HOW CAN SHAREHOLDERS' AGREEMENTS SHAPE CORPORATE GOVERNANCE AND DIRECTORS' LIABILITY?

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Preliminary Communication
UDC: 347.44:005.658-057.162
DOI: https://doi.org/10.22598/iele.2022.9.2.7

HOW CAN SHAREHOLDERS' AGREEMENTS SHAPE CORPORATE GOVERNANCE AND DIRECTORS' LIABILITY? *

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ABSTRACT

The interplay between contract and state corporate law in shaping corporate governance is not a novelty. In this article author questions the impact of private ordering through the shareholders' agreement (further in text: SA) on corporate governance and possibly on the director's duties and liabilities. The author argues that the SA might have far-reaching consequences for all the stakeholders and third persons as there are only a few limitations to its content, mainly referring to the mandatory rules of corporate law and general limitations of contract law. It means shareholders can impose additional rules for governance to directors, for transfer of shares, employment policy, and others. The author shall question whether SA can modify the articles of association. This article aims to reassess the balance between corporate and contract law instruments for the companies' governance. The author argues that analyzing corporate governance without considering contractual tools, such as SA, becomes incomplete and seriously undermines rethinking fundamental principles of corporate governance, such as the issue of directors' liability.

Keywords: *shareholders agreement, corporate governance, director's liability*

1. INTRODUCTION

Law and articles of association traditionally set fundamental features of the corporate governance of companies. However, recent practice shows that there

* The writing of this paper was supported by the University of Rijeka project (uni-ri-drustv-18-43) "Legal Aspects of Companies Restructuring and Transition Towards New Corporate Governance Culture."

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is yet another tool, a contract, by which the shareholders try to tailor the corporate governance of the company according to their needs. These contracts between company members, or where at least one of the parties is a shareholder, regarding the matters of corporate governance are called shareholders' agreements (further in text: SA). Although SA is widely present in corporate practice, they are mostly not regulated in comparative legislation and is seriously undermined in scholarly writings. This leaves many questions open throughout different national jurisdictions. The research in this article is done by the functional method in the analysis of comparative law. Besides leading legal examples of US and German corporate law, the author shall draw references to Croatian law as an example of the legislature under the heavy influence of German corporate law. The author shall particularly discuss whether SA can modify the articles of association in order to answer which would prevail. Of particular interest is the discussion of how and to what extent SA can affect the company's management and position of directors. This article aims to contribute to the legal discussion regarding the scope of the desirable influence of contract law instruments on creating the corporate governance of companies.

2. CONTRACT LAW OR STATE CORPORATE LAW- WHICH ONE GAVE BIRTH TO MODERN COMPANIES?

From legal to economic literature, there is a long history of debate about what is a company or popularly called the "firm".[1] The legal nature of the company is important to understand and interpret the relations between the shareholders, the management, and other stakeholders of the company. The most prominent theory until today is the one that views the company as a "nexus of contracts", as introduced by Jensen and Meckling in 1976.[2] In essence, it considers that relations between the company's shareholders, management, employees, and other stakeholders are contractual in character.

However, the "nexus of contracts" theory has a long list of critics,[3] with the main argument that relations among the stakeholders of the company cannot

[1] For an overview see in 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, 24 (4) 1998-1999. See also Coase, R. H.: *The Nature of the Firm*, Economica New Series, 4 (16) 1937.

[2] See their seminal paper on the topic, Jensen, M. C.; Meckling, W. H.: *Theory of the firm: managerial behavior, agency costs and ownership structure*, Journal of Financial Economics, 3 1976.

[3] See for example Bratton, W. W.: *The "Nexus of Contracts" Corporation: A Critical Appraisal*, Cornell Law review, 74 1989. The author considers this theory as not empirically sustained, often regarded as self-explanatory with many features remain unclear.

be interpreted through the classical analysis of contractual rights and duties of interested parties solely. Legal authors tend to interpret the "nexus of contracts" theory, not as legally binding contracts concluded between the stakeholders of the company but as the "agreement out of the interests of the relevant parties"[4] or "nexus of reciprocal arrangements".[5] We consider that the most important contribution of the "nexus of contracts" theory is that it draws a clear distinction from the consideration that relations between stakeholders of the company originated from outside authority. It is, thus, widely accepted that the creation of companies is not mandated by the state legislators but that it is in the domain of parties' contractual freedom.

On the other side, corporate law is clearly made by state legislators. It consists of mandatory and default rules whose content depends on the applicable national laws and types of companies in which the business is incorporated.[6] We agree with the authors who claim that the most important contribution of corporate law is that it provides the legal personality to the companies, which allows them to enter into a business transaction as one contracting party and not as a group of individuals.[7] Corporate law draws out yet another crucial feature of the companies, and that is the asset partitioning and the so-called "entity shielding", which in essence, means that the company assets are protected from the shareholders' personal creditors, regardless of the type of the incorporation.[8] Finally, corporate law has effectively construed corporate governance architecture for various legal forms of companies.[9]

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4 See Kornhauser, L. A.: *The nexus of contracts approach to corporations: a comment on Easterbrook and Fischel*, Columbia Law Review, 89 1989, p. 1491.

5 See Eisenberg, M. A.: *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, op. cit., p. 822.

6 Proper distinction between mandatory and default rules is crucial, and the higher contrast in regulator approaches can be seen between U.S. and German corporate law. See in Hopt, K. J.: *Directors' Duties and Shareholders' Rights in the European Union: Mandatory and/or Default Rules?*, ECGI Working Paper Series in Law, Working Paper N°. 312/2016, 2016, [https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id2749237.pdf].

7 See Armour, J.; Hansmann, H.; Kraakman, R.: What is Corporate Law?, in: Kraakman, R.; Armour, J.; Davies, P.; Enriques, L.; Hansmann, H.; Hertig, G.; Hopt, K.; Kanda, H.; Rock, E.: *The Anatomy of Corporate Law, A Comparative and Functional Approach*, Oxford, 2009, p. 6.

8 See Hansmann, H.; Kraakman, R.; Squire, R.: *Law and the Rise of the Firm*, Harvard Law Review, 119 2005, p. 1338.

9 Klausner argues that contractarian theory of corporate law serves only as a starting point in understanding the companies, but that it fails to explain the process and content of the corporate governance of the companies. See in Klausner, M.: *The contractarian theory of corporate law: generation later*, Journal of Corporation Law, 31 (3) 2006.

Although many legal effects provided by the corporate law for the companies could be achieved through contractual drafting as well, corporate law makes the entire business simpler for the shareholders and invokes a degree of security for all the third parties which are conducting business with the company.[10] Corporate law undergoes constant changes and upgrades where state legislators aim to improve the legal environment for all stakeholders of the company and entice entrepreneurship. And these amendments apply to all existing and future companies without the need of shareholders to contractually envelop those changes in their relationship and to the corporate governance of the company, which certainly is an important contribution of the corporate law.

Regardless of whether we consider the company as nexus of various contracts or as a creature of the state corporate law, we can strongly argue that there are certain contracts concluded between the stakeholders of the company. The fundamental contract concluded between the shareholders, many argue, would be the so-called "articles of association", "constitution", "charter" or "memorandum",[11] where shareholders can influence its content depending on the various legal form of the corporation. We shall further discuss the legal nature of the articles of association. In addition, shareholders are free to conclude added contracts among themselves and with the company, in which case these contracts fall under obligations law and not state corporate law.

The author considers that rather than taking a side in the debate about who gave birth to modern corporations, corporate or contract law, the focus of this article is on the interplay of contract and corporate law to provide a better understanding of how their interplay can shapes the corporate governance.

