutory powers of the company. Such exercise of votes would be limited only to the contracting shareholders.

From functional approach securities lending agreements can be used in the UK in order to achieve similar legal effects as with the transfer of voting rights agreement in Lithuania. There are no mandatory rules regulating securities lending agreements that have a single purpose to transfer shares for record date capture purposes. The author believes that the requirement for the lender to stipulate rules and instructions for the borrower to exercise voting rights in a certain way (that is not to the detriment to the lender and the company) would effectively address the problem.

Lastly, companies listed on the London stock exchange have one divergent type of shareholders' agreements – the relationship agreement. The agreement is entered into between the company and the majority shareholder and is effectively designed to protect minority shareholders by obliging the majority shareholder to act in a way that is line with the best corporate governance practices.

PART III: EMPIRICAL ANALYSIS OF SHAREHOLDERS' AGREEMENTS

Chapter 1. Empirical data and methodology

1.1. Introductory comments

In order to assess the actual usage of shareholders' agreements in listed companies a detailed empirical survey has been carried out that included the companies listed on the NASDAQ OMX Vilnius stock exchange, the NYSE Euronext Brussels stock exchange and the London stock exchange. The main purpose of the analysis provided in this part of the dissertation is to explore whether shareholders' agreement (as a legal tool) is used in practice in listed companies in order to mitigate conflicts of interest between different corporate constituents. The results of the empirical analysis might refute observations by some of the company law scholars that shareholders' agreements are rarely entered into amongst the shareholders of listed companies, and to determine the parties, purposes and types of the shareholders' agreements that are actually concluded in practice. The arguments against the shareholders' agreements in listed companies usually include the following points[1104]. First, the number of shareholders in listed companies is often very high and it is presumed that contractual relationships with a large number of shareholders are impractical. Second, restrictions provided in the listing rules of stock exchanges[1105] require that there would be no limitations on the transferability of the shares admitted to trading on regulated markets. Thus, it is argued that

[1104] For example, CADMAN, J. *Shareholders' Agreements. 4th ed.* London: Sweet & Maxwell, 2004, p. 1; FITZGERALD, S.; MUTH, G. *Shareholders' Agreements. 6th edition*. London: Sweet & Maxwell, 2012, p. xxvi; THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 2; MEANS, B. A. Contractual Approach to Shareholder Oppression Law. *The Fordham Law Review*, 2010, Vol. 79, No. 3, p. 1161-1211; LACAVE, I. S.; GUTIERREZ, N. B. Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses. *European Business Organization Law Review*, 2010, Vol. 11, No. 3, p. 423-458; KULMS, R. A Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany. *European Business Organization Law Review*, 2001, No. 2, p. 685-701; MIKALONIENĖ, L. Uždarosios akcinės bendrovės akcininkų sutarties teisinė kvalifikacija. *Teisės problemos*, No. 71, p. 5-27.

[1105] This requirement stems from the Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (OL 2001 L 184/1-66). Especially article 46.

these restrictions reduce the attractiveness of shareholders' agreements. Third, shareholders of listed companies enjoy a higher standard of protection through mandatory (securities) laws, and thus they are not interested in expanding their rights by way of contractual tools (a very common argument is added that shareholders who do not like how the company is being run can always exit the company by selling their shares). All of these arguments are usually presented briefly and vaguely without any broader and deeper explanation as to why these reasons might affect the number of shareholders' agreements in listed companies and decision of the shareholders not to contract.

The author finds the above position to be unconvincing. Firstly, the argument that the number of shareholders makes it almost impossible to enter into shareholders' agreement is very artificial and might be considered only in cases where it would be presumed that shareholders' agreements are possible only amongst all shareholders. However, this is not the case under analysed jurisdictions and shareholders' agreement can be entered into between some of the shareholders of the company and not necessarily only by all of them (most shareholders' agreements are concluded amongst small group of shareholders). It should be agreed that contracting shareholders would most of the time want to concentrate their control over the company and highly dispersed ownership structure might cause significant obstacles (the more shareholders there are, the more parties to the shareholders' agreement there must be in order to obtain effective majority block). Nevertheless, this should be considered only as an additional hindrance that can be overcome and not as an argument that shareholders' agreements in listed companies are almost impossible to conclude. The data presented in this part shows that shareholders are willing to enter into shareholders' agreements even when the numbers of contracting parties are relatively high[1106]. It could also be noted that it is easier for

[1106] For example, some of the shareholders of a company listed on the NYSE Euronext Brussels stock exchange agreed to jointly exercise their voting rights in the general meeting of the shareholders. A total number of 28 shareholders with voting rights ranging from 0,03 % to 5% were parties to the agreement. See: Picanol Group NV. *2009-04-16 Press Release* [interactive]. [Accessed on 2011-04-22] shareholders that have close ties to each other (for example, family members) to enter into shareholders' agreements even when the number of contracting parties is relatively high.

Secondly, the argument on restrictions on the transferability of shares[1107] seems to be a little overextended in case of shareholders' agreements. From one point of view, not necessarily all shares of a given company are traded on the regulated market. There might be a block of shares (that is attained using shareholders' agreement) which is not traded on the market, and thus these shares are not subject to restrictions that are imposed on the publicly traded shares (although the company is nevertheless called as publicly traded one). In these cases the question of restrictions on the transferability of shares does not arise at all. On the other hand, the author does not dispute that Directive 2001/34/EC requires that securities which are traded on the regulated market should be freely negotiable. However, the important question is to whom this obligation applies. From the wording of the Directive 2001/34/EC[1108] and the listing rules of analysed jurisdictions[1109] it could be concluded that the requirement for the shares admitted to trading to be freely

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Available online at: <http://www.picanolgroup.com/NR/rdonlyres/A855A8F1-EAA2-43F9-ACB2-E08C1AE04B82/0/PR16042009Eng.pdf>.

[1107] Essentially, restrictions on the transferability of shares for public companies are usually allowed even in the articles of association. For example, article 510 of the Belgian W.Venn. stipulates that restrictions on the transferability of shares are possible if they are in the interests of the company and do not result in restrictions for longer periods than 6 months after the respective rights have been exercised. Also see: GEENS, K.; WYCKAERT, M. *Beginselen van Belgisch Privaatrecht IV. Verenigingen en Vennootschappen. Deel II: De Vennootschap. A. Algemeen Deel*. Mechelen: Wolters Kluwer Belgium, 2011, p. 54-56.

[1108] In particular article 5(b).

[1109] London Stock Exchange. Admission and Disclosure Standards June 6, 2011 [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/admission-and-disclosure-standards.pdf>, article 1.3; Financial Services Authority. Listing Rules [interactive]. [Accessed on 2012-12-11] Available online at: <http://media.fsahandbook.info/pdf/LR.pdf>, articles 2.1.1(R) and 2.2.4(R); AB NASDAQ OMX Vilnius. The Listing Rules of AB NASDAQ OMX Vilnius [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.nasdaqomxbaltic.com/files/vilnius/teisesaktai/2012/Listing%20Rules%20of%20NASDAQ%20OMX%20Vilnius%20(effective%20as%20of%2004.06.2012)_1.pdf>, articles 4 and 4.3; Euronext N.V. Euronext Rule Book – Book I: Harmonised Rules [interactive]. [Accessed on 2012-12-11] Available online at: <https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/harmonised_rulebook_en_26_october_2012.pdf>, rule No. 6605.

transferable (negotiable)[1110] is applied to the issuer (the publicly listed company), but not to the shareholders who acquire such shares. From this premise following deductions could be made.

Publicly listed companies are not allowed to limit the transferability of shares in any way, for example, by requiring approval of the management body[1111]. Such restrictions cannot be stipulated in the articles of association (or any other internal document) of the company either[1112]. This could be explained by the fact that articles of association are applicable to all of the shareholders (present and future) and are regarded as the constitution of a company. Therefore, the aim of the company, in this regard, is to issue and release into the market freely tradable shares but afterwards company loses control on how each particular shareholder decides to treat his shares (company cannot oblige – with certain exceptions – shareholders to transfer their shares if they are not willing to do so). Shareholders, on the other hand, are not subject to the listing requirements and do not have to comply with them. In other words, the transfer of shares becomes dependable on the will of the shareholder. Once they buy the shares they can freely decide whether they want to keep them, sell them or give them as a gift to their relatives (and

[1110] Admission and Disclosure Standards of the London Stock Exchange provide a definition of negotiable securities: 'transferable securities shall be considered freely negotiable if they can be traded between the parties to a transaction, and subsequently transferred without restriction, and if all securities within the same class as the security in question are fungible'. See: London Stock Exchange. Admission and Disclosure Standards June 6, 2011 [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/admission-and-disclosure-standards.pdf>, p. 6.

[1111] Although some companies have such restrictions in their articles of association. For example, Solvac NV. *Statuten* [interactive]. [Accessed on 2013-06-25] Available online at: <http://www.solvac.be/sites/default/files/statuts_nl-122012.doc>. Articles 7 and 8 stipulate that if shares are transferred to any legal entity, the transaction must be approved by an absolute majority of votes in the board of directors. In author's opinion this is not in line with the ENYSE Euronext requirements for the shares to be freely tradable. See: Euronext Rule Book – Book I: Harmonised Rules [interactive]. [Accessed on 2012-12-11] Available online at: <https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/harmonised_rulebook_en_26_october_2012.pdf>, rule No. 6605. There is a difference between fully tradable shares and free transferability. See: ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 11-12.

[1112] This could happen, for example, if the founding shareholders before the IPO of the company would change articles of association of the company and stipulate certain restrictions on the transferability of the shares, which would apply to all the shareholders of the company.

impose any conditions they want[1113]). The shareholders' agreement in this case should not be regarded as an exception. As it was argued above, by entering into the shareholders' agreement the shareholders express their will on how their rights in the company will be exercised. If they want to, the author is of an opinion, that they are allowed to limit their own rights related to the transferability of the shares. The most important point is that such restrictions should not be imposed upon them (by company or by the articles of association), but would arise from their own actions, will and undertaken obligations. This means that if shareholders enter into contractual relations and agree for any form of restriction on the transferability of shares (for example, on pre-emptive rights) their will should be respected as contract has binding power to them.

Another argument in favour of allowing shareholders to agree on the restrictions of transferability of shares in the shareholders' agreement is that such prohibition is relatively easy to contract around[1114]. Shareholders can established another company (this time private) and transfer all their shares to that company. These shareholders would control 100 % of the shares of the private company and could easily agree on restrictions of transferability of the shares of the private company, which in the end result would affect the transferability of the shares of the listed company[1115]. Still, this does not mean that by using contractual tools shareholders should be allowed to create situations that would amount to share transferability restrictions as if they were implemented in the articles of association (in other words, applying to all shareholders, even those who did not consent with the restrictions). The argument is that there are no provisions restricting shareholders to enter into

[1113] In extreme cases there might even be a testament left by the shareholder who obliges his heirs not to transfer the shares until they become adults. A testament in this case should also be regarded as a restriction on the transferability of shares as it limits the ownership rights of the heirs.

[1114] This line of though mainly applies to public but not private companies.

[1115] For an example on how it is actually done in practice see: AB InBev NV. *Annual Report 2010* [interactive]. [Accessed on 2011-06-19] Available online at: <http://www.ab-inbev.com/pdf/AB_InBev_AR10.pdf>.

privately negotiated contract (that has no legal consequences to other shareholders or their rights) and to limit their rights to transfer ownership of their shares (even if such shares are traded on the regulated market).

Thirdly, it is true that shareholders of publicly listed companies in most of the cases enjoy a greater level of protection[1116] and legislature tends to enact extensive provisions, which most of the time differ from the ones that are applied to the shareholders of privately held companies[1117]. Additional legal protection measures are always welcome. However, this does not necessarily mean that shareholders will become indifferent about how their rights should actually be exercised. Therefore, shareholders' agreements should be viewed not merely as contractual instruments that only grant certain rights to the contracting shareholders (such rights could be granted only against each other), but also as tools enabling shareholders to make use of their actual rights and to enable them to exercise such rights to a full extent. For example, voting agreements allow shareholders to concentrate their control over the company by pooling their voting rights together (after this they might be able to protect their position in the company in a more efficient way). This does not create any additional rights for the shareholders (though sometimes shareholders might reach a threshold which is required in order to be able to make use of certain rights), but allows them to make better use of the rights that they already have. In other words, shareholders' agreements should be also viewed as a tool that actually helps shareholders to utilise the rights that have been granted to them by the legislature. Thus, the number of rights and protection shareholders have (although they are very important) should not be treated as reasons why shareholders avoid shareholders' agreements. The author supposes that the correlation between the shareholder protection laws and the shareholders'

[1116] Additional measures to improve rights of shareholders of listed companies could also be seen from the perspective of the EU. For example, Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ 2007 L 184/17-24).

[1117] For example, under article 47 of the Lithuanian ABI shareholders of private companies enjoy a default pre-emptive right. It could be even argued that in this case they have more protection provided by the legislature.

agreement is equal the correlation between the shareholder empowerment (or rights granting measures) and tools facilitating the actual exercise of shareholders' rights.

The above position of the author is confirmed by the below presented empirical results on the availability of shareholders' agreements in listed companies in the selected jurisdictions.

1.2. Data and methodology

1.2.1. Data sample

The empirical research presented below has been carried out in the first half of the year 2011. During this period a total of 460 companies listed on the NASDAQ OMX Vilnius stock exchange, the NYSE Euronext Brussels stock exchange and the London stock exchange have been analysed. This included 121 companies from the NYSE Euronext Brussels (all of the listed companies that satisfied the criteria), 302 companies from the London stock exchange (all of them were constituents of the FTSE 350 index[1118]) and 37 companies from the NASDAQ OMX Vilnius stock exchange (all of the listed companies that satisfied the criteria).

Only companies that satisfied the criteria listed below were included in the sample:

1) primary listing of the company is at the NYSE Euronext Brussels, NASDAQ OMX Vilnius or London stock exchange;
2) company is incorporated in the same jurisdiction as the stock exchange.

[1118] The FTSE (Financial Times Stock Exchange) 350 index is based on the largest capitalisation companies in the UK markets and is comprised from FTSE 100 index (which comprises of the 100 most highly capitalised blue chip companies, representing approximately 81% of the UK market) and FTSE 250 index (which comprises mid-capitalised companies not covered by the FTSE 100, and represents approximately 15% of UK market capitalisation). See: FTSE International Limited. *FTSE UK Index Series* [interactive]. [Accessed on 2012-12-12] Available online at: <http://www.ftse.com/Indices/UK_Indices/index.jsp>.

These criteria were selected in order to better represent country specifics (if any). Thus, both criteria of primary listing and incorporation in the same jurisdiction where the analysed stock exchange is located are expected to provide more accurate results in each of the analysed jurisdictions. This means that companies that are incorporated outside of the jurisdiction in question or which have their primary listings on another stock exchange will not distort the empirical results presented in this dissertation.

1.2.2. Data sources

It should be emphasised at this point that all the data collected and presented in this dissertation is based on the annual and interim reports provided by the companies themselves[1119]. The following European legislation imposes duties for the listed companies to provide information that is related to shareholders' agreements.

On the European level the obligation to notify about the acquisition or disposal of voting rights (including shareholders' agreements regarding the exercise and/or transfer of voting rights) arises from articles 9-16 of the Directive 2004/109/EC[1120]. More detailed requirements are provided by the Commission Directive 2007/14/EC[1121] (articles 8 and 9 are the most relevant). Additionally, article 10 of the 2004/25/EC Directive[1122] stipulates the requirement to inform on any agreements between shareholders regarding the restrictions on transfer of securities, the restrictions on voting rights and special

[1119] List of all annual and interim reports that were reviewed are listed in the references section of this dissertation.

[1120] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[1121] Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

[1122] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

control rights conferred to the holders of shares. Each annex to this dissertation presenting detailed data on the shareholders' agreements available on each stock exchange begins with an introduction, where it is explained in detail how the European legal acts were transposed into national laws and what kind of disclosure requirements are applicable to listed companies.

In addition to the information provided in the annual and interim reports the author has analysed transparency notifications of each company that are available in each jurisdiction through the mechanism for the central storage of regulated information[1123]. In certain cases transparency notifications provided more detailed information on the purpose and provisions of shareholders' agreements. Moreover, information provided in various online information sources, newspapers and magazines has been also analysed in order to determine the context and possible provisions of the analysed agreements[1124].

Furthermore, if annual reports or other sources indicated that there is shareholders' agreement amongst the shareholders of the company, court cases (including arbitration cases) have been reviewed (if any) in order to determine the structure and content of such agreement. An example of this is AB "LIETUVOS DUJOS", company listed on the NASDAQ OMX Vilnius stock exchange. There was a dispute amongst the shareholders of the company and the arbitration award was made publicly available[1125]. This served as an extensive source to determine the rights and obligations stipulated in the shareholders' agreement.

[1123] Required by article 21(2) of the Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[1124] For example, Vakarų ekspresas. *R. Dunauskas "Gubernijos" į bankrotą nebestums* [interactive]. [Accessed on 2011-06-19] Available online at: <http://www.ve.lt/naujienos/ekonomika/ekonomikos-naujienos/r-dunauskas-gubernijos-i-bankrota-nebestums-/>.

[1125] Arbitration Institute of the Stockholm Chamber of Commerce. Final award made on July 31, 2012, Arbitration No.: V (125/2011). *OAO Gazprom v. Ministry of Energy of the Republic of Lithuania* [interactive]. [Accessed on 2012-11-07] Available online at: <http://arbitrations.ru/files/articles/uploaded/Gazprom_v_Lithuania_Final_Award_SCC.pdf>.

1.2.3. Accuracy of the data

The author tried to provide as accurate data on the shareholders' agreements as possible. However, the information provided by the companies in their annual and interim reports is not always accurate and can sometimes be misleading. It should be stressed that the author did not check or validate in any way whether disclosed information is correct[1126]. For example, ALT Investicijos, AB (this company was delisted from the NASDAQ OMX Vilnius stock exchange when the empirical research was being carried out in early 2011)[1127] disclosed in its interim report for the first six months of 2010 that there are no shareholders' agreements concluded amongst the shareholders of the company[1128]. However, in the same report it is indicated that four shareholders are acting in concert. The question at this point arises how these shareholders are related to each other and what are the grounds for the conclusion that they are acting in concert[1129]. Information relating to this issue was found neither in the documents prepared by the company, nor in the Nordic Exchange Central Storage Facility. When dealing with such cases it was presumed that there is no shareholders' agreement in place (even if it was indicated in the annual and interim reports that the shareholders are acting in concert), unless clearly

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[1126] This task is beyond the resources available to the author. Furthermore, the author relied that companies would disclose the information as it is required by legal acts in particular jurisdiction.

[1127] NASDAQ OMX Vilnius stock exchange. *Market information*, 2011, February [interactive]. [Accessed on 2012-09-26] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/alt/2010_q2_lt_ltl_solo_ias.pdf>http://www.nasdaqomxbaltic.com/market/?pg=bulletins&bb_id=169>.

[1128] ALT Investicijos, AB. *Tarpinių finansinių ataskaitų rinkinys ir tarpinis pranešimas už 6 mėnesių laikotarpį pasibaigusį 2010 m. birželio 30 d.* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/alt/2010_q2_lt_ltl_solo_ias.pdf>, p. 5.

[1129] In this particular situation the shareholders probably were acting in concert in the meaning of articles 24.10.2 and 2.12 of the Listing Rules of the NASDAQ OMX Vilnius stock exchange. See: AB NASDAQ OMX Vilnius. The Listing Rules of AB NASDAQ OMX Vilnius [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.nasdaqomxbaltic.com/files/vilnius/teisesaktai/2012/Listing%20Rules%20of%20NASDAQ%20OMX%20Vilnius%20(effective%20as%20of%2004.06.2012)_1.pdf>. For comparison articles 24 and 2(47) of the Lithuanian Law on Securities provide a list of situations when persons are considered to be acting in concert. The author is of an opinion that listed companies should provide a full disclosure and clearly indicate not only the fact that certain shareholders are acting in concert, but also the grounds on which they are considered to be doing so.

disclosed that shareholders' agreement is concluded by the shareholders of the company.

Due to the above reasons, when interpreting the results of the empirical study on the shareholders' agreements in listed companies it should be noted that the data was gathered from the information provided by the companies themselves[1130]. The author did not check the accuracy of the information and whether factual situation in the company is the same as it is reported in the annual report. This is impossible to check without access to inside documents of each listed company.

Therefore, the availability of shareholders' agreements during the research was determined only by expressly disclosed facts about contractual relationships amongst the shareholders either in annual report of the company, in the transparency notifications made to the supervising authority or available in other sources (for example, market news or articles in mass media). The disclosure of shareholders acting in concert was judged as not sufficient in order to determine contractual relationships between the parties. This is due to the fact that notion 'persons acting in concert' is broader in scope and includes not only shareholders who have concluded shareholders' agreements, but also shareholders who are tied by family relations, who are at the same time members of the management body or who control or are controlled by other shareholders[1131]. For example, shareholders of D'Ieteren NV, a company listed

[1130] For sources of data please see Annexes 1 through 3.

[1131] The definition of 'persons acting in concert' slightly differs in each jurisdiction. For Lithuania see: articles 24 and 2(47) of the Lithuanian Law on Securities. Lithuanian legislature has established a presumption that spouse of the shareholder is also acting in concert with the shareholder. Furthermore, the manager of the company is presumed to be acting in concert with other mangers of the company (if they are shareholders as well). For Belgium see: Wet op de openbaarmaking van belangrijke deelnemingen in emittenten waarvan aandelen zijn toegelaten tot de verhandeling op een gereglementeerde markt en houdende diverse bepalingen (Belgisch Staadsblad, 12 June 2007, No. 2007/03215), articles 3(13), 3(14), 6, 7 and 9. Belgian legislature has adopted purely contractual definition of 'persons acting in concert'. For the UK see: article 422 of the Financial Services and Markets Act 2000 (c8) and Financial Services and Markets Authority. FSA Handbook [interactive]. [Accessed on 2012-11-12] Available online at: http://media.fsahandbook.info/pdf/SUP/11/Annex6G.pdf>, Chapter 11, Annex6G. There is no definition of 'persons acting in concert' in the UK law on transparency obligations. However, FSA provides certain guidelines as to what shareholders are presumed to be acting in concert. On the EU level see: article 2 of Directive 2004/25/EC and article 10 of Directive 2004/109/EC.

on the NYSE Euronext Brussels stock exchange, are presumed to be acting in concert because some of the shareholders are also acting as members of the company, while some shareholders are controlled by other shareholders (certain shareholders are also related by family ties)[1132]. However, there are no indications that there is an agreement between the shareholders regarding the management of the company or related to their duties and rights arising out of the shares of the company. In this case it possible to determine the nature and grounds why certain shareholders are acting in concert. Thus, it was presumed for the purposes of this dissertation that shareholders' agreement has not been concluded amongst the shareholders of D'Ieteren NV. In other words, shareholders' agreement is considered to be concluded in the company when it is expressly indicated in the available information that shareholders are acting in concert on the basis of contractual relationships between them.

In order to avoid any data discrepancies and to be able to produce as accurate results as possible, the author has chosen to analyse all companies that are listed in each stock exchange of the analysed jurisdictions. Due to high number of listed companies on the London stock exchange only companies that are constituents of the FTSE 350 index were selected. Another reason is that these companies represent more than ninety per cent of the market capitalization in the UK.

1.2.4. Date of the shareholders' agreement

The date of the shareholders agreement is indicated as disclosed by the company in the annual report. If there is no date disclosed, the date of the notification to the supervisory authority is indicated as the date of the agreement[1133]. If the date could not be determined N/A sign is used.

[1132] D'Ieteren NV. *Annual Report 2010* [interactive]. [Accessed on 2011-06-22] Available online at: <http://www.dieteren.com/DIeteren%20Flash%20report%202009/AR_ENG/AR_ENG_2009.pdf>.

[1133] For example, Henex SA. *Rapport de Gestion 2010* [interactive]. [Accessed on 2011-06-22] Available online at: <http://www.henex.be/Pdf/Etats%20financiers%20IFRS%202010.pdf>.

1.2.5. Parties to the shareholders' agreement

Parties to the shareholders' agreements have been identified at the time of the conclusion of the agreement. The per cent of shares and voting rights that shareholders' had at that time is also represented in the data. It should be noted that after the research was concluded the shareholding structure of a particular company might have changed and such changes are not reflected in the data provided in this dissertation.

1.2.6. Floating shares

Shareholders' agreements included in the data sample have not been differentiated according to the floatation of shares. All shareholders' agreements provided in the data sample are entered between the shareholders of a listed company, despite the fact whether actual shares are floated or not.

1.2.7. Subject matter of the shareholders' agreement

Tables provided in the annexes of this dissertation also list subject matter of the agreements as it is essential in determining why shareholders have entered into contractual relationships. The author has provided all the information on the subject matter that companies have disclosed and which was available on other legitimate sources of information. This information is used in order to determine the type and purpose of each of the agreements.

1.2.8. Agreements not included in the empirical survey

Not all of the agreements provided in the classification of shareholders' agreements[1134] have been included in the data and some of the agreements have been included only when they met the below discussed criteria.

The data set does not include shareholders' agreements where company is contracting as a shareholder of another company (for example, under joint

[1134] See Part II, Chapter 1.4.5.

venture agreement is pursuing joint business with other persons)[1135]. This is explained by the fact that such agreements are not related to the management and control of the company or rights and duties of shareholders of the company. These shareholders' agreements primarily deal with company's rights and duties as a shareholder of another legal entity. In order not to distort the results provided in this dissertation, mentioned agreements are not represented in the data set.

Joint venture agreements (as they could be sometimes treated as shareholders' agreement if the joint venture is incorporated) are not included in the analysis as their principal scope and regulation of the relationships between the contracting parties is much wider than that of shareholders' agreements[1136]. Joint venture agreements are not always aimed at creating new corporate vehicles to conduct business on behalf of cooperating partners, and thus might be based on partnership between the parties. In cases when joint venture is carried out using incorporated vehicle, it usually involves not only issues related to the management of the new company or relationships amongst the shareholders, but also incorporation, financing, taxation and exit strategies from the newly formed company. As shares of listed companies are traded on stock exchanges it is difficult to form a public joint venture company, as more stringent rules and regulations apply. However, if the subject matter of the joint venture agreement was mainly to control the shareholder (as a legal entity) of the company and to establish how contracting parties will control a listed company under question, such joint venture agreements have been included in the data provided below. For example, shareholders of Groupe Bruxelles Lambert NV, a company listed on the NYSE Euronext Brussels stock

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[1135] An example could be Cable & Wireless Communications plc., which is traded on the London stock exchange. This company is party to several shareholders' agreements. However, these agreements are meant to control subsidiaries of the company and not to regulate relationships amongst the shareholders of the company. See: Cable & Wireless Communications plc. *Annual report 2010* [interactive]. [Accessed on 2011-06-26] Available online at: <http://www.cwc.com/assets/uploads/files/CoSec/2011/Annual-report.pdf>.

[1136] See: THOMAS, K. R.; RYAN, Ch. *The Law and Practice of Shareholders' Agreements. 3rd edition*. London: LexisNexis, 2009, p. 271-309.

exchange, have entered into a joint venture agreement by which they control a newly created company which in turn controls the listed company. The agreement stipulates that listed company should be controlled jointly between the contracting parties through the joint venture company[1137].

