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CORPORATE DEADLOCK AND PROTECTION MECHANISMS: THE ROLE OF CORPORATE AGREEMENTS

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Abstract

This research examines the significance and function of corporate agreements in protecting against deadlock situations from both theoretical and practical perspectives. The study comprehensively explores the legal nature of corporate agreements, international legislative experiences, and the current state of affairs in Uzbekistan. The paper analyzes the definition of corporate deadlock, its underlying causes, and the adverse effects on company operations. Through examining the preventive, regulatory, and protective functions of corporate agreements, the research investigates effective protection mechanisms against deadlock situations. Specifically, it explores opportunities for preventing disputes through pre-establishing rights and obligations among shareholders, creating action algorithms for conflict situations, and regulating voting procedures. The analysis of corporate agreement institutions in Uzbek legislation reveals deficiencies such as insufficient specialized regulatory frameworks and unclear practical implementation mechanisms. Based on research findings, practical recommendations have been developed for improving national legislation by incorporating international best practices.

Keywords: corporate agreement, deadlock, impasse situation, corporate governance, shareholder agreement, dispute prevention, Uzbek legislation.

Introduction

As the renowned entrepreneur Steve Jobs once observed, "Great things in business are never done by one person. They're done by a team of people."

In today's business environment, the complexity of corporate governance continues to increase significantly. Particularly, conflicts arising between shareholders and obstacles encountered in making crucial decisions - namely corporate deadlock



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situations - can profoundly impact corporate operations. Corporate agreements serve as the primary defensive mechanism for safeguarding against such adverse circumstances.

In other words, with the advancement of today's business climate, new challenges emerge in managing corporate organizations. Specifically, disagreements among partners and difficulties in making strategic decisions can negatively affect the overall efficiency of corporations. Corporate agreements represent an effective method for preventing such problems.

The Presidential Decree No. PQ-415 of November 8, 2022, approving the "roadmap" for further improving the legal foundations of corporate relations, stipulates in paragraph 5 the establishment of rights and legal grounds for business entities to conclude corporate agreements. The absence of regulations related to corporate agreements in Uzbekistan's legislative documents limits the opportunities for company participants to exercise their corporate rights.

The corporate agreement institution that emerged in America and England in the late 19th century quickly spread throughout Europe and began to be widely applied as a mechanism for regulating company members' rights.

Analysis of foreign legislation reveals that corporate agreement regulations exist and are practically applied in virtually all developed countries, including the USA, England, Germany, France, and other European nations, as well as in Russia, Belarus, and Ukraine. In legal literature, the content and legal characteristics of corporate agreements are studied through two main approaches. The first approach examines agreements concluded between shareholders in joint-stock companies, while the second analyzes contracts regulating corporate rights concluded by participants of any legal entity.

The initial concept was reflected in research by scholars such as Yu.M. Jornokuy, I.V. Spasibo-Fateyeva, and A.N. Vinnikllar. According to I.V. Spasibo-Fateyeva, shareholder agreements are distinctive contracts implemented within the framework of civil law principles and joint-stock company legislation. These complex agreements have an organizational character, with their enforcement ensured through obligations to sell shares or temporary restrictions on their circulation.



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Currently, the legal essence of corporate agreements is being studied in a broader context. According to M.M. Sigidin's definition, a corporate agreement is a multilateral agreement aimed at effective management of corporate rights through coordinating the activities of corporate legal entity members and implementing common interests.

V.V. Vasileva identifies two groups of characteristics to determine the essence of corporate agreements:

1. **General characteristics as transactions:** voluntary nature, existence of parties, purpose of creating rights and obligations, basis in agreement, free expression of will, legal form requirements, legality, and orientation toward real legal consequences.
2. **Distinguishing features:** the contract subject serves as the basis for differentiation from other contract types.

From this perspective, it is necessary to clarify the relationship between company charter provisions and corporate agreements. Corporate agreements typically may include foundations or procedures establishing conditions under which participants acquire rights or assume obligations to purchase or sell shares (or portions thereof) in the charter capital, determining when such rights and obligations arise. Furthermore, provisions regulating the exercise of participants' preferential rights to purchase shares in charter capital may stipulate different procedures for exercising LLC participants' preferential rights, and such rights may not apply at all in corporate rights alienation according to charter or corporate agreement provisions.

Corporate agreement parties have the right to agree not only on ways to exercise participants' rights but also on corporate agreement terms not conforming to charter provisions. On one hand, this rule indicates the implementation of flexible mechanisms for exercising participants' corporate rights; however, on the other hand, it may become one of the factors leading to corporate disputes and violations of rule of law. This rule may enable specific participant groups to act contrary to company interests, as the charter, being a local document, serves as a source reflecting the company's strategic activities aimed at ensuring corporate interests.

With the development of corporate relations, new types of related relationships begin to emerge. One such relationship is the deadlock situation that arises in



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corporations. Various scholars have provided different definitions of deadlock situations.