3. SHAREHOLDERS' AGREEMENTS VS. ARTICLES OF ASSOCIATION

Analysis of the legal nature and comparison between articles of association and SA can provide further insight into the interplay of contract and corporate law in creating the corporate governance of the companies. They both have contractual features, but while articles of association are fully acknowledged by corporate law, the legal position of SA remains ambiguous. Figuring out

[10] See also Armour, J., Hansmann, H., Kraakman, R.: What is Corporate Law?, *op. cit.*, p. 20. For a more detailed view of the „corporate" benefits see Mahoney, P. G.: *Contract or concession--an essay on the history of corporate*
Law. Georgia Law Review, 34 (2) 2000.

[11] See Easterbrook, F. H.; Fischel, D. R.: *The Corporate Contract*, Columbia Law Review, 89 1989.

their legal nature can provide some answers as to the relationship between contract and state corporate law, but also to the relation between articles of association and SA when the shareholders use both within the same company.

Formation of the articles of association is a condition for forming a company.[12] However, there are different views regarding the legal nature of the articles of association. Among scholars, three possible views of the legal nature of articles of association most often occur. The first qualifies them as a contract, the second as an objective norm (normative theory), and the third as a combination of the first two, the modified objective norm.[13]

However, the most discussed view in the literature is whether the articles of association can qualify as a contract. Viewing articles of association as a contract shows their Roman origins, where the company started as a pure obligation between the partners.[14] There is no doubt that future members of the company voluntarily make a decision to form a company with a freely chosen business purpose. In fact, before registration of the articles of association and the final steps of forming a company, relations of the future shareholders are mostly in the sphere of obligations law.[15] However, it is undisputed that by the conclusion of the articles of association, parties do not only determine rights and obligations among themselves, but they also form the company bodies, their role, and the entire corporate structure. Formation of the corporate structure is usually not a subject of the contractual drafting but rather the case where mandatory and default corporate law rules automatically apply.[16] Thus, it is questionable whether the formation of the corporate bodies and relations

[12] Sometimes, this founding legal instrument is called „statute" or a „partnership agreements". Naturally, there are differences among these instruments depending on the applicable national law and the type of the company. See the analysis for Croatian law in Barbić, J.: *Društveni ugovor kao pravni posao na kome se temelji društvo*, Zbornik Pravnog fakulteta u Zagrebu, 62 (1-2) 2012. For Germany see Schäfer, C.: § 705 in: Habersack, M. (ed.): *Münchener Kommentar zum Bürgerlichen Gesetzbuch: BGB*, Band 7: Schuldrecht Besonderer Teil IV, 8. Auflage, München, 2020, rn 159.

[13] See Podgorelec, P.: *Legal Nature of Articles of Association and Categorization of Their Elements*, Pravnik, 68 (9-10) 2013, p. 650. The founding father of normative theory was Otto von Gierke, whose dogmatic view was that companies are primarily creatures of legislators through normative, i.e. legislative acts. The leading argument revolved around the fact that it was not until the registration of the articles of association that the company can obtain its legal personality. For the role which Gierke had in creation of German dogmatic view on legal persons, see Raiser, T.: *Der Begriff der juristischen Person, Eine Neubesinnung*, Archiv für die civilistische Praxis, 199 (1/2) 1999, p. 120 and further.

[14] See Schäfer, C., § 705, *op. cit.*, rn. 159.

[15] See in Dieckmann, A.: *Gesamthand und juristische Person*, Tübingen, 2019, p. 262.

[16] See also Armour, J.; Hansmann, H.; Kraakman, R.: What is Corporate Law?, *op. cit.*, p. 23.

between the shareholders and other can be understood and interpreted through classical contract theory only.[17]

There are significant differences between articles of association and traditional contracts. In particular, articles of association shall apply to all current and future members of the company,[18] but for its modification and admittance of new members, not all shareholders must agree,[19] which would be the case if the articles of association were considered as a pure consensual, synallagmatic contract.[20] Further, articles of association aim to permanently regulate relations between the shareholders and the inner life of the company in a way it outlives its founders. For those reasons, in German literature, within the contractual theory, scholars debate whether the legal nature of articles of association is purely contractual (Schuldvertrag) or a specific type of organizational contract (Organisationsvertrag).[21] Due to the previously mentioned specifics, scholars' prevailing opinion is that articles of association should be viewed as an organizational contract.[22] Likewise, the extent to which the general obligations law can apply for interpreting the articles of association is questionable, as articles of association cannot be qualified as a traditional synallagmatic contract.[23] In legislations where a contractarian view of the companies is more pronounced, as is the USA, courts, and scholars are more inclined to conclude that the general rule of contract interpretation should be applied to articles of association as an organizational document of the company as well.[24] Thus, the theoretical view favors articles of association to be founded in contract law, but there are

[17] See Podgorelec, P.: *Legal Nature of Articles of Association and Categorization of Their Elements*, *op. cit*, p. 650.

[18] See Schmidt-Leithoff, C.: §2, in: Rowedder, H.; Schmidt-Leithoff, C. (eds.): *Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, 5. Auflage, München, 2013, rn 2, p. 160.

[19] One of the main argument for allowing that the articles of association can be modified without consent of all shareholders is that in such a way shareholders have better opportunity in value-maximizing and adopting the corporation to new needs, as the corporations are usually made with long-term goals. In that way legislators support entrepreneurship. For a discussion see Bebchuk, L. A.: *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments,* Harvard Law Review, 102 (8) 1989, p. 1830.

[20] See Podgorelec, P.: *Legal Nature of Articles of Association and Categorization of Their Elements*, *op. cit*, p. 650.

[21] See Schäfer, C., §705, *op.cit*., rn 159-163.

[22] See Schmidt-Leithoff, C., §2 *op. cit*., p. 160. The same opinion remains undisputed for Croatia as well. See also in Barbić, J.: *Društveni ugovor kao pravni posao na kome se temelji društvo*, *op. cit*, p. 500.

[23] See Schäfer, C., §705, *op.cit*., rn 159-168.

[24] Wischmeier Shaner, M.: *Interpreting Organizational "Contracts" and the Private Ordering of Public Company Governance*, William&Mary Law Review, 60 (3) 2019, p. 1006.

restrictions to interpreting it as a traditional contract and to using general obligations law for potential gap-filling, the extent of which can further depend on the applicable national law.

As to the legal nature of the SA, the most common definition of the SA is that they are a written or oral contract concluded between the parties,[25] where at least one of them is a shareholder, and the subject matter of the contract concerns the company, shares of the company or relations between the shareholders.[26] Thus, SA is mostly considered to be an atypical,[27] consensual, and synallagmatic contract, where general obligations law applies for its interpretation. When it comes to voting for SA, especially if all the shareholders sign them, German courts treat the SA as a private partnership for internal relations between the shareholders, regardless of whether they are disclosed to the company or not.[28] Nowadays, shareholders are generally allowed to conclude SA,[29] and they are widely present in corporate practice, although its relation to the state corporate law is not always clear.

The crucial question for the purpose of this article is can the SA override the articles of association in cases where they contain contradictory provisions. To provide an answer, the author shall confront SA and articles of association on two crucial grounds. First relates to the scope of application of the articles of association and the SA, regarding the parties and the content. The second relates to the rules of the modification of the articles of association – can it be altered by an outside contractual instrument, such as SA?

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[25] No formal requirement for the validity of the SA is definitely one of the major differences in comparison of articles of association and the SA. See Koppensteiner, H. G.; Gruber, M.: §47, in: Rowedder, H.; Schmidt-Leithoff, C. (eds.): *Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, 5. Auflage, München, 2013, Rn 28, p. 1575.