Options to buy or sell shares of the company have been excluded from the analysis, unless such agreements also provide for other provisions regarding the exercise of rights conferred to the shareholders by the shares of the company (or they are part of the other type of shareholders' agreement). For example, IBT NV, a company listed on the NYSE Euronext Brussels stock exchange, shareholders Eckert & Ziegler AG and Steglitz Medinvest UG agreed on call option by which Eckert & Ziegler AG was entitled to acquire shares from Steglitz Medinvest UG and take over the company[1138]. This agreement between shareholders is not reflected in the data tables below. Although shareholders are always parties to the options to buy or sell shares agreements (and other types of agreements that have similar consequences), such agreements as a rule only stipulate how and on what terms shares are transferred from one person to another[1139]. These agreements do not include any provisions on the shareholder mutual control of the company or on the exercise of rights attached to the shares (unless additional shareholders' agreement is entered into as a consequence of the transfer of shares).

Voting trusts constitute a part of this research only if they are created with a specific purpose for the shareholders to jointly exercise their control over the publicly listed company. In light of this research, this purpose is considered to be clearly expressed if the voting trust is accompanied by a shareholders' agreement concluded amongst the same shareholders. This is due to the reason that voting trusts do not create any reciprocal duties and rights of

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[1137] Groupe Bruxelles Lambert NV. *Annual financial report 2010* [interactive]. [Accessed on 2011-03-20] Available online at: <http://en.gbl.be/Images/9_3836.pdf>.

[1138] IBT NV. *Annual Report 2010* [interactive]. [Accessed on 2011-06-22] Available online at: <http://www.ibt-bebig.eu/fileadmin/IR/annual_reports/IBt_Bebig_AR2010-EN.pdf>.

[1139] For an analysis of share transfer agreements see: STILTON, A. *Sale of Shares and Businesses: Law, Practice and Agreements. 3rd edition*. London: Sweet & Maxwell, 2011, p. 111-141.

the shareholders towards each other as their shares (together with voting rights) are transferred to the trust, and in exchange they get certificates that are considered as separate securities that can be traded on the market. This means that shareholders in strict legal sense stop being shareholders of the company (unless not all of their shares are transferred to the trust) and voting trust becomes the shareholder of the company. However, shareholders can still agree on how they are going to exercise their control over the trust (as certificate holders). In other words, voting trust agreement is not a typical shareholders' agreement where shareholders are contracting amongst each other. Nevertheless, voting trusts were included in the data sample, but only if they were accompanied by an additional shareholders' agreement[1140].

1.2.9. Process of empirical study and methodology

When analysing all the data available on each of the listed companies, first the fact whether shareholders' agreement is in place in the company was determined (by analysing annual and interim reports of the company). If the answer was positive, then a detailed in depth analysis was carried out in order to determine the scope and content of the agreement. The actual process and methodology is best illustrated by some examples.

1.2.9.1. AB "PANEVĖŽIO STATYBOS TRESTAS" example

The first example is AB "PANEVĖŽIO STATYBOS TRESTAS" – a company that is listed on the NASDAQ OMX Vilnius stock exchange. During the analysis of the reports provided by this company a transfer of voting rights agreements was found to be concluded amongst the shareholders of the company. As it was explained above, transfer of voting rights agreements for the purposes of this dissertation are considered to be shareholders' agreement.

[1140] For example, AB InBev NV. *Annual Report 2010* [interactive]. [Accessed on 2011-06-19] Available online at: <http://www.ab-inbev.com/pdf/AB_InBev_AR10.pdf>. In this case shareholders established a trust. It is controlled by a shareholder appointed board which makes all the decisions in relation to the exercise of voting rights attached to the shares that belong to the trust.

Due to this reason it has been marked as a positive result (company with shareholders' agreement in place). During a more extensive research it was identified that at the date of conclusion of the agreement the following persons were shareholders of the company: R. J. – 1.84 %, K. B. – 2.38 % and AB „Panevėžio keliai" – 49.72 %[1141]. It was also disclosed that both contracting shareholders are also members of the management board and supervisory body of the majority shareholder of the company – AB „Panevėžio keliai". After confirmation the fact that parties to the shareholders' agreement are actually shareholders of the company and identifying their possible relations to the majority shareholder, other available sources were analysed. In order to establish the purpose of the transfer of voting rights agreements civil cases involving the company were examined. A case was found that involved both shareholders to the agreements and that dealt with the validity and legality of the transfer of voting rights agreements[1142]. From the facts presented in the case it was identified that the purpose of the transfer of voting rights was to avoid mandatory offer to buy the rest of the shares of the company[1143]. All these results have been reflected in the tables on shareholders' agreements provided below.

[1141] According to the latest transparency notifications shareholders of the company who have more than 5 % of voting rights are AB „Panevėžio keliai" – 49,78 %, Skandinaviska Enskildas Banken clients – 6,22 %. Akcinė bendrovė "PANEVĖŽIO STATYBOS TRESTAS". *Akcininkai* [interactive]. [Accessed on 2012-12-12] Available online at: <http://www.pst.lt/lt/main/about/Akcininkai>.

[1142] SCL civil case No. 3K-3-215/2007, 2007 June 27, *M. V. v. R. J., R. J., K. B., N. E. B., V. Š., AB „Panevėžio keliai"*; Panevėžys regional court civil case No. 2A-1-338/2008, 2008 November 19, *M. V. v. R. J., R. J., K. B., N. E. B., V. Š., AB „Panevėžio keliai"*.

[1143] SCL in this case stated that transfer of voting rights in the light of the requirements provided in the Law on Securities do not influence the way that voting rights should be counted (although both shareholders claimed that they no longer can exercise their voting rights). See article 19 of the old wording of the Law on Securities, which stated that shareholders who alone or acting in concert with other persons have acquired 40 % or more of the voting rights in the company have either to transfer their shares or to announce a mandatory offer to buy the rest of the shares of the company. Law on Securities of the Republic of Lithuania (old wording) (Valstybės Žinios, 1996, Nr. 16-412; Valstybės Žinios, 1996, Nr. 62; Valstybės Žinios, 2001, Nr. 112-4074).

1.2.9.2. AB InBev NV example

The next example is AB InBev NV, a company that is listed on the NYSE Euronext Brussels stock exchange. After the analysis of the annual report of the company it was established that there are two shareholders' agreements in place. The first agreement is concluded between BRC Sarl. (2.06 %), Eugenie Patri Sebastien SA (8.31 %), Rayvax Societe d'investissements SA (0.03 % through a subsidiary Sebastien Holding) and Stichting Anheuser-Busch InBev (41.1 %). BRC Sarl. and Eugenie Patri Sebastien SA are not only the shareholders of the company, but also certificate holders of the largest shareholder of the company – Stichting Anheuser-Busch InBev. This is a more complicated shareholder structure which is best illustrated by a figure which is presented below.

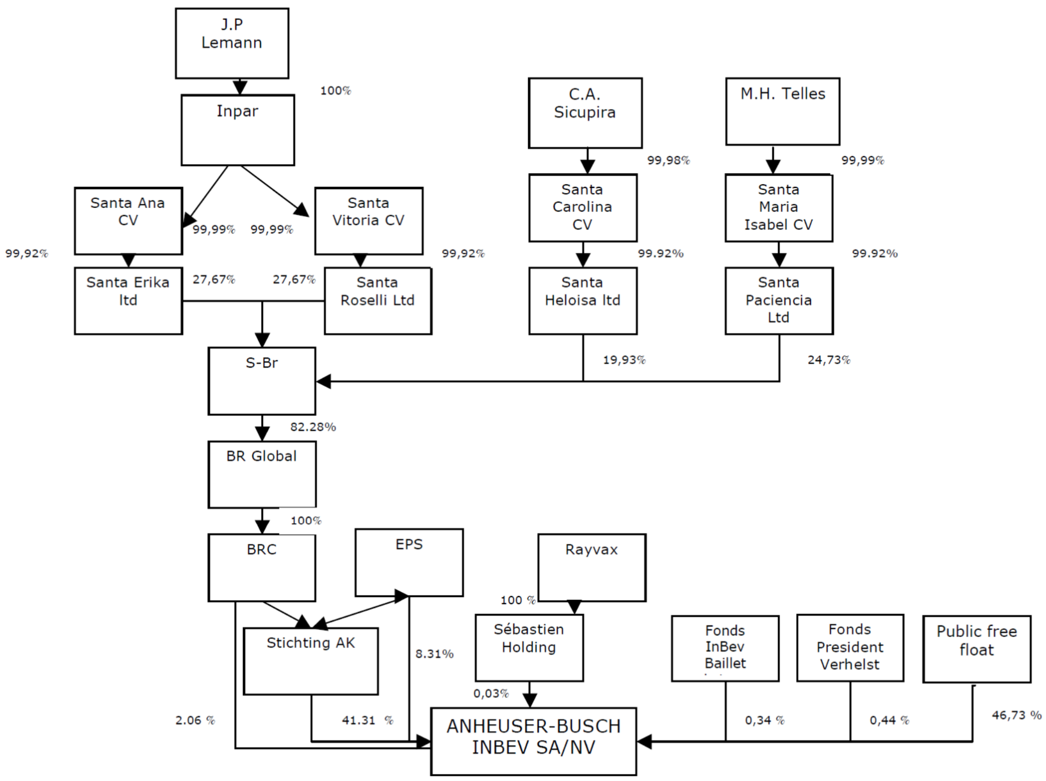

Figure 1: Ownership structure of AB InBev NV[1144]

[1144] AB InBev NV. *Corporate Governance Charter 2011* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.ab-inbev.com/pdf/1101_abinbev_governance_charter_update_18.pdf>, p. 7.

Further analysis revealed that Stichting Anheuser-Busch InBev is a trust created by shareholders BRC Sarl. and Eugenie Patri Sebastien SA in order to jointly exercise control over the company. The shareholders' agreement concluded between the mentioned shareholders is a combination of a voting trust agreement and a voting agreement. Shareholders agreed not only on joint exercise of the voting rights that are controlled directly by them, but also on the mutual management structure of the trust which would allow shareholders to effectively control the listed company (this also includes certain restrictions on the transferability of trust certificates). Shareholders agreed that the trust is to be managed by an eight-member board of directors and that each of the shareholders will have the right to appoint four directors to the board of the trust. Subject to certain exceptions, all decisions of the trust with respect to the shares of the company it holds, including how its shares will be voted at all shareholders' meetings, are to be made by the board prior to each of the general meeting of shareholders of the company. In addition, the shareholders' agreement requires contracting shareholders to vote their directly held shares in the same manner as the shares held by the trust. All this information and additional data is reflected in the annexes to this dissertation.

Chapter 2. Analysis of the empirical data

This chapter analyses and interprets data that has been gathered during the empirical research and which is presented in the tables attached to this dissertation as annexes. The main purpose of the analysis provided below is to show that the shareholders' agreement could be regarded as an appropriate tool to mitigate conflicts of interest between different corporate constituents active in listed companies.

2.1. General findings and indications

A total number of 460 companies listed on the stock exchanges in the analysed jurisdictions are included in the data sample. From this number 63 companies were identified to have 81 shareholders' agreements concluded (13.79 % of all the companies had at least one shareholders' agreement in place[1145]). This included 36 companies (with 50 shareholders' agreements) from the NYSE Euronext Brussels, 20 companies (with 21 shareholders' agreements) from the London stock exchange and 7 companies (with 10 shareholders' agreements) from the NASDAQ OMX Vilnius stock exchange. These findings are summarised in the table below.

	Lithuania	Belgium	The UK
Number of analysed companies	37	121	302
Total number of companies on the stock exchange*	37	121	2641
Per cent of companies analysed / companies listed on the stock exchange	100 %	100 %	11.4 %
Number of companies with shareholders' agreement	7	36	20
Per cent of companies with shareholders' agreement / companies analysed	18.9 %	29.5 %	6.6 %
Total number of shareholders' agreements	10	50	21
Average market capitalization (M)**	3 878	825 370	4 034 121

Table 2: General summary of data and findings on shareholders' agreements[1146]

[1145] This percentage was calculated according to the number of companies that have a shareholders' agreement in place and not according to the actual number of shareholders' agreements in a particular company.

* This row presents total number of companies that are incorporated and have their primary listing in the analysed jurisdiction. The total number of listed companies is higher.

** Market capitalization in Lithuania and Belgium is provided in Euros and in the UK in pounds.

[1146] Data on the total number of companies and market capitalisation in this table is provided from each stock exchange in the jurisdiction analysed in this dissertation. Data is provided for the year 2011.

The general observation from the results of the empirical research would be that shareholders' agreements are actually used in practice amongst the shareholders of listed companies. The overall 13.79 % of all the analysed listed companies have at least one shareholders' agreement in place. This is clear evidence that disproves the arguments provided by some legal scholars that shareholders' agreements in listed companies are very rare and due to specificity of regulations of listed companies are almost never entered into in practice[1147]. In addition, this signals that shareholders up until a certain degree are active in exercising their rights and protecting their interests by entering into contractual relations amongst each other. This also means that if there is no legislative intervention, shareholders in listed companies fall back to contractual means.

The data provides insights that shareholders' agreements are present in all sizes of securities markets: in small (the NASDAQ OMX Vilnius stock exchange), medium (the NYSE Euronext Brussels stock exchange) and very sophisticated and large (the London stock exchange). It is also evident that shareholders' agreements are present both in continental European jurisdictions (Lithuania and Belgium) and in the analysed common law country (the UK). This might be an indication that shareholders' agreement is a widely used contractual tool that does not depend on the market or company size for it to be effective (as it has been shown above, all analysed jurisdiction allow shareholders' agreements to be concluded amongst shareholders).

[1147] See Part III, Chapter 1.1.

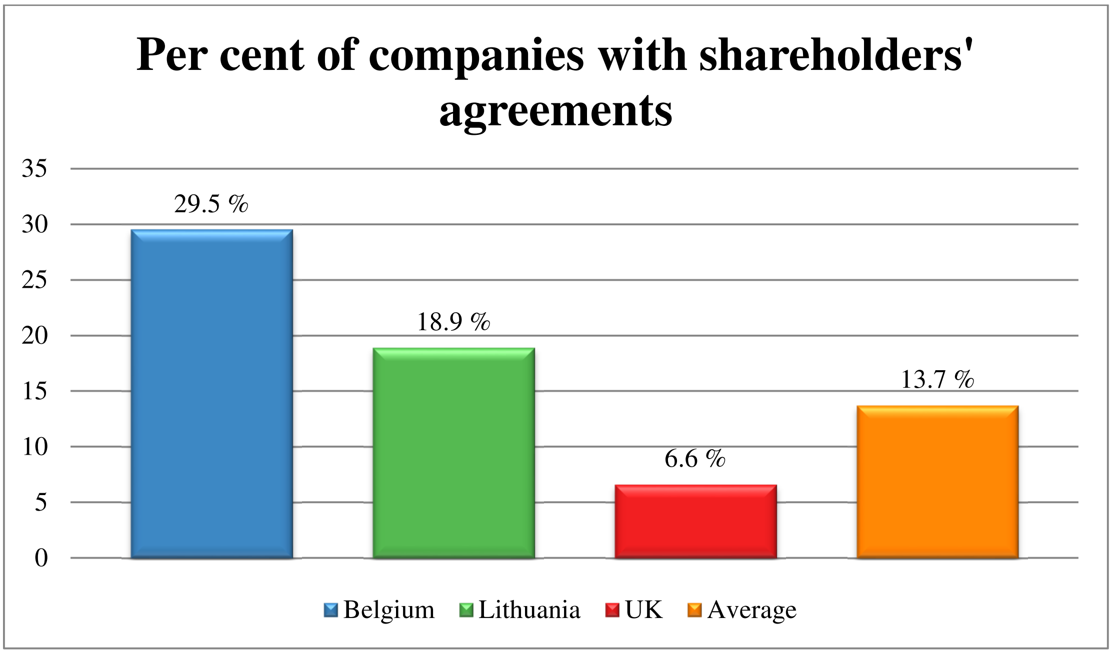

Chart 1: Per cent of listed companies with at least one shareholders' agreement

Although data includes only three jurisdictions, some interesting observations could be made about the availability of shareholders' agreements in different countries. As it can be seen from the table 2 and chart 1 provided above, on average 27.2 % of all the companies listed in both of the European continental jurisdictions have at least one shareholders' agreement. Moreover, empirical data on both jurisdictions shows that the number of shareholders' agreements is much higher than the number of companies that have such agreements, because certain companies have two, three and even five[1148] shareholders' agreements in place. It should also be noted that Belgian shareholders are almost twice as active (29.5 % compared to 18.9 %) than Lithuanian shareholders' in concluding shareholders' agreements. On the other hand, the common law jurisdiction shows very different results. From 302 listed companies analysed in the UK only 20 had at least one shareholders' agreement concluded amongst its shareholders (this amounts to 6.6 % of all the analysed companies). From this number only one company had two

[1148] For example, UCB NV. *Corporate Governance Statement 2010* [interactive]. [Accessed on 2011-06-23] Available online at: <http://www.ucbannualreport.com/dbfiles/mfile/1200/1263/Corporate_governance_statement.pdf>.

shareholders' agreements[1149]. It is evident that there are more than four times fewer shareholders' agreements in the UK compared to the continental Europe (Lithuania and Belgium)[1150]. The author believes that the empirical data provided in this research alone cannot answer the question why such huge differences exist among the continental European jurisdictions and the common law country. However, if the data provided in this dissertation is analysed in light of other empirical researches on protection of shareholders' rights and ownership structures in listed companies some interesting insights could be gained.

2.1.1. Relation of the findings to the Report on the proportionality principle

The general findings of empirical research indicate that there are more shareholders' agreements concluded amongst the shareholders of listed companies than it was found in the Report on the proportionality principle (according to the report, 8 % of all listed companies in the EU have shareholders' agreements)[1151]. However, the Report found that 14 % of all the large companies in the sample had shareholders' agreement in place. This is similar to the findings in this dissertation (which is 13.79 %)[1152].

The empirical research carried out in this dissertation confirms that Belgian shareholders are very active in using shareholders' agreements in order to contractually regulate their position in the company. These findings support the results of the Report on the proportionality principle, where Belgium was also identified as a country with most of shareholders' agreements in place[1153]. Nevertheless, the number of shareholders' agreements appears to be slightly lower as empirical research in this dissertation revealed that 29.5 % of all the

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[1149] Sabmiller plc. *Annual report 2011* [interactive]. [Accessed on 2011-06-29] Available online at: <http://www.sabmiller.com/files/reports/ar2011/2011_annual_report.pdf>.

[1150] 6.6 % in the UK and 27.2 % on average in both continental European jurisdictions.

[1151] Report on the proportionality principle, p. 35.

[1152] Report on the proportionality principle, p. 6.

[1153] Report on the proportionality principle, p. 22.

listed companies in Belgium have shareholders' agreements as opposed to 31 % found in the report[1154]. The results regarding the UK listed companies reveal a rather big gap between this dissertation and the Report on the proportionality principle – 6.6 % and 3 % accordingly[1155]. This means that there might be more than twice as many of shareholders' agreements than it was indicated in the Report. Lithuania was not included in the jurisdictions analysed in the Report on the proportionality principle, and thus no comparative data can be provided at this point.

Overall, it should be considered that empirical research carried out in this dissertation is more precise due to several reasons. First, there are more listed companies included in the sample (with all companies listed in Lithuania and Belgium, and all companies comprising FTSE 350 index in the UK). Second, the author used his own methodology to identify only "real" shareholders' agreements (in contrast to various situations where shareholders are acting in concert). The Report on the proportionality principle describes shareholders' agreements as formal and/or informal shareholders' alliances[1156]. However, it is not clear what kind of shareholders' agreements were included in the research. Due to these reasons it is considered that data provided in this dissertation is more precise and actually reflects the factual situation. This also means that no trends could be identified at this point (it cannot be stated that

[1154] Report on the proportionality principle, p. 35, 38. For a report on Belgium see: Institutional Shareholder Services Europe, European Corporate Governance Institute and the law firm Shearman & Sterling. *Report on the Proportionality Principle in the European Union, Comparative Legal Study, Exhibit C (Part 1)*, 2007 [interactive]. [Accessed on 2012-10-12] Available online at: <http://ec.europa.eu/internal_market/company/docs/shareholders/study/study-exhibit_c_part1_en.pdf>, p. 51-56.

[1155] Report on the proportionality principle, p. 35, p. 80. For a report on the UK see: Institutional Shareholder Services Europe, European Corporate Governance Institute and the law firm Shearman & Sterling. *Report on the Proportionality Principle in the European Union, Comparative Legal Study, Exhibit C (Part 2)*, 2007 [interactive]. [Accessed on 2012-10-12] Available online at: <http://ec.europa.eu/internal_market/company/docs/shareholders/study/study-exhibit_c_part2_en.pdf>, p. 287-288.

[1156] Institutional Shareholder Services Europe, European Corporate Governance Institute and the law firm Shearman & Sterling. *Report on the Proportionality Principle in the European Union, Comparative Legal Study, Exhibit A - Methodology*, 2007 [interactive]. [Accessed on 2012-10-12] Available online at: <http://ec.europa.eu/internal_market/company/docs/shareholders/study/study-exhibit_a_en.pdf>, p. 4.

during the period from 2007 till 2011 the number of shareholders' agreements in the UK has increased twofold), as the data provided in the Report on the proportionality principle might not represent the factual situation that was in 2007.

2.1.2. Shareholders' agreements and protection of shareholders' rights

The question at this point is whether protection offered to shareholders in particular jurisdictions is related to the number of shareholders' agreements in place? In other words, do shareholders tend to contractually protect their interests if legislature has failed to do that on certain level?

It has been suggested in corporate governance research that the level of shareholder protection might be in correlation with the ownership structures of companies and the size of equity markets[1157]. If it was presumed that the hypothesis of La Porta *et al.* is true[1158], this would suggest that the UK shareholders enjoy better protection of their rights, while in Belgium and Lithuania shareholders wanting additional layer of security are entering into shareholders' agreements and strengthening their position in the company using contractual means. Furthermore, the number of shareholders' agreements might be indication of the lack of efficient shareholder protection. This explanation of the results would partly explain why there is a huge difference between the number of shareholders' agreements in the UK in comparison to Lithuania and Belgium (both in relation to the number of companies that have shareholders' agreement in place and to the number of actual shareholders' agreements concluded amongst shareholders).

On the other hand, if Lithuania is compared with Belgium, slightly different results are found. Equity market in Lithuania is very small, while

[1157] See Part I, Chapter 3.1.

[1158] There are scholars arguing that it is not. See: COOLS, S. The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers. *Delaware Journal of Corporate Law*, 2005, Vol. 30, No. 3, p. 697-766.

Belgian stock exchange is almost four times bigger[1159]. The hypothesis provided above would suggest that there should be more shareholders' agreements in Lithuania in comparison to Belgium (the sophistication and size of the stock exchange reflects the level of protection offered to the shareholders of listed companies). However, this is not the case. According to the data presented above, in Lithuania there are almost two times less shareholders' agreements than in Belgium. One of the explanations might be that shareholders in Lithuania might be using other tools to enhance their control over the company, as the ownership is highly concentrated[1160].

Due to the mixed results, conclusion that the number of shareholders' agreements is higher if the level of shareholder protection is low can be neither confirmed, nor denied. The author is of the opinion that the above two factors might correlate with each other at certain level, but there must be some other additional elements that influence the number of shareholders' agreements inside a particular jurisdiction (one of them might be the level of information available to shareholders on the exercise of their respective rights).

2.1.3. Shareholders' agreements and the ownership structure

The divergent practices in entering into shareholders' agreements between the common law jurisdiction and two continental European states could be due to a more inherent state of different ownership patterns. As it was explained above[1161], common law countries are characterized by highly dispersed ownership structure (the UK) while shareholdings in the continental European countries (including Belgium and Lithuania) tend to be concentrated in the hands of a few majority block holders. As the above results indicate,

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[1159] There are studies which indicate that the level of protection of shareholders in Belgium is almost the same as in the UK. However, there are no studies on Lithuania which would provide any insights on the position of shareholders and their rights from comparative perspective. See: VAN DER ELST, Ch. The Influence of Shareholder Rights on Shareholder Behavior. *La Revue Trimestrielle de Droit Financier*, 2010, No. 1, p. 1-13.

[1160] See annex 4. However, due to lack of research at this point, this conclusion cannot be confirmed.

[1161] See Part I, Chapter 3.1.

shareholders’ agreements are more common in jurisdictions where ownership is concentrated, and the number of contractual relationships amongst shareholders drops dramatically in the jurisdiction with dispersed ownerships structure. The question arises if there might be a link between two of these factors.

The model proposed by Berle and Means suggests that in companies with widely dispersed ownership structure the functions of ownership and control are separated and persons providing wealth to the company are no longer in control of it. It can observed that the UK follows the patterns of the Berle and Means model, which might implicate that shareholders of listed companies lack motivation to monitor management and to take at least some of the control in their hands (they are passive shareholders). Minority shareholders might be reluctant to contract with each other in order to gain some of the control over the company, as private benefits of such control would not justify the costs needed to enter into the shareholders’ agreement. In other words, shareholders might view shareholders’ agreements as an instrument that is too costly, and thus this view might be reflected in the empirical results.

On the other hand, Lithuania and Belgium both show very high levels of ownership concentration. In addition, both of them have more shareholders’ agreements amongst shareholders of listed companies than it has been established to be the average in Europe[1162]. This might indicate that shareholders’ agreement is used in order to mitigate negative consequences of conflicts of interest (as theoretical analysis provided in this dissertation suggests the shareholders’ agreement can be an effective tool for this purpose). However, at the same time it might be used to concentrate even more control or to keep the control in the same hands of the majority shareholder (as a control enhancing mechanism).

[1162] Which is 8 % according to the Report on the proportionality principle.

These observations might suggest that shareholders in jurisdictions with highly dispersed ownership structures are reluctant to protect their interests using shareholders' agreements (as it is too costly). While in the jurisdictions with concentrated ownership pattern the said agreements might be used not for protection of minority interests, but to further enhance the control of majority shareholders (which might explain high numbers of such agreements).

In order to confirm (or refute) the above arguments that ownership structure influences the number of shareholders' agreements, it is necessary to examine who are the parties to the shareholders' agreements (is it predominantly majority shareholders or minority shareholders as well) and what types of shareholders' agreements are prevailing in each jurisdiction (do they tend to influence the concentration of power in the hands of majority shareholders). This information is provided in the paragraphs below.

2.2. Long term goal and short term goal agreements

Taking into account the fact that contractual relationships can be entered into either for long term or short term goals, the author believes that it is important to distinguish between the agreements concluded for short term aims and those that were concluded with long term perspectives in mind. This is also relevant bearing in mind that policy formulation documents in the EU[1163] have addressed the problem of long term versus short term viability of listed companies and long term ownership. In this context the author considers that results presented below might reveal whether shareholders' agreements could be regarded as a contractual tool that enhances the long term ownership, obligations and commitments of shareholders in controlling the company. This might provide for more options in encouraging the long term shareholders[1164].

[1163] See Part I, Chapter 5.

[1164] For recommendations of the Reflection Group see: Report of the Reflection Group, p. 46-47.

2.2.1. Presentation of the data

When determining the fact whether shareholders' agreements were entered into with long term goals in mind certain factors were considered. First, it was observed whether the shareholders' agreement is entered for a short term period of time or the term of its termination is not specified in the agreement (or the term is very long). In Belgium there is a statutory requirement that every shareholders' agreement must be limited in time. In these cases it was checked whether the agreement provides for a maximum possible period of validity (depending on the content of the agreement) and whether there are provisions regarding renewal of the contract. The period of validity was not the determining factor in deciding whether a particular shareholders' agreement is concluded with long term goals in mind. Second, all of the transfer of voting rights agreements and securities lending agreements were presumed to be entered with short term goals in mind. This is due to the fact that these agreements are often used in order to avoid certain obligations arising out of the ownership of the shares and voting rights. Third, all relationship agreements (which are predominant in the UK) were considered to be concluded with a long term perspective in mind. This presumption relies on the fact that undertakings of majority shareholder in the relationship agreement can be performed only during a longer period of time. Fourth, if there was not enough information disclosed by the company to determine the goals of the shareholders' agreement, the agreement was excluded from the data set. Due to this reason the number of shareholders' agreements presented in the table 3 below might be slightly different than the total number of shareholders' agreements that have been found to be concluded in listed companies (there was only one case where the author could not identify whether the agreement was entered with short or long term goals in mind.

