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"Shareholders' Agreements in Closely Held Companies: An Analysis of the Regulation in the United States and Italy"

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Firma dello studente

Luca Marazzotta

To my father,

who is going through rough times

hoping in a full recovery

Acknowledgement

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INTRODUCTION

The corporation has acquired over time large importance as a method of property tenure and a means of organizing economic life.[1] Business corporations share the same legal characteristics and face the same problems in almost all jurisdictions.[2] The five legal characteristics that can be found in every corporate law of the world are the following:[3] 1) legal personality; 2) limited liability; 3) free transferability of shares; 4) delegated management; 5) investor ownership. It is common that small-and-medium enterprises adopt the corporate form failing to embrace one or more of the previously mentioned legal characteristics to fit their particular needs.[4] Thus, the role of corporate law is to provide business enterprises a legal form that comprises these five characteristics to reduce the costs of organizing the business.[5]

However, in the early twentieth century, corporation statutes, drafted having in mind the five legal characteristics of the corporation, were addressed only to the needs of public corporations, and not to close corporations as well.[6] Hence, the same rules with almost no exceptions were applied to public and close corporations.[7] In the United States — as well as in other states — courts failed to recognize the differences in the nature and needs between public and close corporations.[8] In this context, participants in the close corporations found in private agreements among themselves a more compatible and flexible method to organize the business according to their needs as compared to provisions of corporate law.[9] The court decisions on the validity of these agreements actually triggered lawmakers to adopt a special corporation statute for close companies to better meet their needs.

The corporate law matter has been influenced and accompanied by the issues of corporate governance which have experienced an increase in importance mainly as a result of the global financial crisis and corporate scandals.[10] The two concepts are interrelated since one of the

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[1] Berle A., Means G. (1932). The Modern Corporation and Private Property, New York: The Macmillan Company, p. 3.
[2] Armour J. *et al*., What Is Corporate Law? In Kraakman R., *et al*. (2009). The Anatomy of Corporate Law: A Comparative and Functional Approach. 3rd edition, *Oxford University Press*, p. 1.
[3] Id.
[4] Id.
[5] Id. at 2.
[6] Wells H. (2008). The Rise of the Close Corporation and the Making of Corporation Law, *Berkeley Business Law Journal*, Vol. 5, pp. 263-316. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1119280.
[7] O'Neal F. H. (1965). Developments in the Regulation of the Close Corporation, *Cornell Law Review*, Vol. 50, No. 4, pp. 641-662. Available at: http://scholarship.law.cornell.edu/clr.
[8] Id. at 641.
[9] Wells H., supra note 6, at 263.
[10] Sun W., Stewart J., Pollard D. (2011). Corporate Governance and the Global Financial Crisis: International Perspectives, Cambridge University Press, p. 1.

fundamental tasks of the corporate law is to provide a system of governance aimed at mitigating the agency problems that arise from the separation of ownership and control characterizing the modern corporation.[11] In this sense, corporate governance, understood as the set of practices within the company that govern the relationships between insiders of the corporation and all stakeholders, intends to align the different interests of all participants in the company.

Therefore, the nature of the corporation will inevitably cause the rise of agency problems which have attracted the concerns of academics all over the world. Of course, depending on the structure of the company two agency problems are likely to arise.[12] First, where the ownership structure is widely dispersed — is the case of public companies in the United States — managers are not actively monitored by shareholders and, thus, can pursue actions for their private benefits that could be detrimental for shareholders. The second agency problem occurs in companies with concentrated ownership structures — close companies and public companies in Continental Europe — where the majority shareholder controls the company_and takes actions to expropriate minority shareholders with the aim to gain private benefits.[13] In this context, the role of corporate governance is to prevent the formation of agency relationships by aligning the interests of the different corporate constituents.

In order to accomplish these objectives, corporate governance comprises a set of both external and internal mechanisms shareholders are allowed to adopt to reduce the conflict of interest. However, these mechanisms, mainly related to the functioning of corporate boards, have a different success rate depending on the company form and where they are used. Of course, given the nature and typical features of close corporations, corporate governance mechanisms based on board characteristics have not the same effect as in public companies. For this reason, close companies' shareholders regulate their relationship and remand the functioning of the company to the use of shareholders' agreements.

The purpose of this work is to analyze the use of shareholders' agreements in closely held companies to mitigate agency problems and their regulation in the U.S. and Italian legal framework. In the first chapter, an overview of closely held companies is provided. In particular, we start by describing the birth of Close Corporation Legislation and its evolution in

[11] Romano R. (1996). Corporate Law and Corporate Governance, *Industrial and Corporate Change*, Vol. 5, No. 2, pp. 277-340. Available at: https://doi.org/10.1093/icc/5.2.277.
[12] Armour J. *et al*., What Is Corporate Law? In Kraakman R., *et al*. (2009). The Anatomy of Corporate Law: A Comparative and Functional Approach. 3rd edition, *Oxford University Press*, p. 29.
[13] Shleifer A., Vishny R. W. (1997). A Survey of Corporate Governance, *Journal of Finance*, Vol. 52, No. 2, pp. 737-782. Available at: https://doi.org/10.1111/j.1540-6261.1997.tb04820.x

the United States and Europe. Then, the characteristics of close companies are presented compared to the features of partnerships and public companies, along with a description of the main problems that are likely to arise in this organizational form. The focus of the second chapter is to offer a deep view of the corporate governance concept. Here, we proceed by introducing the agency problems that affect the relationships between insiders of the corporation. Then, we try to give a definition of corporate governance studying the different perspectives used by academics in defining the concept. The corporate governance changes depending on the system where is inserted. In this context, we analyze the two common corporate governance systems — outsider and insider systems — adopted, respectively, in civil and common law countries. For this reason, we describe the corporate governance framework in the United States and Italy highlighting similarities and differences. The chapter concludes by explaining the corporate governance mechanisms mostly adopted by public companies to incentivize directors to pursue the interests of shareholders to the maximization of their wealth.

In the third chapter, we enter in the main part of the work introducing the concept and characteristics of shareholders' agreements mainly as an instrument used by shareholders in close companies to obtain control of the company and maintain the stability in the ownership structure of the company. Moreover, we try to identify the reasons for the limited use that shareholders' agreements have in the public listed companies. In the last two chapters, we provide a comparative analysis of the regulation of these agreements under the U.S. and Italian legal framework, including the disclosure requirements for listed companies and enforcement of the common types of shareholders' agreements.

CHAPTER 1: A LOOK TO CLOSELY HELD COMPANIES

Summary: Introduction. — 1.1 The Rise of the Close Corporation Legislation. — 1.1.1 The Roots of the Close Corporation Law in USA. — 1.1.2 Developments in the European Close Company Law. — 1.2 The Nature of the Closely Held Company — 1.3 Resemblance of the Close Corporation to the Partnership. — 1.4 Close Company compared to Public Company. — 1.5 Problems in Close Corporations. — 1.5.1 Minority Shareholder "Oppression". — 1.5.2 Legal Remedies for Minority Shareholders. — 1.5.3 Corporate Deadlock. — 1.6 Chapter conclusions.

Introduction

Over the last century, the figure of the closely held company in the company law framework has received increasing academic and legislative attention. The traditional corporate law was founded, since the beginning, upon the needs and the characteristics of the large public company. Given their remarkable features, closely held companies are not comfortable with this framework. Many rules and formalities designed specifically for public companies and imposed upon close counterparties were found to be not applicable. The fundamental difference in the ownership and control between publicly held and closely held corporations has implied the different evolution of governance mechanisms in the two types of corporate form.[14]

Since close companies share some similarities with the partnership form, they were referred to as quasi-partnerships. Both organizational forms are formed on the basis of personal relationships between the parties who agree to jointly start and conduct the business, sharing the benefits and the risks of the business. Moving from this particular resemblance, proponents of this theory have supported the application of partnership law provisions to close companies, especially including enhanced fiduciary duties typical of partnership relationships for shareholders and the right to withdraw their investment from the companies. However, the closely held company seemed not to exactly fit in the partnership form, leading to the need to develop a corporation law well suited for the close companies.

Due to unsatisfactory governing mechanisms provided by the traditional company law, shareholders tried to organize the company through private agreements among themselves. Courts generally voided the private agreements that diverged too far from the statutory norms

[14] Easterbrook F. H., Fischel D. R. (1985) Close Corporations and Agency Costs, *Stanford Law Review*, pp. 271-301.

of corporation law. The concern of validating or refusing private agreements aimed at designing the private ordering of close companies led to the formation of a specific suited law for close corporations.

Before entering into a detailed description of the closely held company, it may be useful to provide an insight into the birth and development of close corporation legislation in the United States and Europe.

1.1 The Rise of the Close Corporation Legislation

Since its inception, corporation law, especially in the United States, has always been particularly inflexible, decisively separating the corporation form, whose functioning rules were fixed by statute, from the partnership, whose enjoyed more flexibility in terms of limited liability and unlimited life.[15] Indeed, corporate statutes drafted in the nineteenth century were based on the needs of the large public corporations that dominated the economic scene of that time.[16] In particular, statutes provided for a mandatory corporate structure that fitted perfectly with the way public corporations were organized: a Board of Directors vested with the power to manage the corporations and shareholders with a limited role in the governance of the corporations.[17]

However, this structure imposed by statutes was not conceived with the needs of close corporations in mind, whose shareholders serves also as managers, and, thus, it created several problems for the governance of this type of business organization. Notably, parties in close corporations were limited by the statute in the ways they could allocate managerial power among themselves.[18]

It was probably because in the nineteenth and early twentieth-century courts still viewed with skepticism private agreements concluded among shareholders attempting to circumvent the board centrality designated by the early corporation law.[19] Moreover, the competition for the corporate charters that characterized this period contributed to direct the legislative efforts towards the public company.[20] States started to compete for corporations charters in order to

[15] Wells H., supra note 6, at 265.
[16] Id. at 265.
[17] Berle A., Means G., supra note 1.
[18] Karjala D. S. (1989). An Analysis of Close Corporation Legislation in the United States, *Arizona State Law Journal*, Vol. 21, pp. 663-704. Available at: https://ssrn.com/abstract=1411450.
[19] Wells H., supra note 6, at 288.
[20] Id.

encourage the incorporation of either domestic and foreign corporations, which were required to pay incorporation fees and taxes to the state of incorporation.[21] In this sense, the foreign incorporation of close corporations seemed inconvenient for both the state concerned, which would have earned little amount in fees and taxes, being these related to the value of corporation's assets and outstanding shares, and both for the close corporations themselves in terms of additional costs and limited advantages of foreign incorporation.[22]

Only in the twentieth-century corporation law began to distinguish between large and small companies, adopting a series of provisions and, then statutes, to reduce the inflexibility of the statutory norms accommodating them to the needs of close corporations.