[26] See for example in Cadman, J.: *Shareholders' Agreements,* London, 2003, p. 3. See Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, in: Mock, S.; Csach, K.; Bohumil, H. (eds): *International Handbook on Shareholder' Agreements, Regulation, Practice and Comparative Analysis*, Berlin, 2018, p. 7.

[27] See Sarkozy, T.: *Shareholders' Agreements*, Acta Juridica Hungarica, 43 (1-2) 2002, p. 123.

[28] See the ruling of German Federal Supreme Court, BGH, 24.11.2008 - II ZR 116/08. For comparison to USA companies, Kulms argues that partnership law may be applicable to voting SA signed by all the shareholders for their internal relations. See Kulms, R. A.: *Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany*. European Business Organization Law Review, 2 2001, p. 693.

[29] Opposite to the view of modern corporate law, in the beginning of 20th century SA, especially voting agreements, were not enforceable before the German and the USA courts. The main reason behind such a view was the need to protect the public interest and preserving the minority rights by not allowing that a shareholder can restrict its right to freely vote on the general meeting of the company. See in Kulms, R. A.: *Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany*, *op. cit.*

3.1 CONFLICT OF ARTICLES OF ASSOCIATION AND SHAREHOLDERS' AGREEMENT – CAN PARTIES AND CONTENT OVERLAP?

The first question should reveal the extent to which we can consider the relationship between the articles of association and the SA regarding the applicable parties of each of these instruments. The main idea is that if these instruments apply to the same persons, then we must discuss whether their content can overlap and thus create a possible contradicting provision.

SA is typically concluded between the shareholders, but it does not have to include all the shareholders.[30] Importantly, at least one of them must be a shareholder in order to qualify the contract as the SA.[31] One of the most important legal effects of the SA is that it can impose obligations only to the shareholders, who are its contractual parties.[32] On the opposite, articles of association include all current and future shareholders and oblige all shareholders. From this alone stems the primary conclusion, and that is that the SA and articles of association do not necessarily have the same parties. The author shall further clarify the issue of possible parties to the SA.

Theory and practice confirm that it is possible that one of the contracting parties of the SA is not a shareholder.[33] It could, for example, be a spouse of the shareholder (which is an example of good practice if the share is marital property)[34] or a creditor of the company and others. The contracting party can also be a manager/shareholder or a manager who is not a shareholder.[35] Involving the managers in the SA, if nothing else, ensures that he/she is well aware of its existence and its content. For example, in family businesses, SA can be used to transfer family values and goals from family members/shareholders to managers.[36]

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30 See in Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, Doctoral dissertation, Vilnius, 2014, p. 328.

31 *Ibid*., p. 174.

32 For such conclusion from comparative perspective see in Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit*., p. 5. For Germany see Schmidt-Leithoff, C.: §3, *op. cit*., rn. 53, p. 212. The same for Croatia in Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo*, Zagreb, 2013, p. 605.

33 See Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit*., p. 17. The same position in Croatian law as well. See Barbić, J.: *Pravo društava, Društva kapitala, Društvo s ograničenom odgovornošću*, Zagreb, 2013, p. 279.

34 See Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit*., p. 185.

35 See Cadman, J.: *Shareholders' Agreements, op. cit*., p. 4.

36 See Astrachan, C. B.; Astrachan, J. H.; Kotlar, J.; Michiels, A.: *Addressing the theory-practice divide in family business research: The case of shareholder agreements*, Journal of Family Business Strategy, 12 (1) 2021, p. 2. Equally, family members can create different mechanisms to directly or indirectly influence the managing of the company with the goal to ensure

Besides with third parties, it has been recorded that shareholders enter into a contract with the company itself, where they, for example, agree on the veto right for a certain company decision such as the change of director, selling off the company's property,[37] awarding remuneration to certain shareholders/managers[38] and other.[39] However, although it is possible that the company is a contracting party, parties should carefully draft the content of such a SA, as the SA could not be binding if it is contrary to mandatory corporate law, especially regarding the functioning of the company's bodies.[40]

Thus, regarding the applicable parties, we conclude that the SA and articles of association do not necessarily have the same parties. However, all shareholders may enter in the SA, or some shareholders enter the SA in which cases we can speak of total or partial overlapping of the parties. It is further necessary to determine if the content of articles of association and SA may overlap.

National laws explicitly provide the mandatory content of the articles of association, depending on the company's legal form.[41] On the opposite, SA is generally not regulated, both in EU[42] and comparative legislations.[43] The content of

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that the business decisions are in accordance with the family values. In some family businesses are thus construed additional bodies, the so-called family councils where family members can, among other, bring business decisions and try to influence the managing body, which is much simpler if the manager is also made part of that body. See Lächler, C.: Familienverfassung und Family Governance, in: Rechenberg, von F. W-G.; Thies, A.; Wiechers, H. (eds.): *Handbuch Familienunternehmen und Unternehmerfamilien*, Stuttgart, 2016, p. 814. More about family council see in Braut Filipović, M.: *Specifičnosti upravljanja obiteljskim društvima*, Zbornik Pravnog fakulteta u Zagrebu, 67 (6) 2017, p. 952.

[37] See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, Yale Journal on Regulation, 38 (4) 2021, p. 1130.

[38] See Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit.*, p. 186.

[39] See the empirical study in Schoenfeld, J.: *Contracts Between Firms and Shareholders*, Journal of Accounting research, 58 (2) 2020.

[40] See Mock, S.; Csach, K.; Bohumil, H.: *Shareholders' Agreements between Corporate and Contract Law*, *op. cit.*, p. 7.

[41] For example, for mandatory content of limited liability company in Germany (GmbH), see Schmidt-Leithoff, C.: §3, *op. cit.*, rn 1, p. 192 and further.

[42] For the EU, SA is mentioned sporadically, the example is the obligation of the shareholders towards the company for transparency of SA in listed companies in certain cases under 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 L 390, 31.12.2004, p. 38–57.

[43] For example, German and Croatian legislature do not regulate SA. However, some legislation, such as USA, provide a legal framework for SA. See section 7.32 of the Revised Model

SA differs regarding their goal and subject matter. Thus, there are various classifications under which they can be sorted.[44] However, the literature emphasizes that the most common goal of SA is to obtain control in the company through concluding voting agreements.[45] The purpose behind voting agreements is usually that contracting parties control the election of the director or to improve the position of minority shareholders and their possible influence over the management of the company.[46] There are a few empirical studies regarding the content of the SA. In the research on U.S. domiciled companies which went IPO in 2021,[47] the primary content of the SA was to achieve control of certain shareholders over the election and composition of the board of directors. Yet another empirical research on the broad example of SA in U.S. domiciled companies concluded between the shareholders (usually controlling shareholders) and the company confirms that the right to elect the director is an important incentive for the conclusion of the SA.[48] From continental Europe, the example of empirical research comes from Italy on the sample of Italian listed companies, where SA was concluded primarily to obtain voting control.[49] Board representation

Business Corporation Act (RMBCA). See also Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit.*, p. 7. Further, takeover law regulates the situations when shareholders act in concert, which can amount to their obligation to put a takeover bid. Shareholders can act in concert as a result from the SA as well. So we can argue that legislators on the European level tackled some consequences of SA, although to a limited extent, but for listed companies solely, with the goal to protect minority shareholders. See in Roth, M.: *Shareholders' Agreements in Listed Companies: Germany*, 2013 [https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2234348], p. 4.