A few examples which shareholders' agreements were considered to be concluded for long term perspective are necessary. First, Avis Europe plc., a company listed on the London stock exchange[1165], has a relationship agreement in place according to which the majority shareholder has undertaken to ensure that the company is managed independently from the influence of the majority shareholder. The relationship agreement provides obligations for the majority shareholder to maintain the independence of the board (which should serve the interests of the company and not of the majority shareholder) throughout the validity of the agreement. Furthermore, the agreement provides that all transactions between the company and the majority shareholder are to be on an arm's length basis. Due to these undertakings of the majority shareholder it is considered that the agreement is concluded with a long term perspective in mind (these obligations are continuous, not temporary, require constant involvement from the majority shareholder and are aimed at the interests of the company as a whole), and therefore shareholders' agreement was classified as an agreement with a long term goal.

The second example is the transfer of voting rights agreement concluded amongst the shareholders of GUBERNIJA, AB which is listed on the NASDAQ OMX Vilnius stock exchange[1166]. According to the publicly available information this agreement was aimed at removing the compromised board and general manager in order to optimize the management of the company. This was a one-time undertaking with a very specific goal. Thus, the agreement was considered to be concluded with short term goals in mind.

	Long term goals	**Short term goals**
Overall results	70	10
Lithuania	4	6
Belgium	45	4
The UK	21	0

Table 3: Shareholders' agreements by long term or short term goals

[1165] Avis Europe plc. *Annual report and accounts 2010* [interactive]. [Accessed on 2011-06-25] Available online at: <http://www.annualreports.com/HostedData/AnnualReports/PDF/ave2010.pdf>.

[1166] GUBERNIJA, AB. *2010 m. šešių mėnesių tarpinis pranešimas ir tarpinė finansinė atskaitomybė (neaudituota)* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.nasdaqomxbaltic.com/upload/reports/gub/2010_q2_lt_ltl_solo_ias.pdf>.

2.2.2. General comments

The chart 2 below clearly demonstrates that the majority of the shareholders' agreements concluded in all the analysed jurisdictions are entered into with long term goals and perspective in mind. Only 13 % of all the agreements from the sample were categorized as being concluded only for short periods of time or having short term goals and perspectives.

These results might indicate two points. First, that shareholders' agreements are concluded only amongst shareholders that have long term ownership goals and long term viability of the company in their mind. This would entail that shareholders, who have short terms goals, are largely disinterested in entering into contractual relationships with their fellow shareholders. In other words, only shareholders who intend to remain shareholders of the company for a longer period of time are more likely to bind themselves contractually with other shareholders. The second point might be that shareholders' agreements act as a catalyst that encourages shareholders to remain shareholders of the company for a longer period of time. This might be explained by the fact that by entering into contractual relationships with other shareholders (for example, by concluding a voting agreement) shareholders might gain more rights and control over the company than they would have otherwise (if they acted alone). Thus, it might be incentive for the shareholder not to sell his shares and remain the shareholder of the company.

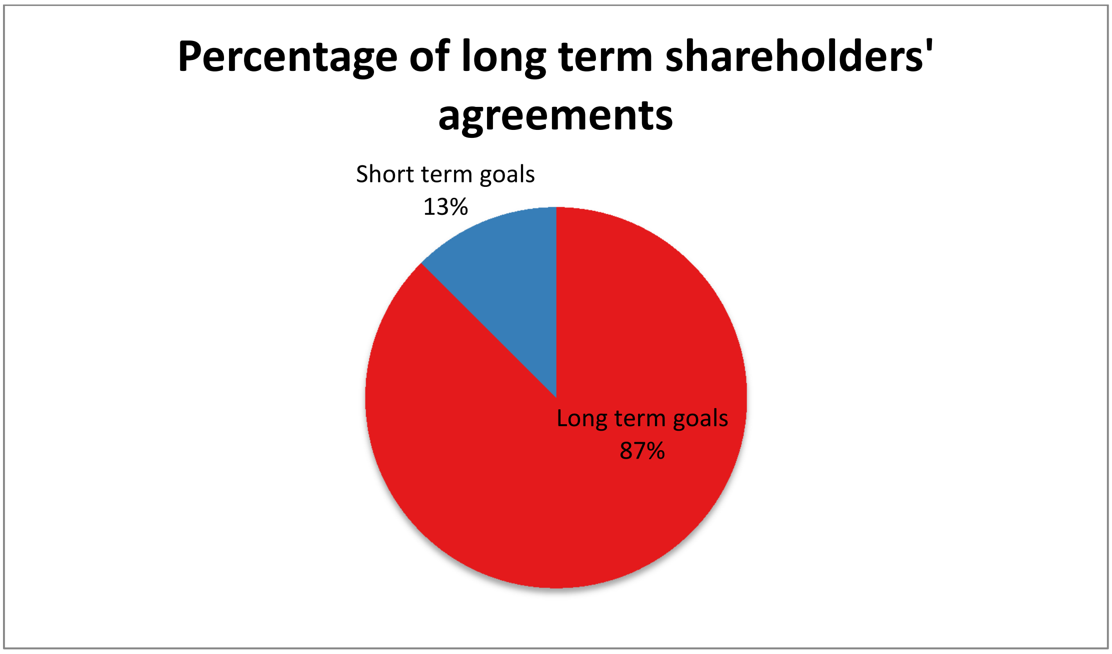

Chart 2: Percentage of long term shareholders' agreements

2.2.3. Country specific comments

Lithuania is the only jurisdiction where the majority of shareholders' agreements were categorized as concluded for the short term. This fact is largely determined by the number of transfer of voting rights agreements that are dominating the types of agreements concluded in Lithuania. As transfer of voting rights agreements were presumed to be by their nature short term goal agreements, this determined the fact that short term agreements constitute six out of ten shareholders' agreements. However, all the voting agreements that were found during the research were identified as concluded for a long term.

In Belgian listed companies almost all of the agreements were considered to be long term agreements with the exception of 4 agreements that were classified as short term. Taking into account the fact that majority of shareholders' agreements amongst Belgian shareholders are voting agreements this trend is easily explained. Voting agreements usually concentrate voting rights of contracting shareholders and the conclusion of the agreements means that shareholders have more rights than they had before entering into contractual relationships. The stronger position and more control rights over the company might be motivators enough for shareholders to be interested in maintaining long term ownership in the company.

In the UK all of the agreements were considered to be entered upon for long term. This was heavily influenced by the fact that 86 % of all the agreements were relationship agreements. The presumption presented above maintains that all relationship agreements are considered as concluded for long term. Lack of short term shareholders' agreements in the UK might be explained by the fact that there were no securities lending agreements identified by the author. This finding is rather unusual as there are multiple studies[1167] that show high usage of securities lending agreements in the UK. These results could be explained only by the lack of disclosure of such information (listed companies might be hesitant to disclosure securities lending agreements that are concluded for the sole purpose of transferring voting rights) or by the fact that publicly listed companies are following recommendations not to use securities lending agreements for transfer of voting rights purposes. In addition, highly dispersed ownership structure might entail more contracting costs for shareholders. With high costs shareholders are less likely to enter into short term relationships with limited short terms goals.

Comparison of the above empirical results in each jurisdiction does not give any differences between Belgium (which is a civil law country) and the UK (which is a common law jurisdiction). In both of these jurisdictions majority of shareholders' agreements were concluded with long term goals in mind. The only country that stands out from the sample is Lithuania. Nonetheless, as discussed above, these results were influenced by the presumption that all of the transfer of voting rights agreements should be considered as entered with short term goals in mind.

[1167] See Part II, Chapter 4.2.

2.3. Number of contracting shareholders per agreement

The number of contracting shareholders per agreement is a very important indicator as to whether shareholders' agreements are being entered into by large groups of shareholders or only amongst a few of them. This data is likely to reveal whether shareholders' agreements could be considered as flexible multiparty contractual tools. Furthermore, coupled with the data on minority and majority contracting trends it might reveal whether shareholders' agreements are actually used by small shareholders (usually contracting in higher numbers) to protect their rights or if they are more directed at preserving the control in the hands of the few majority block holders.

2.3.1. Presentation of the data

The data in the table 4 was calculated in accordance with the following principles. First, if shareholders have been contracting as a group and entered into contractual relations with another group of shareholders they were counted as single shareholder. For example, if a group consists of five shareholders and contracts with a group that consists of three shareholders, it was presumed that there were only two parties to the agreement[1168]. Second, if the shareholders' agreement included a shareholder of the company and shareholders of such shareholder (if the shareholder of the company was a legal person), the shareholder of the company was not taken into account in order not to inflate the actual number of contracting shareholders. Third, if it was indicated in the transparency declaration that some of the contracting shareholders are acting in concert, they were counted as one shareholder. Fourth, in cases where company was contracting with majority shareholder (relationships agreements in the UK), it was presumed that there are two parties to the agreement.

[1168] For an example see: Punch International NV. *Annual Report 2008* [interactive]. [Accessed on 2011-01-27] Available online at: <http://www.punchinternational.com/upl/1/e/doc/1436_4_6_e.pdf>.

	Average number of contracting shareholders	Median of contracting shareholders	Total number of contracting parties
Overall results	3.8	3	305
Lithuania	3.7 (2.7 without akcinė bendrovė "SANITAS").	3	37
Belgium	4.5	3	223
The UK	2.1	2	45

Table 4: Number of shareholders as contracting parties

2.3.2. General observations

The overall results indicate that the average number of contracting shareholders amongst the analysed jurisdictions is high with only around 4 shareholders entering into contractual relations per agreement. The median of shareholders per agreement is 3. This is a possible indication that there are more obstacles (contracting costs, no incentives) than benefits for shareholders' agreement to be entered among large groups of small shareholders. However, at the same time this data suggests that shareholders' agreement is considered to be an effective contractual tool when numbers of contracting parties is not that high. Below the results for each jurisdiction are analysed in more detail.

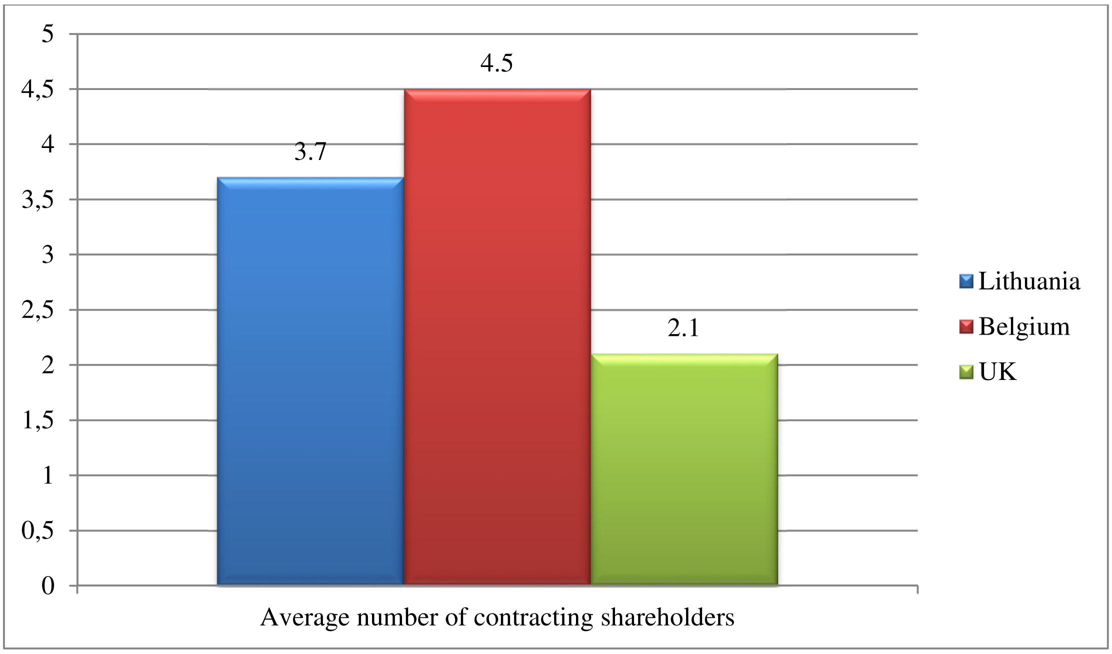

Chart 3: Average number of contracting shareholders per country

2.3.3. Country specific comments

Results from the companies listed in Lithuania show that number of contracting shareholders in each of the cases is very small. The average number of parties is 3.7 and falls down to 2.7 if akcinė bendrovė "SANITAS" is not taken into account. The median of number of contracting shareholders is 3. Moreover, most of the agreements have three shareholders as parties to them. Akcinė bendrovė "SANITAS" is the only company that showed relatively high number of contracting shareholders (twelve of them). Despite this, there were no other companies with higher number of parties than four. These results indicate that shareholders' agreements in Lithuania tend to be entered into only amongst low numbers of shareholders of the company. One possible explanation for this is the high concentration of ownership structure which implies that there are fewer shareholders overall.

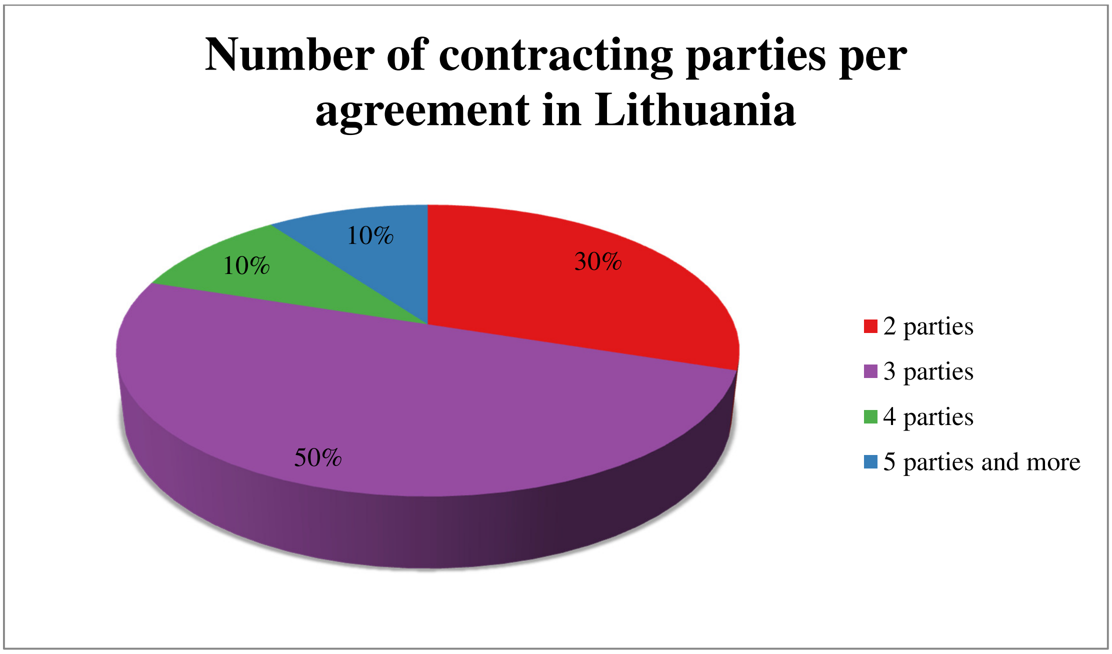

Chart 4: Number of contracting parties per agreement in Lithuania

The number of contracting shareholders in Belgium is slightly higher than in Lithuania. On average there are 4.5 shareholders per each agreement and the median is the same as in Lithuania – three shareholders. However, even 17 of a total of 50 shareholders' agreements concluded in companies listed on the NYSE Euronext Brussels stock exchange had two shareholders as parties. There were only seven companies that had more than five shareholders as parties to the contract. The highest number of contracting shareholders was 26 and two subsequent shareholders' agreements had respectively 16 and 15 parties. From one point of view, this indicates that there are practical examples when large groups of shareholders are entering into shareholders' agreements and are contracting for their position in the company. Thus, such situations are not only theoretically possible, but also are occurring in practice. On the other hand, most of the agreements are between very low numbers of parties and this shows that situations when large groups of minority shareholders are contracting to improve their position in the company are rare.

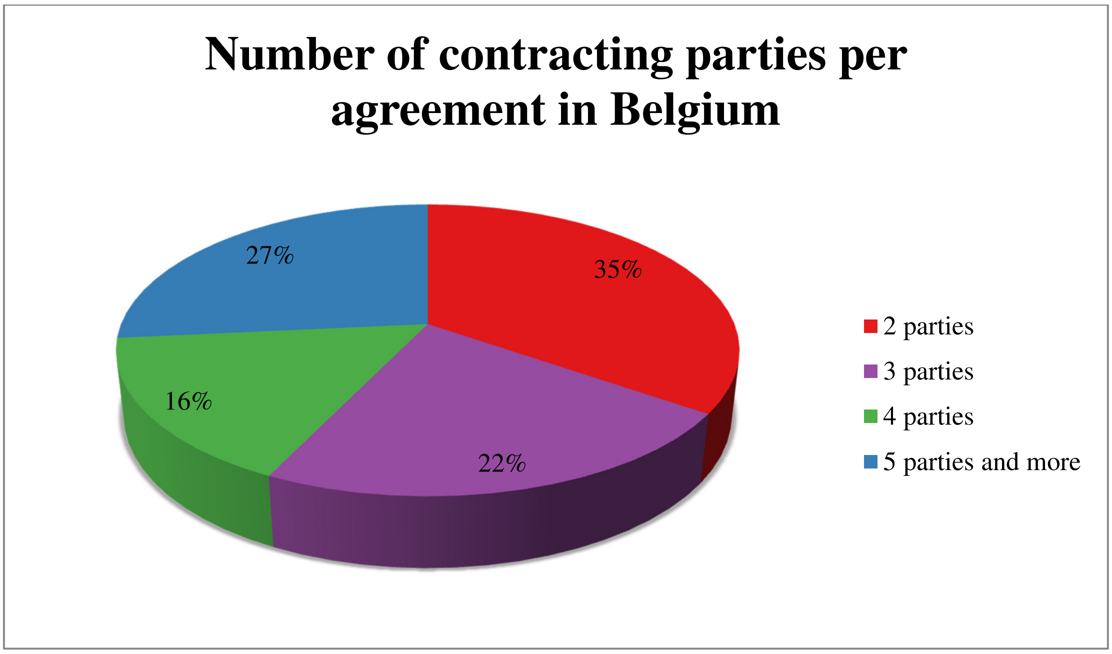

Chart 5: Number of contracting parties per agreement in Belgium

Although shareholding structure is highly dispersed in the UK, the average number of shareholders per each agreement is only 2.1 and the median is two. Most of the analysed agreements in the UK were qualified as relationship agreements and in almost all of the cases the company was a party to the agreement. The fact that the company is a party to the agreement might have raised the number of contracting parties even more. Most of the agreements were concluded between the majority shareholder and the company. Only two shareholders' agreements out of 21 analysed had more than two parties (the number of parties was still relatively low with three and four contracting parties respectively). These results indicate that shareholders in the UK are not active in entering into shareholders' agreements in order to protect their rights. This might be the reasons why most of the UK company law scholars claim that shareholders' agreements in listed companies are a rarity. The fact that there were no shareholders' agreements with more than 5 contracting shareholders found in companies listed on the London stock exchange suggests that it is unlikely that small shareholders are willing and able to use shareholders' agreements in order to protect their interest or establish control over the company.

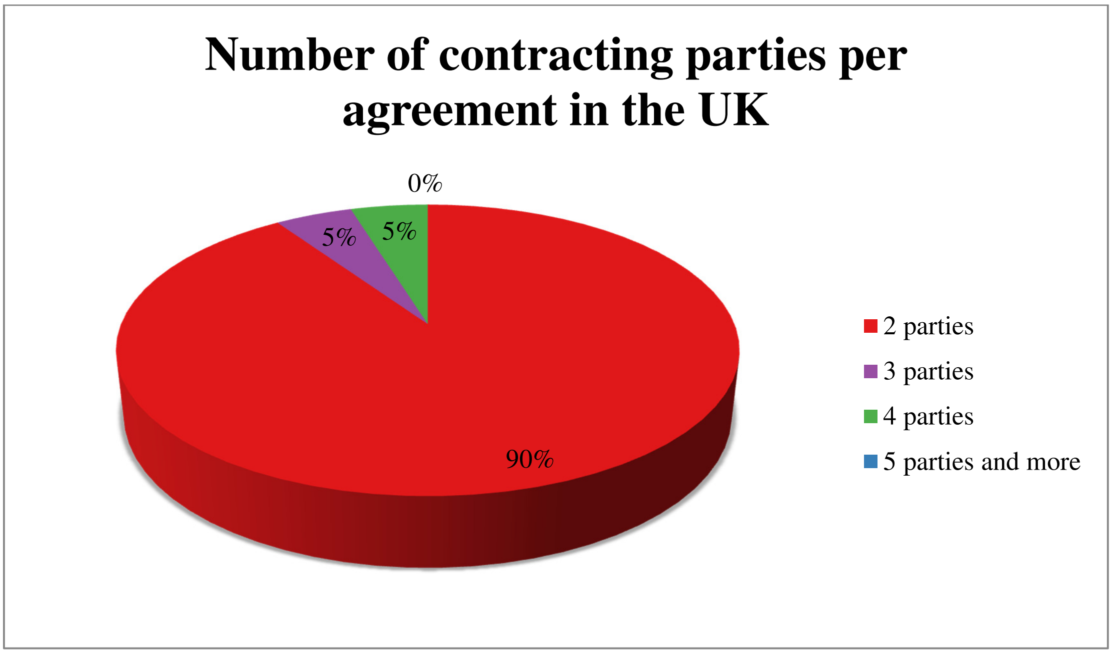

Chart 6: Number of contracting parties per agreement in the UK

Comparison of the above results for Belgium and Lithuania shows that although both countries have similarly concentrated ownership structures, the number of contracting shareholders per agreement is higher in Belgium. This might be an indication that shareholders have smaller blocks of shares and in order for them to establish control over the company or to gain certain block of voting rights they have to enter into contractual relations with a higher number of shareholders. Another possible explanation (together with the fact that Belgium has one the highest number of shareholders' agreements in Europe[1169]) might be that shareholders' agreements in Belgium are primarily

[1169] According to the Report on the proportionality principle, p. 22.

used as control enhancing mechanisms in order to strengthen control of majority shareholder or to create one (this is more likely taken into account the number of contracting shareholders). Furthermore, the relatively high number of contracting shareholders per agreement might look like an obstacle to contract as higher number of contracting parties would entail that the costs associated with conclusion of the agreement are also higher. However, empirical results from Belgium show that shareholders are actively entering into shareholders' agreements despite the relatively high average number of contracting parties. This might indicate that actual benefits accrued after conclusions of the agreement might outweigh the costs incurred while contracting.

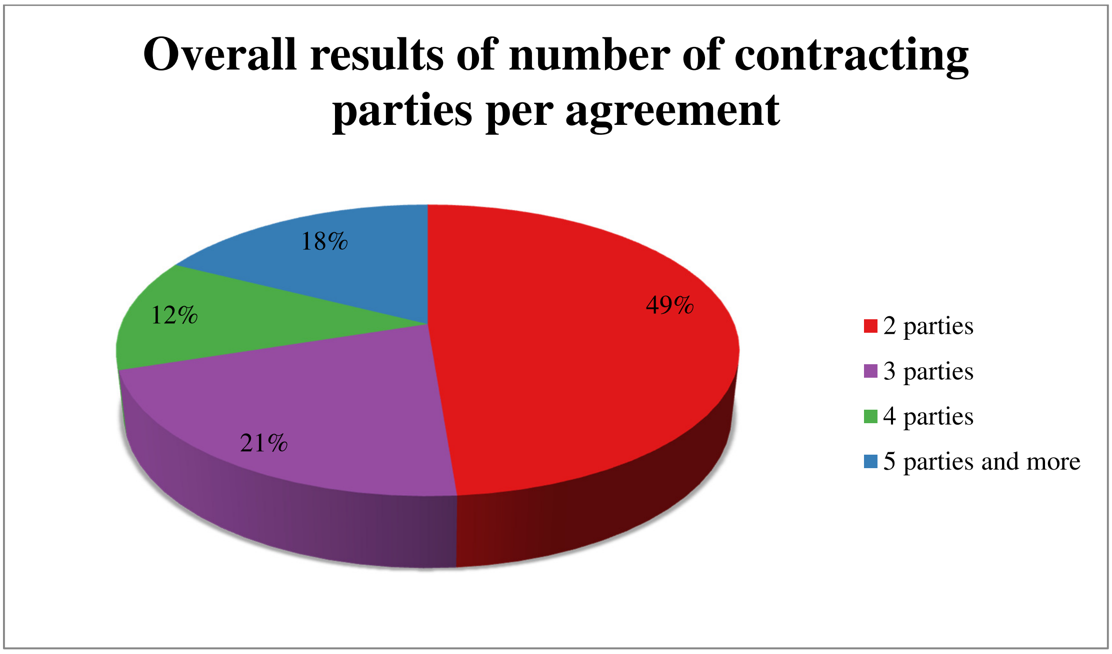

Chart 7: Overall results of number of contracting parties per agreement

It could be observed that the number of contracting shareholders in both civil law jurisdictions is almost two times greater than in the UK (especially considering the fact that the company is usually also a party to such agreements in the UK). These results are confusing as it might be assumed that the number of contracting parties should be greater in jurisdictions with dispersed ownership pattern (as naturally there are more shareholders in each of the company). The possible explanation might be that the number of shareholders required in the common law jurisdiction to reach at least small threshold of voting rights in the company, which would allow such shareholders to exercise some level of control, is so high that such shareholders do not have enough incentives to contract. Relatively higher numbers of contracting shareholders (although they are still small and manageable) in civil law countries suggests that shareholders are most comfortable at contracting with 2-4 other parties and only in exceptional cases the number exceeds ten.

2.4. Minority and majority shareholders

It has been argued in this dissertation that shareholders' agreements viewed from agency theory perspective might serve two alternative purposes: they might be used either as a tool to protect the interests of minority shareholders or as a device that allows concentrating control rights in the hands of the contracting shareholders[1170]. Empirical analysis carried out in this dissertation reveals which of the above purposes is the dominant one in listed companies. The data below provides information on the size of contracting shareholders which together with the above data on the number of shareholders per agreement should provide insights into what kind of shareholders (in terms of size) are entering into shareholders' agreements most frequently.

2.4.1. Presentation of the data

The author has used a few presumptions when determining the size of contracting shareholders. First, in cases where shareholders' agreement was entered amongst the shareholders of the shareholder of the company (for example, in case of a holding company), the number of voting rights held by the shareholder of the company was divided by the number of shareholders of the shareholder and each of them was attributed respective amount of voting rights. For example, if shareholder of the company holds 50 % of voting rights

[1170] See Part II, Chapter 1.3.

and has two shareholders who jointly control the shareholder of the company, then it is presumed that each of them has 25 % of voting rights in the company. Second, in cases where shareholders were contracting in groups, the voting rights of the group was taken into account and not individual rights of shareholders. For example, if three shareholders are entering into shareholders' agreement on the same side and contracting with other shareholders, then voting rights of the three shareholders were summed and counted as one shareholder. The same was done in cases where it was disclosed in annual reports or transparency declarations that shareholders were acting in concert (the voting rights of all persons acting in concert were summed up). Third, in case of relationship agreements (that are predominant amongst the UK companies) only the voting rights of the majority shareholder were included in the data and rights of the company itself (which in these cases were 0 %) were not included in the calculation. Fourth, in case of transfer of voting rights agreements (which were found in Lithuanian companies), both the transferor of the voting rights and the transferee (which usually accounted for 0 % of voting rights) were included in the data. The above measures were taken in order to better reflect factual situation and not to artificially distort the empirical results.