1.1.1 The Roots of the Close Corporation Law in USA

The development of a suited law for close corporations in the US started only from the first half of the twentieth century. As we already said, the first attempt could be brought back to the role that courts played in ruling the validity or invalidity of the agreements made by participants in close corporations.[23] The acceptance of the validity of such agreements by the courts led to the evolution of a common law of close corporation that deviated from the statutory norms.[24] However, the courts seemed to rule not for the general acceptance of private agreements concluded between the participants in close corporations, but instead, they decided the validity or not of such agreements from case to case.[25] In this sense, courts seemed to operate on a discretionary basis validating certain agreements while enforcing the invalidity of others that seemed quite similar.[26] Furthermore, courts refused to validate certain agreements, even if the interests of third parties were not involved and public policy were not at risk.[27]

The decision took by the Court of Appels in Benintendi v. Kenton Hotel Inc. case led the legislature to revise New York's corporation law in 1948 by introducing the first statute specifically confined to the closely-held corporations.[28] The statute prescribed the

[21] Ayres I. (1992). Judging Close Corporations in the Age of Statutes, *Washington University Law Review*, Vol. 70, pp. 365-397. https://openscholarship.wustl.edu/law_lawreview/vol70/iss2/6.
[22] Id. at 377.
[23]Wells H., supra note 6, at 292.
[24] Id.
[25] Israels C. (1948). Close Corporation and the Law, *Cornell Law Review*, Vol. 33, p.488-506. Available at: http://scholarship.law.cornell.edu/clr/vol33/iss4/6.
[26] See Benintendi v. Kenton Hotel, Inc., 60 N.E. 829, NY 1945 compared to Clark v. Dodge, 199 N.E. 641, NY 1936 in Israels C., supra note 25, at 489-497.
[27] See Jackson v. Hooper 76 NJ Eq. 592, N.J. 1910 in Karjala D., supra note 18, at 672.
[28] N.Y. Stock Corp. Law § 9, 1948. In Corporations. Voting Requirements. New York Statute Permits Corporations to Require Unanimity of Greater than Majority Vote for Director or Shareholder Action, *Harvard Law Review*, 1949, Vol. 62, No. 3, pp. 526-528. Available at: https://www.jstor.org/stable/1336551

supermajority as a quorum for the decision in the meeting of the board of directors and shareholders meeting, as long as the provision was adopted by the unanimous consent of the shareholders and appeared in the original certificate of incorporation.[29]

Another step in the recognition of a close corporation law was taken in 1955 by North Carolina with the adoption of the North Carolina Business Corporation Act.[30] The Act rejected the "philosophy" according to which co-owners of a close corporation may not maintain a quasi-partner relationship if they endorsed the corporate form.[31] Specifically, the Act expressly provided that the agreements concluded between shareholders in corporations whose shares are not publicly traded shall not be deemed invalid on the ground that the parties tried to treat the corporation as a partnership.[32] Nonetheless, the section was simply inserted in the North Carolina general incorporation law postponing the drafting of a special statutory regime for close corporations.[33]

The first separate integrated close corporation statute was issued by the state of Florida in 1963.[34] According to the statute, close corporations, defined as those corporations whose shares are not generally traded in the securities market,[35] were allowed to decide to adopt the provisions of the statute or to be subject to the general corporation law applicable to all corporations.[36] The statute generally validated agreements between shareholders related to any aspect of the corporation's affairs,[37] granted shareholders entitled to appoint a director the authority to remove such director with or without cause,[38] provided the dissolution in deadlock cases.[39] Although the provisions contained in the Florida statute resembled those included in the North Carolina Business Corporation Act, they seemed not to be well-drafted compared to the provisions of the latter.[40] The language used in the statute created a sense of uncertainty regarding what corporations are subjected by its provisions and the power those corporations

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[29] Id.
[30] Karjala D., supra note 18, at 669.
[31] Latty E. R. (1956). The Close Corporation and the New North Carolina Business Corporation Act, *North Carolina Law Review 432*, Vol. 34, No. 4, pp. 432-457. Available at: http://scholarship.law.unc.edu/nclr/vol34/iss4/2.
[32] N.C. Gen. Stat. § 55-73(b), 1955 in Latty E. R., supra note 31, at 438.
[33] Karjala D. S. (1980). A Second Look at Special Close Corporation Legislation, *Texas law Review*, Vol. 58, No. 7, pp. 1207-1268. Available at: https://ssrn.com/abstract=1411464.
[34] O'Neal F. H. (1972). Close Corporation Legislation: A Survey and an Evaluation, *Duke Law Journal*, Vol. 21, pp. 867-893. Available at: https://scholarship.law.duke.edu/dlj/vol21/iss5/4.
[35] Fla. Stat. § 608.70 (2), 1963.
[36] Hodge O'Neal F., supra note 34, at 874.
[37] Fla. Stat. § 608.75(1), 1963.
[38] Fla. Stat. § 608.76.
[39] Fla. Stat. § 608.77.
[40] Hodge O'Neal F., supra note 34, at 879.

retain.[41] As result, the Florida Statute failed to provide the road for the evolution of close corporation legislation.[42]

The solution to the problem of close corporation legislation was found in 1967, as the state of Delaware and Maryland adopted close corporation statutes.[43] In Delaware, the statute was drafted as a separate subchapter of the Delaware General Corporation Law and addressed only to those corporations that met the definition of the close corporation included in the statute.[44] In particular, a corporation is closed when all its outstanding shares (1) are held by a limited number of persons not exceeding thirty; (2) are subject to one or more transfer restrictions; (3) are not offered through a public offering.[45] The most significant provisions included in the subchapter concerned the management of the close corporation; specifically, the statute provided that written agreements concluded among the majority shareholders upon the restrictions of the power of the board of directors were not deemed invalid,[46] and empowered shareholders to manage the company's operation without the board of directors subject to the unanimous consent of the former.[47]

In a similar way to Delaware, the state of Maryland implemented a series of provisions for close corporations.[48] According to the Maryland statute, the close corporation denomination is granted to the corporation whose charter includes a statement declaring that it is a close corporation.[49] The declaration of the status of close corporation shall appear upon each certificate of the corporation's shares, and the failure of the charter or any certificate to incorporate this declaration does not undermine the close corporation status.[50] Unlike Delaware, the Maryland Act does not provide for a maximum number of shareholders that a corporation must have to maintain its status of close corporation, nonetheless, it precludes the close corporation form to those corporations having issued: (1) any securities convertible into stock; (2) any voting securities different than stock; (3) any transferable options to subscribe for or purchase any of its stock.[51] Like Delaware, the Maryland statute allows the direct management

[41] Dickson D. (1967). The Florida Close Corporation Act: An Experiment That Failed, *University of Miami Law Review*, Vol. 21, No. 4, pp. 842-853. Available at: https://repository:law.miami.edu/umlr/vol21/iss4/6.
[42] Hodge O'Neal F., supra note 34, at 879.
[43] Id. at 880.
[44] Del. Code Ann. tit.8, § 342, 1968.
[45] Del. Code Ann. tit.8 § 342(a), 1968.
[46] Del. Code Ann. tit.8 § 350, 1968.
[47] Del. Code Ann. tit.8 § 351, 1968.
[48] Wolens J. B. (1968) A Round Peg – A Share Hole: The Close Corporation and the Law, *SMU Law Review*, Vol. 22, pp. 811-838. Available at: https://scholar.smu.edu/smulr/vol22/iss5/7.
[49] Md. Ann. Code art. 23, § 100(a), 1967.
[50] Md. Ann. Code art. 23, § 100(c).
[51] Md. Ann. Code art. 23, § 102(b).

of the corporation's business to the shareholders if provided by the charter,[52] and authorizes agreements among all shareholders concerning the corporation's affairs, requiring, differently from the Delaware statute, the unanimous consent of the shareholders.[53]

Although the issuance of close corporation statutes seemed to represent the solution to the problem of a law recognition for the closely-held businesses, their adoption was quite a failure.[54] Only a relatively small number of corporations filed as statutory close corporations.[55] The reasons behind this failure could be attributed to the lesser need the corporations had of a close corporation statute, once the court started to validate shareholders' agreements and by-law provisions were no longer uncertain.[56] Thus, the corporations began to see the adoption of a close corporation statute as a block to its growth.[57]

From the 1970s, the corporate form was challenged by a new entity, the limited liability company (LLC), introduced by the Wyoming Limited Liability Company Act.[58] The LLC allowed to combine the limited liability protection with the partnership taxation, two usually incompatible elements.[59] Moreover, the LLC allowed greater organizational flexibility by granting all the members the authority to manage the entity, as in the partnership, or to appoint a board of directors, as in a corporation.[60] As result, by 1995 an LLC statute[61] was adopted by every state and the number of new businesses adopting these statutes grew consequently overcoming the close corporation form, still representing today the preferred business form for small companies.[62]

[52] Md. Ann. Code art. 23, § 105(a)(1).
[53] Md. Ann. Code art. 23, § 104(a).
[54] Wells H., supra note 6, at 314.
[55] O'Neal F. H., Thompson R. (2004). O'Neal and Thompson's Close Corporation and LLCs: Law and Practice, 3rd rev. ed., *Thomson West editor*. [Hereinafter, O'Neal and Thompson]
[56] Wells H., supra note 6, at 314.
[57] Id.
[58] Hamill S. (1998). The Origins Behind the Limited Liability Company, *Ohio State Law Journal*, Vol. 59, No. 5, pp. 1459-1522.
[59] Hamill S. (1996). The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question, *Michigan Law Review*, Vol. 95, No. 2, pp. 393-446. Available at: https://www.jstor.org/stable/1290118.
[60] Id. at 394.
[61] Wells H., supra note 6, at 315.
[62] Friedman H. (2004). The Silent LLC Revolution – The Social Cost of Academic Neglect, *Creighton Law Review*, Vol. 38, No. 1. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=613022.

1.1.2 Developments in the European Close Company Law

Differently from the United States, where the close corporation form developed through case law, almost every state in Europe enacted a specific statute governing the closely held companies.[63] Germany was the first country to recognize the fundamental distinction between the publicly held company, the *Atkiengesellschaft* (AG), and the closely held company, the *Gesellschaft mit beschränkter Haftung* (GmbH), providing a separate legal treatment for them.[64] The GmbH was formed and governed by the *Gesetz betreffend die Gesellschaften mit beschrdnkter Haftung* (GmbH Law) of 1892, with the aim to provide a less heavy and expensive business entity for the needs of small and medium-sized enterprises (SMEs).[65] However, the features introduced by the GmbH, including the capital divided by quotas and the opportunity to concentrate the managerial power within one person,[66] were designed on the capital-oriented structure of the publicly held companies.[67]

In the United Kingdom, the private company was recognized for the first time only through the Companies Act of 1907. This act conferred to companies that fit in the definition of private company a series of privileges, including easy terms to form the company,[68] reduced disclosure requirements,[69] and limited liability of the members.[70]

The model of GmbH adopted by Germany was followed also by France with the introduction of its private company, the *société à responsabilité limitée* (SARL), by the Act of 1925. Due to the simplicity of its operation and the facility in which it may be organized, the SARL was a form specifically conceived for the needs of closely held companies.[71] In particular, the Act

[63] De Vries H., Juenger F. (1964) Limited Liability Contract: The GmbH, *Columbia Law Review*, 1964, Vol. 64, No. 5, pp. 866-886. Available at: https://www.jstor.org/stable/1120826.

[64] Scogin Jr. H. (1993) Withdrawal and Expulsion in Germany: A Comparative Perspective on the "Close Corporation Problem", *Michigan Journal of International Law*, Vol. 15, pp. 128-188. Available at: https://repository.law.umich.edu/mjil/vol15/iss1/3.

[65] De Vries H., Juenger F., supra note 64, at 867.

[66] Id. at 871.

[67] McCahery J., Vermeluen E. (2005) Understanding (Un)Incorporated Business Forms – Topics in Corporate Finance, *Amsterdam Center for Corporate Finance*, p. 16.

[68] Companies Act 1907 (7 Edw 7 c 50), § 181, § 109 in Gower L. (1953). The English Private Company, *Law and Contemporary Problems*, Vol. 18, No. 4, pp. 535-545. Available at: https://scholarship.law.duke.edu/lcp/vol18/iss4/6

[69] Companies Act 1907 (7 Edw 7 c 50), § 129.

[70] Gower L., supra note 68, at 540.

