

IBA Guide on Shareholders' Agreements

Argentina

Eduardo Patricio Bonis and Emilia Díaz

NAVARRO CASTEX Abogados, Buenos Aires, Argentina

1. Are shareholders' agreements frequent in Argentina?

Shareholders' agreements are frequent in large corporations and increasingly frequent in medium-sized and family-owned companies, due to the professionalisation of entrepreneurs in our country and the increasing number of foreign or just more sophisticated and demanding investors. In recent years, most investors in family-owned companies have subjected their stock acquisitions to rigorous shareholders' agreements.

2. Which formalities must shareholders' agreements comply with in Argentina?

Despite the fact that there is no specific legal framework for this type of agreements, some brief references can be found in (i) Law No. 23,696 (as amended and restated, the on State reform law), (ii) the Argentine Securities Commission's (as per its acronym in Spanish, the "CNV") 2013 Regulations ("CNV Regulations") regarding companies subject to the public offering regime and control of the CNV, and (iii) the ones established in Law No. 26,831 (as amended and restated, the "Securities Law").

Accordingly, shareholders' agreements are ruled by the general provisions related to contracts contained in the Argentine civil and commercial code ("Civil and Commercial Code"), as well as in the Argentine General Companies Act No. 19,550 (as amended and restated, the "ACA").

Without prejudice to the aforementioned, they are not subject to any particular content or formal requirement apart from the one indicated to companies subject to the public offering regime as will be indicated below.

Regarding companies subject to the public offering regime (besides sharing the lack of legal framework as privately-owned companies), pursuant to the Securities Law, parties to a shareholders' agreement have to inform ~~to~~ and file with the CNV all shareholders' agreements ~~which the purpose of which purpose~~ is to regulate the voting rights in a company whose shares (or its controlling company's shares) are admitted to public offering, in whatever form, including, without limitation, agreements that create the obligation to make prior consultations to exercise voting rights, restrictions on the transfer of shares, etc. Directors, managers, ~~statutory~~ statutory auditors and members of the supervisory board, and the controlling shareholders of these companies have the same reporting obligation to the CNV if they are aware of any such agreement. The Securities Law sets forth that in case of breaching the reporting obligation to the CNV, such agreements "will have no value".

3. Can shareholders' agreements be enforced against third parties such as purchasers of shares or successors?

Most Argentine courts and authors state that shareholders' agreements are binding only upon their signatories. Still, it is possible, through certain mechanisms (e.g. the entry of the agreement into the stock ledger) to enforce the agreement - or at least some of its aspects - against third parties, especially in the case of restriction to share transfers, as further explained in question 8. In such regard, it is worth noting that in the last few years some courts have granted precautionary measures accepting said enforceability regarding lockup clauses included in these agreements.

4. Can shareholders' agreements regulate non-company contents?

Since there is no regulation restricting the content of shareholders' agreements in Argentina, they may deal with non-company matters as long as they do not breach any other mandatory legal provision.

5. Are there limits on the term of shareholders' agreements under Argentine law?

Although there are no statutory restrictions limiting the duration of these agreements in Argentina, the validity of shareholders' agreements with an indefinite time limit has been questioned by local courts and authors.

A time limit should be determined in the light of the purpose of each agreement. Since some courts have concluded that agreements with a long or indefinite term may thwart corporate will, in order to avoid any challenge to their efficacy it is advisable to set the term as a period that does not exceed five years.

In consideration of the above, it is advisable that agreements with an indefinite term provide for withdrawal mechanisms, such as put or call option clauses.

6. Are shareholders' agreements related to actions by directors valid in Argentina?

Since there is no specific regulation in Argentina, and based on the general constitutional principle that everything is permitted unless expressly prohibited, shareholders' agreements may definitely govern directors' conduct. However, under the ACA, directors are subject to diligence and loyalty duties while performing their responsibilities in the best interest of the company, rather than in the interest of a particular group of shareholders. Actions specifically embraced by this duty of loyalty are the prohibition to use corporate assets and confidential information for private purposes, the prohibition to divert corporate opportunities for personal gain, and to refrain from engaging (either directly or indirectly) in conflicts of interest. Upon breach of the referred duties, directors may be held personally liable. In conclusion, although shareholders' agreements may deal with directors' conduct, these agreements may not contradict their duties under the ACA or to the best interests of the company.