Four thresholds were selected for representation of the results: 1) shareholders having 5 % or less of the voting rights; 2) shareholders who have between 5 % (not including) and 30 % (not including) of voting rights; 3) shareholders who have between 30 % (including) and 50 % (not including) of voting rights; and 4) shareholders who have 50 % or more of the voting rights. These four ranges were selected in order to determine the size of block holders who are contracting most actively. The selected ranges reveal both minority shareholders who have less than 5 % of voting rights and majority shareholders who can influence the control of the company even without entering into shareholders' agreement. The two ranges in between are to better determine the size of contracting shareholders.

	Lithuania	Belgium	The UK	Overall*
Number of shareholders having 5 % or less	16	122	0	138
Number of shareholders having between 5 % and 30 %	16	76	12	104
Number of shareholders having between 30 % and 50 %	4	22	5	31
Number of shareholders having more than 50 %	1	3	8	12
Total number of contracting parties	37	223	45	305

Table 5: Size of contracting shareholders[1171]

The overall results indicate that the most active shareholders entering into shareholders' agreements are those who have less than 5 % of voting rights. The number of this group of shareholders (138) is almost equal to the number of the other three groups put together (147). On the other side are the majority shareholders who have more than 50 % of the voting rights. There were only 12 such shareholders in the data. Two groups of shareholders that are between 5 % and 50 % also show a high level of interest in entering into shareholders' agreements, as there were a total of 135 such shareholders (of a total of 305). As the arguments provided below show the most active group of contracting shareholders is constituted from shareholders owning between 5 % and 30 % of voting rights. The chart 4 below graphically shows the distribution of shareholders by the number of their voting rights.

* The number of contracting shareholders in each row and the total amount of contracting shareholders does not add up for the UK because companies as parties to the shareholders' agreement were included in the total number of contracting parties, but were excluded from calculation of voting rights (as they do not hold any of votes in cases of relationship agreements).

[1171] The data in this table is presented according to the voting rights held by the contracting shareholders at the time of entering into shareholders' agreement.

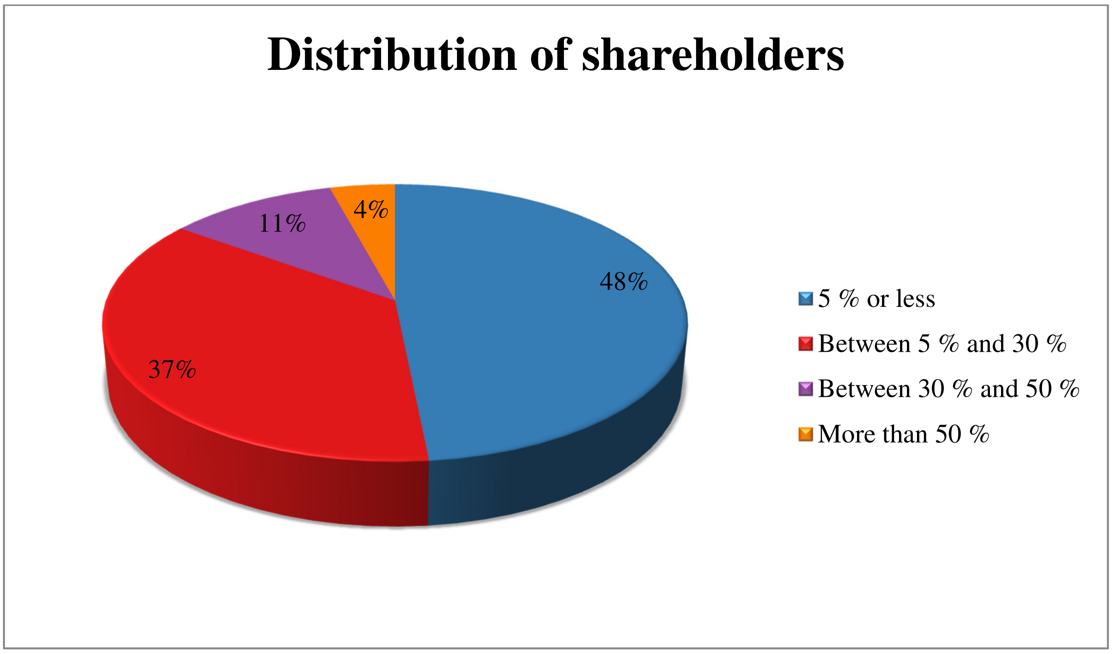

Chart 8: Distribution of shareholders by their voting rights

2.4.2. General observations

One of the possible explanations for the above results is that minority shareholders theoretically are the most interested parties to enter into contractual relations in order to protect their interests. This would confirm theoretical assumptions. Although this data might indicate that there are quite a lot of minority shareholders who are entering into shareholders' agreements, it must be interpreted carefully and with certain reservation. The author believes that the size of contracting shareholders must be interpreted together with the data on the number of contracting shareholders per agreement (which revealed that that number is relatively low (3,8 per agreement)). This means that agreements with more than 5 parties are more of an exception than a rule, and such agreements might be distorting the data on the size of contracting shareholders. After removal of five shareholders' agreements[1172] with the largest number of contracting shareholders from the data sample, the number of contracting shareholders who have 5 % or less voting rights has decreased significantly and constituted 71 shareholders. This means that 6 % of the

[1172] The total number of the agreements in the sample is 81.

agreements accounted for 49 % of total number of contracting minority shareholders. The recalculation of data after the removal of five shareholders' agreements with largest number of parties confirms the findings above that shareholders' agreements with high number of contracting minority shareholders are rare. If minority shareholders are parties to the shareholders' agreement, they are usually contracting with larger block holders.

Furthermore, the number of majority shareholders who have more than 50 % of voting rights is very low (three shareholders in civil law jurisdictions and eight in the UK). This could be explained by the fact that majority shareholders have no incentives to contract with smaller shareholders as they already have the control of the company. This behaviour can be observed, for example, in companies where the majority block of voting rights was acquired by new investors and the remaining shareholders in order to ensure their position as minority shareholders make the sale of shares conditional upon the signing of shareholders' agreement. Apart from these relatively rare cases majority shareholders are presumed to be disinterested in entering into shareholders' agreement as they already have sufficient control over the company to be able to protect their interests.

Shareholders holding between 30 % and 50 % of voting rights constitute the second smallest group of contracting shareholders in the sample. These shareholders hold a stake that is considered to be between *de facto*[1173] and *de jure*[1174] control of the company. Therefore, similarly as the majority shareholders holding more than 50 % of voting rights, they should be considered as less inclined to enter into shareholders' agreements with fellow shareholders (compared to shareholders holding up to 30 % of voting rights). However, the fact that they do not hold *de jure* control over the company

[1173] *De facto* control in this dissertation means an obligation to launch a mandatory takeover bid according to Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23). In Belgium and the UK the threshold is 30 % and in Lithuania it is 1/3 of total voting rights. For the purposes of this dissertation the threshold of 30 % is used.

[1174] *De jure* control is when shareholders can determine the outcome of the general meeting of shareholders in accordance to law. This usually requires owning more than 50 % of total voting rights.

motivates them to enter into contractual relations and this is reflected in the results (31 shareholders were identified).

The largest group of shareholders constitutes shareholders having voting rights between 5 % and 30 %. There were a total of 104 of such shareholders. Possible explanation for these results is that medium sized shareholders are the most interested in entering into shareholders' agreements both with other medium sized shareholders and with minority ones. By entering into shareholders' agreements with other medium sized shareholders they can establish mutual control over the company, while minority shareholders are especially important in cases where several of the medium sized shareholders are competing for control over the company. Due to the above reasons, the medium sized shareholders should be regarded not only as interested in contractually enhancing their position in the company (as would the theory suggest), but also as capable of doing this in practice.

The overall results also reveal that the number of contracting shareholders decreases as their control rights in the company increase. This is to be expected as the more voting rights shareholders have, the more power they can exercise over the company and the less interested they are to share such power with other smaller shareholders. This again confirms the conclusion that the more voting rights the shareholders have, the less interested they become in contractually restricting themselves.

2.4.3. Jurisdiction specific comments

Following the overall trend of the analysed jurisdictions the shareholders with 5 % or less of voting rights and shareholders with control rights between 5 % and 30 % were found to be the most active in Lithuania (16 shareholders were identified in each group). However, the number in the group with shareholders owning 5 % or less was mostly influenced by the shareholders' agreement amongst the shareholders of akcinė bendrovė "SANITAS" which has eight minority shareholders out of a total of twelve parties to the agreement. If this agreement is eliminated from the data, then the number of minority shareholders drops by half and is only eight. There was only one shareholder who had more than 50 % of voting rights (the shareholder had 84.37 %). The biggest single group of contracting shareholders were the medium ones (there were 16 shareholders holding between 5 % and 30 % of voting rights). They were contracting mainly amongst themselves. Four agreements were identified to be concluded only amongst the shareholders controlling between 30 % and 50 % of the voting rights. These results suggest that in Lithuania minority and majority shareholders are not entering into contractual relations very often. The most active group is the medium sized shareholders. The reason for this might be similar as in Belgium – medium sized shareholders have the most incentives to contract in order to be able to exert more power over the control of the company.

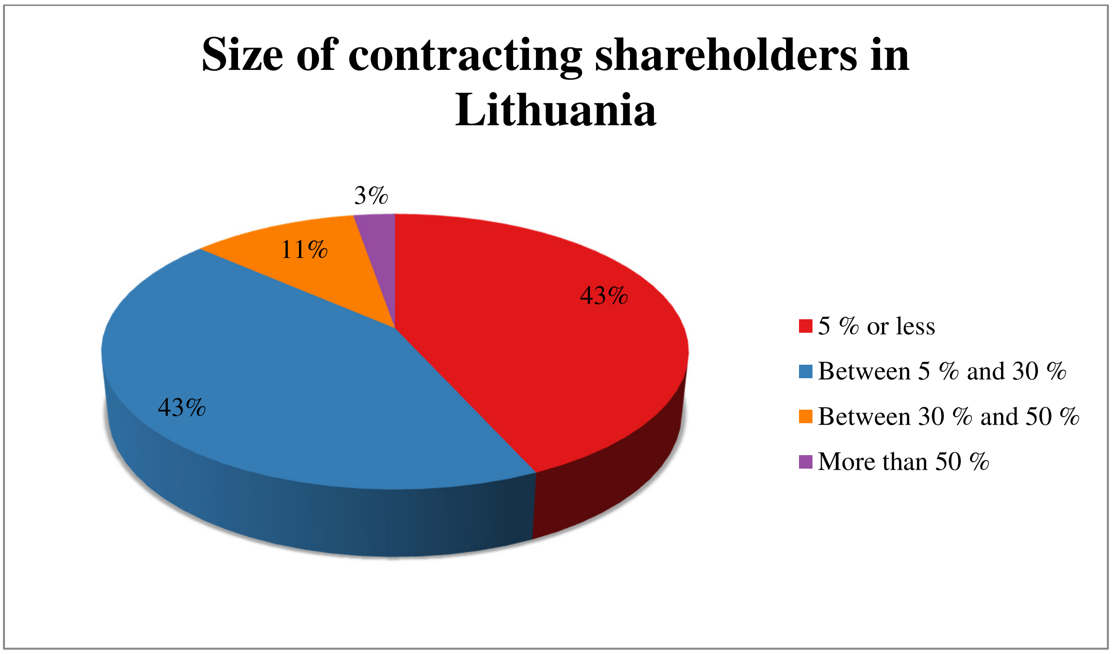

Chart 9: Size of contracting shareholders in Lithuania

Minority shareholders formed the largest group of contracting shareholders (122 in total) in Belgium and, in comparison to Lithuania, there were more agreements where minority shareholders were contracting in large groups. Majority shareholders were the least interested to contract as only three shareholders having more than 50 % of voting rights were identified. The medium sized shareholders were found to be a strong group with 76 shareholders in total (from 5 % to 30 % of voting rights). However, differently than in Lithuania, these shareholders were equally contracting not only with other medium sized shareholders, but also with minority ones.

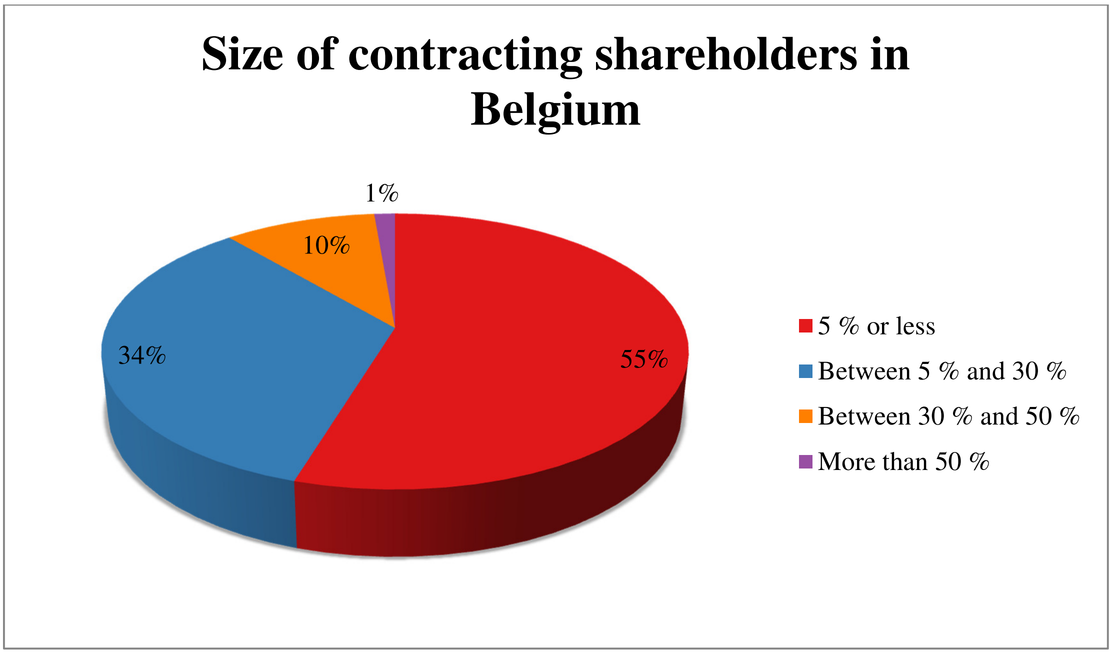

Chart 10: Size of contracting shareholders in Belgium

The results on the shareholders' agreements in the UK listed companies are particularly interesting. The UK is a common law jurisdiction with a highly dispersed ownership structure and it might be presumed that the number of shareholders' agreements with contracting minority shareholders would be the highest. However, this is not the case. The data presented in this dissertation does not reveal even a single agreement where there would be at least one shareholder with 5 % or less of voting rights. The smallest shareholder was found to hold 8.83 % of the voting rights. Moreover, it had the highest number of contracting majority shareholders who had more than 50 % of voting rights in the company (eight shareholders or 32 % from the sample). The number of shareholders controlling between 30 % and 50 % of the voting rights was also the highest (five shareholders or 20 % from the UK sample). The explanation for these findings is that the predominant type of shareholders' agreement that was identified in the UK listed companies was the relationship agreement (a few voting agreements that were found were very limited in scope). This agreement usually entails that there are contractual relationships established between the majority shareholder and the company. Because most of the agreements were relationship agreements, the number of majority shareholders is particularly high in the UK.

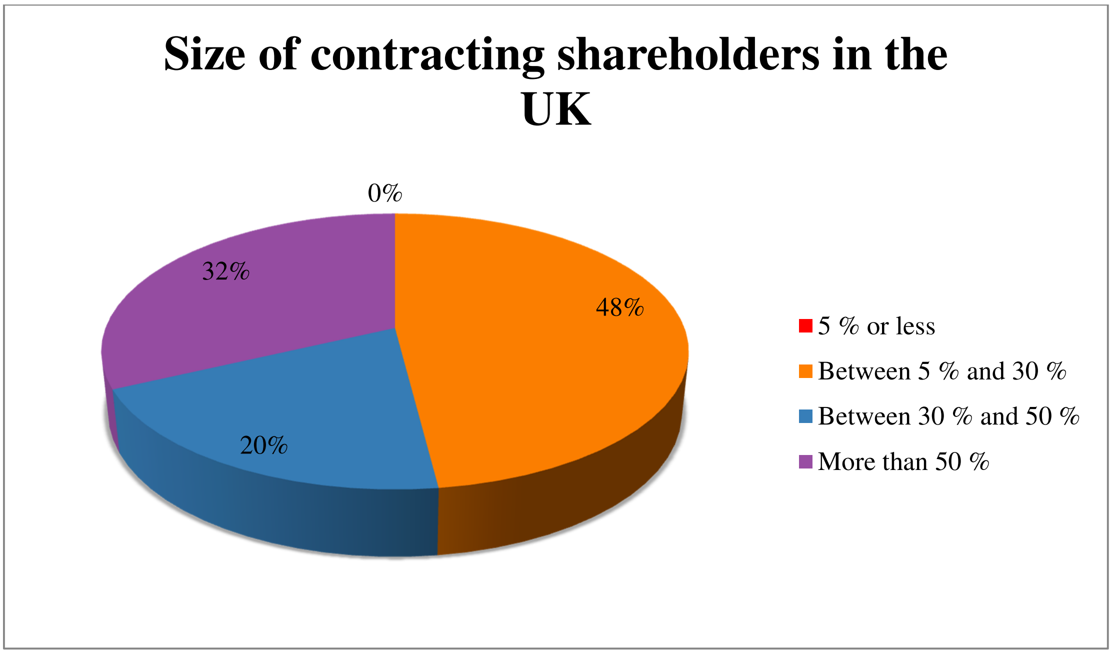

Chart 11: Size of contracting shareholders in the UK

Comparison of the above results from civil law jurisdictions with the common law jurisdiction reveals that, contrary to the theoretical presumptions that minority shareholders are expected to be more active in jurisdictions with dispersed ownership structure, the minority shareholders are quite active in the civil law countries (with some reservations). At the same time the activity of majority shareholders is observed to be more frequent in the UK, when in Lithuania and Belgium large block holders are considered to be passive in sense of entering into shareholders' agreements. These results are in line with the theoretical assumptions that small shareholders in highly dispersed ownership pattern jurisdictions are passive and are rationally apathetic because the small control rights are not enough to incentivize them[1175].

[1175] Other scholars conducting empirical research on shareholder protection laws have also noted this trend. See: SIEMS, M. M. Shareholder Protection Across Countries - Is the EU on the Right Track? *DICE-Report - Journal for Institutional Comparisons*, 2006, Vol. 4, No. 3, p. 40-41.

2.5. Types of shareholders' agreements

The type of shareholders' agreement represents what kind of civil relationships are formed amongst the contracting shareholders. This chapter provides data on the types of shareholders' agreements that have been analysed in Part II Chapter 1.4.5. above. However, the same type of shareholders' agreement might be entered into for different purposes. For example, the voting agreement can be entered into by the minority shareholders in order to strengthen their position in the company and to protect their interests. At the same time the voting agreement can also serve as a control enhancing mechanism for the majority shareholder. Therefore, data on the purpose of the agreements is presented further this chapter.

2.5.1. Presentation of the data

In presenting and interpreting the data the author relied on a number of presumptions. First, agreements that, according to the transparency declarations, were concluded in order to adopt a common lasting policy in the company were presumed to be voting agreements (if it was not stated otherwise in the available disclosed information). Second, agreements that were identified as a certain type of shareholders' agreement by the contracting parties themselves were classified as such. For example, if it was disclosed unambiguously that shareholders' agreement is a voting agreement or a transfer of voting rights agreement, then they were classified accordingly. Third, in certain cases it was hard to precisely determine the exact type of shareholders' agreement as the undertakings of the shareholders were mixed. In these situations underlying and main commitments disclosed in the annual reports of the companies (as presented in the annexes) were identified and the agreement was classified according to the prevailing commitments. For example, if shareholders agreed to exercise joint control over the company and at the same time provided for certain restrictions regarding the transferability of shares, it was presumed that the transferability restrictions are supplementing the voting agreement. Therefore, such agreements were classified as voting agreements. Fourth, if there was not enough information disclosed by the company to determine the type of the shareholders' agreement such agreement is not included in the data set. Due to this reason the number of shareholders' agreements presented in the table below might be slightly different than the total number of shareholders' agreements that were found to be concluded in listed companies.

In relation to the theoretical classification of shareholders' agreements provided in Part II, Chapter 1.4.5., all shareholders' agreements were classified into the following types: 1) voting agreements; 2) transfer of voting rights agreements; 3) relationship agreements; 4) restriction of transfer of shares agreements; 5) securities lending agreements. In determining the type of shareholders' agreement all the available information on each agreement (which is provided for each jurisdiction in the annexes 1-3) was analysed and weighed.

	Lithuania	Belgium	The UK	Overall
Voting agreement	4	42	2	48
Transfer of voting rights agreement	5	0	0	5
Relationship agreement	0	0	18	19
Restriction of transfer of shares agreement	0	6	1	7

Table 6: Types of shareholders' agreements

According to the table No. 6 of a total of 81 shareholders' agreements analysed in this dissertation 48 were voting agreements, 19 were qualified as relationship agreements, 7 primarily included provisions on the restriction on transferability of shares, 5 were concluded to transfer voting rights to other persons and only 2 were considered as securities lending agreements (they are not represented in the table).

2.5.2. General comments

Voting agreements according to the data provided in the chart No. 8 are the primary type of shareholders' agreements that are being concluded amongst the shareholders of listed companies in the analysed jurisdictions. Some other types of agreements are found only in certain jurisdictions and this depends upon specific legal regime or the structure of ownership that is prevailing in that jurisdiction.

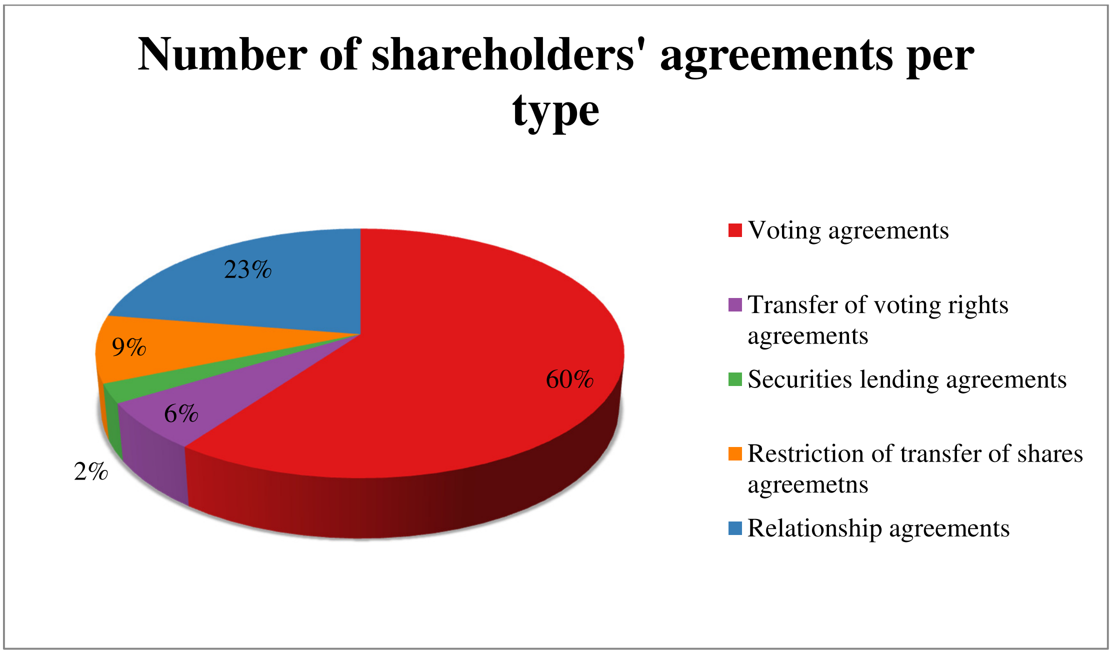

Chart 12: Number of shareholders' agreements per type

60 % of all the agreements are related to the exercise of voting rights of contracting shareholders. The prevalence of voting agreements over any other type of shareholders' agreements could be explained by the fact that for shareholders voting rights are the primary source of power in the company. By exercising their voting rights shareholders are entitled to remove and appoint members of the management body of the company, change articles of association, approve or disapprove mergers, acquisitions and make other important decisions that greatly impact the activities and business cycles of the company. Therefore, the greatest results from contractual relations might be achieved by coordinating the exercise of most powerful rights, namely the voting rights. These theoretical deliberations are affirmed by empirical results. Shareholders see the value of their voting rights and try to amplify them by the coordinating the exercise of such rights with other shareholders. Another reason for high number of voting agreements is that certain stipulations in the shareholders' agreements essentially require exercise of voting rights (even if it

is not expressly stated so in the agreement). For example, if parties agree that each of them has a right to appoint one member of the management body, this means that parties have agreed to vote in the general meeting of shareholders in a way that would guarantee that the candidate proposed by the other party is elected. Essentially, this is also a voting agreement. In other words, any undertaking that requires active participation on behalf of the shareholder in exercising his voting rights is fundamentally a voting agreement.

All of the other types of shareholders' agreements together constitute 40 % of all the agreements concluded in the analysed sample. Half of them (23 %) are the relationship agreements that were only found in the UK. The transfers of voting rights, security lending and restriction on transfer of shares agreements are not that popular among the shareholders. This could be explained by the fact that they usually address only a small issue and cannot be used to address a wide scale of questions as, in comparison, the voting agreement can achieve. Another point is that such agreements usually play supporting role for obligations arising out of the voting agreements, and thus are rarely entered into in their pure form. For example, a large proportion of the voting agreements have in addition provisions that limit the free transferability of shares of contracting shareholders (this is done in order to ensure the long term perspectives of the agreement and actual enforcement). From the 48 voting agreements included in the sample 13 included at least some provisions on the restrictions on the transferability of shares. These arguments help explain why the number of other types of shareholders' agreements is relatively small as compared to the number of voting agreements.

2.5.3. Comments per country

There were no relationship agreements or restriction of transfer of shares agreements found amongst the shareholders of companies listed on the NASDAQ OMX stock exchange. The most common agreements were the transfer of voting rights agreements that are regulated only in Lithuania. These agreements were followed by the voting agreements. There was only one securities lending agreement concluded in the analysed companies.

The high number of transfer of voting rights agreements in Lithuania (50 % of all the shareholders' agreements) might be considered as surprising because it even exceeds the number of the voting agreements. One of the possible explanations might be that shareholders by transferring their voting rights try to avoid certain obligations arising from the company and securities laws. The other possible explanation is that transfer of the voting rights is justly used for its purpose and shareholders transfer their voting rights in order to be able to exercise them more effectively.

Although there are no provisions regulating securities lending agreements in the Republic of Lithuania, these agreements are not prohibited and empirical results revealed that there is one agreement concluded amongst the shareholders of Lithuanian listed companies.