[71] Becker L. (1963). The Société Anonyme and the Société a Responsabilité Limitée in France, *New York University Law Review*, Vol. 38, No. 5, pp. 835-889.

provided that a minimum of two persons are required to constitute a SARL,[72] and its shares cannot be subject to a public offering[73] or be negotiable.[74]

Since the formation of the European Community in 1957 by the Treaty of Rome, its efforts have been focused on the harmonization of Member State company law. In particular, the Treaty provides that the Member States are free to establish branches or subsidiaries in another Member State, abolishing restrictions on this freedom,[75] unless incompatibilities among the company laws of the Member State arises.[76] In order to reduce these incompatibilities and according to article 54(3)(g) of the Treaty, which required that the members adopted equivalent safeguards for the protection of its interests and others, the Community adopted a series of directives to coordinate the company laws of the diverse Member States.[77] The Community decided to set target points in the directives toward which the company law of each Member State should converge, without formulating a separate Community law.[78]

Analyzing the harmonization of company laws of the Member States on the close corporations, an important directive was represented by the Twelfth Council Directive of December 1989 on Single-Member Private Limited Liability Companies.[79] The Directive created a legal instrument permitting the limitation of liability of the sole entrepreneur throughout the European Community.[80] In this sense, the closely held company does not lose the limited liability if the company is formed by a single shareholder, either upon formation or after the formation.[81]

However, the body of directives brought in the European Community landscape a set of cumbersome and costly harmonized rules that seemed to be inefficient for closely-held companies specifically.[82] If it is true, that the mandatory rules convey the impression to be beneficial for public companies in reducing the complexity and administrative costs, at the same

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[72] Law of 7 March 1925 art. 5, 1925, Code de Commerce 85 in Becker L., supra note 71, at 879.
[73] Law of 7 March 1925 art. 22, 1925, Code de Commerce 85.
[74] Law of 7 March 1925 art. 21, 1925, Code de Commerce 85.
[75] European Union, Treaty Establishing the European Community, Rome Treaty, 25 March 1957, art.52.
[76] Donald D. (1991). Company Law in the European Community: Toward Supranational Incorporation, *Penn State International Law Review*, Vol. 9, No. 1, pp. 1-51. Available at: http://elibrary.law.psu.edu/psilr/vol9/iss1/2.
[77] Id. at 4.
[78] Id. at 5.
[79] Id. at 6.
[80] Council of the European Union, Twelfth Council Directive of 21 December 1989 on Single-Member, Private Limited Liability Companies, *Office Journal of the European Communities*, 30 December 1989, L 395, Vol. 32, at 40.
[81] Id. art. 2, at 41.
[82] McCahery J., Vermeulen E. (2001). Regulatory Competition and the Evolution of Closely Held Business Forms in Europe, *Tilburg University*, at 2. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=292766.

time they have the effect to create higher costs for the closed corporation.[83] In particular, the European Community company law requirements — such as the prescription of a minimum capital requirement and disclosure standards — are perceived as over regulatory and unequal to the specific features of the closely-held business, causing the latter to incur additional costs.[84] Besides, the harmonization process was hindered by diversity in corporate law norms in the diverse member states, and by the unwillingness of them to adopt harmonized rules.[85]

In a context in which large publicly held companies continue to hold the most benefits from the company law, the efforts of European policymakers of introducing new organizational forms, offering cost-saving advantages for entrepreneurs and small firms, have been uneven across member states and also produced poor results.[86] In particular, following the U.S. and Jersey experience, the U.K. turned the tide by introducing the limited liability partnerships (LLPs) form by the Limited Liability Partnership Act of 2000.[87] This form, thought to provide economic benefits to individual firms, was a blend of partnership and company that resembles more the limited liability company (LLC) rather than the U.S. limited liability partnership.[88] On one hand, the LLP recalls the features of the corporate form in terms of operating formalities, while on the other hand, the decision-making rules resemble the partnership organizational form.[89]

Similarly to the corporate form, the Act provides the legal personality of the entity,[90] limited liability of the members, and requires that the LLP has to be registered at Company House to be legitimately formed.[91] On the organizational side, likewise partnerships, the Act granted LLP flexibility in deciding who represents the partnership, how profits are distributed, and who takes decisions.[92] Furthermore, the LLP is subject to partnership taxation, according to which only the members are subject to taxation, not the partnership itself.[93] Even if the LLP was constituted to provide economic benefits to small and medium-sized enterprises, the company law requirements — in terms of filing, accounting, disclosure, and filing — increased the

[83] Id. at 4.
[84] Id. at 5.
[85] Id. at 18.
[86] Id. at 35.
[87] Siems M. (2009). Regulatory Competition in Partnership Law, *Cambridge University Press*, 2009, Vol. 58, No. 4, pp. 767-802. Available at: https://www.jstor.org/stable/25622245.
[88] Id. at 784.
[89] McCahery J., Vermeulen E., supra note 82, at 38.
[90] Limited Liability Partnership Act 2000, ch. 12, s. 1. Available at: https://www.legislation.gov.uk/ukpga/2000/12.
[91] Limited Liability Partnership Act 2000, ch. 12 ss. 2, 3.
[92] Siems M., supra note 87, at 785.
[93] Limited Liability Partnership Act 2000, ch. 12, s. 10.

complexity and the transaction costs of the LLP, making this organizational form economically inaccessible for most SMEs.[94]

Another effort in introducing a new organizational structure, carrying cost advantages for the closely held business form, has been made by the French lawmakers with the establishment of *société par actions simplifiée* (SAS) in 1994.[95] The SAS is a legal entity that provides partners greater flexibility in the organization and control of the entity, allowing them to decide the decision-making structure of the firm and the content of the bylaws.[96] Nonetheless, the SAS is still subject to the mandatory provisions in the French civil code that apply to the companies, excepting for those provisions relating to the management boards and shareholders' meetings.[97] The extension of the corporate law provisions to the SAS generates additional costs and enhances the complexity for this type of entity.[98] Even if the management engages in drafting the bylaws, to adapt the general corporation framework to the needs of the closely-held business, the costs incurred— including transaction costs, information asymmetries, and strategic behavior— may deter them to adopt the SAS organizational form.[99]

Despite the attempts of national lawmakers to create organizational forms specifically suited to meet the needs of close corporations, the European Community lawmakers have always been too focused on enacting provisions for the harmonization of public company law, spending poor efforts in adopting the same provisions for the closely-held companies.[100] At the same time, the Commission has believed that the corporate requirements conceived having the public companies' needs in mind were not appropriate for SMEs, which instead require less burdensome and simpler conditions for doing business across the European Union.[101] For this reason, following the introduction of the European Public Company (SE) in 2001, the European Commission adopted the European Private Company (SPE) regulated by the Proposal for a Council Regulation on the Statute for a European Private Company of 2008.[102] According to what the Explanatory Memorandum attached to the Proposal states, the SPE is an organizational

[94] McCahery J., Vermeulen E., supra note 82, at 39, and Siems M. supra note 87, at 785 (explain how the LLP form is most suitable and most adopted by multinational audit and accounting firms).
[95] McCahery J., Vermeulen E., supra note 67, at 36.
[96] McCahery J., Vermeulen E., supra note 82, at 41.
[97] McCahery J., Vermeulen E., supra note 67, at 36.
[98] Id.
[99] McCahery J., Vermeulen E., supra note 82, at 43.
[100] Id. at 45.
[101] European Commission, Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for more Engaged Shareholders and Sustainable Companies, COM (2012) 740 final, Strasbourg 12 December 2012, p. 13.
[102] Guidotti R. (2012). The European Private Company: The Current Situation, *German Law Journal*, Vol. 13, pp. 331-344. Available at: https://ssrn.com/abstract=2033025.

form designated for the SMEs to enhance their cross-border operations in the Single Market by providing entrepreneurs the same, and flexible provisions across the Member States.[103] In this sense, SMEs are allowed to adopt the SPE form in establishing a subsidiary in another jurisdiction, reducing the costs that otherwise would be problematic considering their limited financial resources.[104]

The efforts in the introduction of a business entity aimed at facilitating cross-board activities can be explained by the low number of SMEs engaging in these activities. In fact, in 2008, although SMEs accounted for 99% of companies in the European Union, only 8% engaged in cross-board trade, and 5% established subsidiaries or joint ventures abroad.[105] Thus, the European Community through the adoption of the SPE sought to ensure greater inclusion of SMEs in the Single Market to strengthen their growth.[106] Given the flexibility required by the small and medium-sized enterprises, the Commission's proposal established simpler requirements for the formation of an SPE.[107] In particular, the minimum capital required is only €1,[108] and its registered office and the central administration can be located in two different Member States.[109] Moreover, greater flexibility is granted to SPE's shareholders in determining the internal organization of the company.[110] In the articles of association of the SPE, the founders may decide to opt for a one-tier or two-tier management structure, in which the administrative board— in the first case— or the management board — in the second case — is responsible for the management of the entity.[111] The articles may establish the majority required to pass shareholders' resolution, but for specified matters is required a qualified majority not less than two-thirds of the total voting rights.[112] However, the implementation of the SPE regulation was blocked during the Hungarian Council Presidency of 2011, in which the Member States did not agree on a draft regulation of the SPE, especially regarding co-determination and

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[103] European Commission, Proposal for a Council Regulation on the statute for a European private company, COM, 396 final, Brussels, 25 June 2008, § 2. Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52008PC0396.
[104] Siems M., Herzog L., Rosenhager E. (2009). The European Private Company (SPE): An Attractive New Legal Form of Doing Business?, *Butterworths Journal of International Banking and Financial Law*, pp. 247-250. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1350465.
[105] European Commission, Proposal for a Council Regulation on the statute for a European private company, COM, 396 final, Brussels, 25 June 2008, § 1.
[106] Guidotti R., supra note 102, at 332.
[107] Siems M., Herzog L., Rosenhager E., supra note 104.
[108] European Commission, Proposal for a Council Regulation on the statute for a European private company, COM, 396 final, Brussels, 25 June 2008, art. 19.
[109] Id. art. 7.
[110] Siems M., Herzog L., Rosenhager E., supra note 104.
[111] European Commission, Proposal for a Council Regulation on the statute for a European private company, COM, 396 final, Brussels, 25 June 2008, art. 2(d).
[112] Id. art. 27(2).

taxes issues moved forward by the German exponents.[113] As result, the Proposal was definitively dismissed by the European Commission in 2014.

Since a unified legal form was still viewed with positivity by the Member States, in 2014 the Commission put forward another proposal for a single-member private limited company, the *Societas Unius Personae* (SUP). Different from the Proposal on SPE, the rules governing the SUP were established by a Directive rather than a Regulation, showing the intention to aim for a harmonization rather than standardization.[114] As in the SPE, the minimum capital required to set up a SUP was €1, but of particular relevance was the provisions allowing the company to be formed online. The governance was also simplified with the restriction prohibiting the company to be formed with more than one member.[115] Although the Proposal was aimed to solve the major issues of the previous proposal, the SUP Proposal was finally withdrawn in 2017 by the PANA Committee, due to the possibility of using the online formation to create "letterbox companies" to evade taxes.

Despite the ongoing efforts of the European Community, the process of creating a new entity available throughout the Community designed to meet the needs of SMEs has experienced a failure. The reluctance of some states to adopt regulations at a supranational level may be explained by their intention to maintain the authority upon the provisions and regulation of which incorporated form available to new SMEs are subject. Finally, the introduction of a European private company may be pursued, only if the European Community is able to create a market demand for this supranational company form.

1.2 The Nature of the Closely Held Company

Despite the term "close corporation" is widely used in almost every jurisdiction, a common statutory definition of the close corporation has not been established. In this sense, Kessler properly compared the close corporation to a "spiral staircase, hard to describe but recognizable

[113] Eckardt M. (2012). The Societas Privata Europaea – Could it Promote the Internationalization of Small and Medium-Sized Enterprises?, *Andrássy Working Paper Series No. 27*, at 3. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2307429.

[114] Ghetti R. (2018). Unification, Harmonisation and Competition in European Company Forms, *European Business Law Review*, Vol. 29, No. 5, pp. 813-842. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2859164.

[115] European Commission, Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability company, Brussel, 9 April 2014, COM (2014) 212 final, 2. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014PC0212.

when you see one".[116] Even if a precise definition is not available, it is more functional to exhibit the characteristic features that distinguish the close corporation all around the world.[117] Consistently to the judgment of the Massachusetts Supreme Judicial Court in the iconic case Donahue v. Rodd Electrotype Co.,[118] the close corporation is characterized by (a) a small number of shareholders, (b) active shareholders participation in the management (c) no ready market for corporate shares, (d) share transfer restrictions.

Thus, firstly, the close corporation is owned by few shareholders, often family members, who —differently from shareholders in public companies — have invested all or most of their wealth in the company. Secondly, ownership and control in close corporations are not definitively separated as in the public companies. Shareholders take substantial participation in the management of the company, serving also as managers and incurring in directors' liabilities. Thirdly, shareholders cannot offer shares in the public market, impeding shareholders to cash out their investment anytime to employ it in other business opportunities. Lastly, shares are subject to transfer restrictions provisions included in the articles of association or shareholders' agreements. These restrictions allow shareholders to determine, according to their preferences, by whom the shareholders' group is formed.[119]

In addition to the characteristics mentioned above, it is possible to identify other distinguishable features of closed companies.[120] First, relationships among corporation's members are characterized by greater flexibility and considerable party autonomy, to the extent that the primary source of close companies organization is not found in statutory law, but rather in the articles of association. Second, the majority position is relatively stable over time, thus, giving poor opportunities to minority shareholders to obtain a majority stake even after the death or retirement of one of the majority shareholders. Third, the lack of a secondary market where to sell the shares makes the valuation of close companies complicated and not accurate since the absence of reliable mechanisms for establishing the value of shares.