[44] For an overview see in Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit.*, p. 195.

[45] See Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit.*, p. 32.

[46] See Čulinović Herc, E.; Hasić. T.: *Sudjelovanje dioničara u radu glavne skupštine dioničkog društva prema noveli zakona o trgovačkim društvima*, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, 32 (1) 2011, p. 35.

[47] Rauterberg made a study on the example of 901 U.S. domiciled company which went IPO in the period from 2013-2018. See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance, op. cit.,* p. 1149.

[48] Schoenfeld conducts a study on the example of 13D filings from the SEC's EDGAR for the years 1996–2018. Schoenfeld argues that even 15% of examined SA's has a management representation clause. However, the highest rate of 28% has a private placement clause though, under which the company obliges itself to sell shares under pre-determined price, which is of special importance in closed corporations. See Schoenfeld, J.: *Contracts Between Firms and Shareholders*, *op. cit.*, p. 408.

[49] Baglioni conducted a research on the publicly available dana from Consob, in the time frame of ten years, finishing in 2007. See Baglioni, A.: *Shareholders' agreements and voting power: evidence from Italian listed firms,* Applied Economics, 43 (27) 2011.

was of high importance as well. In Croatia, there is no empirical research on the use of SA in practice. One of the reasons is that SA is not publicly available.[50] Other content of SA often concerns the restrictions on the transfer of shares, agreements on profit sharing in favor of certain shareholders (typical for venture and private equity funds), various call and put options, drag along rights, additional information provided to minority shareholders, and others.[51]

That does not mean that there are no restrictions for these agreements. Sometimes, the national legislation explicitly imposes certain limitations. For example, according to both German[52] and Croatian[53] company laws, it is a misdemeanor to contract any compensation or benefit in the name of the obligation from the contract on how to vote at the general meeting. Further, both German and Croatian legislators provide that if a shareholder undertakes to vote according to the company's instructions, the management or the supervisory board,[54] such a contract would be null and void. Further, shareholders could not, through the SA give voting rights to a third person who is not a shareholder.[55] Such provisions are a clear example of how national legislators can restrict possible shareholder voting agreements.

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[50] However, due to its strategic importance to Croatian economy, the most famous SA is the one concluded between the Government of Republic of Croatia and the MOL Hungarian Oil and Gas PLC over the strategic rights in the joint-stock company INA. For an overview of the privatization process and subsequent entering of the MOL in the structure of INA see in Kecskés, A.; Jelinić, Z.: Monistički i dualistički ustroj organa dioničkog društava u Mađarskoj i Hrvatskoj s posebnim naglaskom na problem korporativnog upravljanja u hrvatskoj naftnoj kompaniji INA d.d., in: Župan, M.; Vinković, M. (eds.): *Suvremeni pravni izazovi: EU-Mađarska-Hrvatska*, Pečuh-Osijek, 2012. The SA is available at [https://molincroatia.com/sites/default/files/GMA%2030-01-2009_EN.pdf], accessed on 18/10/2022.

[51] See Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit.*, p. 195; Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit.*, p. 32.

[52] For Germany see § 405 par. 3, no. 6 and 7 of Aktiengesetz vom 6. September 1965 (BGBl. I S. 1089), das zuletzt durch Artikel 2 des Gesetzes vom 20. Juli 2022 (BGBl. I S. 1166) geändert worden ist.

[53] For Croatia see articles 631/1/7 and 631/1/8 of the Croatian Companies Act, Official Gazette, Nos. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19, 34/22. See also Jurić, D.; Zubović, A.: *Protupreuzimateljske mjere i položaj uprave ciljnog društva u postupku preuzimanja dioničkog društva*, Zbornik Pravnog fakulteta u Rijeci, 30 (1) 2009, p. 305.

[54] The same solution is adopted in German and Croatian company laws. See §136 par. 2 Aktiengesetz; Article 293 par. 2 of the CCA.

[55] For restrictions in German law see more Koppensteiner, H. G.; Gruber, M., §47, *op. cit.*, Rn 31, p. 1576. Author argues that the SA cannot override restriction on voting which are mandatory set in the law.

Further, shareholders can modify certain rights only via articles of association in order to be legally binding, i.e. to have a legal effect on the company. For example, in Croatian law, it is explicitly stated that restrictions on the transfer of shares should be inserted in the articles of association.[56] Such a solution protects all shareholders and preserves selected default rules of corporate law, which can be modified with the legal effect on the company, but only if made known and agreed upon by the requested majority of shareholders in the general meeting. It provides a certain degree of legal certainty to third parties as well. At the same time, it is a major disadvantage for those shareholders who entered a SA.

In other cases, we can argue that SA is subject to applicable general contract law limitations.[57] If we qualify the SA as a contract, which was previously discussed, then it should be interpreted that contractual remedies should be applied.[58] In the previous example, if a party to a voting agreement votes differently than agreed upon in the general meeting, such a vote shall be valid, but the other parties of SA can ask the party in breach for compensation of damages.[59]

To conclude, the content of SA is not regulated. Thus, shareholders are mostly free in its formation (limitations are set in mandatory corporate and contract law). Thus, there is no obstacle that the parties agree on a certain issue that is already regulated by the articles of association. In other words, it is possible that the content of the articles of association and of the SA overlaps, where the problem arises if these provisions are conflicted.[60]

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[56] For joint-stock companies see article 227 par 2 of the CCA. For limited liability company see article 412 par. 4 of the CCA. However, there is no explicit provision stating that such an agreement would be null and void if made outside of the articles of association. Author is of the opinion that if the parties would agree on the restriction of transfer of shares via SA, and not via articles of association, such an agreement would produce no legal effects towards the company. However, there is no obstacle that such an agreement binds the contractual parties, who could in case of breach, seek the compensation of damages. Further examples in Croatian law when modification of shareholder's rights should be done via articles of association to have a binding effect to the company would be introduction of special benefit for a member (Article 392 of the CCA), management and representation of the company (Articles 422 and 426 of the CCA), sharing of the profit (Article 406 par 2 of the CCA) and other.

[57] See Mock, S.; Csach, K.; Bohumil, H.: Shareholders' Agreements between Corporate and Contract Law, *op. cit.*, p. 13.

[58] Duffy, M. J.: *Shareholders Agreements and Shareholders' Remedies Contract Versus Statute*, Bond Law Review, 20 (2) 2008, p. 12.

[59] For Croatia, this standpoint is confirmed both in theory and in practice. See Barbić, J.: *Djelovanje zajednice (poola) prava glasa*, Revija Kopaoničke škole prirodnog prava, 1 2019, p. 258; Judgement of Visokog Trgovačkog suda, Pž-7466/04-4 from 18. September 2007. The same conclusion for German law see in Roth, M.: *Shareholders' Agreements in Listed Companies: Germany, op. cit.*, p. 12.

[60] Same line of thinking in Duffy, M. J.: *Shareholders Agreements and Shareholders' Remedies Contract Versus Statute*, op. cit., p. 8.

The author argues that for further discussion in resolving the conflict between articles of association and SA, the crucial issue is whether the articles of association could be modified by the subsequent SA, which shall be further elaborated.

3.2. CONFLICT OF ARTICLES OF ASSOCIATION AND SHAREHOLDERS' AGREEMENT – CAN SHAREHOLDERS' AGREEMENT MODIFY THE ARTICLES OF ASSOCIATION?

If the parties and content of SA and articles of association can overlap, this can lead to inconsistent solutions and disputes between the parties as to what is applicable. In such cases, a court should determine the parties' true will. In the author's opinion, the answer should be found in consideration of can the parties change the articles of the association through the SA.