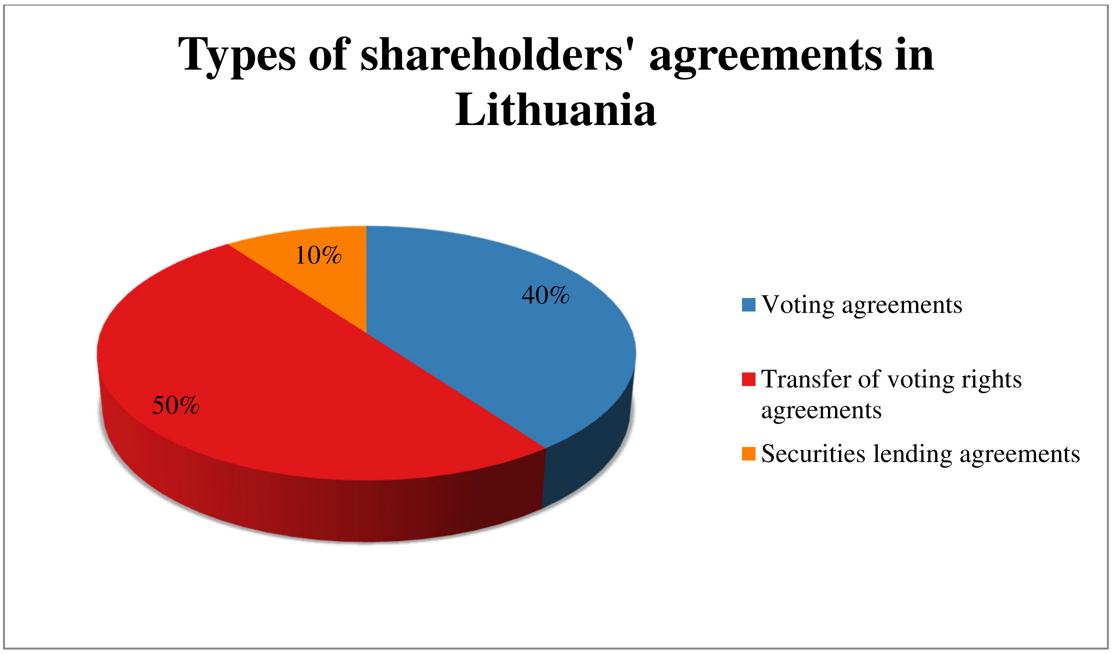

Chart 13: Types of shareholders' agreements in Lithuania

The Belgian shareholders are most active in concluding voting agreements. These agreements constitute even 86 % of the total number of shareholders' agreements concluded in the companies listed on the NYSE Euronext Brussels stock exchange. Such behaviour of shareholders (as noted earlier) is to be expected, as voting agreements include rules and undertakings related to the most valuable non-pecuniary right that shareholders have. Some of these agreements also included provisions on restriction on the transferability of shares. A total of 13 voting agreements (out of 42) included such undertakings, and were assessed to serve as an additional safety mechanism in order to ensure that contracting parties adhere to the agreement. One of the explanations why there is a high number of voting agreements in Belgium is their enforceability and validity status coupled with high presence of concentrated ownership structures in listed companies.

The other two types of shareholders' agreements (securities lending and restriction of transfer of shares agreements) constitute the rest 14 % of all the shareholders' agreements. There were no relationship or transfer of voting rights agreements found in Belgian listed companies.

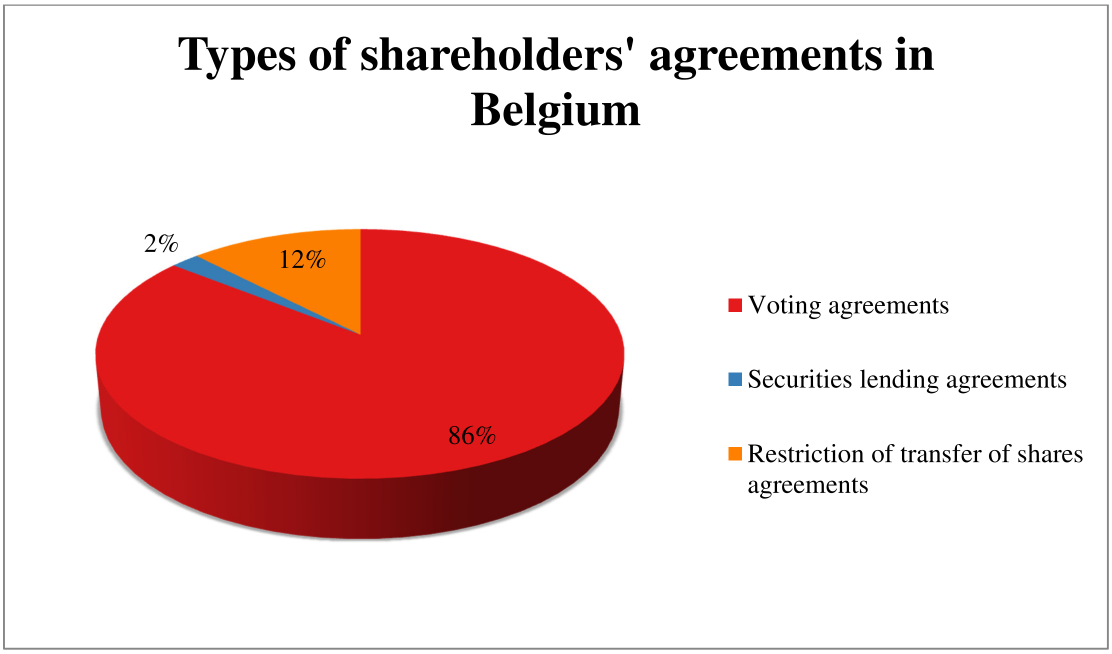

Chart 14: Types of shareholders' agreements in Belgium

Empirical results in the UK are also very specific. The most occurring type of agreement is the relationship agreement that is found only in the UK. 86 % of total shareholders agreements concluded amongst the shareholders of companies listed on the London stock exchange were considered to be relationship agreements, 9 % were voting agreements[1176] and only one shareholders' agreement dealt specifically with the restriction on transfer of shares issues.

The reason for the high number of relationship agreements should be considered to lie in the fact that majority shareholders in the UK listed companies are relatively rare. In order to compete with other companies that have dispersed ownership structures for financing majority shareholders have to come up with ways of showing the minority shareholders that it is safe to invest in their companies. Therefore, in contrast to the civil jurisdictions analysed in this dissertation, relationship agreements (as a type of shareholders' agreement) in the UK serve not as control enhancing mechanisms, but as control diluting contractual tool.

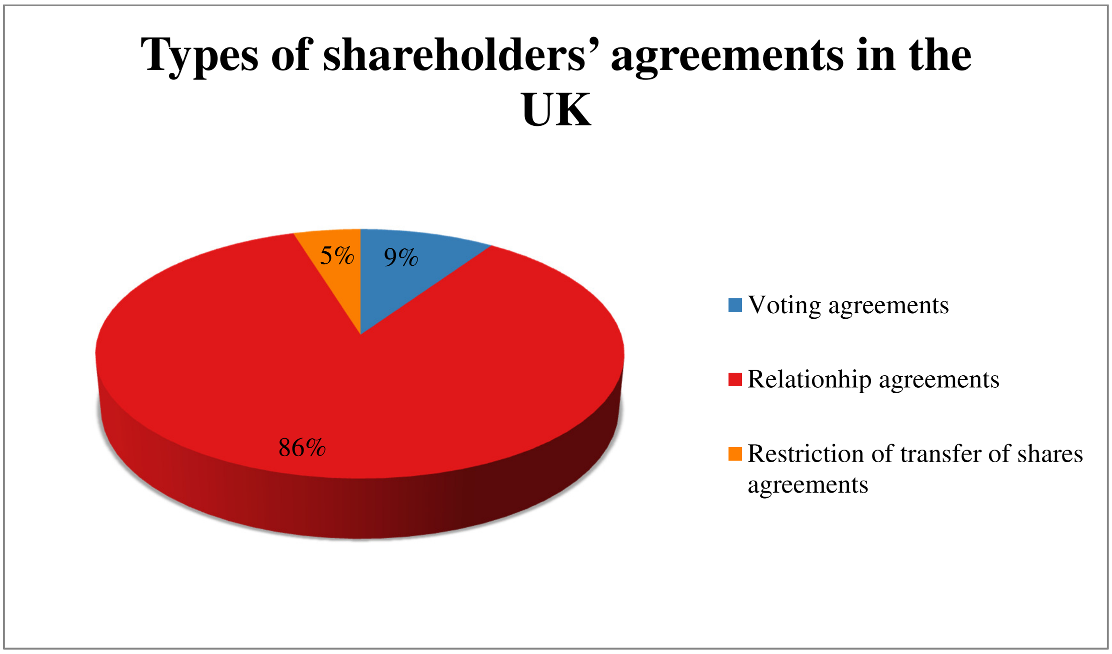

Chart 15: Types of shareholders' agreements in the UK

All of the three jurisdictions analysed in this dissertation show divergent results on which type of shareholders' agreement is most common amongst the

[1176] It should be noted that agreement concluded in Alliance Trust plc. does not entirely fall under the definition of shareholders' agreement provided in this dissertation. The agreement obliges Alliance Trust Savings Nominees Limited to vote only those shares that have clear instructions on how to vote. Therefore, this agreement does not have a shareholder as a party. However, it obliges the trust to abstain from voting the shares held in the trust, unless clear instructions are provided by the real shareholders.

shareholders of listed companies. The type of shareholders' agreement dominating in each of the country was different. In Lithuania the transfer of voting rights agreements were concluded in most of the cases. Belgian shareholders were primarily focused on the voting agreements. While in the UK the relationship agreements played the most important role. In addition, it could be observed that shareholders' agreements in two of the three analysed jurisdictions are specific and available only in that particular jurisdiction. Lithuania has specific rules relating to the transfer of voting rights agreements that are not found in other two jurisdictions. Consequently, there are no transfer of voting rights agreements in Belgium and the UK. At the same time the ownership structure of the UK listed companies pressures majority shareholders to limit their rights in order to ensure financing from the capital markets. This should be considered the reason why relationship agreements are prevailing in the UK and are found neither in Lithuania, nor in Belgium. These results also suggest that the type of shareholders agreement that is prevailing in each of the jurisdictions largely depends on two criteria: 1) the specific regulations of certain types of shareholders' agreements; 2) the ownership structure of listed companies.

2.6. Purpose of shareholders' agreements

This section of the chapter provides analysis of the empirical research on the purpose of the shareholders' agreements that were identified in this dissertation. The author is of an opinion that together with the analysis provided above on the type of the agreements this information might reveal the reasons behind contractual relationships of shareholders.

2.6.1. Presentation of the data

It should be noted that each of the contracting shareholders might have his own reasons and agenda for entering into shareholders' agreements. It can be expected that these personal interests would rarely be exactly the same or coincide in different cases. However, some generalizations were made in order to provide general trend and some insights. Taking into account the arguments laid down above in this dissertation[1177], two main purposes were distinguished: 1) shareholders' agreements that were entered into for the primarily purpose of concentrating control in the company, and 2) shareholders' agreements that provide or are intended to provide certain level of protection to the minority shareholders. It should be noted that the decision whether the agreement falls in one category or another is subjective and based on the author's understanding of the provisions of each of the shareholders' agreements that were disclosed at the time of this research.

In order to categorize agreements in accordance with their purpose certain presumptions were made. First, all relationships agreements were presumed to be entered in order to protect minority shareholders. This assumption was made taking into consideration the fact that majority shareholder limits his rights and provides for certain obligations and guarantees regarding his dealings with the company. Consequently, undertakings facilitate the situation of the minority shareholders. Second, the agreements that provide restrictions on the transferability of shares and agreements on mutual consent of the shareholders to acquire and retain control over the company were all deemed to be concluded for the purpose of concentration of control. Third, some agreements had provisions that featured both the concentration of control and minority protection rules. In these cases the author distilled the main purpose of the agreement from the available information and classified it accordingly. Fourth, in determining the purpose of the agreement the number of contracting shareholders was taken into account. If there were many contracting minority shareholders, it was presumed that the agreement was concluded for the protection of minority shareholders (unless minority shareholders were related to the majority shareholders). Fifth, if the number of

[1177] See Part II, Chapter 1.3.

voting rights of contracting shareholders exceeded 50 % (even if shareholders' agreement was concluded amongst high number of small shareholders), the agreement was classified as having its primary purpose to concentrate control. Sixth, if there was not enough information disclosed by the company to determine the purpose of the shareholders' agreement, the agreement was excluded from the data set. Due to this reason the number of shareholders' agreements presented in the table No. 7 might be slightly different from the total number of shareholders' agreements that were found to be concluded in listed companies.

	Concentration of control	Minority protection
Overall results	49	31
Lithuania	9	1
Belgium	39	10
The UK	1	20

Table 7: Purpose of the shareholders' agreements

Out of a total of 81 shareholders' agreements that were analysed, 49 were identified to be concluded for the purposes of concentrating control, while 31 were considered as protecting the interests of minority shareholders. Highest number of concentration of control agreements was concluded in Belgium, whereas minority shareholders were considered to be most frequently contractually protected in the UK. The results in the table No. 7 indicate that overall the purpose to concentrate control over the company is the driving force behind the contractual relationships amongst shareholders. However, the difference between the two purposes cannot be considered as substantial.

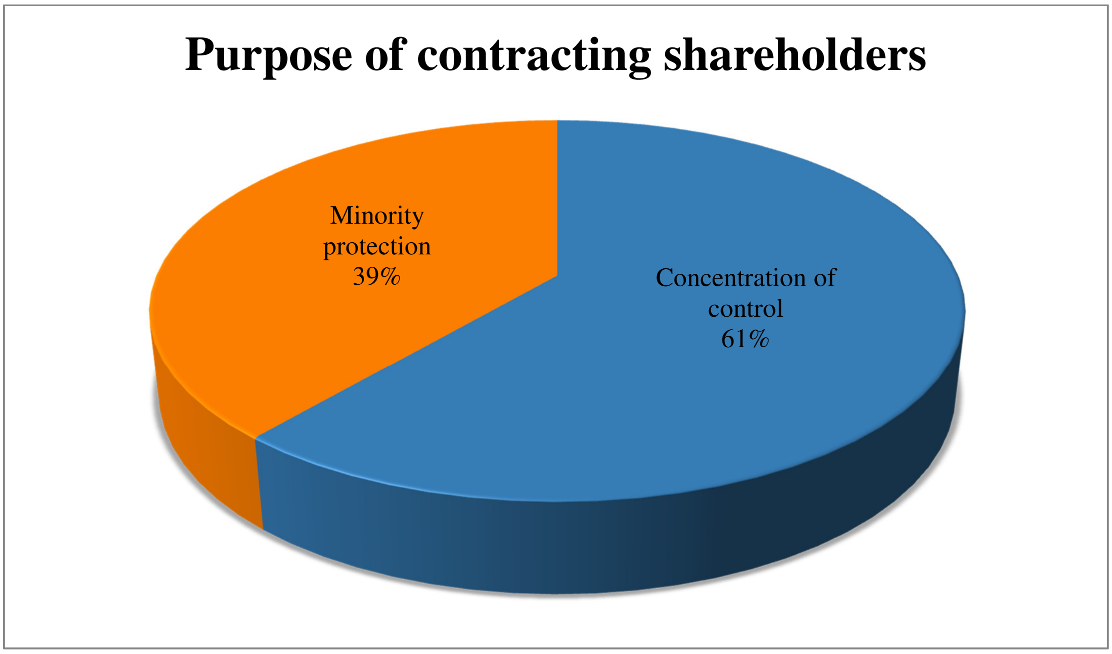

Chart 16: Purpose of contracting shareholders

2.6.2. General observations

The above results show that neither of the two purposes is prevailing as almost 4 out of 10 agreements are concluded for the protection of the minority shareholders, and 6 out of 10 agreements are aimed at concentrating control of the contracting shareholders. Such results are in line with the theoretical arguments that shareholders' agreements can be used for both the protection of minority shareholders and for concentration of control. However, it should be stressed that the number of agreements protecting minority shareholders is high due to the fact that relationship agreements in the UK were presumed to be concluded for the benefit of minority shareholders. If the relationship agreements are excluded from the calculation, then the number of agreements concluded for the protection of minority shareholders falls drastically and amounts to 11 agreements. In contrast to 49 agreements that were concluded for concentration of control, the number is more than four times lower. Such change in the number of minority protection agreements would suggest that in practice the tendencies for shareholders to agree on minority protection are relatively low.

Nonetheless, data on the purpose of the shareholders' agreements is a clear and unambiguous indication that two of the agency problems: the conflict of interests between majority and minority shareholders and the divergence of interest between shareholders and management body are addressed in practice using contractual tools. This data also indicates that shareholders are not only capable but also willing to take matters of their rights and interests into their own hands.

2.6.3. Comments on each of the analysed jurisdictions

In Lithuania 90 % of the shareholders' agreements are aimed at concentrating control in the hands of contracting shareholders and only one agreement out of every ten is aimed at protecting minority shareholders. This might be an indication that minority shareholders do not have enough incentives in Lithuania to contractually protect their interests and that the costs of entering into contractual relationships might be too high (this includes lack of information and help from competent authorities, including the NASDAQ OMX Vilnius stock exchange). The results also show that highly concentrated ownership structure (which is prevailing in Lithuania) is becoming even more concentrated due to shareholders' agreements. Thus, the actual effect that contractual relationships among Lithuanian shareholders have is not the one of protection of minority shareholders, but of acquiring and maintaining control over the company in the hands of contracting shareholders.

Chart 17: Purpose of shareholders' agreements in Lithuania

In Belgium the empirical results show that similar situation as in Lithuania exists. Shareholders' agreements with the purpose of concentration of control are dominating and constitute 80 % of all the concluded agreements. Although the number of agreements that are intended to protect minority shareholders is slightly higher than in Lithuania (10 % in Lithuania and 20 % in Belgium), nevertheless it should still be considered that protection of minority shareholders using contractual means in Belgium is not common.

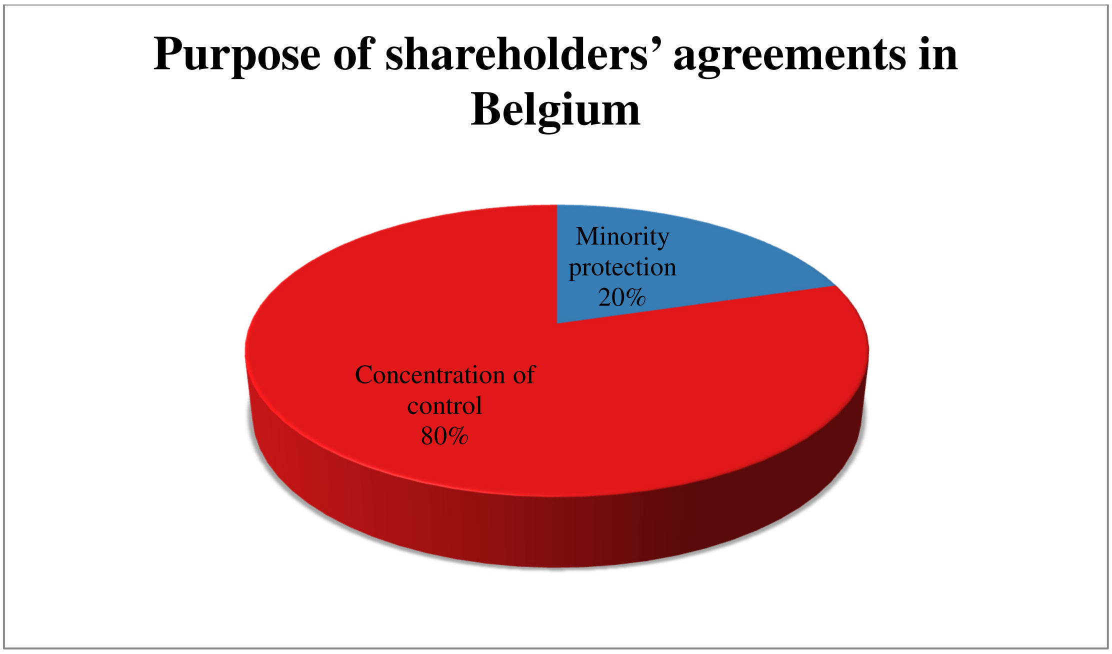

Chart 18: Purpose of shareholders' agreements in Belgium

In the UK, on the other hand, the dominating type of shareholders' agreements is the relationship agreement. Therefore, the main purpose for contracting in the UK is to protect minority shareholders. This is done not by empowering minority shareholders, but by the majority shareholder contractually limiting his influence over the company. Even 95 % of all the agreements in the UK were identified as concluded for the interests of the minority shareholders.

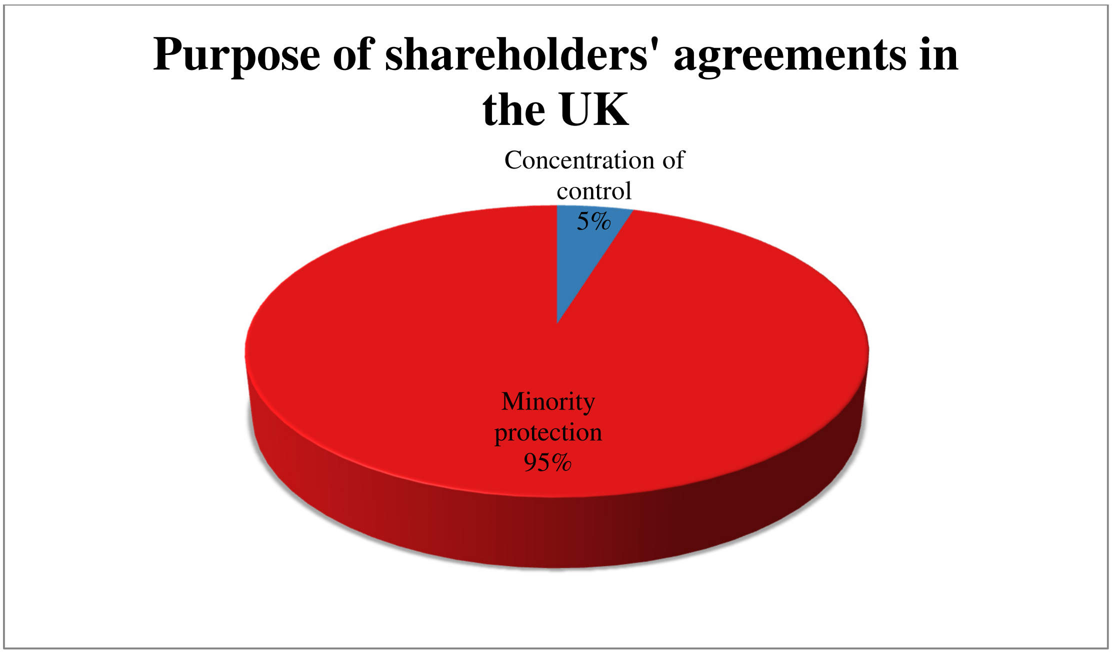

Chart 19: Purpose of shareholders' agreements in the UK

From the one point of view, these results should not be considered as surprising. Both civil law jurisdictions analysed in this dissertation have highly concentrated ownership structures. Due to this reason the intentions of the shareholders might be interpreted as aimed at protecting their interests by pooling together their control rights with other shareholders. Shareholders' agreements in these cases function as a control enhancing mechanism that confers more powers to contracting shareholders. While in the common law jurisdiction the ownership structure is scattered, and thus in order to reassure minority shareholders to invest and maintain their investment in the company the majority shareholder is compelled to contractually limit his influence over the company (and in this way protect the interests of the minority shareholders). From another perspective, the behaviour of the shareholders revealed in this dissertation might be considered as peculiar. As it was argued, theoretically minority shareholders in concentrated jurisdictions should try to protect their interests by all means possible, including shareholders' agreements. While in the UK, where dispersed ownership is prevailing, shareholders might be presumed to try to concentrate the control in their hands in order to mitigate negative consequences of conflicts of interest with the managing body. However, these theoretical presumptions fail against the empirical results that show that in reality the aims of the shareholders are on the other side of the spectrum. Therefore, shareholders' agreements in the concentrated ownership jurisdictions in practice are used to further concentrate the control over the company, and in the common law jurisdiction with highly dispersed ownership they are used to disperse the ownership even more.

2.7. Voting agreements and control of the company

The results of the empirical research provided above suggest that the most common type of shareholders' agreements is the voting agreement, which is mostly used to concentrate control in the company. At this point the question is what level of control over the company shareholders are aiming to achieve by joint exercise of voting rights. Are they aiming for *de jure* control of the company or try to achieve *de facto* control? Are minority shareholders trying to gain additional rights in the company in order to balance the influence of the majority shareholder? Due to a relatively small number of voting agreements found in the sample in Lithuania and the UK comparative analysis between the three selected jurisdictions is not provided in this dissertation[1178]. However, the author is able to provide general observations regarding the use of voting

[1178] It should be mentioned that the majority of the voting agreements analysed in this section of the dissertation are from NYSE Euronext Brussels stock exchange. Voting agreements in Lithuanian and the UK are relatively rare.

agreements and what level of control over the company contracting shareholders are aiming to achieve.

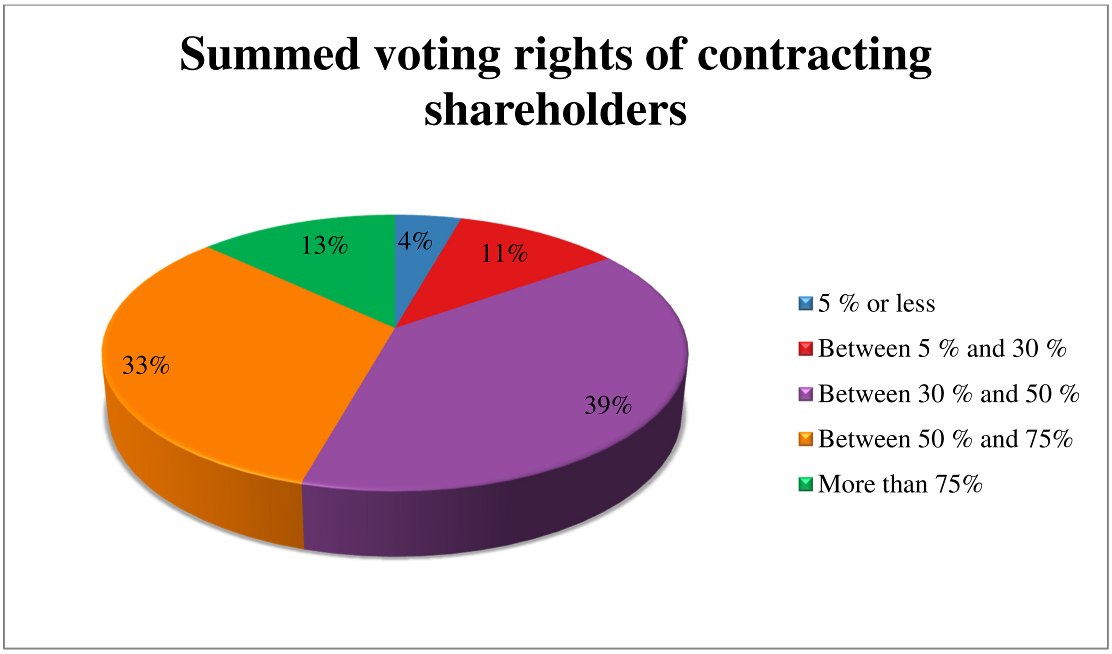

Chart 20: Summed voting rights of contracting shareholders

The above chart reveals that only 15 % of all the voting agreements are used to gain up to 30 % of voting rights in the company. This might be considered as another indication that minority shareholders are relatively passive to protect their interests to gain additional rights by concentrating control (for example, the right to put items on the agenda of the general meeting and to table draft resolutions as per article 6 of the Directive 2007/36/EC[1179]). Minority shareholders are most likely disinterested to acquire up to 30 % of the voting rights due to high coordination costs in comparison to the benefits gained. Similarly, the number of shareholders' agreements that focus on concentration of voting rights above 75 % is also low. However, this suggests that the contracting shareholders see no added value in gaining voting rights above 75 % as *de jure* control of the company can be effectively secured with just a little bit more than 50 % of total voting rights. This means that

[1179] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ 2007 L 184/17-24).

voting agreements are rarely used to gain summed voting rights below 30 % and above 75 % of total voting rights in the company.