7. Does the law of Argentina permit restrictions on transfer of shares?

The ACA expressly provides in Section 214 that shares may be freely transferred. However, restrictions on share transfers are allowed in certain circumstances, namely: (a) where the by-laws so stipulate; and (b) where said restrictions do not entail a total prohibition and/or a violation of mandatory legal provisions. For such purposes, it may be useful to restrict share transfers through the mechanisms described in the following question, since in principle they ~~fulfill~~fulfil the requirements referred above.

In a new corporate type brought by the Support for Entrepreneurial Activity Law (Law No. 27,349 enacted on November 16th, 2016) which is the Simplified Shares Corporation (*Sociedad por Acciones Simplificadas*, or S.A.S. as per its acronym in Spanish), the transfer of shares can be restricted by stipulating such restrictions in the articles of associations or bylaws. According with such law, the transfer of shares can be subject to the prior authorization of a partners meeting, and can also be banned up to a maximum term of 10 years as from its issuance. Furthermore, such maximum term of 10 years can be renewed for terms not exceeding 10 years provided that such decision is approved unanimously.

8. What mechanisms does the law of Argentina permit for regulating share transfers?

Below we analyse the share transfer mechanisms most commonly included in shareholders' agreements in Argentina. To avoid any potential controversy in their implementation, it is advisable to set a clear and fair valuation method for the determination of the value of shares.

(a) **Right of first refusal:** under this mechanism, a shareholder who wants to sell his shares must first offer them to the existing shareholders, subject to the same terms and conditions as those offered to third parties.

(b) **Right of first offer:** the right of first offer merely obliges a shareholder to undergo exclusive good faith negotiations with the holder of the first-offer right before negotiating with any third parties.

(c) **First option:** this mechanism is similar to the right of first refusal or first offer, but a fixed price is agreed upon from the outset.

(d) **Russian roulette:** this mechanism entitles the buyer to fix the price of the shares, often subject to certain restrictions. However, the buyer undertakes to give the seller a purchase option on his stake at the same price per share he offered.

(e) **Tag-along rights:** tag-along rights enable minority shareholders to sell their stake jointly with majority shareholders.

(f) **Drag-along rights:** under this clause, majority shareholders can force minority shareholders to sell their stake under the same price and conditions as any other seller.

(g) **Consent powers:** this mechanism requires the board of directors' consent prior to the transfer of shares. It must be carefully structured, in order not to entail a complete prohibition of the transfer, which is not valid under Argentine law.

(h) **Buyback rights:** under this mechanism, a company may repurchase stock in limited circumstances. Privately-owned companies are subject to the restrictions set forth by Section 220 of the ACA (e.g. that the repurchase be intended to avoid a serious damage to the company), while public companies are governed by the requirements of the Securities Law and the CNV Regulations (e.g. that equal treatment towards shareholders be assured).

(i) **Buy-sell agreements:** under this mechanism shareholders are obliged to sell, and the company is obliged to repurchase stock in limited circumstances, such as withdrawal or death of a shareholder. The limitations described in item (e) above also apply to this case.

(j) **Put and call option clauses:** a put option clause confers upon a shareholder the right to sell stock at a specific price on or before a certain date. A call option clause grants shareholders the right to buy at a specific price on or before a certain date.

It is important to point out that the Civil and Commercial Code has regulated several aspects of some of the mechanisms indicated above.

The most controversial one is the one related to Option Contracts. Such contracts are regulated under the section which governs preliminary contracts, and are defined as contracts that contain an option to execute a definitive contract granting to its beneficiary the irrevocable option to accept such contract or not. The most controversial issue in this regard is that for all preliminary contracts, ~~—~~ thus including the option contracts, ~~—~~ the new Civil and Commercial Code (in force since August 1st 2015) sets forth a maximum duration term of one year (Article 994 of the Civil and Commercial Code). Due to the novelty of these provisions, there is still uncertainty in the legal community as to their characterization as mandatory provisions or not, and hence if they may be left aside by the parties, particularly, the one related to the maximum duration term of one year which, in the M&A legal practice, would be an important legal inconvenient for the implementation of some of the mechanisms indicated above. It is worth mentioning however that the majority of legal doctrine understands that such maximum term would only be applicable to option contract as such and not options contracts included or part of more complex contracts like SPAs in M&A transactions.