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[116] Kessler R. (1967). With Limited Liability For All: Why Not a Partnership Corporation?, *Fordham Law Review*, Vol. 36, pp. 235-306. Available at: < https://ir.lawnet.fordham.edu/flr/vol36/iss2/4>.
[117] Fleischer H. (2017). The Law of Close Corporations, in Schauer M., Verschraegen B., (eds.), General Reports of the XIXth Congress of the International Academy of Comparative Law, Springer, 2017, Vol. 24, pp. 319-350.
[118] Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d 505, 511 (Mass. 1975).
[119] Fleischer H., supra note 117, at 321.
[120] Bachmann G. *et al*. (2014). Regulating the Closed Corporation, De Gruyter, ECFR Special Volume 4, Berlin 2004, p. 33 and ss.

1.3 Resemblance of the Close Corporation to the Partnership

Bearing in mind the characteristics discussed before, close corporations are similar to partnerships. Both organizational forms tend to have few owners who often participate in the management, and whose ownership positions transferability is usually restricted and lacks an active market.[121] As specified by Israel, some shareholders in close corporations consider themselves partners seeking to conduct their business in the manner of a partnership.[122]

In the light of this resemblance, when courts found themselves dealing with issues not covered by the close corporation law, they often applied the partnership law principles to close corporations. Particularly relevant is the decision of the Massachusetts Supreme Judicial Court in the Donahue v. Rodd Electrotype Co. case concerning the fiduciary duties owed by shareholders in close corporations. The court held that since the "fundamental resemblance of the close corporation to the partnership…stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another…"[123] Hence, the court analyzed the issue under the partnership law rather than the corporate law, applying the higher partnership fiduciary duties.[124] The Massachusetts court followed the majority rule, according to which all shareholders in close corporations —since they are viewed as partners— owe an enhanced fiduciary duty to each other.[125] This approach is opposed to the minority rule, according to which corporate fiduciary duties are applied in the relationship between shareholders.[126]

The proponents of the partnership analogy argue that the fundamental principles of partnership law should apply also to the law of close corporations. Although the analogy may be beneficial, it presents some drawbacks and can be questionable. Assuming that, participants in close companies incorporate only to benefit from the favorable tax treatment or limited liabilities while they still want to be treated as partners, is wrong and ignores the knowledge of the participants in distinguishing the differences between the corporate and the partnership law.[127]

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[121] Moll D. (2010). Protection of Minority Shareholders in Closely Held Corporations: Donahue v. Rodd Electrotype Co. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1663388.
[122] Israels C., supra note 25, at 488.
[123] Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d at 515 (Mass. 1975).
[124] Siegel M. (2005). Fiduciary Duty Myths in Close Corporate Law, pp. 377-534. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=689601.
[125] Id. at 399.
[126] Id. at 439.
[127] Easterbrook F., Fischel D., supra note 14, at 298.

1.4 Close Company compared to Public Company

Although close and public companies share the corporation form, the fundamental characteristics of the two organizational forms differ sharply. The public corporation or publicly held company is commonly defined as the entity whose shares are freely transferable in an active securities market. By definition, shareholders in public companies may realize their investment at any time by selling their stock positions in a public market according to the Wall Street rule. Conversely, no active market is accessible by close corporations' shareholders, whose shares are subject to transfer restrictions.

Moreover, differently from close corporations, in which shareholders are few and take an active role in the management of the company, public corporations are characterized —at least in principle— by the separation of ownership and control.[128] In public companies, shareholders are passive investors who take no part in the labor or the management of the corporation, but rather delegate the control of the corporate activities to the management board.[129] They solely invest money in the company to receive a return on their investment through dividend payments or the sale of their shares at an appreciated price.[130] On the contrary, close corporations' shareholders usually participate actively in the company with a significant role in the management or as employees.[131] They normally receive the return on their investment in the form of employee compensation and dividend distribution, rather than through the sale of shares at an appreciated value in a public market.[132]

Given their position in the company, close corporation shareholders are usually family members or, at least, are involved in a relationship that requires a high level of trust; hence, the restrictions on the transfer of shares may be justified by the aim to maintain the continuity of people they work with.[133] In contrast, in public companies the ownership is usually dispersed among thousands of shareholders who rarely work as employees; thus, no restrictions on the transfer of shares could be justified in public companies, where the transferability is the rule.[134]

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[128] Berle A., Means G., supra note 1.
[129] Moll D., supra note 121, at 1.
[130] Id.
[131] Id. at 2.
[132] Id.
[133] Wells H., supra note 6, at 275.
[134] Id. at 275.

Also, the stable majority position that characterizes the close company is not present in the context of public listed companies, where changes in the ownership structure are not so uncommon and anybody is potentially a majority or a minority shareholder.[135]

In the case of abusive conduct by the board of directors or the majority shareholder, in public companies, an "oppressed" shareholder may escape these abuses by simply selling their shares on a securities market. However, this is not the case for the close corporation shareholder. The presence of restrictions on the transfer of the shares and the lack of an active market to sell them, lock up shareholders in close corporations, exposing the minority shareholder to the opportunistic behavior of the controlling shareholder.

Hence, considering the particular features described above, close corporations are affected by several problems. These problems, mostly related to management and control, put the company in a vulnerable position, especially the minority shareholder who, subject to the effect of the majority rule, could be expropriated from the company decision-making process and, consequently, lose its control over its investment without the possibility to freely liquidate its position and leave the company.[136]

1.5 Problems in Close Corporations

As discussed above, the problems close corporations must face in this normal conduct of business are mainly related to its nature. In particular, the absence of a public market for corporate shares and the traditional corporate law norms applied to a such flexible organizational form creates serious problems for the whole company and the minority shareholder more specifically. The most common and perhaps the most cumbersome problems represented by the minority shareholder oppression and the so-called "corporate deadlock" will be discussed below.

1.5.1 Minority Shareholder "Oppression"

According to what has been said, shareholders in close corporations are granted no exit rights, which have the effects of locking-up their investment into the company without allowing the liquidation of their position in a public market. The presence of a securities market in which

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[135] Perakis E. (2002). Rights of Minority Shareholders: XVIth Congress of the International Academy of Comparative Law, Brisbane 2002, p. 20.
[136] Id.

shares can be sold protects investors in public companies from the behavior of those who control the entity.

However, in close corporations where no ready market in which shareholders may sell their shares is present, the capital provided by minority shareholders is "seized" and used as majority shareholders see fit.[137] Even if the minority shareholder could identify potential investors, the minority ownership position which carries insufficient voting rights to control the operations of the company, especially in companies with a track record of majority oppression, is unlikely to generate interests in outside investors.[138] Moreover, in close companies, minority shareholders have no right to demand a buyout or a dissolution to liquidate their ownership position.[139] Besides, the majority shareholder may use its power to conclude unbalanced transactions with the company, dismiss minority shareholders, grant himself inflated directors' salaries, and restrict the distribution of dividends, leaving minority shareholders only with the option to sell their shares to the majority shareholder at a discount price.[140] Consequently, minority shareholders are in a vulnerable position subject to the "oppression" of the controlling group.

The vulnerable position of minority shareholders is marked under the majority rule that characterized the corporate form. This rule requires a simple majority to adopt meeting resolutions, and thus, any shareholder holding the majority stake can make all ordinary resolutions.[141] Following the majority rule, the majority shareholder has the right to appoint the majority of the Board of Directors members, who keeps control over the decision of the company.[142] Since the directors respond to the wishes of shareholders who elected them, the majority shareholder effectively controls the board and has the power to make decisions that could be harmful to the minority shareholder's interests.[143]

These decisions known as "freeze-out" or "squeeze-out" techniques have the effect to restrict the financial and participatory rights of the minority shareholders.[144] The most common

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[137] Moll D. (2005). Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History, *Wake Forest Law Review*, Vol. 40, pp. 883-976. Available at: https://ssrn.com/abstract=869310.
[138] Id. at 898-899.
[139] Id. at 900-905. [The buyout right consists in forcing the purchase of the shares by the company. It ensures minority shareholders recover the value of their investment. The dissolution right is typical provided in the partnership form. It consists of proving liquidity to business owners through the sale of the company and the allocation of a proportionate share of the company's sale value to each owner.]
[140] Bachmann G. *et al*., supra note 120, at 30.
[141] Id. at 33.
[142] Moll D., supra note 121, at 2.
[143] Id.
[144] Id. at 3.

techniques — often used in combination — encompass the refusal to declare dividends, the termination of the minority shareholder's employment, the removal of the minority shareholder from the Board of Directors, the refusal of access to information, and the majority shareholder subtraction of corporate earnings.[145] Besides, the majority shareholder is likely to enter into unbalanced transactions — "sweetheart deal" — with the company itself, for example, by purchasing company's property at a price far below the market value, obtaining interest-free loans from the company, leasing office space to the company at an inflated rent, and so on.[146] Company buyback of shares from the majority shareholder falls within the set of sweetheart deals when the purchase price is above the intrinsic value of the shares, thus, resulting in a breach of duty towards minority shareholders to whom the same opportunity was not granted.[147]

Another factor, which contributes to the advancement of minority shareholder oppression, is the absence of advance planning for "preventing contracts" between shareholders, aimed at anticipating possible events that would cause an oppression situation.[148] Through the use of preventing contracts, shareholders may regulate numerous aspects concerning their relationship, such as how salaries will be determined, the allocation of power for the minority within the Board, and mechanisms to resolve disputes among them.[149] However, the planning activity is not easy for the parties, especially for this type of contract concerning a long-term relationship. The first reason can be that contracts are incomplete by their nature. It is impossible and costly for the parties to anticipate and regulate all the possible future contingencies that may occur in a long-term relationship. The second reason can be explained by the ignorance of shareholders in close corporations in legal matters, such as the need for contractual protection in this specific case.[150] Furthermore, the ignorance of minority shareholders of other factors — such as, the potential shareholder conflicts, the applicable legal rules, and the effects of majority control — or their overtrust in the good faith of the majority shareholders are reasons that prevent the formation of protective contracts.[151]

Apart from statutory legal protections, including qualified statutory majority requirements for specific matters for resolution as amendments of the articles of association, minority shareholders may rely on self-protection mechanisms to protect themselves from the

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[145] Id.
[146] Bachmann G. *et al*., supra note 120, at 37.
[147] Id. at 40.
[148] Utset M. (2003). A Theory of Self-Control Problems and Incomplete Contracting: The Case of Shareholder Contracts, *Utah Law Review*, pp. 1329-1411. Available at: https://ssrn.com/abstract=597143.
[149] Id. at 1343.
[150] Moll D., supra note 137, at 912.
[151] Utset M., supra note 148, at 1345.

opportunistic behavior of the majority shareholder.[152] Minority shareholders can include a veto right in the articles of association for specific resolutions, setting apart the majority rule, or by the means of shareholders' voting agreements, they may regulate how the voting rights should be cast in the general meeting.[153]

In the European Community, many rules are adopted to protect minority shareholders, including reinforced majorities for specific fundamental matters, double majorities for decisions affecting special classes of shares, anti-dilution mechanisms in case of a capital increase, sterilization of voting rights attached to treasury shares, and so forth.[154] For instance, art. 44 of Directive 2012/30/EU provides that a reinforced majority of at least two-thirds of the votes attached to shares is required for taking decisions of the general meeting concerning a capital reduction or a capital increase.[155]

Notwithstanding that some courts impose a fiduciary duty between shareholders of a close corporation, freeze-out techniques are generally considered legal and acceptable. This is possible since the internal corporate decisions involving the main shareholders' oppression issues, such as management, dividend, and employment matters are protected under the business judgment rule.[156] Consequently, fiduciary duty principles provide inadequate protection for the oppressed minority shareholder.