Most of the voting agreements were entered to concentrate control between 30 % and 50 % (in total 39 % of all the agreements) and between 50 % and 75 % (in total 33 % of all the agreements) of total voting rights. This is an indication that voting agreements are used mainly as a control enhancing mechanism for the medium sized shareholders to be able to extract private benefits of control. The contracting shareholders are mainly focused on crossing the *de facto* or *de jure* control thresholds, which might suggest that voting agreements are used to gain control over the company and not just to be able to exercise specific rights requiring a relatively small number of voting rights.

The results on the summed number of voting rights of the contracting shareholders provide insights that rights to put items on the agenda of the general meeting and to table draft resolutions for items on the agenda provided in article 6 of the Directive 2007/36/EC that require no more than 5 % of total voting rights are not considered important by the shareholders. Only 4 % of total voting agreements had the goal to acquire up to 5 % of voting rights. This might be indication that some of the rights provided in the Directive 2007/36/EC are not enhancing shareholder control over the company in practice and shareholders consider them as insignificant. However, national laws of each jurisdiction might provide other rights for the shareholders that cross the 5 % threshold (and in this way might motivate minority shareholders to contract more actively).

Due to a high number of voting agreements that concentrate control above the 30 % threshold, the question arises whether the requirement for the mandatory bid rule as per article 5 of the Directive 2004/25/EC[1180] has been

[1180] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

met. As this dissertation does not deal with takeover regulation, this question and possible answers are left for future research.

Chapter 3. Part IV conclusions

The empirical data presented in this dissertation offers certain insights on the availability of shareholders' agreements in listed companies:

1) The fact that 13.79 % of the companies listed on the stock exchanges of the analysed jurisdictions have at least one shareholders' agreement amongst its shareholders shows that the shareholders' agreement, as a contractual tool, is actually used in practice in listed companies. Therefore, this fact must be acknowledged and cannot be ignored in the corporate research.
2) Shareholders in jurisdictions with concentrated ownership structure are more active in concluding shareholders' agreements (27.2 % of all the listed companies); while in jurisdictions with dispersed ownership structure the shareholders' agreements are less common (6.6 % of all the listed companies). This might be an indication that the ownership structure dominating in a particular jurisdiction might influence the presence of shareholders' agreements in listed companies. The ownership structure is considered to influence the type of shareholders' agreements that are entered into in particular jurisdiction. For example, in the UK the relationship agreements are dominant.
3) Research results on whether the level of protection in each of the analysed jurisdictions has effect on the presence of the shareholders' agreements are mixed, and therefore it cannot be concluded that in the jurisdictions with better shareholder protection laws (and thus more sophisticated securities markets) there are less shareholders' agreements in listed companies (and *vice versa*). Despite this, the author is of an

opinion that the level of shareholder protection is one of the factors that correlates with the presence of shareholders' agreements.

4) Empirical research indicates that in jurisdictions with both dispersed and concentrated ownership structures the majority of the agreements are concluded for long term perspective and goals (with the exception of Lithuania). This might be an indication that shareholders' agreements are appropriate tools to promote long term ownership in listed companies.
5) On average there are between 3 and 4 parties to the shareholders' agreement which shows that large groups of contracting shareholders (this is most of the cases important to minority shareholders) are rare. Possible explanation is that costs and other related obstacles associated with concluding the shareholders' agreement are higher for larger groups of contracting shareholders than the benefits that can be gained from contracting. Therefore, it is less likely that large numbers of minority shareholders (with relatively small voting rights) are to enter into shareholders' agreement in order to improve their position in the company.
6) The data on the size of contracting shareholders suggests that shareholders having between 5 % and 30 % of the voting rights are most likely to conclude shareholders' agreement. In contrast, shareholders owning more than 50 % of the voting rights are less common parties to the shareholders' agreement. Therefore, it can be concluded that the interest to enter into shareholders' agreements decreases as the control rights in the company increase.
7) The most common type of shareholders' agreement is the voting agreement. Thus, shareholders tend to contract on the exercise of their most valuable non-pecuniary right – the right to vote. This might be explained by the fact that most important decisions in the company are adopted by the general meeting of shareholders and require the exercise of voting right.

8) Voting agreements are used mostly by medium sized shareholders to further concentrate control in order to gain either *de jure* or *de facto* control of the company. Furthermore, agreements with the summed voting rights of contracting shareholders below 30 % and above 75 % are not common. There were only 4 % of voting agreements to act in concert with a total of 5 % (or less) of voting rights which might be an indication that shareholders do not value the rights to put items on the agenda of the general meeting and to table draft resolutions for items on the agenda as they are indicated in article 6 of the Directive 2007/36/EC.
9) The results of the empirical research indicate that shareholders' agreements are entered for both purposes: in order to concentrate the control and in order to protect the interests of the minority shareholders. Despite this, the majority of all the agreements are entered in order to concentrate the control of the company. Therefore, the function of the shareholders' agreement to protect the interests of the minority shareholders is not very common in practice (especially in concentrated ownership jurisdictions).

PART IV: A TOOL TO MITIGATE CORPORATE CONFLICTS OF INTEREST

The above theoretical, comparative and empirical analysis shows that shareholders' agreement should be considered as a contractual tool that is available not only to shareholders of private companies, but also to companies listed on the stock exchanges. The question is whether this contractual tool can be used to mitigate negative consequences of conflicts of interest arising amongst corporate constituents (with a particular emphasis on majority and minority shareholders and conflicts of interest between shareholders as a class and management body). It is argued below that shareholders' agreement 'is essentially a device for reducing conflict'[1181].

Chapter 1. Theoretical approach

Theoretical analysis provided in this dissertation has revealed that listed companies play an important role in the economies of the states. Legal scholars, independent non-governmental institutions, national and European legislative bodies specifically address, analyse and regulate various issues concerning listed companies. In Europe shareholders in this context are treated with special attention and their position and rights are being enhanced continuously.

However, strictly legal approach to issues in listed companies is insufficient as it does not provide any insights into the inner relations existing within the company. Therefore, when analysing legal measures and instruments that influence relationships between different corporate constituents legal scholars have to take advantage of the theories of the firm provided by the economists. Although there are no perfect theories, the author's position is that agency theory is best suited for analysing different legal strategies to mitigate agency problems. This position is based on the fact that agency theory takes into account the human nature (the REMM model)

[1181] THOMAS, K. R.; RYAN, Ch. The Law and Practice of Shareholders' Agreements. 3rd edition. London: LexisNexis, 2009, p. 1.

and defines what type of relationships develop between different corporate constituents. Agency theory suggests that the members of the management body are the agents of the shareholders (who act as a principal). Accordingly, majority shareholders are the agents of the minority shareholders who are considered to be the principals. Thus, agency theory is capable of explaining and providing theoretical ground for legal intervention (regulation) into two types of conflicts of interest: firstly, between shareholders and the management body and, secondly, amongst majority and minority shareholders.

From theoretical point of view, shareholders' agreements in their essence are contractual coordination devices that help shareholders to jointly control the company and to establish themselves in the company by actively exercising their rights and protecting their interests. Although they are primarily based on the principle of freedom of contract, their subject matter must be related at least to: the company (for example, policy and strategy of the company); the shares of the company (for example, restriction on transfer of shares); and (or) rights, duties and obligations of shareholders' towards each other (for example, to vote in concert) or towards the company (for example, contractual duty of the shareholder to transact with the company at an arms' length principle).

As shareholders' agreements are based on the principle of freedom of contract, they depend on the will of contracting shareholders. If shareholders are active and seek to protect their interests (this happens when benefits of contracting outweigh the costs), they are likely to enter into shareholders' agreement. On the other hand, if shareholders are just passive investors who do not have any incentives to contract, they will more likely rely on other statutory rights that grant them protection (which might be not as effective, but not as costly as well).

The freedom of contract is both the strength and the weakness of shareholders' agreements. The strength of this tool is that it can be adapted to the needs and interests of contracting shareholders and to every company in question. While some laws conferring additional rights or protection to shareholders might be actually counterproductive[1182], shareholders' agreements do not suffer from this downside as they are created and entered into by shareholders themselves. This feature allows shareholders' agreement to be a very flexible and effective tool to solve agency problems. On the other hand, the weakness is that shareholders have to be active and try to protect their position in the company with their own actions (which might entail additional costs). This means that in order to be better protected (and to gain additional rights against each other and the company) shareholders have to put even more resources into their investment in the company. This might be considered as a bar for minority shareholders who are less incentivized to monitor how the companies are managed and run.

From the agency perspective, there are two main reasons why shareholders enter into contractual relations. First, they might seek to concentrate control, obtain more power over the company and in this way mitigate negative consequences of conflicts of interest between shareholders and the management body of the company. Due to the reason that conflicts of interest between the management body and the shareholders are sharper in countries with dispersed ownership structures, it could be theoretically presumed that in these jurisdictions there are more shareholders' agreements with the aim to concentrate control. Second, minority shareholders might seek to protect their interests and enhance their rights in order to prevent the majority shareholder from expropriating them. Considering the fact that minority shareholders are likely to be abused by the majority shareholder only in the jurisdiction with a concentrated ownership structure, it is a valid theoretical presumption that shareholders' agreements with the aim to protect minority shareholders should be prevailing in such countries.

According to agency theory, the agent is presumed to act opportunistically and this in most of the cases is against the interest of the

[1182] ARMOUR, J. *et al*. Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis. *Journal of Empirical Legal Studies*, 2009, Vol. 6, No. 2, p. 374.

principal. Opportunistic behaviour arises only after the principal-agent relations are established (for example, majority shareholders are apt to act opportunistically only after acquire majority shares of the company and only when there are minority shareholders). Thus, appropriate safeguards that are devised *ex ante* benefit the *ex post* relations between the principal and agent in mitigating negative consequences of possible opportunistic behaviour[1183]. Shareholders' agreement in this regard serves as *ex ante* mechanism to safeguard the interests of the principal[1184].

From the theoretical perspective there are three obstacles that might hinder the conclusion of shareholders' agreements in listed companies. Firstly, the contracting costs might be too high (including coordination, negotiation and drafting costs). This means that the conclusion of the contract might be too costly when weighed against the benefits that it might create for the contracting parties. Secondly, the rational shareholder apathy hypothesis presumes that individual shareholders are not interested in exercising their voting rights. It is easier for them to exit the company than to gather all the relevant information in order to cast an informed vote in the general meeting of shareholders. This passive behaviour might prevent shareholders from entering into contractual relations as this might hinder the ability of the shareholder to exit the company. Thirdly, under the incomplete contracts presumption, it is impossible (or extremely costly) to draft a contract that would predict and regulate all possible relations and issues that might develop between the contracting parties. This uncertainty might be the reason that could prevent shareholders from contracting.

Taking into account the above arguments, it could be stated that theoretically shareholders' agreements are well suited to mitigate negative consequences of conflicts of interest (both in case of shareholders v.

[1183] WILLIAMSON, O. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: The Free Press, 1985, p. 48-49.

[1184] After conclusion of the agreement it could still be argued that parties can act opportunistically and breach the shareholders' agreement or deviate from its provisions in other ways.

management body and in minority shareholders v. majority shareholders). However, there the above presented obstacles that might prevent shareholders of listed companies from entering into shareholders' agreements.

Chapter 2. Comparative approach

The comparative analysis provided in the second part of this dissertation has shown that legal regime of shareholders' agreements in Lithuania, Belgium and the UK allows shareholders of listed companies (and other companies as well) to enter into contractual relationships in order to *ex ante* regulate various issues and possible future problems that might arise between them. The actual legal environment in all of the examined jurisdictions facilitates the use of shareholders' agreements by not providing detailed regulations and limiting the scope and content of the agreement. Therefore, the contractual relations amongst shareholders are mostly based on the principle of freedom of contract (parties are allowed to contract about everything except what is expressly prohibited by the law).

The author is of an opinion that such legal regime (with only certain restrictions related to the subject matter of particular types of shareholders' agreements) should be considered as optimal. First, it allows shareholders to freely decide and tailor each agreement to their specific needs and situation. There already are numerous provisions in company laws that are considered to be default[1185]. Thus, shareholders have to be given a chance to decide on whether to apply rules provided in the company acts or to tailor them to their needs (which in certain cases can be done not only by amending articles of association, but also by entering into shareholders' agreement). This is especially important as default rules or provisions should not be considered as optimal to all companies due to different ownership structures, size of the

[1185] ARMOUR, J.; HANSMANN, H.; KRAAKMAN, R. What is Corporate Law? In KRAAKMAN, R. *et al.* (eds.) *The Anatomy of Corporate Law: A Comparative and Functional Approach. 2nd edition*. Oxford: Oxford University Press, 2009, p. 20-23.

company, goals and interests of contracting shareholders, number of parties and voting rights held by the shareholders. Second, due to great variety of possible situations and scenarios that could be the subject matter of shareholders' agreements, the legislature should not try to regulate them in great detail or try to provide limited description of shareholders' agreement. This is a task that should be considered as being beyond the capability of any legislature and would only undermine the usage of shareholders' agreements in practice. Even if there were detailed general provisions on shareholders' agreements, the constantly (and rapidly) changing economic reality, the needs of shareholders and the way that modern companies are managed would dictate that such statutory provisions would have to be adapted to the reality very often. Thus, they would hinder the development of the relations amongst shareholders. Third, the legislature (or courts) is in better position to provide limited number of restrictions to the subject matter of particular types of the shareholders' agreement (statutory restrictions, as in Lithuania and Belgium, or rules formulated by case law, as it is in the UK). This approach allows to react quickly to changing practice and prevent possible abuses of shareholders' agreements that might disrupt the balance of powers between different bodies within the company (for example, restriction to agree on voting for all the proposals of the managing body of the company does precisely that). Fourth, by not providing any detailed provisions of shareholders' agreements the legislature leaves actual control of the validity of the agreements to the courts. They can react faster, analyse situation on a case by case basis and are usually equipped with necessary tools to provide effective remedies depending on the situation.

Despite certain positive aspects that have been enumerated above, there are also drawbacks of not having general legal provisions on shareholders' agreements. First, it is easier for shareholders to abuse certain company law rules and to distort distribution of power within the company when there are no strict rules regulating or prohibiting possible abusive behaviour (one example is the securities lending agreement which can be used to gain voting rights in the general meeting of shareholders that are vastly disproportional to the economic interests of the respective shareholder). However, as mentioned above, this might be overcome by certain restrictions imposed by the legislature on the subject matter of different types of shareholders' agreements (in case of securities lending agreement it might be stipulated that shareholder lending the shares has to provide with the rules and procedure on how the borrower has to exercise votes attached to the shares that are being lent). Such intervention does not require the legislature to regulate specific type of shareholders' agreement in great length, only to provide certain restrictions as to the subject matter of the agreement (for example, regulation on voting agreements in Lithuania and Belgium). Second, lack of legislation could pose some problems with enforceability of shareholders' agreements. This can be overcome by case law (as it is in the UK with voting agreements) or by imposing a general standard on the validity and legality of shareholders' agreements (as it was the case in Belgium where courts first recognised the validity of shareholders' agreements and later legislature implemented a general provision into the W.Venn.). Third, lack of statutory provisions might create uncertainty amongst the shareholders (including the validity and enforceability of the agreement), and thus shareholders might be actually hesitant to enter into contractual relations or might be oblivious to the fact that there is such possibility. The best example is the relationship agreements in the UK. Similar agreements are found neither in Belgium, nor in Lithuania. However, taking into account the fact that ownership structure in continental Europe is concentrated, the relationship agreement should be considered as a reasonable contractual tool to prevent majority shareholders from expropriating the minority. The problem lies in the validity and enforceability of such agreement. There are neither statutory acts, nor case law on whether majority shareholder could be obliged to perform his undertakings against the company (especially by the minority shareholders who are not parties to the agreement, but could be considered as beneficiaries of the contract). In other words, the lack of recognition of such agreements might be the cause of their absence.

The above provided arguments against and for detailed legislative intervention in the field of shareholders' agreements together with the view provided by some academic scholars that it should not be expected that all issues and possible conflicts of interest between different corporate constituents could be resolved using only contractual means, suggests a more balanced approach[1186]. Neither statutory provisions, nor contracts alone are capable of settling various conflicts of interest that plague corporate law. These two instruments should be used simultaneously taking into account the actual situation that exists in a particular country and in the majority of the companies. Thus, statutory law should provide default rules, which would be applicable in case shareholders or the company does not choose to amend them, and mandatory rules that would insure that public policy is observed and that abuse of power in the company is limited as much as possible.

Firstly, taking into account the ambiguity that is always around the shareholders' agreements, statutory provisions should clearly state whether such contractual relationships amongst shareholders are valid and enforceable (including specific performance remedy). For example, in Lithuania it is still not clear whether voting agreements can be enforced in the courts. This does not mean that there must be extensive and detailed regulation. On the contrary, statutory provisions should just legalize shareholders' agreements and leave majority part of their implementation to the contracting parties.

Secondly, in order to limit abusive behaviour that has been already recognised by scholars, courts or is clearly seen in practice, the legislature can provide specific restrictions on the subject matter of a particular type of shareholders' agreement. For example, in Belgium there are no restrictions to conclude a voting agreement against a monetary gain (which would amount to vote buying). There have been a lot of attention form company law scholars around the world that vote buying should be at least limited. Thus, it might be

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[1186] DAVIES, P. L. *Gower and Davies' Principles of Modern Company Law. 8th edition*. London: Sweet & Maxwell, 2008, p. 112.

feasible for the Belgian legislature to consider an additional restriction on the subject matter of the voting agreement.

Thirdly, standards should be adopted in order to allow courts to decide on the validity and enforceability issues of shareholders' agreements when they are in line with statutory restrictions, but are against interests of one of the contracting parties or corporate constituents of the company. Standards also allow the laws to remain up to date and enable courts to react to the most relevant situations that occur in practice. The best example is the standard in the UK and Belgium that all shareholders' agreements have to be in the interests of the company. Similar rules also exist in other countries. For example, in France shareholders are required to exercise their voting rights in the interests of all the shareholders of the company (the concept might be a little narrower than the interests of the company) and not solely to meet their own private interests[1187].This standard insures that there will be no abusive contracting in order to shift the control and power in the company and at the same time hurt the interests of other corporate constituents. There is no such standard in Lithuania, therefore it would be recommended for the Lithuanian legislature to consider implementing it into the CC. The author is of an opinion that general contract law rules and standards for invalidating shareholders' agreement are not sufficient. Firstly, it would be generally harder for shareholders that are not parties to the shareholders' agreement to justify and prove that their rights and interests might be infringed by the agreement[1188]. Secondly, it would be legally unjustified to rely solely on the rules for validity of the decisions adopted in the general meeting of shareholders, which can be invalidated if they are against good faith and reasonableness principles[1189]. This would not solve the problem at its core (shareholders' agreement), but would only eliminate the negative consequences (decision of the general

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[1187] ANDENAS, M.; WOOLDRIDGE, F. *European Comparative Company Law*. Cambridge: Cambridge University Press, 2009, p. 296.

[1188] For example, under articles 1.78(4) and 6.227 (3) of the Lithuanian CC there is a limited number of persons who can apply to court with a claim to invalidate a contract.

[1189] Article 2.82(4) of the Lithuanian CC.

meeting of shareholders). Shareholders' agreement would still be valid and would be relied upon while voting in the future. There might be also shareholders' agreements that do not necessarily provide for rules to vote in the general meeting of shareholders, and thus no decision might be adopted in accordance to such agreements. Thirdly, from the perspective of Lithuanian law, there is already an obligation for the members of the management bodies to act in the interests of the company[1190]. Therefore, such concept should be already known and additional obligation for the shareholders' agreement to be in the interests of the company would not create any additional uncertainties to the legal system. Fourthly, as was argued above[1191], the theoretical shareholder versus stakeholder debate translates into the interests of the company. Thus, the test to be applied on the shareholders' agreements should also reflect the position that a particular jurisdiction holds regarding the interests of shareholders and other stakeholders. Fifthly, the accumulation of voting rights presupposes possible abusive behaviour of majority shareholders. Due to this reason all of the major jurisdictions in the world provide for a check or test in order to ensure that the interests of other corporate constituents are not infringed[1192]. Taking into consideration all the arguments provided above, it should be concluded that requirement for the shareholders' agreements to be in the interests of the company are in line with the general principles of company law (shareholders should determine what is right and wrong and not company law) and should not be regarded as surplus.

To sum up, comparative analysis on the shareholders' agreements in Belgium, Lithuania and the UK revealed that legislature does not provide detailed regulation of shareholders' agreements in general. There are certain restrictions formulated for particular types of shareholders' agreements, but they are usually clearly defined and limited to particular cases. Therefore, the conclusion is that there are no statutory or case law restrictions for

[1190] For example, article 19(8) of the Lithuanian ABI.
[1191] See Part I, Chapter 3.3.
[1192] SIEMS, M. *Convergence in Shareholder Law*, Cambridge: Cambridge University Press, 2008, p. 201-204.

shareholders' agreements to be entered into amongst the shareholders of companies listed on the regulated markets. Thus, from a comparative point of view shareholders' agreements can be used as a tool to mitigate agency costs.

Chapter 3. Empirical approach

In part 3 of this dissertation a thorough empirical analysis is provided in order to test whether shareholders' agreements are actually being concluded in practice.

The results show that 13.79 % of all the analysed listed companies have at least one shareholders' agreement concluded amongst the shareholders. This is a clear indication that shareholders' agreements are present in listed companies and neither scholars, nor legislature can neglect this fact in carrying out research or enacting statutory acts. The most active shareholders are in continental Europe (in Belgium in particular), while activity of shareholders in the UK seems to confirm the shareholder passivity hypothesis. There are almost five times less shareholders' agreements concluded in the UK than there are in Belgium. This observation suggests that there are certain reasons for such considerable differences between selected jurisdictions. However, possible explanations can be given only if the empirical results are interpreted together with the theoretical and comparative approach (please see next chapter).

Furthermore, it has been established that there are more shareholders' agreements concluded with long term perspective than there are short term contractual relations. These results demonstrate that shareholders' agreements in the eyes of contracting parties are seen as devices that can be effectively utilized only during a long period of time. Thus, shareholders who enter into contractual relations with their fellow shareholders are more likely to remain owning the shares of the company in comparison to those that do not have any binding contractual relations with other shareholders. In the light of mitigation of the agency costs, this might be an important feature of the shareholders' agreement. The long term perspective of the contracting shareholders allows them to agree at least on the basic rules of the game. As their welfare and interests depend on the performance of the contractual obligations and rights, it might be presumed that the risk for one of the shareholders to start expropriating other shareholders is reduced (at least for the contracting shareholders).

The most likely size of the shareholder, who is a party to the shareholders' agreement, is between 5 % and 30 %, while very small minority shareholders with less than 5 % of voting rights and majority shareholders with more than 50 % are an exception. This entails that while shareholders' agreements are concluded in the listed companies, most of the times they are limited to a certain group of shareholders who are neither too small (and thus disinterested in contracting), nor too big (who have all the control over the company they need). Thus, the presence of shareholders' agreements most of the times is limited to the relatively large shareholders who have incentives to contract amongst themselves (or with minority shareholders) in order to gain additional benefits of control over the company. The results on the size of contracting shareholders might also suggest that shareholders' agreements are most effective in companies with relatively concentrated ownership structures: with a number of large shareholders, who individually do not have enough power to control the company, and the company remains solely in the hands of the management body. Therefore, the contractual relations amongst the shareholders allow concentrating control, and thus mitigating the agency problem between the shareholders and the management body of the company.

The size of the contracting shareholders closely correlates with the fact that shareholders' agreements are rarely concluded between a large number of contracting parties and on average there are 3-4 shareholders to the agreement. Only a small number of shareholders' agreements analysed in this dissertation had more than ten parties. From agency theory perspective this confirms the position that very small shareholders are less likely to contract as they incur more costs. Due to the small stake that each small shareholder has in the company, a relatively large number of contracting parties (usually more than ten) is needed in order to achieve a threshold of voting rights that at least gives a limited amount of control over the company. At the same time, relatively large shareholders need less contracting shareholders as the amount of voting rights they own is much higher and they can achieve the same results as the minority shareholder, but with fewer conttracting shareholders. Thus, the coordination costs are presumed to be much lower. One possible explanation for the above observations is that shareholders' agreements that have their principal purpose to protect rights of the minority shareholders are less likely between minority shareholders themselves as they incur more costs compared to relatively large shareholders in protecting their rights.

The most common shareholders' agreements from the data sample provided in this dissertation are the ones dealing with the voting rights of the shareholders. This result suggests that shareholders enter into contractual relationships most of the times in order to efficiently exercise their most valuable control right over the company – the right to vote. In continental Europe the distribution of power is stipulated in the statutory acts and majority of the provisions on the control over the company are of mandatory nature. Shareholders usually have the ultimate decision making power, provided that they can effectively exercise their voting rights. Thus, the number of shareholders' agreements dealing with voting rights of the shareholders represents their willingness to protect their rights and interests. Depending on the aim of the contract, the shareholders' agreement regarding the exercise of voting rights can mitigate both agency problems: they can empower shareholders in case of shareholders v. management conflicts of interest or they can allow minority shareholders to protect their interests against possible expropriation by the majority shareholder.

All the agreements analysed in this dissertation were divided into two groups according to the purpose they were concluded for. The results on the purpose of the shareholders' agreements suggest that contractual relationships amongst shareholders to concentrate control are more likely in jurisdictions with the concentrated ownership structure, while there are more shareholders' agreements with the purpose to protect minority shareholders in the countries with dispersed ownership structures. Thus, from the perspective of agency theory, shareholders' agreement as a legal tool is more likely to be effective in continental European countries in order to avoid the conflicts of interest between shareholders as a class and the management body. While in common law jurisdictions it might be presumed to be more effective in mitigating the negative consequences of the agency problem between minority and majority shareholders.

To sum the insights provided by the empirical research, it might be stated that shareholders' agreement can be used as a tool to mitigate negative consequences of conflicts of interest. However, there are certain factors and situations where the shareholders' agreement is likely to be more effective or the parties are more likely to be interested to contract. Thus, the effectiveness of the agreement depends on the number of voting rights of the contracting parties, the purpose of the agreement, the number of the contracting parties and whether the agreement is concluded for a long term.

Chapter 4. Systematic approach

The results of the theoretical, comparative and empirical research should be interpreted and analysed in conjunction with each other. The author believes that this gives a more holistic approach that might provide more and different insights than studying shareholders' agreements strictly from theoretical, comparative or empirical point of view.

4.1. Empirical results contradict theoretical arguments

This dissertation started with a theoretical presumption that shareholders' agreements can be used as contractual tools to mitigate negative consequences of conflicts of interest in publicly listed companies. The theoretical analysis suggested that shareholders' agreements are best suited to mitigate the agency problem between shareholders and the management body in the jurisdictions with dispersed ownership structures. Furthermore, it was argued that in concentrated ownership jurisdictions shareholders' agreements might mitigate conflicts of interest between majority and minority shareholders. However, taking into account the results from the empirical research, the theoretical assumptions have to be adjusted.