Most corporate laws provide that any modification of the articles of association, regardless of the legal form of the company, should be done through formal procedures involving the general meeting and achieving a certain majority of shareholders' votes.[61] Also, articles of association and their amendments are publicly available (usually through Court registers). So, is it even possible to consider that the articles of association could be modified through an outside contractual instrument, such as SA?

Among the scholars, the prevailing opinion is that the breach of the SA, for example, of the voting agreement, does not affect the validity of shareholders' actions in the company's general meeting.[62] Such a conclusion stems from the understanding that only the articles of association can govern internal corporate governance, specifically, the functioning of the organs. In the same line of thinking, Sarkozy argues that articles of association and SA should be independently ruled upon and understood as having different consequences for the parties, as the SA derives from the contract law and articles of association

[61] See Enriques, L.; Hansmann, H.; Kraakman, R.: The Basic Governance Structure: The Interests of Shareholders as a Class, in: Kraakman, R.; Armour, J.; Davies, P.; Enriques, L.; Hansmann, H.; Hertig, G.; Hopt, K.; Kanda, H.; Rock, E.: *The Anatomy of Corporate Law, A Comparative and Functional Approach*, Oxford, 2009, p. 82. For Germany see Schmidt-Leithoff, C.: §3, *op. cit.*, rn. 1, p. 192. For Croatia see article 454 of the CCA.

[62] For continental law in Europe see for example Gomard, B.: *Shareholders' Agreements in Danish Law*, Scandinavian Studies in Law, 16 1972, p. 129. For German law see Koppensteiner, H. G.; Gruber, M., §47, *op. cit.*, Rn 32, p. 1577. The same for Croatia in Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo*, op. cit., p. 605. For common law positions see for example in Duffy, M. J.: *Shareholders Agreements and Shareholders' Remedies Contract Versus Statute*, *op. cit.*, p. 8.

from the corporate law.[63] This argument narrows down even further the possibility of modifying the articles of association by a SA.

The only interpretation that allows considering such an option is if we qualify the articles of association as a contract. Under general contract law, modification of an existing contract should always be strictly interpreted, and usually, the unilateral consent of the parties would be required.[64] This would lead to a conclusion that articles of association could not be subsequently modified without the consent of all of the shareholders. In other words, any possible modification of the articles of the association through the SA that would apply to all the shareholders could be done only if all the shareholders are also parties to the SA.

However, as was previously discussed, there is no clear agreement among scholars as to the legal nature of the articles of association. The prevailing opinion is that it is an organizational contract, where due to its specifics, it is questionable whether general contract law can be used for its interpretation. Nevertheless, not all provisions of articles of association have the same legal effect. They can be divided into mandatory and facultative provisions,[65] where within the facultative provisions, it is possible to insert the contractual clauses which would apply to all shareholders. Such contractual clauses are, for example, the composition of the management board, arbitration clauses, and others.[66] It has been argued in German literature that such provisions could be subsequently altered by other contract law instruments, such as SA.[67] In the same line of thinking, an ancillary agreement between the company and managers, e.g. on a lower compensation in the event of resignation, can also override a conflicting provision with the articles of association.[68] However, the subsequent change, done outside the articles of association, shall have legal effect only on the contracting party of the SA. If all shareholders are also parties to the SA, then we can speak of modifying the facultative contractual provisions of the articles of the association through the SA.[69]

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[63] See Sarkozy, T.: *Shareholders' Agreements, op. cit.*, p. 131.

[64] See for example in Kötz, H.: *European Contract Law*, Oxford, 2017, p. 63.

[65] See Schmidt-Leithoff, C., §3, *op. cit.*, rn 2, p. 193 and further. See also in Barbić, J.: *Društveni ugovor kao pravni posao na kome se temelji društvo*, *op. cit*, p. 510.

[66] The same conclusion for private ordering of shareholders in USA companies. See Thompson, R. B.: *The Law's Limit on Contracts in a Corporation*, Journal of Corporation Law, 15 (3) 1990.

[67] See Schmidt-Leithoff, C., §3, *op. cit.*, rn 53, p. 212. In the same line of thinking for Croatian law see Barbić, J.: *Pravo društava, Društva kapitala, Društvo s ograničenom odgovornošću*, *op. cit.*, p. 283.

[68] See Schmidt-Leithoff, C., §3, *op. cit.,* rn 53, p. 212.

[69] Theory and courts in USA largely support unanimous agreements by the shareholders done outside of the articles of association. This freedom is not however without limitations, the

To conclude, even in the hypothetical case where all shareholders would be the parties of the SA, the court would be highly reluctant to adopt the position that the shareholders contractually, through the provisions of the SA, modified the articles of association. Formal requirements for modifying the articles of association are usually mandatory provisions. We support the finding that the only exception could be in the case when SA modified the facultative contractual provisions of the articles of association and if all shareholders agreed on its modification in the SA. Considering these difficulties, parties should consider whether the change of articles of the association through a SA is prudent, as its legal effectiveness could be questioned. In each case, there is no obstacle that the parties of SA agree to propose an amendment of articles of association in the general meeting and that, through the corporate law, change the articles of association in a way that corresponds to their will previously expressed in the SA.

Although provisions of the articles of association shall mostly prevail over the SA, it should be noted that by that it does not mean that the articles of association could prohibit conclusions of the SA.[70] They cannot be considered as a source of mandatory law for the contractual capacity of the shareholders. However, the author argues that if the parties agreed in the articles of association not to enter into any or a specific SA, a breach of such a provision could lead to contractual remedies, such as compensatory damages.

If the SA, in most cases, cannot modify the articles of association, the author shall further discuss whether the SA affects the corporate governance of the company at all.

4. CAN SHAREHOLDERS' AGREEMENTS AFFECT THE CORPORATE GOVERNANCE OF THE COMPANY?

As discussed, SA, in most cases, cannot modify the articles of association. At the same time, the presence of SA in practice rises, and the content of the SA has very few limitations. The dominant view among scholars and practitioners is that SA is mostly used in privately held companies,[71] but there is no obstacle

primary limit being the fiduciary duty of managers/directors. See Thompson, R. B.: *The Law's Limit on Contracts in a Corporation*, *op. cit.*, p. 395.

[70] See Barbić, J.: *Pravo društava, Društva kapitala, Društvo s ograničenom odgovornošću*, *op. cit.*, p. 281.

[71] For an overview of arguments why SA are more of interest to shareholders of the closely held companies vs listed companies see in Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit.*, p. 157. The prevailing argument is that by using the contract, minority shareholders can obtain a better position towards the controlling shareholders, especially as in privately held companies there is no easy way out of the compa-

for shareholders to use them in public companies (companies whose shares are traded on the regulated market) as well,[72] which is confirmed in previously elaborated studies.

The crucial issue remains whether the SA can change the corporate governance of the company. To answer that, we must answer two questions: can shareholders modify default corporate rules equally by articles of association and by SA, and can shareholders modify the mandatory corporate rules by SA that they could not modify by the articles of association?

The answer to the first question should be found in applicable national corporate laws and the interplay between the articles of association and the SA, which was *in extenso* discussed in the previous chapter of this article. The conclusion was that parties could modify default corporate rules by SA as well, but it shall mostly have a binding effect only on those shareholders who are contractual parties of the SA. In other words, SA shall not be legally binding for the companies, and legal actions of the shareholders on the general meetings contrary to the SA shall be valid (the example is voting contrary to the SA). Modifications with binding effect on all shareholders are possible only if all shareholders are parties to the SA (unanimous SA).[73] Equally, corporate law can provide that some modifications in order to be legally binding must be done through the articles of association. The example put forth was the transfer of shares under Croatian law. Thus, generally speaking, shareholders can make almost all modifications of the default corporate law provisions by the SA. What is the biggest difference in comparison to the articles of association is to whom such modifications shall be binding, to all or only to certain shareholders or other stakeholders.