1.5.2 Legal Remedies for Minority Shareholders

Minority shareholders are left with different legal remedies to protect their position in situations when the resolution taken in the shareholders' meeting violates the law or the articles of association.[157]

First, minority shareholders are granted the right to file an action challenging the validity of shareholders' resolutions. The claims for compensation of minority shareholders may be required through direct action or derivative action, and their regulation depends on the jurisdiction. Direct actions refer to a breach of rights suffered directly from the shareholder who

[152] Bachmann G. *et al.*, supra note 120, at 42.
[153] Id. at 43.
[154] De Luca N. (2017). European Company Law: Text, Cases and Materials, *Cambridge Univ. Press*, I, p. 328.
[155] Id. at 329.
[156] Moll D., supra note 137, at 909-910. [Under the business judgement rule the manager is liberated by any liabilities as long as its decision was made "on an informed basis, in good faith, and in the honest belief that the action was taken in the best interest of the company."]
[157] Bachmann G. *et al.*, supra note 120, at 63.

brings a personal action for compensation. For example, the UK legislator allows a shareholder whose rights have been violated by the company to enforce them by bringing a direct action.[158] On the other hand, shareholders may pursue these claims through a derivative action in which the corporation itself is the party directly involved and shareholders simply suing on the corporation's behalf receiving the compensation in an indirect way.[159] For example, in Italy, art. 2476-ter c.c. provides that any shareholder can file an action against the company's director.[160] In the United States, some jurisdictions allow the file of direct actions for all cases of breach of fiduciary duties that harm minority shareholders, while other jurisdictions do not differentiate between direct and derivate actions.[161]

Second, shareholders are granted the right of exit from the corporation for a good cause in specific circumstances. For example, in Italy, art. 2473 c.c. provides that the articles of association determine when a shareholder may withdraw from the company and establish the relative procedures.[162] In any case, shareholders, who have not agreed to the resolution adopted to change the purpose or legal form, to merge or split-up the company, to revoke the liquidation status, to transfer the company's seat abroad, to eliminate one or more exit grounds, are entitled to exit the company. Moreover, the article provides that, if the corporation is created for an indefinite period, a shareholder may exercise its exit right at any moment with a notice of 180 days unless the articles of association provide for a longer period, but not longer than 1 year. Within 180 days also the repayment of the holding shall take place at their market value at the time of the exit statement.

Third, most jurisdictions allow shareholders to require access to the books and records of the company for inspection purposes. However, shareholders requiring the inspection must prove the existence of a reasonable purpose for the request, such as to find wrongdoing, to assist shareholder litigation, to help in the valuation of the shares, and so forth.[163]

Finally, shareholders can protect themselves through extrajudicial remedies that are increasing their importance in the close companies. Arbitration and mediation clauses are common to find in the articles of association of close companies as a means of dispute resolution.[164] In

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[158] Id. at 64.
[159] Pinto A. R. (2014). Protection of Close Corporation Minority Shareholders in the United States, *Brooklyn Law School Legal Studies Research Papers*, No. 369, pp. 361-385. Available at: http://ssrn.com/abstract=2398059.
[160] Bachmann G. *et al*., supra note 120, at 65.
[161] Id. at 66.
[162] See Civil Code art. 2473, Italy 2003.
[163] Pinto A. R., supra note 159, at 365.
[164] Bachmann G. *et al*., supra note 120, at 70.

particular, mediation clauses are more useful in this type of company since they permit to value disputes from case to case, analyzing the intertwined relationships characterizing close companies.[165]

1.5.3 Corporate Deadlock

Conflicts in close corporations may arise for reasons other than the oppression of minority shareholders caused by the opportunistic behavior of the majority shareholder.[166] These conflicts are likely to arise in deadlock situations. Generally, a company is in a deadlock situation when its decisional process is in a stalemate.[167] Thus, it means that an internal conflict between shareholders and directors prevent them from properly operating the company, causing the latter to be paralyzed. The deadlock usually occurs in two situations that typically arise in close companies.[168] The first situation arises when the members of the board of directors and/or the shareholders are equally divided on a management affair and are unable to take proper management actions.[169] The second situation occurs when a majority in the board of directors controls the management of the corporation, and shareholders, equally divided, are unable to appoint a new board of directors, allowing the current majority to control the corporate management indefinitely.[170]

Additionally, a deadlock may occur even in the case in which shareholders holding the same ownership stake refuse to join together and form a majority, or a veto right is granted to the minority shareholder to protect him/her from the oppressive conduct of the majority.[171] Simply, a deadlock occurs whenever a participant has the power to freeze the other participants to pursue corporate activities.[172]

Due to its particular features, the close corporation is particularly vulnerable to deadlock situations. Typically, close corporations are owned by few investors who also take a management position, and who invest all or most of their wealth in the company. Since no

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[165] Id.
[166] Id. at 77.
[167] Ripken S. K. (2003). The Provisional Director remedy for Corporate Deadlock: A Proposed Model Statute, *Washington and Lee Law Review*, Vol. 60, No. 1, pp. 111-181. Available at: https://ssrn.com/abstract=925938.
[168] McDonald D. K. (1979). Deadlock and Dissolution in the Close Corporation: Has the Sacred Cow Been Butchered?, *Nebraska Law Review*, Vol. 58, pp. 791-825. Available at: https://digitalcommons.unl.edu/nlr/vol58/iss3/8.
[169] Id. at 794.
[170] Id. at 795.
[171] Ripken S. K., supra note 167, at 120.
[172] Id. at 121.

public market is available, dissenting shareholders cannot freely sell their shares and leave the company. Moreover, most shareholders in close corporations are family members or close friends, who have a personal relationship with each other. These personal ties may increase the possibility that conflicts and misunderstandings occur, causing the company gridlock and even its demise.[173] Despite courts provided the dissolution of the company or the buy-out of the shares of the dissenting shareholder as remedies for deadlock situations, close corporation shareholders are reluctant to consider these remedies acceptable.[174] Since they spent considerable money and energy in creating the success of the enterprise, they have no personal interest to dissolve the company or leave it through a buy-out agreement.[175] For this reason, third party remedies are surely more desired by parties who want to preserve the ongoing nature of the company. These remedies involve the intervention of a neutral third party who can be distinguished in: (a) a "custodian" or "temporary receiver", that maintains the operation of the company until an agreement between the parties has been reached; (b) an arbitrator, who resolves the dispute among the shareholders by making a binding decision after having considered the claims of both parties; (c) a mediator, who facilitates the communication and negotiation between the parties to find a mutually acceptable solution; (d) a provisional director, who is vested with the power to vote at boards meetings to break deadlocks, and, at the same time, acts as a mediator to find alternative ways to solve the issues.[176]

However, the use of a third party completely external to the company, especially in the case of a provisional director, raised the concern to what extent the courts may interfere and be involved with the internal business affairs of the company.[177] Even if, by definition, courts should not interfere in the corporation affairs, leaving shareholders with the freedom to take actions under the authority vested in them, the same deadlock situation may be so harmful to affect the other corporate parties to justify a court intervention to resolve the situation.[178] The best solution could be to balance the autonomy of shareholders, whose interests should be primary, with courts intervention keeping it at the minimum that the safeguard of public policy requires.[179]

[173] Id. at 123.
[174] Id. at 124.
[175] Id.
[176] Id. at 125-134.
[177] Id. at 137.
[178] Id. at 141.
[179] Id. at 144.

1.6 Chapter conclusions

The present chapter has identified an overview of the developments that occurred in the European and United States Company Law with regards to the Close Corporation legislation and the consequent definition and recognition of the close company form. A description of the features of the closely held company has been provided, along with the similarities shared with the partnership form without neglecting the differences between the two business forms and the doubts of scholars and academics in accepting the resemblance theory. The chapter continues by comparing the closely held company with the publicly held company to which most of the efforts of early legislators have been addressed. Of particular interest is the description of the different roles shareholders have in close and public companies. While in public companies they are passive investors who simply invest their money to receive a return on investment, in close companies, shareholders are not focused just on the economic part, but rather they invest money and claim an active role in the management of the company. Obviously, minority shareholders are more exposed to majority oppression in the close companies where no market for shares is available.

Therefore, the chapter concludes with a representation of the major problems close companies are subject to and the attempt of legislators to provide mechanisms to reduce them. In particular, it has been described the major risks mainly investors holding the minority stake in the business are likely to face and their consequent exposure to the opportunistic behavior of the controlling shareholder.

CHAPTER 2: CORPORATE GOVERNANCE IN CLOSE AND PUBLIC COMPANIES

Introduction

Corporate governance refers to the systems or rules, relationships, and processes within a company aimed at guaranteeing the proper and efficient management of the company. Corporate governance examines the structure of rights and responsibilities of stakeholders within the company and stakeholders with vested interests in the firm, such as customers, suppliers, community, government.

This chapter is introduced with an understanding of agency problems that arise from the typical relationship between shareholders and managers and within the shareholders themselves. The agency problem occurs whenever the interests of a principal and an agent are not aligned and come into a conflict. The agency problem arises in both public and close companies with a different connotation. While in public companies the agent, represented by the manager, is likely to pursue its interests to the detriment of the principal or shareholders, in close companies the agent is constituted by the majority shareholder who takes actions that mostly have the effect to expropriate the principal, in this case, the minority shareholder. In this context, corporate governance can be used to modify the rules under which the agent behaves, steering it towards the maximization of the principal interest.

After looking at the different definitions that academics and agencies provided, the chapter describes the different corporate governance mechanisms related to the ownership structure that characterized the different countries. The chapter continues with an analysis of the corporate governance framework of the countries under study, namely the U.S. and Italy and it concludes with a description of the internal corporate governance mechanisms used to solve the agency problem and reduce the information asymmetries between the parties.

2.1 The Agency Problem

The Agency Theory stems from the difficulties arising from the typical agency relationship that characterizes the modern corporation. An agency relationship is a contract in which one party (the principal) delegates another person (the agent) to perform certain activities on its behalf.[180] Thus, the agent is supposed to act to maximize the interest of the principal. However, often the principal and the agent have both different interests which do not converge at the same point, and thus, the agent is moved by its interest to act to maximize its welfare.[181] This divergence of interests represents the origin of agency problems. The agency problem occurs whenever the agent acts in its interest to the detriment of the principal's interest. The resulting conflict of interests between the principal and the agent may lead to costly inefficiencies harming the welfare of the former. The authority delegated by the principal to the agent puts the latter in a favorable condition to act opportunistically towards the principal and the company itself. On its side, the principal needs to adopt control and incentive mechanisms trying to align the interests of the agent with its own.

The most common agency relationship in modern corporations is the shareholder-manager relationship. The manager (the agent) is appointed by the shareholder (the principal) to oversee the management of the company, of which the latter is the residual claimant bearing all the risk associated with the incorrect functioning of this type of relationship. In this context, the agency problem derives from the phenomenon of separation of ownership and control that distinguishes the modern corporation.[182] The shareholder provides the capital to the firm and delegates the control to the managers who employ the capital in the business activities.[183] Information asymmetries between the two parties necessarily arise, since managers are more informed on how to allocate capital provided by the shareholder. While shareholders are focused on raising the stock price and on high dividends, on the other hand, managers may be focused on increasing the profits or, at the opposite, they may be lazy or fraudulent.[184] These conflictual objectives of the counterparties may lead managers to make investment decisions not optimal for the welfare of the shareholders, leading to the rise of agency problems.

[180] Jensen M. C., Meckling W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, *Journal of Financial Economics*, Vol. 3, No. 4. Available at: https://ssrn.com/abstract=94043.
[181] Id.
[182] Shleifer A., Vishny R. W., supra note 13, at 740.
[183] Berle A., Means G., supra note 1.
[184] Aguilera R. V., Jackson G. (2003). The Cross-National Diversity of Corporate Governance: Dimensions and Determinants, *Academy of Management Review*, Vol. 28, No. 3, pp. 447-465.

However, the separation of ownership and control is not present in close companies in which the shareholders and the manager are often the same person. Also, in Continental Europe just in few listed companies, the ownership structure is dispersed as in the U.S. In most listed companies the ownership structure is typically concentrated, with one shareholder or a family holding the majority of votes.[185] In these companies, another agency problem between the majority and minority shareholders is likely to arise. The majority shareholders effectively exercise control over the company that allows them to take actions aimed at seizing the extra benefits of the company.[186] As we already discussed, these actions might be detrimental to the minority shareholders. However, minority shareholders may rely on various mechanisms to protect their rights and interests.[187]

The third agency problem lies in the relationship between the corporation (the agent) itself and the other stakeholders (the principal) — customers, creditors, employees — with whom the company contracts with.[188] The risk associated with this agency problem is the possibility that the company behaves opportunistically towards the stakeholders — for example by misleading customers, expropriating creditors, or exploiting workers.[189] This problem is strictly related to the stakeholder theory, according to which the company directors have the duty to balance and maximize the interest of every party involved in the company's business.