As it was explained above, the empirical data contradicts the theoretical assumptions. The results suggest that shareholders' agreements with the purpose to concentrate control are prevailing in the jurisdictions with the concentrated ownership structures, while the interests of minority shareholders are more often protected in the jurisdiction with dispersed ownership structure. This phenomenon can be explained by the following arguments and comments. First, the theoretical assumption that shareholders' agreements can be concluded in listed companies should be narrowed by the empirical observations that contractual relationships are formed amongst a limited number of shareholders who on average own a relatively large part of voting rights in the company. This entails that obstacles to contract (coordination costs and rational shareholder apathy) must affect primarily minority shareholders. For this reason, agreements only amongst minority shareholders are very rare, and thus it is more difficult for such shareholders to contractually protect their interests. However, minority shareholders can still be parties to the shareholders' agreements if they are contracting with relatively large shareholder. Their interests can also be protected even without them being parties to the agreement (for example, by the relationship agreement). These observations are furthermore supported by the fact that there are more shareholders' agreements concluded in continental Europe (where ownership concentration is very high) than there are in the UK. The majority of the agreements in the UK are relationship agreements that are usually concluded between majority shareholder and the company (these agreements protect the interests of minority shareholders).

Second, the most common type of shareholders' agreements is the voting agreement. This signifies that costs incurred while contracting are outweighed by the benefits in majority of the cases only when the most valuable right that the shareholders have (the right to vote) is the object of the agreement. Thus, contractual relations enable shareholders to exercise their voting rights in a more efficient way. However, this observation is valid only when a critical mass of voting rights is reached. Empirical data shows that most active shareholders own between 5 % and 30 % of total voting rights and try to collectively achieve either *de jure* or *de facto* control of the company. Minority shareholders are less likely to enter into a voting agreement because the threshold needed for the benefits to outweigh the costs is harder for them to reach. In these cases there are more contracting parties who have their own private interests that might be in conflict with the other contracting shareholders. For these reasons the author supports the view that shareholders' agreements are less likely to be concluded amongst the minority shareholders.

Thirdly, it has been identified in this work that the number of contracting shareholders decreases as their control rights in the company increase. This might be falsely interpreted as supporting the theoretical hypothesis that minority shareholders might contractually protect themselves against the majority shareholders. It might be argued that there are many small shareholders who contractually bind themselves with fellow shareholders, while majority shareholders are relatively rare. However, this is not the case. Only few shareholders' agreements where most of the shareholders were minority shareholders have been found. On the other hand, majority of the agreements were entered into by medium sized shareholders (owning between 5 % and 30 % of total voting rights) who were contracting amongst each other. This confirms the view that medium sized shareholders and majority shareholders are generally not interested in contracting with minority shareholders. Therefore, theoretical arguments that minority shareholders can effectively contract with medium sized and majority shareholders should not be supported.

These arguments suggest that minority shareholders are most of the times in a position that prevents them from contracting effectively amongst each other. This results in fewer numbers of shareholders' agreements amongst minority shareholders with the purpose to protect minority shareholders both in the concentrated and dispersed ownership jurisdictions.

4.2. Shareholders' agreements in the dispersed ownership jurisdiction

The analysis provided in this dissertation poses another challenging question. The empirical analysis revealed that there are less shareholders' agreements in dispersed ownership jurisdiction as compared to the concentrated ownership jurisdictions. Why do such differences exist?

First, the data provided in this dissertation illustrates that shareholders' agreements are mostly concluded amongst medium sized shareholders (owning between 5 % and 30 % of voting rights) and there are 3-4 contracting shareholders on average. These conditions match the situation in the concentrated ownership jurisdictions. However, in dispersed ownership jurisdictions there are only few shareholders holding between 5 % and 30 % of voting rights. Most of the shareholders are very small and do not have large voting blocks. Thus, there are fewer shareholders' agreements compared to the concentrated ownership jurisdictions.

Secondly, as it was mentioned throughout this dissertation, the coordination costs for a large number of small shareholders are considered to be higher than the costs incurred by few relatively large shareholders. In addition to this, the private benefits of control are likely to be lower for a larger number of small shareholders than for a few relatively large owners of the shares. The lack of financial incentives and possible future gains (that would outweigh incurred costs) greatly limit the possibility that a shareholders' agreement is concluded only amongst minority shareholders. This confirms theoretical assumptions that small shareholders in highly dispersed ownership pattern jurisdictions are passive and are rationally apathetic because the small control rights are not enough to incentivize them.

Thirdly, the most common type of shareholders' agreements (the voting agreement) is relatively rare in the UK. Most of the agreements were identified as relationship agreements concluded between the company and majority shareholder. Thus, shareholders in the UK are considered to be passive in collectively exercising their voting rights.

Taking into account all the arguments and empirical data provided in this dissertation the author has identified the following criteria and characteristics, which increase the likelihood for the shareholders' agreement to be concluded amongst the shareholders of a particular company:

1) The statutory acts or case law clearly recognise the validity and enforceability of shareholders' agreements;
2) The shareholders have long term goals and perspective regarding the business of the company and their participation in it;
3) There are three to five relatively large shareholders whose voting rights combined would form at least a simple majority of all the voting rights;
4) The company is listed in the jurisdiction with a concentrated ownership structure;
5) Shareholders are willing to coordinate the exercise of their voting rights (costs are lower than benefits).

4.3. Regulation of shareholders' agreements

The next observation is related to the comparative and empirical research. The comparative analysis of selected jurisdictions has shown that each of the countries deals with the regulation of shareholders' agreements in a slightly different way. Moreover, the empirical research has partially revealed that recognition of a particular type of shareholders' agreement has direct influence to the number of such agreement actually concluded in practice by the shareholders of listed companies.

The author's views are that in order for the shareholders' agreement to become an effective contractual tool that is capable of solving agency problems there are some necessary preconditions (which should be weighed and balanced against each other). Firstly, it should be always kept in mind that this is a contractual tool that is based on the principle of freedom of contract. This is the strength of this contractual device. Too much rules or complex regulations in national laws would severely weaken or limit the possibility for shareholders to adopt the contract to their specific needs. Therefore, shareholders' agreements have to be kept as flexible as it is possible. Secondly, it cannot be denied that (as any legal device or measure) shareholders' agreements can be abused and might cause more damages to other shareholders or the company than it is creating benefit to the contracting shareholders. Such reoccurring abuses should be identified in each of the jurisdiction separately. However, the number of such restrictions should be limited. A very flexible way to deal with possible restrictions is to require that shareholders' agreements would not be against the interests of the company (which also include shareholders as a class). This would not restrict shareholders from benefiting from contractual relations, but would at the same time align their interests with the interests of the company. Thirdly, in order to balance the freedom of contract with possible statutory restrictions, the control of validity and enforceability of shareholders' agreements should be left to courts (or arbitration as might be the case). This would require legislature to establish only general principles (as, for example, interests of the company) that would be invoked and interpreted by courts. Furthermore, this approach would create a strong link between a tailored contract amongst shareholders and accordingly tailored decision of the court that would take into account actual relations among shareholders. Fourthly, this dissertation has established a direct link between the availability of certain types of shareholders' agreements in listed companies and the recognition of them by the legislature.

Therefore, in order to promote certain type of shareholders' agreements and encourage shareholders to enter into contractual relationships the legislature should clearly indicate in the statutory acts whether a particular type of shareholders' agreements is valid and enforceable contract. For example, shareholders in the concentrated ownership jurisdictions might be unaware of the possibility to enter into relationship agreements, and therefore the number of agreements that protect minority shareholders is significantly lower.

4.4. Shareholders' agreements and EU initiatives

The Action plan 2012 emphasizes the engagement and participation of shareholders in control of listed companies as well as long term ownership issues. From the theoretical perspective, shareholders' agreement might perfectly facilitate both of these goals as it allows shareholders to combine their control rights and engage in management of the company more effectively. Empirical evidence indicates that majority of the shareholders' agreements concluded in all of the analysed jurisdictions are entered with long term goals and perspective in mind. Therefore, shareholders contractually binding themselves are well motivated to engage in long term control of the company. However, as it was already discussed, this contractual tool is currently limited mostly to medium sized shareholders. In order to promote it amongst minority shareholders and to stimulate them to engage in control of the company, the contracting costs for minority shareholders should be lowered. As a result, shareholders' agreement could be viewed as one of the tools to achieve goals provided in the Action plan 2012.

Directive 2007/36/EC claims to strengthen shareholders' rights and encourage them to participate in general meetings of shareholders more actively. This directive harmonises and enables shareholders to put items on the agenda of the general meeting and to table draft resolutions for items on the agenda. According to article 6 of the directive threshold required for the exercise of these rights should not exceed 5 % of the company's share capital.

However, majority of the voting agreements identified in this dissertation concentrate voting rights between 30 % and 50 %. This might indicate that shareholders entering into shareholders' agreements value the actual control in the company and not rights to influence agenda of the general meeting. This might be signalling that some of the rights provided in the Directive 2007/36/EC are not enhancing shareholder control over the company in practice and shareholders consider them as insignificant.

4.5. Shareholders' agreements and corporate governance

Throughout this dissertation the author presented constructive arguments and empirical research results which show that shareholders' agreements have significant impact on the way companies are controlled and on the relationships of different corporate constituents. In other words, shareholders' agreements are directly related to corporate governance.

Firstly, taking into account the example that was given in Part II, Chapter 1.5., shareholders' agreements can have direct and major influence on the ownership structure of the company, the distribution of control rights amongst the shareholders and the rights of the shareholders regarding the management and corporate structure of the company. The general line of thought should be that such contractual arrangements amongst the shareholders should create adverse consequences neither to the company, nor to any third parties. These key issues are part of the corporate governance debate, and therefore shareholders' agreements should be considered every time an inquiry is made into the ownership structure and control of the company.

Secondly, theoretical arguments presented in Part II, Chapter 1 suggest that shareholders' agreements are capable of solving two agency problems: the manager-shareholders and majority-minority shareholder conflict of interests. There are neither theoretical, nor statutory restrictions in the analysed jurisdictions that would prevent shareholders' agreements to impact the control and management of the company (except for the statutory and court formulated rules that prevent shareholders from abusing their rights and position using shareholders' agreements).

Thirdly, despite theoretical presumptions, the research indicates that shareholders' agreements are primarily used as control enhancing mechanisms mostly by medium sized shareholders (from 5 % to 30 % of total voting rights), who aim to achieve joint control of the company (between 30 % and 75 %). Thus, although shareholders' agreements have the potential to mitigate both agency problems, in practice they might be only used to concentrate control in the hands of group of shareholders and partially mitigate the shareholder-manager conflict of interests between the mangers of the company and contracting shareholders (if such conflict exists in that particular company). The above arguments suggest that minority shareholders might be left to face possible negative consequences as controlling group of shareholders might start expropriating them.

The conclusive comment is that shareholders' agreements can be theoretically used to mitigate conflicting interests between corporate constituents in listed companies. However, there is a large gap between what is possible in theory and how shareholders' agreements are used in practice. Therefore, this conclusion is mainly limited to shareholder-manager conflict of interests and is viable only in situations where medium sized shareholders are seeking to gain control of the company (*de jure* or *de facto*). Taking into account that shareholders' agreement is a liberal contractual tool based on the principle of contractual freedom, the legislature is in a good position to determine its course of development, prevent possible abuses and stimulate the benefits (preferably facilitate its use amongst minority shareholders). The existing differences in ownership structure prevailing in listed companies of each jurisdiction and the developed practice of entering into shareholders' agreements have to be taken into account before implementing any statutory changes.

CONCLUSIONS

Conclusions directly related to the statements defended in this dissertation

1. Legal theories of the company (legal entity) are insufficient to explain the reasons for which companies exist. They do not provide insights into the internal structure of the company and problems that arise between different corporate constituents when economic activity is organized through a legal form of a company. In order to enable company law to provide efficient legal remedies and tools to mitigate negative consequences of cooperation through a company, theories of the firm provided by economics are to be taken into account. As agency theory provides the best workable insights (although not perfect) on the internal relations between different corporate constituents active within a firm, corporate law has to recognise and embrace agency theory in order to provide efficient legislation.

2. Shareholders' agreement is a written or oral contract between the shareholders of a company (at least one of the shareholders has to be a party), which is governed by the general principles of contract law. Shareholders' agreement is a *sui generis* contract and primarily based on the freedom of contract principle. The defining characteristic which allows shareholders' agreement to be distinguished from other contractual relationships is that its subject matter has to be related to all of the following: the company, the shares of the company and rights, duties or obligations of shareholders towards each other or towards the company.

   From the perspective of agency theory, shareholders' agreements can theoretically be used for two main purposes: to concentrate control in the hands of the shareholders, which would reduce negative consequences of the managers-shareholders conflict of interests; or to protect interests of the minority shareholders, which would address the minority-majority agency problem. Empirical results also confirm that shareholders' agreements are used for the above purposes.

3. The theoretical and comparative analysis provided in this dissertation supports the conclusion that extensive and detailed intervention from the legislature in the context of shareholders' agreements is unnecessary. In order for shareholders' agreements to be a feasible solution for dealing with agency problems, statutory acts have to provide that shareholders' agreement is a valid contract, which can be enforced in courts. Restrictions on the subject matter of the agreement are necessary only to limit possible abusive behaviour of contracting shareholders and expropriation of other corporate constituents. The statutory provisions should at least contain restrictions to: 1) undermine the interests of the company; 2) vote or refrain from voting for consideration; 3) vote according to the instructions of the company, its subsidiaries or any of the legal bodies (or their members) formed within the company.

All of the analysed jurisdictions follow the above criteria. However, in light of the research provided in this dissertation the author offers certain recommendations for Lithuania and Belgium.

Lithuania:

1) The Lithuanian ABI should contain a general clause on the validity and enforceability (including specific performance) of shareholders' agreements;
2) The Lithuanian legislature should adopt an additional standard that all shareholders' agreements have to be in the interests of the company. The enforcement of this standard should be left to courts to decide on a case by case basis;
3) Shareholders asking for remedies from the court for breach of the voting agreement should be allowed to choose whether they require

recalculation of votes, annulment of the decisions of the general meetings of shareholders (only in cases where voting of the shareholders in breach had decisive influence on the adoption of the decisions) or they want to protect their interests by specific performance;

4) The restrictions that are applicable to the voting agreement should be also applied to the transfer of voting rights agreement.

Belgium:

1) The Belgian legislature should consider adding additional restriction to the subject matter of the voting agreement in order to prohibit voting or refraining from voting for consideration;
2) Belgian courts should be enabled to apply re-calculation of votes as a legal remedy in cases where the decision of the general meeting of shareholders was adopted by the votes cast in breach of the provisions of the voting agreement. Re-calculation of votes should be available by the request of the claimant and only when voting agreement provides detailed rules on how the votes should be exercised.

4. Shareholders in jurisdictions with concentrated ownership structure are very active in concluding shareholders' agreements (27.2 % of all the listed companies). In jurisdictions with dispersed ownership structure shareholders' agreements are less common (6.6 % of all the listed companies). Contrary to the theoretical assumptions, shareholders' agreements in concentrated ownership jurisdictions are used to concentrate control. In dispersed ownership jurisdictions shareholders' agreements are mostly used to protect minority shareholders and limit possible abusive behaviour of the majority shareholder.

The number of shareholders' agreements in listed companies might indicate that in jurisdictions with concentrated ownership structure coordination costs amongst shareholders are lower than agency costs. However, shareholders' agreements are mainly used as a control enhancing mechanism by the medium sized shareholders (from 5 % to 30 % of total voting rights) to gain *de jure* or *de facto* control of the company. Most of the shareholders' agreements are concluded between 3-4 parties that have long term goals in the company. Furthermore, the number of contracting shareholders decreases as their control rights in the company increase. The research results on the number of shareholders' agreements in jurisdictions with better shareholder protection laws (and thus more sophisticated securities markets) are mixed. However, from the countries analysed there might be indications that the number of shareholders' agreements is less dependent on the level of shareholder protection.

Minority shareholders in the analysed jurisdictions are prevented from effectively protecting their interests using shareholders' agreements. Therefore, legislature, other competent regulatory authority or self-regulatory organization, for example, the stock exchange, should reduce the coordination costs for minority shareholders (preferably through soft law) in order to stimulate shareholders' agreements.

5. The following criteria and characteristics influence the likelihood for the shareholders' agreement to be concluded amongst the shareholders of a listed company:
   1) The statutory acts or case law clearly recognise the validity and enforceability of shareholders' agreements;
   2) The shareholders have long term goals and perspective regarding the business of the company and their participation in it;
   3) There are three to five medium sized shareholders whose voting rights combined represent at least 30 % of all the voting rights;

4) The company is listed in the jurisdiction with a concentrated ownership structure;
5) Shareholders are willing to coordinate the exercise of their voting rights through a voting agreement (costs are lower than benefits).

Conclusions not directly related to the statements defended in this dissertation but observed during the research

Some of the conclusions that the author made during the process of writing this dissertation are not directly related to the statements defended, but will be nevertheless stated below:

1. The author observed that there is no clear cut definition of 'acting in concert' at the EU level. The definitions provided in all three analysed jurisdictions are different and provide for different levels of cooperation and/or relations amongst shareholders in order trigger the 'acting in concert' requirements. This hinders the relationships of shareholders, including the conclusion of shareholders' agreements. Thus, a clear and precise definition of who and under what conditions is considered to be 'acting in concert' would be welcome at the EU level.

2. Lithuanian case law on the validity of decisions of the general meeting of shareholders is flawed. The number of voting rights should not be considered as a single decisive factor in determining the validity of the decision of the general meeting of shareholders. Courts should on a case by case basis decide whether the interests of a company (or minority shareholders) were infringed, and whether such infringement would justify the annulment of the decision of the general meeting of shareholders (regardless of the number of voting rights that the majority shareholder has and whether the same decision might be adopted in the next general meeting of shareholders or not).

Suggestions for future research

A dissertation is a work limited in time, scope and available resources. For these reasons there are always some unanswered questions that might be addressed in the future by the author or some other legal scholars interested in the field. The author also believes that after an in depth study and analysis provided in this dissertation he is obliged to share not only the conclusions, but also his insights on promising legal issues that should be properly addressed in the academic discourse in the future. Below are some of possible interesting research questions and topics that should be considered:

- How is the ownership structure of a particular company influenced by the conclusion of the shareholders' agreement? The research might deal with ownership structures in companies before and after the conclusion of shareholders' agreement and the impact it has on the change of shareholdings;
- Should the shareholders' agreements be (not) disclosed in full by the companies listed on the stock exchanges? What are the reasons and consequences to the company, existing shareholders and future investors that would justify obligation for listed companies (and their shareholders) to disclose shareholders' agreements?
- The data set presented in the empirical part of this dissertation is limited. Therefore, future research should be focused on expanding the data on the availability of shareholders' agreements in other jurisdictions, especially the ones that belong to the common law family;
- The comparative research in this dissertation was mainly focused on the statutory and case law regarding shareholders' agreements. Future research might deal with the question whether stock exchanges themselves (or other non-governmental and independent institutions and organisations) should promote shareholders' agreements in listed companies by issuing soft law (for example, guidelines). The guidelines might be aimed at reducing agency conflicts and aligning the interests of various groups of shareholders;

- This dissertation revealed that in the UK there is a particular type of shareholders' agreement called the relationship agreement. Future academic inquiries could focus on adaptation of relationship agreement in other countries, especially in continental Europe. The most interesting question in this regard is whether non contracting shareholders could sue the majority shareholder and enforce the relationship agreement;
- Comparative analysis has shown that securities lending agreements (when they are used for the purposes to acquire voting rights) are not regulated in any of the analysed jurisdictions. The future research should clearly identify the risks that these agreements pose and offer a legislative approach on how to regulate them.
- The results presented in the dissertation indicate that shareholders' agreements are the cause for crossing the mandatory bid threshold applied to listed companies. A study would be welcome in order to analyse how shareholders adhere to the mandatory bid requirement and how shareholders' agreements influence the actual application of takeover regulation.

ANNEXES

Annex 1: Shareholders' agreements in companies listed on NASDAQ OMX Vilnius stock exchange

1.1. Introductory remarks to Annex 1

Annex 1 presents data on shareholders' agreements concluded by the shareholders of companies (AB) listed on the NASDAQ OMX Vilnius stock exchange in the Republic of Lithuania. The data represents only those shareholders' agreements that have shareholders of the company or shareholders of the shareholders of the company (if shareholders are legal entities) as parties to the agreement. The table below does not list shareholders' agreements where company is contracting as a shareholder of another company. These shareholders' agreements have been deemed to be not associated with the internal structure of the company or its management and have not been included in the empirical research. However, shareholders' agreements related to the internal structure or management of the company where company is acting as a party (and not as a shareholder of some other entity) have been included in the analysis.

Considering the fact that NASDAQ OMX Vilnius stock exchange is small and the number of listed companies is small, all of the companies listed on the exchange have been included in the analysis. Only the companies that are incorporated in the Republic of Lithuania and that have their primary listing on the NASDAQ OMX Vilnius stock exchange have been included in the table below.

The analysis of the shareholders' agreements provided below has been carried out during the first six months of the year 2011. During the period of time from 2011 until the publication of this dissertation some of the companies have been delisted due to bankruptcy or other reasons. This has been indicated in the table provided below. However, the research results are provided as they were when the research was conducted in the first half of 2011.

According to the data provided in the table, a total of 37 companies have been analysed. There were a total of 10 shareholders' agreements found in 7 companies listed on the NASDAQ OMX Vilnius stock exchange in the Republic of Lithuania. The data suggests that 18.9 %[1193] of all the companies listed on the Lithuanian stock exchange have (or had during some time in the past) a shareholders' agreement in place.

The obligation to notify about the acquisition or disposal of voting rights (including shareholders' agreements regarding the exercise and/or transfer of voting rights) on the European level arises from Articles 9-16 of the Directive 2004/109/EC[1194]. More detailed rules are provided by the Commission Directive 2007/14/EC[1195] (Articles 8 and 9 are the most relevant for the present analysis). Directive 2004/109/EC has been transposed into the national laws of the Republic of Lithuania through the Law on Securities[1196]. Articles 23 and 24 stipulate the obligation to notify regarding the acquisition or disposal of the blocks of shares (including voting rights) and set the rules on how the voting rights are counted for the notification obligation. The former Securities Commission of the Republic of Lithuania[1197] has adopted detailed

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[1193] This percentage was calculated according to the number of companies that have a shareholders' agreement in place and not according to the actual number of shareholders' agreements.

[1194] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[1195] Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

[1196] Law on Securities of the Republic of Lithuania (Valstybės Žinios, 2007, No. 17-626; Valstybės Žinios, 2011, No. 145-6819).

[1197] Lithuanian legislature has decided to change the functional approach to financial supervision and starting from 1 January 2012 implemented integrated model according to which all the functions related to the financial supervision are carried out by the Central Bank of the Republic of Lithuania. See: Law on the reform of the financial supervision system of the Republic of Lithuania (Valstybės Žinios, 2011, No. 145-6811); Government of the Republic of Lithuania resolution No. 580 of 19 May 2010 regarding the adoption of conception of integration of the financial supervisory institutions (Valstybės Žinios, 2010, No. 61-2991). From comparative point of view the UK has also adopted an integrated approach with Financial Services Authority acting as the sole universal regulator of financial markets. See: The Group of Thirty. *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*. Washington: The Group of Thirty, 2008 [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.legco.gov.hk/yr08-09/english/panels/fa/papers/fa0223cb1-837-3-e.pdf>, p. 28-29. In contrast, Belgium in 2011 has moved to the other direction and changed the integrated approach in the two peaks model. The National Bank of Belgium is the principal prudential supervisor for the Belgian financial system and the Financial rules regarding the acquisition and disposal of shares (including voting rights) and in this way transposed Commission Directive 2007/14/EC[1198].

A further obligation on the level of the European community to inform on any agreements between shareholders regarding the restrictions on transfer of securities, the restrictions on voting rights and special control rights conferred to the holders of shares is stipulated in Article 10 of the 2004/25/EC Directive[1199]. This Directive in the Republic of Lithuania has been implemented by the Law on Securities, Law on Financial Accountability of Legal Entities[1200] (especially Article 25(3)) and a resolution by the former Securities Commission of the Republic of Lithuania regarding the submission and preparation of periodic and additional information on financial accountability[1201] (with emphasis on Article 12).

According to the Listing Rules of the NASDAQ OMX VILNIUS companies also have disclosure obligations related to the shareholders' agreements[1202]. Article 27.8 stipulates that where the company becomes aware of mutual agreements between the shareholders who, in concert, hold more than 5% of the votes of the issuer or of their agreements concluded with other

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Services and Markets Authority the supervisor for financial markets, investment products and of the rules of conduct that apply to financial institutions. See: DE BRUYCKER, J. VAN LANDEGHEM, K. GOLDSCHMIDT, E. *Reform of the Belgian financial supervisory structure, introduction of the Twin Peaks model in Belgium*, 2011 [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.worldservicesgroup.com/publications.asp?action=article&artid=3839>; WYMEERSCH, E. O. The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors. *European Business Organization Law Review*, 2007, Nr. 8, p. 237 – 306.

1198 Securities Commission of the Republic of Lithuania. Resolution of 23 February 2007 No. 1K-5 regarding the adoption of rules on notification of acquisition or disposal of blocks of shares (Valstybės Žinios, 2007, No. 26-981).

1199 Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

1200 Law on Financial Accountability of Legal Entities of the Republic of Lithuania (Valstybės Žinios, 2001, No. 99-3516; Valstybės Žinios, 2008, No. 79-3098).

1201 Securities Commission of the Republic of Lithuania. Resolution of 23 February 2003 No. 1K-3 regarding the adoption of rules on submission and preparation of periodic and additional information on financial accountability (Valstybės Žinios, 2007, No. 26-979).

1202 AB NASDAQ OMX Vilnius. The Listing Rules of AB NASDAQ OMX Vilnius [interactive]. [Accessed on 2012-08-08] Available online at: <http://www.nasdaqomxbaltic.com/files/vilnius/teisesaktai/2012/Listing%20Rules%20of%20NASDAQ%20OMX%20Vilnius%20(effective%20as%20of%2004.06.2012)_1.pdf>.

shareholders or third parties which are aimed at restricting the free transferability of the shares or which may have a significant effect on the price of the issued shares, the company is obliged to make a public disclosure of said agreements.

In the light of the above legal requirements companies that are admitted to regulated market on the NASDAQ OMX Vilnius stock exchange have an obligation to disclose in their financial accountability documents (annual and interim reports) the fact about all the shareholders' agreements (or any other cases where shareholders are acting in concert) including voting agreements and transfer of voting rights agreements. Thus, this was the legal basis for the empirical study on the availability of shareholders' agreements in the companies traded on the NASDAQ OMX Vilnius stock exchange.

The below provided data was gathered and analysed according to information provided in the following sources:

1) Annual and interim reports provided by listed companies on the NASDAQ OMX Vilnius stock exchange's website available online at: www.nasdaqomxbaltic.com;
2) Announcements and notices of the companies listed on the NASDAQ OMX Vilnius stock exchange provided in their own corporate websites;
3) The Nordic Exchange Central Storage Facility available online at www.crib.lt[1203];
4) Case law provided by the Lithuanian courts available online at www.infolex.lt;
5) Other information provided in various online information sources, newspapers and magazines.

[1203] The Central Storage Facility stores all the information related to the companies listed on NASDAQ OMX Vilnius stock exchange. Central Storage Facility functions according to: Securities Commission of the Republic of Lithuania. Resolution of 23 February 2007 No. 1K-4 regarding the adoption of rules on public disclosure of regulated information (Valstybės Žinios, 2007, No. 26-980); Securities Commission of the Republic of Lithuania. Resolution of 5 May 2011 No. 13K-4 regarding the adoption of guidelines for the public disclosure of regulated information in the Central Storage Facility.

It should be noted that in the information provided by the listed companies (usually the annual and interim reports) it is disclosed that shareholders are acting in concert and are related. However, it is not disclosed how and in what legal means the relations between the shareholders and their concerted actions are conveyed. In these cases it is also not disclosed whether there is a shareholders' agreement in place. Having in mind the legislative requirements provided above and depending on the actual content of the shareholders' agreement conclude among the shareholders of the company, situations where a shareholders' agreement is concluded but disclosure of information obligation is not triggered are possible. Due to this reason the data and results on the shareholders' agreements in the Republic of Lithuania might be slightly inaccurate. There might be more shareholders' agreements in place than it has been recorded by this research.

