

SHAREHOLDERS' AGREEMENT: HOW TO
APPLY IT IN KAZAKHSTAN

A shareholders' agreement is a contractual document between shareholders that serves as a conventional contract. This document is generally used in common law jurisdictions. It is concluded between two or more shareholders of a company, as well as with the company itself.

This article tackles the issues of the possibility of conclusion of the shareholders' agreement and applicability of common law clauses in the agreements of the companies incorporated in Kazakhstan in the form of a limited liability partnership (LLP). In this article, we address the exit rights clauses and other provisions that are commonly used in common law jurisdictions and evaluate the permissibility of these clauses in Kazakhstan. The article may be of interest to the foreign investors willing to incorporate a joint venture in Kazakhstan as well as to local entities that deal with issues arising from the relationships between the LLP's participants.

The organization and operation of companies in Kazakhstan is regulated by the Law on LLP dated April 22, 1998 No. 220-I (hereinafter – the "LLP Law"). However, the LLP Law is silent on the matter regarding the conclusion of shareholders' agreement. The current Kazakhstan corporate legislation does not explicitly recognize the shareholders' agreement which is one of the most frequently used instruments by foreign investors. Nevertheless, Kazakhstan civil law generally supports the principle of "freedom of contract" and this does not prohibit the conclusion of the shareholders' agreement.

Given the fact that neither the Civil Code of the Republic of Kazakhstan dated December 27, 2020 (hereinafter – the "Civil Code") of Kazakhstan nor the LLP Law do not provide a legal definition of the shareholders' agreement, there is ambiguity as to the correlation between the shareholders' agreement and foundation agreement/the charter of the LLP. The judicial practice in Kazakhstan demonstrates that in cases where the shareholders' agreement contradicts the LLP's foundation agreement/charter or additionally regulates the status of the LLP participants the courts tend to attribute the prevailing nature to the foundation agreement and the charter, which are corporate documents directly provided by the law.

Applicable law

The other issue could be related to the applicable law. The foreign investors might want to apply foreign law to shareholders' agreements. However, under Article 1114 of the Civil Code, Kazakh law shall be applicable to any agreement concluded in relation to a legal entity that is to be founded or already founded in Kazakhstan. Consequently, shareholders' agreements of the participants of the LLP established in the Republic of Kazakhstan shall be subject to regulation only by the Kazakhstan legislation. This restricting provision might be a problem for foreign investors because they might want to choose another governing law that is more flexible and familiar to them.

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However, taking into account the “freedom of contract” principle, while drafting shareholders’ agreement, participants of the LLP may include common law clauses that aim to minimize the future conflicts between participants and give them more confidence in the management of a company. Yet, most of these contractual arrangements are not expressly stated in the codes or in the statutes of Kazakhstan.

Drag-Along and Tag-Along

In the drag-along arrangement, a shareholder is entitled to “drag along” another shareholder in the event of an arranged sale of the company to the third party. Under this provision, shareholders are obliged to sell their shares to the same buyer under the same terms and conditions. A drag-along arrangement is a tool that mainly protects the majority shareholder of the company from the opportunistic behaviour of the minority shareholder. In turn, a tag-along provision creates protection for the minority shareholder of a company. This arrangement grants a shareholder to sell his shares to the buyer under the same terms and conditions applied to another shareholder.

The legislation of the Republic of Kazakhstan does not contain direct norms governing the drag-along and tag-along rights of the LLP participants. However, in accordance with the LLP Law, an LLP participant is allowed to alienate its share in the LLP to third parties or pledge a share to secure the participant’s obligation before a third party, unless otherwise provided by the foundation documents. The foundation documents of the LLP may stipulate that the sale of a share to a third party is permissible only if certain conditions are met. These conditions can be drag-along and tag-along rights. However, in accordance with the LLP Law, the requirements for the pre-emptive right of other participants of the LLP to purchase the shares must be met because this provision is mandatory.

Deadlock

Deadlock situations emerge when the shareholders are unable to resolve the issue due to the absence of unanimity regarding the business of the company. When the numbers of shareholders are even, the problem of deadlock can be a major issue. A deadlock may lead to the dissolution of the business entity. The methods of preventing and resolving deadlocks arising in disputes between the participants of the LLP, currently, do not have legislative consolidation in the Republic of Kazakhstan. We believe that any mechanisms for resolving deadlocks may be regulated by the agreements between the participants of the LLP, if they do not contradict the mandatory provisions of the law, violate the rights and the legitimate interests of the LLP itself, other participants, and third parties.