In this context, the role of corporate governance is to balance the information asymmetries and mitigate the agency conflicts arising within the company, aligning the interests of the agent and the principal.[190]

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[185] Enriques L., Volpin P. (2007). Corporate Governance Reforms in Continental Europe, *Journal of Economic Perspectives*, Vol. 21, No. 1, pp. 117-140.
[186] Dyck A., Zingales L. (2004). Private Benefits of Control: An International Comparison, *Journal of Finance*, Vol. 59, No. 2, pp. 537-600.
[187] Enriques L. *et al.*, The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies. In Kraakman R., *et al*. (2009). The Anatomy of Corporate Law: A Comparative and Functional Approach. 3rd edition, *Oxford University Press*, p. 80.
[188] Armour J., Hansmann H., Kraakman R., Agency Problems and Legal Strategies in Kraakman R., *et al*. (2009). The Anatomy of Corporate Law: A Comparative and Functional Approach. 3rd edition, *Oxford University Press*, p. 30.
[189] Id. at 30.
[190] Davis J. H., Schoorman F. D. & Donaldson L. (1997). Toward a Stewardship Theory of Management, *The Academy of Management Review*, Vol. 22, No. 1, pp. 20-47.

2.2 Definition of Corporate Governance

The term corporate governance has been the subject of numerous studies in the political and scientific context of the major industrial countries.[191] The financial and accounting scandals of the last years have brought the need to revise the corporate governance practices to offer investors stronger safeguards and increasing obligations and requirements to which directors should comply.[192] Although the term corporate governance has been used for many years, no common definition was developed, and those provided by different scholars and authors differ from each other and are usually ambiguous. Basically, the concept of corporate governance was studied from different perspectives.

Coda defines the corporate governance system as the set of functioning characters of the governance and control bodies in the relationship between them and with the representatives of the property and with the managerial structure.[193] On the other hand, Kose and Senbet take an external perspective stating that "*the corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected*".[194] This definition supports the argument that the company has obligations not only towards its shareholders but, at the same way, to all stakeholders, whose involvement is fundamental for the success of the firm.[195]

Shleifer and Vishny consider the economic interests of the corporate participants in defining corporate governance as the system that "*deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investments*".[196] Similarly, Rajan and Zingales define corporate governance in a finance perspective as "*the complex set of constraints that shape the ex-post bargaining over the quasi-rent generated by a firm*".[197]

The OECD definition covers all the aspects of the corporate governance framework. It states that "*corporate governance involves a set of relationships between a company's management,*

[191] Montefiori C. (2009). La Corporate Governance e gli amministratori indipendenti: Le società quotate a controllo pubblico, 1st edition, *Aracne editrice*, p. 6.
[192] Id.
[193] Id. at 8
[194] Kose J., Senbet L. W. (1997). Corporate Governance and Board Effectiveness, *NYU Working Paper No. FIN-98-045*. Available at: https://ssrn.com/abstract=1297747.
[195] Donaldson T., Preston L. E. (1995). The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications, *The Academy of Management Review*, Vol. 20, No. 1, pp. 65-91. Available at: https://www.jstor.org/stable/258887.
[196] Shleifer A., Vishny R. W, supra note 13, at 737.
[197] Rajan R. G., Zingales L. (1998). Power in a Theory of the Firm, *Quarterly Journal of Economics*, Vol. 113, No. 2, pp. 387-432. Available at: https://www.jstor.org/stable/2586908.

its board, its shareholders and other stakeholders".[198] In this sense, corporate governance has the role to provide the structure through which the corporation objects are set and determine the means of achieving those objectives and monitoring performances.[199] This structure points out the allocation of rights, roles, and responsibilities among the different participants in the company — such as shareholders, the board, managers, and the stakeholders — and specifies the procedures and rules for making decisions on companies affairs.

Despite the difficulties in establishing a commonly accepted and adopted standard definition, corporate governance can be simply identified in a system of principles and rules that provides guidelines for organizing companies internally in a more efficient way, to reduce and manage the conflicting interests between the internal participants and the stakeholders.

2.3 Corporate Governance Systems

An important role in determining the economic performance of the firm is played by corporate governance systems which, through their mechanisms, affect the return on investments of the external finance providers of the firm.[200] To be efficient a corporate governance system must be able to reduce the information asymmetries and ease monitoring for suppliers of finance when they provide the capital to be allocated to the corporation.[201] Corporate governance systems are related to the degree of ownership and control and differ in countries characterized by dispersed ownership — outsider systems — and countries characterized by concentrated ownership or control — insider systems.[202]

The different patterns of ownership and control require different corporate control mechanisms and incentives: although concentrated ownership seems to crate long-term relationship between the company and its investors, the private benefit the owner may receive could cause costly delays in taking the necessary corrective actions; on the other hand, although in a dispersed ownership structure the likelihood of taking prematurely corrective actions is probably higher, the presence of diversified public owners can be more appropriate for high-risk companies that

[198] OECD, G20/OECD Principles of Corporate Governance, *OECD Publishing*, 2015, Paris. Available at: http://dx.doi.org/10.1787/9789264236882-en.
[199] Id. at 9.
[200] Edwards J., Nibler M. (2000). Corporate Governance in Germany: The Role of Banks and Ownership Concentration, *Economic Policy*, Vol. 15, No. 31, pp. 237-267. Available at: https://www.jstor.org/stable/1344697.
[201] Id. at 239.
[202] Maher M., Andersson T. (2000). Corporate Governance: Effects on Firm Performance and Economic Growth, *OECD*. Available at: https://ssrn.com/abstract=218490.

require a large amount of investment capital.[203] Despite both systems have developed from different regulatory, institutional, and political environments, they share an internal consistent governance system and a unique blend of corporate control.[204]

2.3.1 Outsider or Anglo-Saxon Model

Outsider systems or market systems are typical of common law countries —the United States, United Kingdom, Canada, and Australia— characterized by relatively widely dispersed ownership and control.[205] This model, also known as the Anglo-Saxon model, is founded on the notion of market capitalism, according to which the ownership stake and decentralized market can operate in a self-controlled and balanced manner.[206] Thus, in Anglo-American countries (U.S., U.K., Australia, and Canada) corporations have generally similar systems of corporate governance. Outsider systems are characterized by the following features: (1) dispersed equity ownership with large institutional holdings; (2) primacy of shareholders' interests; (3) broad delegation of management power; (4) strong emphasis on the protection of minority shareholders; (5) strict disclosure requirements.[207]

The dispersed equity ownership feature emphasizes the fact that, in these countries, companies rarely have a controlling shareholder. Rather than investing in just one company, shareholders prefer to invest in different companies to diversify the risk. Moreover, in these countries, a typical phenomenon is the increased ownership stake owned by institutional investors — such as mutual funds, pension funds, and insurance companies.[208] For example, in the U.S. and U.K., the largest institutional investors on average hold more than 30% of the capital stake in public listed companies.[209] As well as individual investors, institutional investors typically have no interest in running the business, rather they work with a well-diversified portfolio of businesses in which they invest their money intending to maximize their return on investments.[210] Since in

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[203] Franks J., Mayer C. (1997). Corporate Ownership and Control in the U.K., Germany, and France, *Journal of Applied Corporate Finance*, Vol. 9, pp. 30-45.
[204] Babic V. (2003). Corporate Governance Problems in Transition Economies, *Winston-Salem: Wake Forest University*.
[205] OECD (2019). OECD Corporate Governance Factbook 2019, p. 19. Available at: www.oecd.org/corporate/corporate-governance-factbook.htm
[206] Cernat L. (2004). The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or still the century of diversity? *Journal of European Public Policy*, Vol. 11, No. 1, pp. 147-166.
[207] Nestor S., Thompson J. K. (2001). Corporate Governance Patterns in OECD Economies: is Convergence under way? Available at: https://www.researchgate.net/publication/241635212.
[208] Id. at 5.
[209] De La Cruz A., Medina A., Tang Y. (2019). Owners of the World's Listed Companies, *OECD Capital Market Series*, Paris 2019. Available at: http://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm.
[210] Nestor S., Thompson J. K., supra note 207, at 5.

this system ownership is widely spread and shareholders are not interested in running the company, the power to manage the company is vested in the management board. Shareholders have no incentives to monitor the conduct of directors (free-riding problem)[211], who have relative freedom to run the company as they see fit. However, this does not mean that directors are not accountable to the shareholders' interests. For this reason, outsider systems are coupled with a series of external corporate governance mechanisms deemed at reducing the managers' opportunistic behavior.

The outsider model strongly emphasizes the protection of shareholders' rights, in particular those of the minority shareholders, which is related to an active stock market.[212] The absence of concentrated ownership and the presence of an active market reduce the need for active corporate governance.[213] Since unhappy minority shareholders may sell their ownership position in the securities market any time they want, intrusive corporate governance mechanisms protecting the minority rights are not necessary. These systems also promote a more reliable and adequate distribution of information that enables investors to make more informed investment decisions.[214] An example may be the elaboration of rules that prevent a group of shareholders from communicating and sharing information among themselves without making the information available to all shareholders.[215]

Thus, the model supports the use of public capital markets in influencing the behavior of the parties.[216] Whenever managers fail to maximize shareholders' value and share price falls, the company is exposed to take-over bids and inefficient managers are at risk to be removed.[217] The public capital market works as a regulatory system that incentives managers to act in the interest of shareholders.

If, on one hand, outsider systems incentive shareholders investments in a diversified portfolio and reduce the room for shareholders conflicts thank the high dispersion of capital, on the other

[211] The free ride problem denotes a situation in which individual benefits from something, without contributing to the payment of it. Shareholders in a widely owned corporation have no incentive to monitor the conduct of directors and managers because of the free-ride problem. If a shareholder actively monitors the directors' activities, the benefit received by an improved directors' performance will be shared with all the other shareholders, while the monitoring cost will be bear only by the shareholder who took the monitoring role. For a deeper point of view, see Fluck Z., Khanna N. (2007). Corporate Boards, Executive Compensation and the Free-Rider Problem of Monitoring. Available at: https://www.researchgate.net/publication/265144097.
[212] Maher M., Andersson T., supra note 202, at 17.
[213] Id.
[214] Id.
[215] Id. at 18.
[216] Id.
[217] Id.

side these systems have been criticized for their short-termism in delivering the results to shareholders that may be harmful to the success of the company and creates agency problems between parties within the company.[218]

2.3.2 Insider or Continental Model

Insider corporate governance systems adopted by Continental European countries — except the U.K. — and Japan, are characterized by concentrated ownership and long-term stable relationships between participants within the company.[219] The majority or almost majority of shares are held by a single investor or a group of investors, who effectively exercise control over the company. Group of insiders is typically individuals, family members, or banks and holding companies.[220] The existence of strict ties among insiders facilitate the communication among them and promote the jointly and close monitoring of the board activities.[221] As well as outsider systems the control of the business activities lies in the hands of management, however, differently from market systems, in insider systems controlling shareholders and managers communicate intensely. Given their large investment in the company, majority shareholders have the interest to monitor closely the activity of the management board and have the power to influence the election of the management. Thus, they may use their power to force managers to direct the business activities towards their interests.

Conversely to outsider systems that emphasize the primacy of shareholders' interests, the Continental model focuses not only on the interests of shareholders, but also on those of all stakeholders — managers, employees, customers, suppliers, and community.[222] According to this view, stakeholders exercise their right to participate in the corporate decisions through their membership in the supervisory board — typical of two-tier systems.[223]

In insider systems, the protection of minority shareholders' rights is weaker than in market systems. This is because insider systems are more tolerant of a group of shareholders who act jointly to control the management while excluding the minority part.[224]

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[218] Id. at 18-22.
[219] Nestor S., Thompson J. K., supra note 207, at 9.
[220] Id.
[221] Id.
[222] Giurca Vasilescu L. (2008). Corporate Governance in Developing and Emerging Countries: the case of Romania, *Munich Personal RePEc Archive*. Available at: https://mpra.ub.uni-muenchen.de/11053/.
[223] Schilling F. (2001). Corporate Governance in Germany: the move to shareholder value, *Corporate Governance: An International Review*, Vol. 9, No. 3, pp. 148-151.
[224] Nestor S., Thompson J. K., supra note 207, at 9.