1.2. Table of shareholders’ agreements in the Republic of Lithuania

Table of shareholders’ agreements in the Republic of Lithuania is unavailable in electronic version of the dissertation due to private data protection legislation. If you have any questions, please contact the author directly at paulius@miliauskas.org.

Annex 2: Shareholders' agreements in companies listed on NYSE Euronext Brussels stock exchange

2.1. Introductory remarks to Annex 2

Annex 2 presents data on shareholders' agreements concluded by the shareholders of companies (NV) listed on the NYSE Euronext Brussels stock exchange in of Belgium. The data represents only those shareholders' agreements that have shareholders of the company or shareholders of the shareholders of the company (if shareholders are legal entities) as the parties to the agreement. The table below does not list shareholders' agreements where the company is contracting as a shareholder of another company (when shareholders of the company in question are not involved). These shareholders' agreements have been deemed to be not associated with the internal structure of the company or its management and have not been included in the empirical research. However, shareholders' agreements related to the internal structure or management of the company where company is acting as a party (and not as a shareholder of some other entity) have been included in the analysis.

Considering the fact that NYSE Euronext Brussels stock exchange is relatively small and the number of listed companies is not large[1204], all of the companies listed on the exchange satisfying the criteria set have been included in the analysis. Only the companies that are incorporated in Belgium and that have their primary listing on the NYSE Euronext Brussels stock exchange have been included in the research. The criteria have been selected in order to represent as much as possible the Belgian market and only the companies that are active on the Belgian market. Thus, companies that have their secondary listing on the NYSE Euronext Brussels stock exchange or that were not incorporate in Belgium at the time of this research have not been included in the data sample. Inclusion of such companies could have distorted the final

[1204] Although compared to the NASDAQ OMX Vilnius stock exchange the number of companies listed is almost six times bigger.

results of the research. These requirements have decreased the number of actually analysed companies as some of them had their primary listings in NYSE Euronext Paris in France or NYSE Euronext Amsterdam in the Netherlands (approximately 40 companies did not make it into the research data). A total number of 121 companies (all that satisfied the above criteria) have been analyses and included in the data provided in the table below. It has been established that from the analysed 121 companies a total of 36 have at least one shareholders' agreement concluded among shareholders. There were a total of 50 shareholders' agreements concluded in these companies. The data suggests that 29.5 %[1205] of all the companies listed on the Belgian stock exchange have (or had during some time in the past) a shareholders' agreement in place.

The obligation to notify about the acquisition or disposal of voting rights (including shareholders' agreements regarding the exercise and/or transfer of voting rights) on the European level arises from Articles 9-16 of the Directive 2004/109/EC[1206]. More detailed rules are provided by the Commission Directive 2007/14/EC[1207] (Articles 8 and 9 are the most relevant for the present analysis). In Belgium the obligation to disclose information regarding the acquired or disposed blocks of shares and voting rights conferred by the shares is stipulated in Articles 514, 515 and 515bis of the W.Venn. Furthermore, Articles 95 and 96 of the W.Venn. oblige companies to provide annual and interim reports. A more detailed transposition of the above Directives can be found in the Law on the Disclosure of Major Shareholdings

[1205] This percentage was calculated according to the number of companies that have a shareholders' agreement in place and not according to the actual number of shareholders' agreements.

[1206] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

[1207] Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

in companies whose shares are admitted to trading on a regulated market[1208] and in the Royal Decree on the disclosure of major shareholdings[1209]. Article 6(1) of the Law on the Disclosure of Major Shareholdings stipulates that 'any natural or legal person who directly or indirectly acquires voting securities in an issuer shall notify the issuer and the CBFA of the number and proportion of existing voting rights of the issuer he holds as a result of the acquisition, where the voting rights attached to the voting securities he holds reach 5% or more of the total existing voting rights'. The same notification obligation applies if the shares are disposed or exceed the 10 %, 15 % (and so on) threshold. Moreover, Article 6(4) provides that notification is required 'where natural or legal persons conclude, modify or terminate an agreement to act in concert if, as a result, the proportion of the voting rights that are the subject of the agreement, or the proportion of the voting rights held by a party to the agreement, reaches, exceeds or falls below one of the thresholds provided for in § 1, even if there has not been any acquisition or disposal'. Notification requirement also applies to the modification of the said agreement. Additional requirement stipulated in Article 7 of the mentioned Law requires disclosing if the shares are not transferred but third party is entitled to exercise these voting rights[1210]. Thus, the disclosure obligation encompasses the obligation to disclose about the shareholders' agreements (especially if they deal with the exercise of the voting rights). According to another Royal Decree companies are required to

[1208] Wet op de openbaarmaking van belangrijke deelnemingen in emittenten waarvan aandelen zijn toegelaten tot de verhandeling op een gereglementeerde markt en houdende diverse bepalingen (Belgisch Staadsblad, 12 June 2007, No. 2007/03215).

[1209] Koninklijk besluit op de openbaarmaking van belangrijke deelnemingen (Belgisch Staadsblad, 4 March 2008, No. 2008/03071).

[1210] Article 7 provides the following cases: 1) an agreement providing for the temporary transfer for consideration of voting rights; 2) a pledge of voting securities as collateral, provided the pledgee controls the voting rights; 3) a life interest in voting securities, provided the natural or legal person who has the life interest in these voting securities controls the voting rights; 4) a deposit of voting securities, provided the custodian can exercise the voting rights at its discretion in the absence of specific instructions from the securities holders; 5) a proxy, provided the mandated proxy can exercise the voting rights at its discretion in the absence of specific instructions from the securities holders.

disclose all the information regarding the voting rights held by its shareholders and any agreements among the shareholders[1211].

Another obligation on the level of the European community to inform on any agreements between shareholders regarding the restrictions on transfer of securities, the restrictions on voting rights and special control rights conferred to the holders of shares is stipulated in Article 10 of the 2004/25/EC Directive[1212]. The Directive has been transposed by the Belgian Law on Takeover Bids[1213] and Royal Decree in disclosure of information[1214]. Article 34 of this Royal Decree stipulates that listed companies have to disclose any restrictions, either legal or prescribed by the articles of association, on the transfer of the shares or on voting rights conferred by the shares. Holders of any shares with special control rights and a description of those rights have to be made public. And most importantly any agreements between shareholders which may result in restrictions on the transfer of shares and/or the exercise of voting rights have to be disclosed.

Companies have to disclose information about the shareholders' agreements in place according to the Information vade mecum of the NYSE Euronext Brussels stock exchange[1215]. Article V.2.1.1. requires companies listed on the NYSE Euronext Brussels stock exchange to disclose in their annual reports any restrictions on the transfer of the shares, on the exercise of voting rights and any special control rights (with description) if any. Further,

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[1211] Koninklijk besluit betreffende de verplichtingen van emittenten van financiële instrumenten die zijn toegelaten tot de verhandeling op een gereglementeerde markt (Belgisch Staatsblad, 3 December 2007, No. 2007/03508).

[1212] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

[1213] Wet op de openbare overnamebiedingen (Belgisch Staatsblad, 26 April 2007, No. 2007/03184).

[1214] Koninklijk besluit betreffende de verplichtingen van emittenten van financiële instrumenten die zijn toegelaten tot de verhandeling op een gereglementeerde markt (Belgisch Staatsblad, 3 December 2007, No. 2007/03508).

[1215] NYSE Euronext Brussels. *Information vade mecum. Obligations of Information of the Companies Admitted to Trading on the Regulated Market Euronext Brussels*, 2012 [interactive]. [Accessed on 2012-10-09] Available online at: <https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/vade_mecum_euronext_eng_apr2012.pdf>.

Article VI.1.2. repeats the same requirements for disclosure as stipulated in above mentioned laws and Royal Decrees. Namely, it requires disclosure on any agreements that allow shareholders of the company to act in concert and to collectively exercise their voting rights. It also requires disclosure on the transfer of voting rights to any other third party.

In the context of legal requirements provided above, companies that are admitted to regulated market on the NYSE Euronext Brussels stock exchange have an obligation to disclose in their financial accountability documents (annual and interim reports) the fact about all the shareholders' agreements (or any other cases where shareholders are acting in concert) including voting agreements and transfer of voting rights agreements. Thus, this was the legal basis for the empirical study on the availability of shareholders' agreements in the companies traded on the NYSE Euronext Brussels stock exchange.

The below provided data was gathered and analysed according to information provided in the following sources:

1) Annual and interim reports provided by listed companies on the NYSE Euronext Brussels stock exchange's website available online at: www.euronext.com;
2) Announcements and notices of the companies listed on the NYSE Euronext Brussels stock exchange provided in their own corporate websites;
3) The Storage of Regulated Information (SOTRI) available online at http://stori.fsma.be;
4) Other information provided in various online information sources, newspapers and magazines.

2.2. Table of shareholders' agreements in Belgium

Table of shareholders' agreements in Belgium is unavailable in electronic version of the dissertation due to private data protection legislation. If you have any questions, please contact the author directly at paulius@miliauskas.org.

Annex 3: Shareholders' agreements in companies listed on London stock exchange

3.1. Introductory remarks to Annex 3

Annex 3 presents data on shareholders' agreements concluded by the shareholders of companies (PLC) listed on the London stock exchange in the United Kingdom. The data represents only those shareholders' agreements that have shareholders of the company or shareholders of the shareholders of the company (if shareholders are legal entities) as the parties to the agreement. The table below does not list shareholders' agreements where the company is contracting as a shareholder of another company (in other words where the company is a party to the shareholders' agreement). These shareholders' agreements have been deemed to be not associated with the internal structure of the company or its management and have not been included in the empirical research. However, shareholders' agreements related to the internal structure or management of the company where company is acting as a party (and not as a shareholder of some other entity) have been included in the analysis.

London stock exchange is one of the biggest stock exchanges in the world. When this research was being carried out (March 31 2011) there were a total of 2 641 companies listed on the London stock exchange. Due to the high number of listed companies and the limited scope and time of this research, only companies from the FTSE 350 index that have their primary listing on the London stock exchange and are incorporated in the United Kingdom have been selected. A total number of 302 companies (all that satisfied the above criteria) have been analyses and included in the data provided in the table below. The research has shown that from the sample of 302 companies a total of 20 have at least one shareholders' agreement concluded among shareholders. There were a total of 21 shareholders' agreements concluded in these 20 companies. The data suggests that 6.6 %[1216] of all the companies listed on the London stock exchange have (or had during some time in the past) a shareholders' agreement in place. This number is lower than the average of the EU (which is 8 %).

The obligation to notify about the acquisition or disposal of voting rights (including shareholders' agreements regarding the exercise and/or transfer of voting rights) on the European level arises from Articles 9-16 of the Directive 2004/109/EC[1217]. More detailed rules are provided by the Commission Directive 2007/14/EC[1218] (Articles 8 and 9 are the most relevant for the analysis). Articles 1265-1273 of the CA 2006 stipulate how and where the Directive 2004/109/EC is transposed in the United Kingdom. The general obligation to inform about the shareholdings and voting rights is stipulated in the Financial Services and Markets Act 2000[1219]. Articles 89A-89G stipulate a right for the competent authority to make rules for the purposes of the transparency obligations of the Directive 2004/109/EC and establish general principles which should be contained in the mentioned rules. Financial services authority of the United Kingdom has implemented this right by adopting Disclosure and Transparency Rules[1220]. Article 5.1.2. of the Disclosure and Transparency Rules obliges natural and legal persons to disclose their voting rights held as shareholder or held or deemed to be held through direct or indirect holding of financial instruments. Article 5.2.1. stipulates that

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1216 This percentage was calculated according to the number of companies that have a shareholders' agreement in place and not according to the actual number of shareholders' agreements.

1217 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ 2004 L 390/39-57).

1218 Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (OJ 2007 L 69/27-36).

1219 Financial Services and Markets Act 2000 (c8). June 14, 2006. Also see: Financial Services and Markets Act 2000 (c8). Explanatory notes [interactive]. [Accessed on 2012-07-03] Available online at: <http://www.legislation.gov.uk/ukpga/2000/8/notes/data.pdf>, part 6 and Companies Act 2006. Explanatory notes [interactive]. [Accessed on 2012-07-03] Available online at: <http://www.legislation.gov.uk/ukpga/2006/46/notes/contents>, part 43.

1220 Financial Services Authority. Disclosure and Transparency Rules [interactive]. [Accessed on 2012-09-18] Available online at: <http://media.fsahandbook.info/pdf/DTR.pdf>.

shareholders that fall under the requirement of the disclosure of their voting rights are also deemed to be persons who have concluded shareholders' agreement in order to establish a lasting policy towards the management of the company by coordinated exercise their voting rights. Temporary transfer for consideration of voting rights also is required to be reported. It is interesting to note that voting rights attaching to shares deposited with a person (which the person can exercise at its discretion in the absence of specific instructions from the shareholders) must also be disclosed as belonging to the person with whom the voting rights are deposited. A more country specific provision is provided in Article 5.1.1. and it states that a stock-lending agreement which provides for the outright transfer of securities and which provides the lender with a right to call for re-delivery of the lent stock (or its equivalent) is not (as respects the lender) to be taken as involving a disposal of any shares which may be the subject of the stock loan. This could be explained by the fact that stock-lending is common practice in the United Kingdom and is used for short selling the stocks for investment purposes[1221]. If the agreement provides no right to the lender to call for the re-delivery of the lent stock at any time, this could fall under the obligation to inform about the transfer of voting rights. Considering the practice used in the United Kingdom to conceal the voting rights using various financial instruments[1222] Article 5.3. of the Disclosure and Transparency Rules stipulates a duty to make a disclosure regarding the voting rights if the thresholds stipulated in the of the Disclosure and Transparency Rules are reached using any financial instruments which are held directly or indirectly (this goes in line with the provision that shareholdings to not change in cases of stock-lending agreements when the lender has a right to call for the re-delivery of the lent stock). In order to provide investors and shareholders

[1221] Financial Services Authority. Technical Note – Disclosure and transparency rules. In *United Kingdom Listing Authority Publications* [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.fsa.gov.uk/pubs/ukla/disclosure_transparency.pdf>, p. 18.

[1222] For an analysis see: HU, H. T. C.; BLACK, B. The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership. *Southern California Law Review*, 2006, Vol. 79, No. 4, p. 811 – 908.

with the relevant information Article 5.6. requires the company to make a notification regarding the shareholdings and voting rights each calendar month.

Article 10 of the 2004/25/EC Directive[1223] stipulates the requirement on the level of the European community to inform on any agreements between shareholders regarding the restrictions on transfer of securities, the restrictions on voting rights and special control rights conferred to the holders of shares. This requirement in the United Kingdom has been transposed by the Disclosure and Transparency Rules and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008[1224]. Part 6 of the Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 states that the directors' annual report for a financial year of the company that has its securities carrying voting rights admitted to trading on a regulated market must contain detailed information including: 1) any restrictions on the transfer of securities in the company, including in particular limitations on the holding of securities, and requirements to obtain the approval of the company, or of other holders of securities in the company, for a transfer of securities; 2) special rights of the shareholders with regard to control of the company; 3) any restrictions on voting rights, including in particular limitations on voting rights of holders of a given percentage or number of votes, deadlines for exercising voting rights, and arrangements by which, with the company's co-operation, financial rights carried by securities are held by a person other than the holder of the securities; 4) any agreements between holders of securities that are known to the company and may result in restrictions on the transfer of securities or on voting rights.

It should be also mentioned that Articles 29 and 30 of the CA 2006 also oblige companies to provide the Registrar with all the relevant agreements agreed to by all the members of a class of shareholders. However, in case of

[1223] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OL 2004 L 142/12-23).

[1224] Secretary of State for Trade and Consumer Affairs. The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, No 410 [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.legislation.gov.uk/uksi/2008/410/contents/made>.

listed companies this requirement is rendered almost useless as the author is not aware of any cases when a shareholders' agreement would be entered into by all the shareholders of the company.

The Admission and Disclosure Standards of the London stock exchange require all the companies that are admitted to trading on the market to comply with the disclosure obligations of the companies' securities regulator[1225].

In the context of legal requirements provided above, companies that are admitted to regulated market on the London stock exchange have an obligation to disclose in their financial accountability documents (annual and interim reports) the fact about all the shareholders' agreements (or any other cases where shareholders are acting in concert) including voting agreements and transfer of voting rights agreements. Thus, this was the legal basis for the empirical study on the availability of shareholders' agreements in the companies traded on the London stock exchange.

The below provided data was gathered and analysed according to information provided in the following sources:

1) Annual and interim reports provided by listed companies on the London stock exchange's website available online at: www.londonstockexchange.com;
2) Announcements and notices of the companies listed on the London stock exchange provided in their own corporate websites;
3) The National Storage Mechanism available online at http://www.morningstar.co.uk/uk/NSM;
4) Other information provided in various online information sources, newspapers and magazines.

[1225] London Stock Exchange. Admission and Disclosure Standards June 6, 2011 [interactive]. [Accessed on 2012-09-18] Available online at: <http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/admission-and-disclosure-standards.pdf>, p. 13.

3.2. Table of shareholders' agreements in the United Kingdom

Table of shareholders' agreements in the United Kingdom is unavailable in electronic version of the dissertation due to private data protection legislation. If you have any questions, please contact the author directly at paulius@miliauskas.org.

Annex 4: Ownership structure in Lithuania

4.1. Introductory remarks to Annex 4

A survey of public companies listed on the NASDAQ OMX Vilnius stock exchange has revealed that shareholding structure of public companies in Lithuania is highly concentrated and follows the general trend in the continental Europe[1226]. Author has analysed all the companies listed on the NASDAQ OMX Vilnius stock exchange on August 11, 2012 according to the data provided by the listed companies in their 2011 annual reports.

To determine the structure of ownership all the shareholders who control more than 5 % of the voting rights in the general meeting of shareholders were analysed. This choice was determined by the fact that transparency regulations require listed companies to disclose shareholdings larger than 5 %. While determining the control of the company author relied on the voting rights of the shareholders rather than on the cash flow rights (there were cases when voting rights conferred more control over the company than cash flow rights.). For the purposes of this dissertation no differentiate between the ownership types (state, families, etc.) is provided in the data below. The empirical research was carried out with the single purpose to determine whether the shareholdings are concentrated and, if yes, what the degree of concentration is. If there were shareholders acting in concert (due to family relations, shareholders' agreement or other reasons) they were treated as one and their voting rights were summed. The data provided in this annex, in author's opinion, is an important indication of actual control exercised by the shareholders and general meeting of the shareholders.

[1226] LA PORTA, R., LOPEZ-DE-SILANES, F.; SHLEIFER, A. Corporate Ownership Around the World. *The Journal of Finance*, 1999, Vol. 54, No. 2, p. 471-517; FACCIO, M.; LANG, L.H.P. The Ultimate Ownership of Western European Corporations. *The Journal of Financial Economics*, 2002, No. 65, p. 365-395. VAN DER ELST, Ch. Shareholder Mobility in Five European Countries. *ECGI – Law Working Paper No. 104/2008*, 2008 [interactive]. [Accessed on 2012-10-10] Available online at: <http://ssrn.com/abstract=1123108>.

The research has shown that from the 33 listed companies[1227] analysed the largest shareholder (together with persons acting in concert, if any): 1) held more than 30 % of voting rights in 30 companies (91 % of all the companies); 2) held more than 50 % of voting rights in 25 companies (75 % of all the companies); 3) held more than 75 % of voting rights in 11 companies (33 % of all the companies). These numbers are even higher when voting rights of the first two largest shareholders are counted together. Even 27 companies (81 % of all the companies) had two shareholders that together controlled more than 50 % of all the voting rights conferred by the shares. There are no companies where the largest shareholder (together with persons acting in concert) would hold less than 25 % of total voting rights in the general meeting of shareholders.

The results presented below provide clear evidence that ownership structure in Lithuanian listed companies is highly concentrated. Thus, shareholders have a very strong influence over the management bodies of the company and can be very important constituents in Lithuania while directing companies or forming their strategy and policy. Shareholders' agreements in this regard might be considered to play huge role in further concentrating power in the company between the first two shareholders holding most of the voting rights.

[1227] This represents the number of companies that were listed on NASDAQ OMX Vilnius stock exchange at the date of analysis of ownership structure concentration.

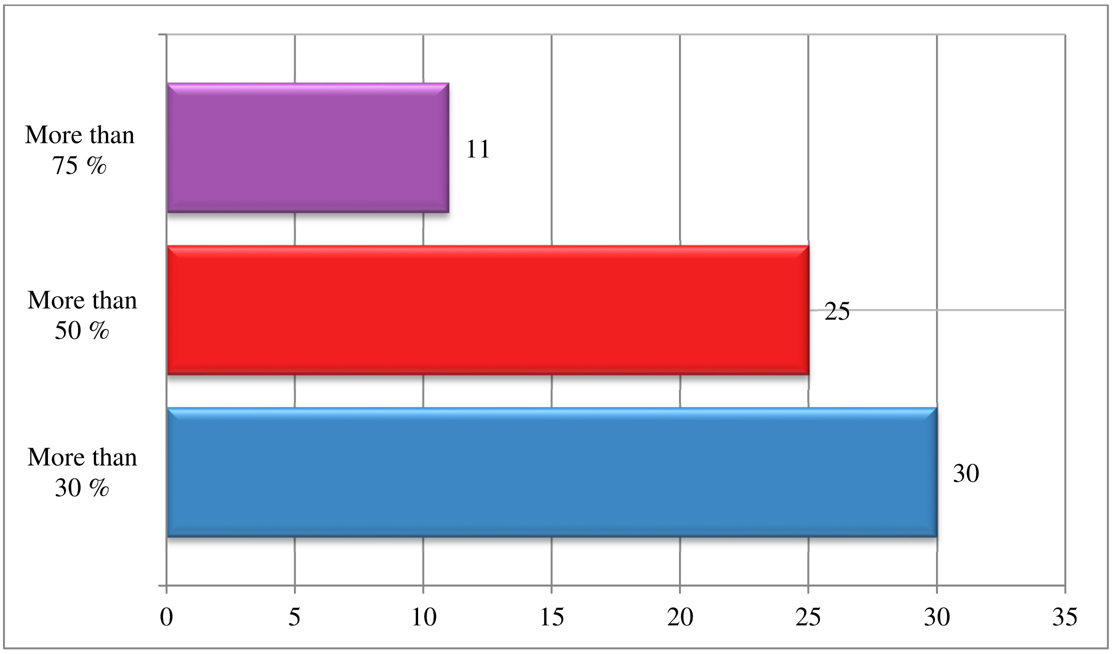

Chart 21: Ownership concentration with single shareholder owning voting rights

The below provided data was gathered and analysed according to information provided in the following sources:

1) Annual and interim reports for the year 2011 provided by listed companies on the NASDAQ OMX Vilnius stock exchange's website available online at: www.nasdaqomxbaltic.com;
2) Announcements and notices of the companies listed on the NASDAQ OMX Vilnius stock exchange provided in their own corporate websites;
3) The Nordic Exchange Central Storage Facility available online at www.crib.lt.

4.2. Table of ownership structure in Lithuania

No.	Company	Shareholdings (%)					1st + 2nd (%)	Acting in concert	Total % acting in concert
		1st	2nd	3rd	4th	5th			
1	AB "Agrowill Group"	19,54	12,78	12,73	11,31	9,84	32,32	-	
2	Įmonių grupė "ALITA", AB	84,37	14,48	-	-	-	98,85	-	
3	Akcinė bendrovė "ANYKŠČIŲ VYNAS"	94,9	0	-	-	-	94,9	-	
4	Akcinė prekybos bendrovė „APRANGA“	53,7	12,6	7,3	5,9	-	66,3	-	
5	Akcinė bendrovė „City Service“	63,92	10,02	5,2	20,86	-	73,94	-	
6	Akcinė bendrovė "DVARČIONIŲ KERAMIKA"	92,25	0	-	-	-	92,25	-	
7	Akcinė bendrovė "GRIGIŠKĖS"	48,79	14,55	9,4	-	-	63,34	-	
8	AB "GUBERNIJA"	28,58	9,95	-	-	-	38,53	1 and 2 acting in concert	38,53
9	Akcinė bendrovė "INVALDA"	25,52	18,56	10,38	6,63	5,55	44,08	2 and 5 acting in concert with additionally 0,41 % and 0,001 % shareholders.	15,93
10	Akcinė bendrovė "Kauno energija"	92,82	0	-	-	-	92,82	-	
11	Akcinė bendrovė "KLAIPĖDOS BALDAI"	76,25	4,5	3,39	1,9	-	80,75	-	
12	Akcinė bendrovė "Klaipėdos nafta"	70,63	10	3,31	2,95	-	80,63	-	
13	AB LESTO	82,63	11,76	-	-	-	94,39	-	
14	Akcinė bendrovė "LIETUVOS DUJOS"	38,9	37,1	17,7	-	-	76	1, 2 and 3 act in concert	93,7

No.	Company	Shareholdings (%)					1^{st} + 2^{nd} (%)	Acting in concert	Total % acting in concert
15	Akcinė bendrovė "LIETUVOS ENERGIJA"	96,13	0	-	-	-	96,13	-	
16	Akcinė bendrovė "LIETUVOS JŪRŲ LAIVININKYSTĖ"	56,66	5,65	5,53	-	-	62,31	-	
17	Akcinė bendrovė "Limarko laivininkystės kompanija"	86,1	0	-	-	-	86,1	-	
18	Akcinė bendrovė "LINAS"	21,01	9,98	9,82	9,82	8,97	30,99	2 and 3 acting in concert.	19,8
19	AB "Linas Agro Group"	54,16	13,35	10,73	6,18	-	67,51	-	
20	AB LITGRID turtas	97,5	0	-	-	-	97,5	-	
21	Akcinė bendrovė "Pieno žvaigždės"	32,79	14,09	12,41	11,4	9,47	46,88	1 is a group of persons acting in concert.	
22	Akcinė bendrovė "PANEVĖŽIO STATYBOS TRESTAS"	49,78	5,94	-	-	-	55,72	-	
23	Akcinė bendrovė "ROKIŠKIO SŪRIS"	39,75	19,9	9,42	7,17	-	59,65	1 and 2 acting in concert.	59,65
24	Akcinė bendrovė "SANITAS"	99,4	0	-	-	-	99,4	-	
25	Akcinė bendrovė Šiaulių bankas	19,57	6,24	-	-	-	25,81	1, 2 and other persons acting in concert.	43,46
26	Akcinė bendrovė "Snaigė"	59,86	8,38	5,72	-	-	68,24	-	
27	TEO LT, AB	68,29	7,24	-	-	-	75,53	-	
28	Akcinė bendrovė Ūkio bankas	53,1	9,47	7,1	-	-	62,57	-	
29	Akcinė bendrovė "UTENOS TRIKOTAŽAS"	51,12	13,61	10,54	5,52	-	64,73	-	
30	Akcinė bendrovė "VILNIAUS BALDAI"	72,14	10,07	-	-	-	82,21	-	

No.	Company	Shareholdings (%)					$1^{st} + 2^{nd}$ (%)	Acting in concert	Total % acting in concert
31	Akcinė bendrovė "VILNIAUS DEGTINĖ"	68,29	10	9,76	9,24	-	78,29	-	
32	AB "VILKYŠKIŲ PIENINĖ"	50,8	8,49	8,25	-	-	59,29	-	
33	Akcinė bendrovė "ŽEMAITIJOS PIENAS"	44,63	8,18	7,45	6,25	-	52,81	1 and 4 acting in concert.	50,88

Table 8: Ownership structure in the Republic of Lithuania

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Practical material

Case Law

The Republic of Lithuania

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