9. In Argentina do by-laws tend to be tailor-drafted, or do they tend to use standard formats?

Although many Argentine corporations operate on a standard by-laws basis, in recent years we have seen a steady tendency towards tailor-drafting the by-laws not only to better adapt them to the reality of each company, but to avoid the pitfalls that poorly conceived by-laws may bring during the company's lifetime. In addition, upon negotiating the terms of a joint venture or an M&A transaction, it is common to incorporate tailor-drafted terms into the by-laws. This way, the new terms will become binding, and known by shareholders and third parties.

Standard formats are commonly used nowadays in *Sociedad por Acciones Simplificadas*, S.A.S., in order to register a new company in the expedite term of 24 hours given that in order to be granted such expedite incorporation term, the articles of incorporation and by-laws of the new SAS company have to follow the templates provided by the corresponding Public Registry of Commerce.

10. What are the motives in Argentina for executing shareholders' agreements?

The reason for executing a shareholders' agreement is closely related to the matter that it governs. One of the most frequent reasons is directly or indirectly to influence the company's decision-making. Other reasons may be the regulation of voting schemes, corporate governance, control-keeping matters, and the protection of the rights of minority shareholders.

In some other cases it may be to define the voting criteria prior to the shareholders' meeting, avoiding unnecessary disputes and long meetings, as well as the way in which the company will be chaired.

Likewise, shareholders may be willing to execute shareholders' agreements to stipulate certain provisions they do not want to disclose since, unlike by-laws, shareholders' agreements can be kept confidential. These agreements are also more flexible than the by-laws, since they can be easily updated or amended without requiring the approval of any governmental agency.

11. What contents tend to be included in shareholders' agreements in Argentina?

Since there is no specific legal provision governing or limiting shareholders' agreements, they may regulate a wide range of matters, including without limitation: (a) the election of directors; (b) quorum and majorities; (c) the activities to be undertaken by the company; (d) the company's financing; (e) the exercise of share preferences or purchase-sale rights; (f) information rights; (g) shareholders' general and specific obligations, such as contributing with trademarks or business; (h) directors' compensation; (i) restrictions on share transfers; and (j) key man clauses, notwithstanding Section 256 of the ACA, which provides for the revocation of directors by the shareholders' meeting.

12. What determines the content included in shareholders' agreements in Argentina?

The main elements influencing the content generally included in shareholders' agreements can be summarized as follows: (i) whether the agreement will be binding upon all the shareholders or only upon some of them; (ii) whether the agreement will include company and non-company matters; (iii) whether the agreement will include certain provisions that should not be included in the bylaws; (iv) the need for confidentiality and flexibility; (v) whether there may be formal obstacles created by the competent regulatory authority; (vi) the term of duration; and (vii) the enforceability of the agreement against purchasers.

13. What are the most common types of clause in shareholders' agreements in Argentina?

Shareholders' agreements normally include the following clauses: (a) corporate governance; (b) information and control guarantees; (c) dividends distribution, company financing and investment policies; (d) debt-to-equity conversion procedures; (e) deadlock provisions; (g) assignment; (h) anticipated termination; (i) by-laws amendment; (j) confidentiality; (k) dispute resolution clauses; and (l) restriction of share transfers, as analysed in question 8.

14. Which mechanisms are allowed under Argentine law to ensure the participation and control of minorities in the board of directors?

The ACA sets out several mechanisms to ensure the participation of minorities in the board of directors. Firstly, it provides for two types of stock: common and preferred. Common stock confers identical economic rights to all shareholders, although they may grant between one and five votes per share. On the other hand, preferred stock grants economic preferences over common stock, regardless of shareholders' limited voting rights. Since the ACA does not allow the combination of economic preferential rights with multiple voting rights, preferred stock may only confer up to one vote per share or even a lack of any voting rights (ACA, Section 216).