Differently from outsider systems, the ownership structures of insider systems companies are characterized by less presence of institutional investors. The stake of ownership owned by pension funds, mutual funds, and insurance companies is not comparable to those owned in Anglo-Saxon countries, where they emerged as the most active and largest class of investors.[225] The Insider model is concentrated on the banking system. Banks seek to create complex and long-term relationships with corporate clients.[226] Rather than stressing the need for public disclosure as in market systems, the banking system interacts with its clients through insider communication.[227] Given the lack of sophisticated institutional investors and the prominent figure of the bank in the financing role, corporations have a narrow range of financial assets available compared to corporations in market-based countries.[228]

The Continental model has the powerful advantage of reducing the agency costs between majority shareholders and managers. Since they invest most of their wealth into the company, they have the incentive of monitoring closely the management and influencing it to act in their interest. Thus, the intensive communication between the two parties ensures that management performs long-term investments, without worrying about stock prices level and threats of a takeover. However, on the other hand, the control exercised by controlling shareholders over the board gives rise to agency problems between majority and minority shareholders. The controlling shareholder may have the incentive to extra private benefits by colluding with the management at the expense of minority shareholders.[229] For example, Blockholders may force the management to divert resources to other companies they completely own, damaging in this way the minority shareholders.[230]

In insider systems, the focus of corporate governance and regulations is shifted from reducing managers' opportunism directing their effort to shareholder maximization value, to the protection of minority shareholders from the interest of the controlling shareholder to extract its private benefits to the detriment of those of minority shareholders.[231]

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[225] Id.
[226] Id. at 10.
[227] Id.
[228] Id.
[229] Maher M., Andersson T., supra note 202, at 24.
[230] Becht M. (1997). Strong Blockholders, Weak Owners and the Need for European Mandatory Disclosure, in European Corporate Governance Network, The Separation of Ownership and Control: A Survey of 7 European Countries. Preliminary Report to the European Commission, Brussels 1997.
[231] Cenzi Venezze F. (2013). The Costs of Control-Enhancing Mechanisms: How Regulatory Dualism Can Create Value in the Privatization of State-Owned Firms in Europe, *Harvard Law School*, p. 1. Available at: http://nrs.harvard.edu/urn-3:HUL.InstRepos:10985156

2.3.3 Control-Enhancing Mechanisms

As stated above, in Continental European listed companies, where the presence of a controlling shareholder is common, the most important corporate governance concern is the protection of minority shareholders from the controlling shareholder's actions aimed at extracting its private benefit at the expense of minority shareholders. This problem is particularly exacerbated in situations where the voting rights of controlling shareholders exceed their cash-flow rights.[232] This gap is likely to affect the relationship between controlling shareholders and minority shareholders in two ways:[233] first, it deviates the interests of insiders from the maximization of shareholders' value, and second, it prevents the threat of hostile takeovers due to the presence of a controlling stake. The separation of voting rights and cash-flow rights can be reached through the use of control-enhancing mechanisms (CEMs).

The most common ad effective CEMs are the issuance of multiple voting rights shares and the use of pyramidal ownership structures. Multiple voting rights shares represent a deviation from the one-share-one-vote rule, and they involve the allocation of different voting power to the owners of different classes of shares.[234] On the other hand, the pyramidal ownership structure refers to the situation where a controlling shareholder or group directly controls a company, which in turn has majority participation in another company, which itself controls a third company, and so forth.[235] Through the use of pyramidal structure, the large shareholder is able to maintain control of even large listed companies situated at the bottom of the structure without investing the amount of money that would be necessary to obtain the same amount of voting power in the companies.[236]

The two CEMs are differently adopted depending on the country concerned. While multiple voting rights shares are commonly used in the United States, on the other hand, pyramidal structures are widespread in European countries such as Greece, Italy, Spain, and Portugal. Despite this distinction in countries areas, empirical research indicates that pyramidal structures are more common than dual-class shares in absolute terms.[237]

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[232] Id.
[233] Id. at 4.
[234] Id. at 10.
[235] Almeida H. V., Wolfenzon D. (2006). A Theory of Pyramidal Ownership and Family Business Groups, *The Journal of Finance*, Vol. 61, No. 6, pp. 2637-2680. Available at: https://www.jstor.org/stable/4123441.
[236] Cenzi Venezze F., supra note 231, at 11.
[237] La Porta R. *et al* (1999). Corporate Ownership around the world, *Journal of Finance*, Vol.54, pp. 471-517.

The United States is characterized by a rare presence of pyramidal ownership structures in listed companies.[238] According to Randal Morck, this is principally due to the introduction of the intercompany dividend taxation in 1930, which has rendered pyramidal structures more costly for controlling investors.[239] In this sense, U.S. listed companies are more likely to use dual-class shares to separate voting rights from cash-flow rights.[240] Gompers *et al*. found that 6% of U.S. listed companies — 8% of market capitalization — have adopted dual-class shares.[241]

However, differently from the United States, Greece, Spain, Portugal, and Italy have adopted pyramidal structures as a favorite CEM. For instance, in Italy, despite the attempts of the legislator to reduce the adoption of pyramidal ownership structures, 12% of listed companies, representing 36% of market capitalization, are controlled by pyramidal groups.[242]

Even if pyramids structures and multiple voting rights shares involve different mechanisms to separate voting rights from cash-flow rights, they both are likely to exacerbate agency problems.[243] They are negatively perceived by institutional investors who expect a discount on the price paid to purchase shares in companies where these mechanisms are present. For example, in the United States companies are not allowed to issue multiple voting rights shares after the IPO, leading outsider investors to apply a discount on the price paid to purchase the shares because of the presence of a sub-optimal ownership structure of the company.[244] In the same way, although pyramid structures can be adopted even after the IPO, investors can apply the discount on the likelihood that the pyramid structure will be used in the next future.[245]

2.4 Country-Specific Corporate Governance Framework

Once having identified and described the main two corporate governance systems and the ownership structure that distinguish the corporate entities within both systems, we provide a brief analysis of the corporate governance frameworks and ownership structures of the two

[238] Id. at 510.
[239] Morck R. (2004). How to Eliminate Pyramidal Business Groups-The Double Taxation of Inter-Corporate Dividends and Other Incisive Uses of Tax Policy, *NBER Working Paper No. w10944*. Available at: https://ssrn.com/abstract=629586.
[240] Cenzi Venezze F., supra note 231, at 12.
[241] Gompers P. A., Ishii J., Metrick A. (2010). Extreme Governance: An Analysis of Dual-Class Firms in the United States, *The Review of Financial Studies*, Vol. 23, pp. 1051-1088.
[242] CONSOB, Report on Corporate Governance of Italian Listed Companies 2019. Available at: http://www.consob.it/web/consob-and-its-activities/abs-rcg/-/asset_publisher/K2uhgZAhU021/content/2019-report-on-corporate-governance/718268.
[243] Cenzi Venezze F., supra note 231, at 27.
[244] Id. at 29.
[245] Id. at 30.

countries under our study, namely Italy and the U.S. This description is useful to understand what the different features of the corporate governance and ownership structure are and how these elements affect the methods applied in both countries to prevent the controlling shareholder's extraction of private benefits at the expense of minority shareholders.

2.4.1 Italian Framework

The Italian corporate governance system may be classified as Latin Model, although it owns particular features that do not fit perfectly into the international standard models.[246] This system, along with the German Model, belongs to the insider or relationship-based system that characterized most European countries and which is opposed to the Anglo-Saxon models centered on market rules.[247] The Latin system is more flexible than the German system since shareholders are free to decide to structure the board of directors in two ways: one board as in the Anglo-Saxon model, or two boards like the German model.[248]

Generally, as in the Insider model, Italian listed and unlisted companies are owned by few shareholders, who are often linked by familiar or friendship ties and are able to exert their control over the corporation.[249] In fact, according to the report on corporate governance published by the CONSOB at the end of 2018 more than half of the Italian listed companies (53%) are controlled by a shareholder owning a stake higher than half of the capital, 25% are weakly controlled with a stake lower than the 50%, and 10% are owned by a coalition of shareholders. Only 5% of listed firms — representing 20.5% of market capitalization — are widely held. The presence of institutional investors is not yet diffused (27% of listed companies) but is growing with a prevalence of foreign institutional investors upon the Italian ones. Within institutional investors, the presence of banks and insurance companies (mostly Italian) is declining at the expense of the so-called "active investors" such as private equity, venture capital company, and sovereign funds. There is a decline in the adoption of pyramid structure and issuance of preferred shares, possibly due to an increase in market pressure.[250]

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[246] Melis A. (2000). Corporate Governance in Italy, *Corporate Governance an International Review*, Vol.8, No. 4, pp. 347-355. Available at: https://onlinelibrary.wiley.com/doi/pdf/10.1111/1467-8683.00213.
[247] Id. at 347.
[248] Alam *et al*. (2019). An Overview of Corporate Governance Models in Financial Institutions, *International Journal of Management and Sustainability*, Vol. 8, No. 4, pp. 181-195.
[249] Segato L. (2006). A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat as a Case Study, *Northwestern Journal of International Law & Business*, Vol. 26, pp. 373-446. Available at: http://scholarlycommons.law.northwestern.edu/njilb.
[250] CONSOB, Report on Corporate Governance of Italian Listed Companies 2019.

The Company Law is contained in articles 2060 to 2642 of the Civil Code, which provisions regulate all the matters related to business organization, from the forms of business to the role and relationship between shareholders, the board of directors, and the board of auditors.[251] The Consolidated Law on Finance (T.U.F.) provides a legal framework for financial markets. Companies may adhere to the Corporate Governance Code, issued by the Corporate Governance Committee, which comprehends the principles and suggested practices of corporate governance.[252] Like in other jurisdictions, in Italy companies may decide to issue preferred shares, which are shares with limited voting rights for a value not higher than half of the capital. However, probably due to strict legal constraints and insufficient investor protection, this instrument has not been so used by investors.[253]

Shareholders in Italian close and public companies elect a Board of Directors (BoDs), which has the role to govern the business, and a Board of Auditors which, with an audit role, simply supervises the conduct of directors. Although in publicly-held corporations the Board of Directors retains the exclusive authority to manage — or appoint the management — of the company's business,[254] in privately-held companies can be established a rule that vests shareholders with the authority to take management role and decisions. All the members of the BoDs are elected by the shareholders, with the partial exception that vacancies in the board due to resignation or other causes may be temporarily filled by the board members.[255] The board is elected for a maximum period of three years, and the members shall be eligible for re-election unless otherwise provided by statute, and they can be removed at any time, but if the removal occurs without cause, dismissed directors are entitled to compensation for damage.[256] In listed companies, article 147-ter of the Consolidated Law on Finance provides the mandatory representation of minority shareholders in the BoDs. The statute provides that the members of the BoDs must be elected on the basis of the list of candidates and defines the minimum participation share required for their presentation, at an extent not above a fortieth of the share capital. The statute also provides that at list one BoDs' member shall be elected from the

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[251] Stanghellini L. (1995). Corporate Governance in Italy: Strong Owners, Faithful Managers. An Assessment and a Proposal for Reform, *Indiana International & Comparative Law Review*, Vol. 6, No. 1, pp. 91-185. Available at: https://journals.iupui.edu/index.php/iiclr/article/view/17591.

[252] Corporate Governance Committee, Corporate Governance Code, 2020. Available at: https://www.borsaitaliana.it/comitato-corporate-governance/codice/codice.en.htm.

[253] Bianchi M., Bianco M. (2006). Italian Corporate Governance in the last 15 years: from pyramids to coalitions? *European Corporate Governance Institute*. Available at: http://ssrn.com/abstract_id=952147.

[254] Civil Code art. 2380-bis Italy.

[255] Civil Code art. 2386(1) Italy. [When vacancies involve the majority of the board of directors' members, incumbent directors cannot fill vacancies, but instead, they must call a shareholders meeting to replace the missing members. Civil Code art. 2386(2)]

[256] Civil Code art. 2383 (2)(3) Italy.

minority list that obtained the largest number of votes and is not linked in any way with the shareholders who have submitted or voted for the list which came in first by number of votes.[257] As regards the compensation of directors and managers, companies should follow the general criteria of corporate governance in designing the compensation plan, with the recommendation to adopt long-term incentive mechanisms — like stock option plans — to align the interests of the board with those of shareholders.