As to the second question, Rauterberg argues that shareholders can, in certain cases, modify even the mandatory corporate law provisions by the SA, where the example would be the separation of the voting power and control.[74] Precisely, it refers to the voting SA where even minority shareholders can agree to vote for the election of a certain director and obtain voting control which

ny as there is no regulated market for selling the shares to third parties. See e.g. Means, B.: *A contractual approach to shareholder oppression law*, Fordham Law Review, 79 (3) 2010.

[72] See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance, op. cit.,* p. 1133. See the study of Schoenfeld, J.: *Contracts Between Firms and Shareholders*, *op. cit.*

[73] For a specific regulation of unanimous SA, and its particular place in regulation of corporate governance, see Hay, R. J.; Smith, L. A.: *The Unanimous Shareholders Agreement: A New Device for Shareholders Control*, Canadian Business Law Journal, 10 (4) 1985.

[74] See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance, op. cit.*, p. 1128.

they otherwise would not have. Such a practice is especially present when venture and private equity funds invest in the company.[75] One notable example would also be the nomination of the exact person who shall act as a director in voting agreements between shareholders.[76] This could be of particular interest to family businesses that prefer to have a family member as the CEO. While that is possible to achieve in SA, shareholders could not insert in the articles of association the obligation to vote for a certain person to act as a director or directly nominate the director/management board without fulfilling additional conditions.[77]

The more questionable issue is whether shareholders can waive certain mandatory rules of the corporate law, such as the duty of loyalty towards the company by both the shareholders and the directors. In German literature, a clear standpoint is taken that shareholders could not agree in the SA to limit the duty of loyalty towards the company and other shareholders.[78] In that light, a very peculiar practice arose in the companies incorporated in selected USA countries, led by the Delaware companies, where shareholders can, from 2000, explicitly waive *ex ante* the doctrine of opportunities and its consequences for the directors and shareholders.[79] On the opposite, European legislators request informed consent from disinterested directors on a case-by-case occurrence in order to support the director in appropriate business opportunities instead of the company.[80] This is important because it firstly demonstrates that the

[75] Control rights through voting rights is crucial for investors as are venture and private equity funds. Once negotiated, the contract by which these investors obtain certain control rights can be undoubtedly qualified as SA. See the study Kaplan, S. N.; Strömberg, P.: *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, Review of Economic Studies, 70 2003.

[76] See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance, op. cit.*, p. 1146.

[77] In Croatian law, in the limited liability company shareholders can nominate the management board directly in the articles of association only if they nominate one of the founders, i.e., one of the shareholders who signed the articles of association during the constitution of the company. See article 423 par. 2 of the CCA. For the joint-stock companies, only the members of the first supervisory board (in the one-tier system) or board of directors (in the two-tier system) can be nominated in the articles of association. See article 180 of the CCA.

[78] See Koppensteiner, H. G.; Gruber, M.: §47, *op. cit.,* Rn 31, p. 1577. Roth, M.: *Shareholders' Agreements in Listed Companies: Germany, op. cit.*, p. 8.

[79] There is no universal waiver, but certain requirements must be met. See Rauterberg, G.; Talley, E.: *Contracting out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, Columbia Law Review, 117 2017, p. 1095.

[80] Such a standpoint is taken at least in UK, Germany, France and Italy. See Enriques, L.; Hertig, G.; Kanda, H.: Related-Party Transactions, in Kraakman, R.; Armour, J.; Davies, P.; Enriques, L.; Hansmann, H.; Hertig, G.; Hopt, K.; Kanda, H.; Rock, E.: *The Anatomy of Cor-*

shareholders are interested in contractually altering the mandatory corporate law and, secondly, that certain legislators started to allow shareholders to contractually modify some fundamental principles of corporate law regarding the directors' liability.[81]

In each case, the boundaries of the contractual freedom of SA exist. As previously discussed, mandatory rules of corporate law and general limitations of contract law should apply to the SA. Still, shareholders enjoy greater contractual freedom in SA than in the articles of association. Voting agreements in joint-stock companies, where corporate law strictly mandates shareholders' rights, is a primary example. Such SA could significantly impact all shareholders and stakeholders of the company. If some shareholders obtain control in the company, which they otherwise would not have, and if they are doing so outside of the articles of association, some authors argue that in modern corporate law, we witness the rise of stealth governance.[82] It reflects the notion that contract law instruments, undisclosed to parties outside of the contract, alter the company's governance. As the SA is mostly undisclosed to any third party,[83] the actual number and content of these agreements, together with the possible impact on the governance of the companies, remains unclear. Regardless of the possibly significant influence, this issue is seriously undermined in scholarly writings on the corporate governance of the companies.

Criticism of tailoring corporate governance by SA exists. One of the main reasons is that it facilitates unequal treatment of shareholders in the company and

porate Law, A Comparative and Functional Approach, Oxford, 2009, p. 167. For consideration of corporate opportunities doctrine in the wider context of the *self-dealing* transactions of directors see extensively in Braut Filipović, M.: *Položaj članova uprave dioničkog društva pri sklapanju ugovora u ime društva, ali s osobnim interesom u pravnom poslu*, Zbornik Pravnog fakulteta u Zagrebu, 62 (4) 2012.

[81] It should be noted that the study conducted by Rauterberg shows that the waiver of doctrine of opportunities occured mostly in articles of assotiation of the companies, which is a good practice as it condones that all shareholders at least had an opportunity to vote regarding such a provision of articles of association. See Rauterberg, G.: *The Separation of Voting and Control: The Role of Contract in Corporate Governance, op. cit.*, p. 1126.

[82] Fisch, J. E.: *Stealth Governance: Shareholder Agreements and Private Ordering*, Washington University Law Review, 99 2022.

[83] SA are mostly undisclosed in the practice. There is no requirement for the shareholders of closed companies to disclose such agreements, while public companies could, under certain conditions, depending on the applicable law, be obliged to publicly disclose SA or to have certain legal consequences. For example, if the parties concluded the SA they could be found that they act in concert, where under the takeover law, they would be obliged to pose takeover bid. For an overview for German law see in: Roth, M.: *Shareholders' Agreements in Listed Companies: Germany, op. cit.*

sacrifices transparency of governance of the company towards third persons.[84] The unequal position of the shareholders could stem from the separation of control and voting power as allocated by the corporate law, especially in cases when all shareholders do not conclude SA. In the extreme, decisions regarding the company could be made by shareholders *de facto* outside of the general meeting by only the selected shareholders who entered the SA. The author is of the opinion that further empirical studies should be conducted to reveal the actual position of shareholders and third parties in cases when SA exists parallel to public articles of association. If the analysis shows that there are possible concerns, it could serve as a starting point for reassessing the scope of the desirable influence of contract law instruments on the corporate governance of the companies by both scholars and state legislators.