Also, minority shareholders holding 2% of corporate voting rights are entitled to request the statutory auditor (officer entrusted with the supervision of corporate affairs in companies exceeding a certain corporate capital under the ACA) to investigate matters within his scope of competence, and to discuss said matters openly in shareholders' meetings. Moreover, the statutory auditor may call for a shareholders' meeting if he determines that the board has not dealt properly with a particular matter (ACA, Section 294 (1)). This way, minority shareholders may exercise certain control over the board of directors, even if this mechanism does not assure them the right to appoint a director. Likewise, shareholders representing at least 5% of corporate voting rights are entitled to request that the board or the statutory auditor call for a shareholders' meeting in order to consider a certain matter, by serving a notice to either of them, with details of the proposed matters to be discussed. Shareholders holding 10% of corporate voting rights, whether individually or jointly, are entitled to request court precautionary measures, such as the appointment of an external administrator, to take over the company's management.

Finally, pursuant to Section 263 of the ACA, cumulative voting is also allowed, thus enabling minority shareholders to appoint at least one director in the board, through a complex mechanism that cannot be subject to any restrictions in the bylaws, and which depends on the number of directors of the company. Another efficient mechanism to allow minority shareholders to appoint directors is the creation of stock classes under the by-laws.

15. Is it possible in Argentina to ensure minority shareholder control by means of a shareholders' agreement?

Definitively, The ACA sets out several legal mechanisms to protect minority shareholders. Pursuant to Sections 55, 60, 66, 67, 159, 213, 234, 249 (2nd paragraph), 294(6) and (11) of the ACA, minority shareholders enjoy broad information rights, among other essential protections.

In addition, courts have recognised the right of shareholders to challenge shareholders' and Board of Directors' meetings, regardless of their stake in the company. The former does not exclude the possibility to provide information rights under the shareholders' agreement, the violation of which may result in disciplinary measures against the breaching party.

16. What are the usual valuation mechanisms in connection with share transfers?

Apart from the traditional book or net worth value models, the most common methods and techniques for the valuation of companies are net present value, adjusted present value, venture capital and option valuation models. Such models have both advantages and disadvantages, and the final choice will depend on the type of company and/or industry. In Argentina, the usual valuation models are based on a multiple of past-earnings, net assets value, and EBITDA. It is highly advisable that valuation clauses include a mechanism providing for the appointment of experts upon failure by the parties to agree on the value determination of shares.

17. Is it admissible for a shareholders' agreement clause to refer dispute resolution to a foreign jurisdiction or applicable law?

Pursuant to Section 1 of the Civil and Commercial Procedural Code, to the extent that disputes have an international and monetary nature, it is admissible to refer them to a foreign court and under a foreign law. Argentine law is extremely restrictive regarding the choice of jurisdiction and applicable law, since it requires the existence of connecting factors. The absence of these factors may give rise to challenges to the foreign courts' jurisdiction on a forum shopping basis.

18. Is it admissible for a shareholders' agreement to include an arbitration clause with a foreign venue and/or applicable law?

In Argentina, arbitration clauses are admissible either for domestic or international shareholders' agreements. Litigating in Argentina may be cumbersome and time consuming, because of the complexity of court proceedings and the wide range of resources allowed against court judgments. Arbitration proceedings, instead, are flexible, confidential and shorter than court proceedings. As a general rule, Argentine courts will recognize and enforce arbitration agreements governed either by Argentine or foreign law.

According with the Civil and Commercial Code provisions' which regulates arbitration agreements, parties may agree on the venue of the arbitration, on the procedure to be applied by the appointed arbitrators, and on the language of said procedure.

Furthermore, it is worth noting that Argentina is a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. Thus, Argentine courts will recognise and enforce any award rendered in an arbitration sitting abroad on a reciprocal basis to the extent that it deals with commercial matters in accordance with the meaning of said term under Argentine law. On the other hand, awards rendered in international arbitrations sitting

in Argentina are treated as domestic awards; thus, they are not subject to exequatur and they are enforced by the same procedure applicable to domestic awards.