Non-Compete Clause

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Non-compete clauses are generally used to protect corporate interest by restricting one party to share or use the information for its own benefit after exiting from the shareholding in the company. As a rule, the terms of the non-compete clauses cover such aspects as traditional non-competes, non-solicitation agreements, and confidentiality agreements.

The current legislation of the Republic of Kazakhstan does not provide provisions directly regulating competition between participants when one of them leaves the LLP. However, based on the Civil Code, actions of individuals and legal entities aimed at causing damage to another person, abusing the right in other forms, as well as exercising the right contrary to its purpose are not allowed. No one has the right to take advantage of their dishonest behaviour. Based on the abovementioned and other provisions of the Civil Code, we believe that the application of non-compete clauses shall not violate the legislation of the Republic of Kazakhstan and the use of this concept is possible.

Voting at General Meeting of Participants

Kazakhstan legislation presumes the right of the participant to vote at its discretion. If the shareholders' agreement provides for an obligation of a party to a shareholders' agreement to vote in a certain way at the general meeting of participants, the prevailing opinion is that if a party to a shareholders' agreement violates its obligation to vote in a certain way, such a party can only be held liable for a breach of the contractual obligation (for example, it will be sanctioned to pay a fine), but such a party cannot be ultimately forced to vote in a certain way.

Taking into account the abovementioned, we recommend keeping in mind the following aspects while drafting a shareholders' agreement.

- Firstly, there should not be a discrepancy or contradiction between shareholders' agreement and the foundation agreement/charter of the LLP. To avoid conflict, the provisions of the shareholders' agreement should be properly drafted in compliance with the foundation agreement/charter of the LLP.
- Secondly, the mandatory Kazakhstan rules, for instance, the pre-emptive rights of participants for the purchase of alienated shares in the LLP or other rules concerning the alienation of shares should be taken into consideration because if the provisions of the shareholders' agreement are contrary to the mandatory rules, then the agreement might not be valid.

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- Thirdly, the courts tend to attribute the prevailing nature of the LLP's foundation agreement when the shareholders' agreement contradicts the foundation agreement or the LLP's charter. For this reason, it might be recommended to incorporate shareholders' agreement's terms and conditions into the foundation agreement and/or the charter of the LLP.
- Finally, it may be recommended to establish a holding company (JV) in the Astana International Financial Centre (hereinafter – the "AIFC") which will own a subsidiary in Kazakhstan. AIFC is a financial centre located in Nur-Sultan that has a special status in terms of legal regulation separated from the general legislation of the Republic of Kazakhstan. AIFC participant is a legal entity registered in accordance with the current law of the AIFC. If the holding company becomes a member or is established in AIFC, the AIFC law will be applied to the AIFC company. Although English law is not governing of the AIFC, the acts governing most relations in the AIFC, including contractual relations, are based on the principles, law, and precedents of the law of England and Wales. Hence, it will be possible to fully use the concepts of the common law in terms of the application of the shareholders' agreement.

Also, AIFC participants may transfer their disputes related to the corporate agreements to AIFC court. The AIFC Court is an independent body and not included in the judicial system of the Republic of Kazakhstan. The alternative mechanism for resolving disputes is the AIFC International Arbitration Centre. However, the disputes would be considered only if only there is an arbitration agreement between the parties.

As things stand now, Kazakhstan does not generally prohibit the use of common law concepts, such as shareholders' agreement and other provisions (deadlock, tag-along, drag-along and non-compete clause). Yet, the unfamiliar nature of shareholders' agreement might be problematic for Kazakhstani judges and it will bring mistrust to this type of agreement.

A shareholders' agreement is a flexible and effective tool for exercising shareholders' rights and protecting their interests. In our opinion, the introduction and implementation of shareholders' agreement into Kazakhstani law as it, for instance, has been already done in Russia, will help not only to protect the rights of shareholders and attract investments but also liberalize Kazakhstan corporate legislation in general.