5. CAN SHAREHOLDERS' AGREEMENTS AFFECT DIRECTORS' LIABILITY?

As previously stated, managers can be contracting parties of the SA, regardless of whether they are shareholders of the company. Some investors have an interest in including in the SA only a shareholder who participates in managing the company as well (which is often when venture and private equity funds enter the company).[85] By participating in SA, shareholders can take obligations to act in accordance with the SA. If the shareholder/manager participates in SA, author considers it should be clearly stated in the SA whether he/she presumes obligations as a shareholder or as a manager of the company.[86] Contractual freedom for shareholders contains fewer restrictions than for managers/directors of the company, so managers/directors must be careful in order to avoid any possible breach of duty of loyalty or of fiduciary duty towards the company.[87]

It is clear in both literature and practice that shareholders can, through SA, especially voting SA, directly affect the composition of the supervisory or

[84] See Fisch, J. E.: *Stealth Governance: Shareholder Agreements and Private Ordering, op. cit.*, p. 916.

[85] Chemla, G.; Ljungqvist, A.; Habib, M. A.: *An Analysis of Shareholder Agreements*, Journal of the European Economic Association, 5 (1) 2007, p. 94.

[86] Also Miliauskas, P.: *Company law aspects of shareholders' agreements in listed companies*, *op. cit.*, p. 185.

[87] A Canadian case clearly demonstrates this point. See Ringuet v. Bergeron, 1960 CanLII 67 (SCC), [1960] SCR 672. („The agreement did not tie the hands of the parties in their capacity as directors so as to contravene any of the provisions of the Quebec Companies Act." „The clause specifying unanimity in voting had no reference to director's meetings, but to shareholders' meetings.").

managing bodies of the company, depending on the legal form of the companies. If shareholders have the power to directly appoint and remove directors of the company, it could be argued that they hold the ultimate power over the management of the company.[88] So, if shareholders can, through SA contract to obtain higher control over the company, could directors use the SA to negotiate for a lower degree of liability? The author shall further discuss whether modifying the directors' liability through the SA is possible.

First, one must answer whether it is possible to modify directors' liability at all. National legislators should provide the answer. Generally speaking, it is considered that the US legislator is more flexible and that it provides fewer mandatory provisions in the corporate law than countries of the European Union.[89] On the level of the European Union, only some aspects of company law are harmonised and mostly only regarding the joint stock companies,[90] but most of these harmonisation rules, such as rules on capital, shareholders rights and minority protection, are considered mandatory.[91] Naturally, the ratio between mandatory and default rules in corporate law depends on the company's legal form. In joint-stock companies, the number of mandatory provisions is the highest,[92] while limited liability companies are known for their flexibility where dispositive norms prevail. However, the problem arises as it is not always clear which provisions of the corporate law are mandatory,[93] in which

[88] Power to appoint and remove directors could be regarded as more powerful tool than other legal constraints put on the directors, such as duty of loyalty towards the company, duty of care and other. See Enriques, L.; Hansmann, H.; Kraakman, R.: The Basic Governance Structure: The Interests of Shareholders as a Class, *op. cit.,* p. 79.

[89] See in Hopt, K. J.: *Directors' Duties and Shareholders' Rights in the European Union: Mandatory and/or Default Rules?, op. cit*., p. 4. Just a reminder, from a contractarian view of the company, there should practically be no mandatory provisions in corporate law, which would naturally include the issue regarding the liability as well. See a discussion in Welch, E. P.; Saunders, R. S.: *Freedom and its limits in the Delaware General Corporation Law*, Delaware Journal of Corporate Law, 33 2008, p. 844.

[90] See in Petrović, S.; Jakšić, T.; Bilić, A.: IV. Pravo društava, in: Josipović, T. (ed): *Privatno pravo Europske unije - posebni dio*, Zagreb, 2022.

[91] See in Hopt, K. J.: *Directors' Duties and Shareholders' Rights in the European Union: Mandatory and/or Default Rules?, op. cit*., p. 14.

[92] § 23 par. 5. of Aktiengesetz explicitely provides that any deviation from the provisions is possible only if that has been expressly permitted. The main reasons for this strictness are legal certainty, creditor protection and investors protection. For the argumentation in favour of retaining the mandatory character of most of provisions of joint-stock companies see Petrikowski, M.: *Satzungsstrenge Contra Gestaltungsfreiheit im Recht der „Deutschen" AG und SE*, Dissertation, Bielefeld, 2009.

[93] See Fisch, J. E.: *Stealth Governance: Shareholder Agreements and Private Ordering, op. cit*., p. 923.

cases one must consult both theory and judicial practice in order to obtain an answer.

The liability of managers or directors towards shareholders and the company is one of the crucial issues of corporate governance,[94] regardless of the legal type of the company. For joint-stock companies and limited liability companies, German[95] and Croatian[96] legislators provide that the liability of managers and directors is a mandatory provision. Their liability cannot be altered by either articles of association or by contractual instruments.[97] In the study on directors' duties and liabilities in the countries of European Union, it has been reported that the liability framework for managers and directors is mandatory.[98] Lately, there have been some serious considerations about whether this strict approach to director's liability, where directors bear unlimited personal liability, should be more relaxed, and specifically, should the German law be amended in order to allow certain limitations of the directors' liability. The most repeated proposition is to extend the labour law principle to corporate managers and limit the amount of damages in cases in which the harm was caused by simple negligence.[99] Still, the German legislature regarding directors' personal liability remains unchanged.

On the other hand, US legislators took a different approach. It allows for certain limitations of the duty of care.[100] In particular, the most prominent example is always the Delaware Code, which from 1986 explicitly allows corporations to adopt a charter provision that limits or eliminates certain director liability

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94 Hopt, K. J.: *Unternehmenskontrolle (Corporate Governance),* Überlegungen *zu einem internationalen und interdisziplinären Thema*, Jahrbuch 2000 der Braunschweigischen Wissenschaftlichen Gesellschaft, Braunschweig, 2002, p. 172.

95 Arden, J.: *Haftung der Geschäftsleiter und Aufsichtsratsmitglieder bei unklarer Rechtslage*, Tübingen, 2018, p. 9.

96 See Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo, op. cit.*, p. 832.

97 For German law see Arden, J.: *Haftung der Geschäftsleiter und Aufsichtsratsmitglieder bei unklarer Rechtslage, op. cit.*, p. 9. For Croatian law see Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo, op. cit.*, p. 832.

98 Gerner-Beurle, C.; Paech, P.; Schuster, E. P.: *Study on directors' duties and liability, prepared for the European Commission for DG Market*, London, 2012, [https://ssrn.com/abstract=3886382], p. 172.

99 See Wagner, G.: *Officers' and Directors' Liability Under German Law – A Potemkin Village, Theoretical Inquiries in Law*, 16 (1) 2015, p. 77; Mock, S.: Limitation of the Personal Liability of Directors in German Corporate Law in Jurčová, M.; Novotná, M. (ed.): *Damages as a Remedy in Private Law*, Prague, 2016.

100 Hopt, K. J.: *Unternehmenskontrolle (Corporate Governance),* Überlegungen *zu einem internationalen und interdisziplinären Thema*, *op. cit.*, p. 173.

for monetary damages in duty-of-care claims.[101] Importantly, under the same provisions, directors cannot limit the liability stemming from their duty of loyalty towards the company and shareholders and for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law.[102] The primary reason for allowing such limitation was the prevention of the exodus of directors from company boards due to their fear of exposure to potential personal liability claims.[103] Although this provision is still in force, it gained some serious criticism, mainly that the deterrence role of duty of care can now be eliminated.[104] Thus, under many USA states, although there can be no universal elimination of directors' liability, it is possible to limit directors' duty of care. However, in order for such limitation to be effective, it must be done in the articles of association of the company.[105] Thus, parties could not insert such a limitation through the SA.