Legal literature presents various perspectives on corporate deadlock. Specifically, according to N. Kozlova, "deadlock refers to a dispute situation among corporate-type legal entity founders where founders have equal voting shares but cannot reach agreement with each other."¹

D.I. Stepanov describes deadlock as follows: "a situation where corporation participants cannot reach agreement on matters of fundamental importance regarding participation in managing its activities."²

According to J.I. Yuldashev, "corporate deadlock situations represent one of the problems seriously affecting company operations. Such situations arise due to disagreements among shareholders or board members regarding important decisions and cause significant damage to company activities."³

Business parties typically enter partnerships with ambitions to promote growth opportunities, pool resources, and ultimately increase shareholder returns. During preparation of various cash flow forecasts and business growth charts, insufficient consideration is often given to future possibilities of corporate deadlock.

Deadlock usually arises in 50:50 joint ventures where each shareholder owns 50 percent of a company and parties cannot reach decisions on matters of significance for the company. This can have the unfortunate effect of paralyzing company operations.

Without specific provisions in company constitutional documents addressing deadlock scenarios, the main remedy available to shareholders would be seeking redress through courts. Given practical difficulties and expenses in obtaining court judgments, inclusion of deadlock resolution provisions in company constitutional documents is normally recommended.

Corporate deadlock is frequently cited as justification for courts to invoke powers and order sale of one shareholder's stock in minority shareholder litigation. While

¹ Kozlova N.V. Deadlock: how to exit corporate impasse and avoid it

² Stepanov D.I. Deadlocks in non-public corporations: possible options for developing legislation and judicial practice

³ Yuldashev, J. I. (2024). The Importance of Using Modern Technologies in Resolving Corporate Deadlock Situations



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deadlock constitutes legitimate grounds for bringing lawsuits seeking court intervention, it does not serve as an automatic solution leading to court-ordered buyouts of shareholders.⁴

Under the New Jersey Business Corporations Act, deadlock is defined and can be found under two circumstances. Deadlock may exist when "shareholders are so divided that they have not been able, for two consecutive meetings, to elect successors to directors whose terms have expired or would have expired if successors had been elected and qualified." The second manner involves situations where "directors or other persons having management authority are unable to effect action on one or more substantial matters respecting management of the company's business."

All these definitions indicate that during deadlock processes, corporations find themselves in impossible situations where their activities face serious threats. This can lead to various consequences, the most significant being the company's financial derailment. When companies experience financial difficulties, this causes serious damage to shareholder profits. Since the primary objective of establishing or joining joint-stock companies is profit generation, assets that cease generating profits become worthless to everyone. The question arises: how can corporate agreements serve as protective mechanisms for preventing corporate deadlock?⁵

A corporate agreement represents a specialized arrangement concluded between subjects operating within corporate systems. The primary function of such agreements is establishing procedures for exercising shareholding and participation rights while clearly defining the scope of parties' mutual rights and obligations.

Such agreements serve the following objectives:

- Coordinating participants' various interests in corporate governance
- Preventing corporate disputes and disagreements
- Improving corporate governance system efficiency

In essence, corporate agreements function as fundamental instruments regulating relationships among corporation members and clarifying their legal obligations.

⁴ Nick Simpson / Unlocking corporate deadlock

⁵ How to (Legally) Resolve Corporate Deadlock and Mismanagement



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As mentioned above, preventing disputes and disagreements represents one of the primary objectives of corporate agreements. The definition included in the Civil Code states: "Participants or certain participants of business entities have the right to conclude mutual corporate agreements regarding exercise of their membership rights. According to such agreements, participants of the respective business entities assume obligations to exercise or refrain from exercising their membership rights, including voting in general meetings of participants, coordinated implementation of company management actions, acquiring or transferring their shares (stocks) in charter funds (charter capital) at specified prices or under certain circumstances, or refraining from acquiring or transferring to other persons." Agreements are concluded with prior forecasting of potential disagreements that may arise in company activities. Agreements also specify consequences related to their violation. Such agreements both grant rights to parties and impose obligations, meaning that corporate agreements generally function more as restraining mechanisms.

Conclusion

In conclusion, the role of corporate agreements in protecting against deadlock situations is crucial. Corporate deadlock represents one of the primary problems seriously affecting company operations in modern business environments, potentially leading to companies' inability to make strategic decisions, disruption of financial stability, and cessation of business activities due to disagreements among shareholders. Corporate agreements serve as the most effective means of protection against such problems through their preventive, regulatory, and protective functions. They strengthen corporate governance systems by clearly defining rights and obligations among shareholders, forecasting potential disagreements, and regulating action algorithms and voting procedures in dispute situations. The agreement's function as a "restraining mechanism" constitutes one of its key characteristics.

The corporate agreement institution in Uzbek legislation remains incompletely developed, with observed deficiencies including insufficient specialized regulatory frameworks, unclear practical implementation mechanisms, and inadequate adoption of international experience. While the definition included in the Civil Code



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represents an initial step, creating comprehensive legislative frameworks remains necessary.

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