Does the mandatory framework of managers' and directors' liability equal to the conclusion that managers cannot avoid their duty to compensate for damages? Although the liability framework is mostly mandatory, there are certain options available to alleviate the negative consequences of liability for managers/directors. Before the actual breach of the duty, managers/directors can contract D&O insurance policies and indemnification clauses which can protect them from duty to compensate any possible damages triggered by their liability.[106] Also, the obligation to provide compensation does not arise towards the company where the action taken is based on a lawful resolution adopted by the general meeting. After the breach of their duties towards the company,

[101] See § 102(b)(7) of Delaware Code. This is one of the most famous provisions of the Delaware Code. See in Fisch, J. E.: *Governance by Contract: The Implications for Corporate Bylaws*, California Law Review, 106 2018, p. 379. May other USA states followed this solution.

[102] See § 102(b)(7) of Delaware Code.

[103] Besides exodus of directors, at the time of amending the Delaware code, there was a crisis in the field of directors and officers insurance. See Lee, T. C.: *Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and The Erosion of the Directors' Duty of Care*, University of Pennsylvania Law Review, 136 (1) 1987-1988, p. 256. Fear of personal liability claims was founded on serious amount of case law, where the liability of directors on the basis of their duty of care was frequently put forward. See DeMott, D. A.: *Limiting Directors' Liability, Washington University Law*, Quarterly, 66 (2) 1988.

[104] See Lee, T. C.: *Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and The Erosion of the Directors' Duty of Care*, *op. cit.,* 280.

[105] See Fisch, J. E.: *Stealth Governance: Shareholder Agreements and Private Ordering*, *op. cit.,* p. 957.

[106] See Gomes Ramos, M. E.: *Corporate Indemnification: Experiences in USA and Developments in Germany, Italy and Portugal*, European Company and Financial Law Review, 14 (4) 2017.

shareholders can waive or agree to a settlement of the claim to compensation of managers/directors by the company under additional conditions.[107]

Indemnification clauses of the directors are of particular interest for the purpose of this article, as they are usually concluded between the directors and the company by contract outside of the articles of association. There is no obstacle that an indemnification clause be inserted in the SA where the manager/director is also a contracting party or to assure shareholders that the directors they elect will be indemnified under certain conditions.[108] Corporate indemnification usually covers cases when the liability is invoked towards the third person but not towards the company itself.[109] The indemnification of directors is not harmonised on the EU level, and most EU member states do not have specific provisions regarding the indemnification of a director.[110] It means that the director can contract for indemnification clauses, where limitation to such clauses would be general rules on exclusion and limitation of liability of applicable national law. Thus, directors could limit their personal exposure to claims by inserting an indemnification clause in the SA with the company, and such a provision could provide a *de facto* limitation of their liability under the conditions that it does not violate applicable national general rules on limitation of liability.

Finally, can the SA contain provisions which enter into a sphere of directors' governance of the company? In particular, is the director obliged to follow the instructions of the shareholders imposed on him/her by the SA? If he is doing so, can it affect its potential liability? From the German law perspective, followed by Croatian, the answer is positive for the limited liability company (GmbH), explaining that shareholders are generally allowed to instruct managers.[111] Thus, there is no obstacle that such an instruction originates from the

[107] Same solution adopted in Germany and Croatia. For Germany see § 93 par 4 of Aktiengesetz. For Croatia see article 252 par 4 of CCA. In that it is crucial that the general meeting adopts the decision prior the act in question. Otherwise, there can be no exculpation towards the company, but only possible waiver or settlement not before three years since the arisal of the claim. See Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo, op. cit.*, p. 846.

[108] For such a practice see Corporation Law Committee of the Association of the Bar of the City of New York: *The Enforceability and Effectiveness of Typical Shareholders Agreement Provisions*, The Business Lawyer, 65 (4) 2010, p. 1165.

[109] See Gomes Ramos, M. E.: *Corporate Indemnification: Experiences in USA and Developments in Germany, Italy and Portugal*, *op. cit.*, p. 748.

[110] See Gerner-Beurle, C.; Paech, P.; Schuster, E. P.: *Study on directors' duties and liability, prepared for the European Commission for DG Market, op. cit.*, p. 184.

[111] For German law see § 37 of the Gesetz betreffend die Gesellschaften mit beschränkter Haftung in der im Bundesgesetzblatt Teil III, Gliederungsnummer 4123-1, veröffentlichten bereinigten Fassung, das zuletzt durch Artikel 6 des Gesetzes vom 15. Juli 2022 (BGBl. I S. 1146) geändert worden is. For Croatian law see article 427 of the CCA.

shareholders through the SA.[112] The author considers that this should be interpreted in a way that shareholders should decisions reached in the SA confirm through corporate law mechanism, i.e. on the general meeting, especially in cases where not all shareholders are parties to the SA. After all, directors' liability stems from the corporate law provisions, and it should be differentiated from any possible contractual liability arising from potential breach of private ordering between directors and shareholders, such as the SA.

The answer is more complex for joint-stock companies, where managers should be more independent to maintain the balance between the company's organs.[113] As previously discussed, the duty of loyalty towards the company is a mandatory limitation to any possible influence on directors' decision-making process. Regardless, we can freely state that SA, especially the voting SA will probably influence the management of the company, at least indirectly, thus making the SA and the will of its contracting party a very powerful tool in tailoring the corporate governance of the company.

To conclude, shareholders can obtain a significant level of control over the management of the company through the SA. By ensuring the majority voting on general meeting resolutions, they can obtain the power to appoint and remove the director of the company, what is traditionally considered to be the ultimate power over the management of the company. Whether directors are obliged to follow the instructions of the shareholders imposed on him/her by the SA remains somewhat unclear, as it depends heavily on the applicable national law and legal type of the company. Further, even for German legislation, which is considered the strictest, there have been some calls for introducing possible limitations on directors' personal liability. If we consider that the influence from US legislators already softened the director's liability through the business judgment rule regarding the duty of care, then we can question whether, in the future, it could influence directors' liability regarding the possible introduction of *ex-ante* limitation of duty of care as well (as it was introduced by Delaware law). In that case, both scholars and practitioners should launch a debate and reassess the standing of private ordering in companies, such as SA, and its influence on corporate governance and possible limitations of directors' liability.

[112] See in Kulms, R. A.: *Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany, op. cit.*, p. 697.

[113] For Croatian law see Barbić, J.: *Pravo društava, Društva kapitala, Dioničko društvo, op. cit.*, p. 833.

6. CONCLUSION

Shareholders evidently want to arrange the corporate governance of the company differently than the default rules. Such a statement is not a novelty in corporate law. However, what is surprising is that the recent practice shows that shareholders modify these rules on a contractual basis outside of the corporate law instruments. The legal instrument often used to achieve that is the SA. The SA is generally not regulated. Thus, it offers shareholders flexibility in the choice of contractual parties, formation, and content, which is not the case with articles of association. What is important, shareholders can make almost all modifications of the default corporate law provisions by the SA. The biggest difference compared to the articles of association is to whom such modifications shall be binding, to all or only certain shareholders or other stakeholders. This leads to the conclusion that shareholders can obtain a significant level of control over the corporate governance of the company through the SA. In the author's opinion, a rethinking of corporate governance should more extensively include the private ordering, such as SA, of the shareholders. Otherwise, one cannot escape the conclusion that there are two parallel spheres of governing the company, where we confront and discuss the consequences of their convergence only sporadically, leaving important legal issues and consequences unclear. One of the goals of this article is to raise awareness of the importance of SA for the corporate governance of Croatian companies as well. To fully grasp the legal position and importance of SA, there should be more future research focusing on empirical data on the existence, content, and effectiveness of SA in both comparative and Croatian practice.

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