The Board of Auditors or Supervisory Board (*Collegio sindacale)* is composed of independent auditors entrusted by shareholders with the supervision of the directors.[258] This board ensures compliance with the law and the Articles of Association, observance of the principles of good administration, the adequacy of the organizational, administrative, and accounting structure, and its proper functioning.[259]As provided for the BoDs the mandate of the Board of Auditors is a maximum of three years, and the members can be dismissed only for cause.[260] Shareholders directly appoint the three or five members of the Board of Auditors, of which among them at least one member should be an auditor recorded in the proper legal register; in the lack of this registration, the other members should be selected among those registered in professional registers or among university professors in the law or economic field.[261] The condition required to be an auditor is independence. Professionals who are linked in any way to shareholders or to the company itself, cannot be elected as auditors and are disqualified from the office.[262] As in the Board of Directors, in listed companies, one member of the Board of Auditors shall be elected by the minority shareholders who are not linked with the shareholders who submitted or voted the list which came in first by number of votes.[263]

For listed companies, the external audit is mandatory and has the aim to periodically audit the financial statements and check the accounts and records of the company. The auditing activity should be performed by an external legal auditor recorder in the proper register or by an audit firm.[264] In the limited liability company (*s.r.l.*), the obligation to appoint an external auditor arises only when the company is required to draft consolidated financial statements or controls

[257] Consolidated Law on Finance (TUF), art. 147-ter.
[258] Stanghellini L., supra note 251, at 110.
[259] Consolidated Law on Finance (TUF), art. 149(1)
[260] Civil Code art. 2400(1)(2) Italy.
[261] Civil Code art. 2397(1)(2) Italy.
[262] Civil Code art. 2399 Italy.
[263] Consolidated Law on Finance (TUF), art. 148.
[264] Civil Code art. 2409-bis Italy.

a company subject to statutory audit, or when it has exceeded for two consecutive financial years two of three thresholds specified by the article 2435-bis Civil Code.[265]

Therefore, the prevailing ownership structure of Italian corporations is marked by the presence of a majority shareholder or "blockholder" who take the control of the company and is able to monitor effectively the management actions.[266] As we said before if it is true that this structure reduces the agency problem between shareholders and managers, on the other hand, it increases the possibility that an agency problem between the majority and minority shareholder arises.[267] In this sense, the Italian company law has probably contributed excessively to the certainty of control at the expense of shareholders' protection.[268]

2.4.2 The U.S.A. Framework

As an outsider country, the ownership structure of public companies in the United States is usually widely spread among a large number of shareholders. The United States is traditionally portrayed as a political economy having most companies with dispersed ownership structures and the presence of private and institutional investors, and few listed companies having large blockholders. However, since the financial crisis, a powerful ongoing trend is changing the ownership structure of listed firms in the US.[269]

Empirical evidence has shown that few listed companies can be considered widely held, while most companies present multiple blockholders, each owning more than a 5% stake.[270] In contrast to Italy and European countries in general, United States public companies are characterized by high participation of institutional investors in the ownership structure. At the end of 2017, institutional investors held around 72% of the United States stock market value, of which 61% of these holdings were held by US institutions.[271] Moreover, US institutional

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[265] Civil Code art. 2477 Italy.
[266] Segato L., supra note 249, at 379.
[267] Id.
[268] Bianchi M., Bianco M., Enriques L., Pyramidal groups and separation between ownership and control in Italy, in Barca F., Becht M. (2002). The Control of Corporate Europe, *Oxford University Press*, pp. 154-186.
[269] Fichtner J. (2019). The Rise of Institutional Investors. Available at: https://www.researchgate.net/publication/334268680_The_Rise_of_Institutional_Investors.
[270] Rossetto S., Staglianò R. (2016). Ownership Concentration and Firm Risk. Evidence from the US, *3rd Law and Economic Policy International Workshop Recent Developments in Corporate Governance*, ESSEC, Paris 2016.
[271] De La Cruz A., Medina A., Tang Y., supra note 209, at 22.

investors account for significant holdings in foreign markets, holding 22% and 17% in 2017 of the public equity in the United Kingdom and Canada, respectively.[272]

In the United States, corporate law is regulated at the State level, with each state owning its law. However, since the US has allowed regulatory competition, most corporations decide to incorporate in Delaware to enjoy the low corporate taxation. Thus, the Delaware Code has become the reference point for the United States corporate law. Securities law is regulated by the Securities Act of 1993 and the Securities Exchange Act of 1934. The corporate governance law is regulated by different legal regimes, including mainly State law and federal statutory rules, and by certain rules promulgated by the Securities and Exchange Commission (SEC).[273] Besides, stock exchanges, such as NASDAQ and NYSE impose certain mandatory requirements on a company listed in such exchanges that must be disclosed in their annual report. Like Italy, United States allows corporations to issue different classes of shares, shares with limited or no voting powers, on condition that they are stated in the certificate of incorporation or of any amendment thereto, or in the resolution providing for the issue of such shares adopted by the BoDs.[274]

Like in the other Common Law countries, in the United States the Board of Directors is structured according to the one-tier system. Differently from two-tier systems, the management and control of the company are performed by one governing body, without the presence of a Supervisory Board, whose function is instead performed by a committee formed within the Board itself. Directors are elected by shareholders at the annual general meeting for a one-year term unless the company adopts a staggered board.[275] Under Delaware law, the default rule for the election of the board is plurality voting unless companies provide for cumulative voting.[276] The director need not be a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe.[277] Shareholders may remove directors with or without cause unless the articles of incorporation provide that directors can be removed only for cause, or if cumulative voting is authorized, the director cannot be removed if the number of votes sufficient to elect him under cumulative voting is voted against the removal.[278] Any vacancies occurring in the BoDs may be filled by shareholders or by the board of directors unless the articles of

[272] Id. at 22.
[273] OECD, supra note 205, at 31.
[274] DEL. CODE ANN. tit. 8, §151(a), United States (1953).
[275] MODEL BUS. CORP. ACT ANN. § 8.03, United States (4th ed. 2008).
[276] OECD, supra note 205, at 124.
[277] MODEL BUS. CORP. ACT ANN. § 8.02.
[278] Id. § 8.08.

incorporation provide otherwise.[279] The quorum required for board of directors' resolutions is the majority of the votes cast by directors unless the articles of incorporation provide for a different quorum that, however, cannot be lower than one-third of the number of directors.[280] Unlike Italian jurisdiction, the United States corporate does not provide for a mandatory representation of minority shareholders in listed companies. The United States does not provide for obligations concerning directors' remuneration, giving the board of directors the duty to fix the compensation of directors unless the articles of incorporation or bylaws provide otherwise.[281]

As in Italy, the law provides for the mandatory audit of the company's annual financial statements by an external audit firm hired by the company's auditing committee. The external auditors are independent professionals who examine the company's financial statements, accounting books, and transaction records and prepare a report containing an opinion on the financial statements to be filed with the U.S. Securities and Exchange Commission (SEC). Private companies are not required to have their financial statements audited. Although no mandatory audit is provided, some private companies undergo an independent audit to satisfy lenders or shareholders.

In conclusion, the uncommon presence of a blockholder in the ownership structure of US companies reduces the likelihood of controlling shareholders measures that expropriate the minority shareholders to extract benefits for them. Therefore, especially in a legal framework in which controlling shareholders monitoring is not available, the use of incentives like performance-related compensations, constitute a helpful tool to align the interests of the management body with those of shareholders, thus reducing the likelihood that agency problems between the two parties arise.

2.5 Corporate Governance Mechanisms

As mentioned above, the organization of the ownership and control in both public and close companies give rise to agency problems representing an obstacle to the proper functioning of the company. Corporate governance provides a series of mechanisms designed to reduce agency costs and solve corporate agency problems aligning shareholders' and managers' interests. Corporate governance mechanisms can be divided into two categories: internal and external

[279] Id. § 8.10.
[280] Id. § 8.24.
[281] Id. § 8.11.

mechanisms.[282] External mechanisms comprehend market-based techniques that are external to the management of the company designed to reinforce the internal governance structure of the company.[283] On the other hand, internal mechanisms derive from the nexus of contracts among participants in the company.[284]

Undoubtedly close companies adopt different external and internal corporate governance mechanisms. From their choice of the organizational forms to adopt, they implicitly define and determine the internal corporate governance mechanisms. For example, in certain cases, the chosen business form allows companies for a corporate governance structure in which the owners take control of the firm without the board, or shareholders may opt for a company of a certain size to benefit from the two-tiered system.[285] The internal mechanisms, like the ownership, also depend on the source of finance close companies obtain. Companies associated with high risk are rarely able to obtain funding from the banks, but at the same time, they attract private equity investors who usually take a management role in the company and, more in general, implement respect, integrity, transparency, and confidentiality within the company.[286]

The building of trust and an enhanced reputation for private equity investors is an example of an effective external corporate governance mechanism employed by close companies. On the other hand, the market for corporate control is an effective corporate governance external mechanism for publicly held companies. The threat of hostile takeover incentives the management to forego actions aimed at increasing their wealth that could be detrimental for the company.[287]

The internal mechanisms are constituted by the board of directors and audit committee and their characteristics, such as board size, board composition, board diversity, and audit committee's independence.[288] Thus, adopting better corporate governance internal practices, such as an

[282] Weir C., Laing D., McKnight P. J. (2003). Internal and External Governance Mechanisms: Their Impact on the Performance of Large UK Public Companies, *Journal of Business Finance & Accounting*, Vol. 29, No. 5-6, pp. 579-611.
[283] OECD (2006). Corporate Governance of Non-Listed Companies in Emerging Markets, at 10.
[284] Id. at 9.
[285] Id.
[286] Id. at 12
[287] Id. at 10.
[288] Mustafa A.S. *et al*. (2018). Board diversity, audit committee characteristics and audit quality: The moderating role of control-ownership wedge, *Business and Economic Horizons*, Vol. 14, No. 3, pp. 587-614.

enhanced board of directors and audit committees, improves the monitoring of the management and reduce the asymmetry problems that result in a better performance of the company.[289]

Therefore, understanding the internal mechanisms of corporate governance is fundamental to solve the agency problem and improve the firm performance and value. In the following part, we analyze the aforementioned features that have a greater influence on the quality of the board of directors and audit committee by reviewing the large literature that studied the relationship between these characteristics and the firm performance.

2.5.1 Board Size

The Board of directors is considered an important internal corporate governance mechanism for aligning the interests of the management and all stakeholders to those of the company and shareholders specifically.[290] According to Zahra and Pearce, the board has the important role to select and replace the CEO, who represents the interest of shareholders and provides counsel to the top management, and monitor managers' actions and company performance.[291] Thus, through these activities, the board may improve the company's performance.

A large portion of the academic research on corporate governance has focused on studying the relation between board size and corporate performance. Most of these studies argue the existence of a negative association between the two variables.[292] Yermack sustains that board size is negatively related to firm value, since companies with large board usually use their assets less efficiently, resulting in lower profits.[293] Similarly, Hermalin and Weisbach state that the board size is negatively associated with the company's financial performance and quality of the decision-making process.[294] Lipton and Lorsch argue that a small board size — eight or nine members with at least two independent directors — is ideal in monitoring activities because CEO cannot easily exert his influence over the board, and thus results in better corporate

[289] Aldamen *et al*. (2012). Audit committee characteristics and firm performance during the global financial crisis, *Accounting and Finance*, Vol. 52, pp. 971-1000.
[290] Sanda A., Garba T. & Mikailu A. S. (2008). Board Independence and Firm Financial Performance: Evidence from Nigeria, African Economic Research Consortium, Nairobi, AERC Research paper 213, pp. 1-35.
[291] Zahra S.A., Pearce J.A. (1989). Board of Directors and Corporate Financial Performance: A Review and Integrative Model, *Journal of Management*, Vol. 15, No. 2, pp. 291-334.
[292] Isik O., Ince A.R. (2016). Board Size, Board Composition and Performance: An Investigation on Turkish Banks, *International Business Research*, Vol. 9, No. 2, pp. 74-84.
[293] Yermack D. (1996). Higher Market Valuation of Companies with a Small Board of Directors, *Journal of Financial Economics*, Vol. 40, No. 2, pp. 185-211.
[294] Hermalin B., & Weisbach M. (2003). Boards of Directors as an Endogenously-Determined Institution: A Survey of the Economic Literature, *Economic Policy Review*, Vol. 9, No. 1, pp. 7-26. Available at: https://ssrn.com/abstract=794804.

performance.[295] Similarly, Jensen sustains the effectiveness of small board sizes — seven or eight members — in improving the firm performance.[296] Forbes and Milliken demonstrate that in large boards is difficult to coordinate the contribution of the members, and the potential for free riding is higher.[297]

Conversely, the smaller part of the studies emphasizes a positive relation between board size and firm performance. According to Zahra and Pearce, some studies found that large boards composed of directors with diverse educational and industrial backgrounds improve the quality of the decision-making and make the CEO domination of the board harder to happen.[298] Even Dalton and Dalton argue that large boards increase the spread of advice and counsel from the members to the CEO and executive and promote the diversity of the board in terms of skills, experience, age, gender, and race.[299] A part of the researchers studied the relationship between board size and the capital structure of the company. Berger *et al*. found that large board size creates pressure on the board to make managers pursue lower leverage to increase company performance.[300] Anderson *et al.* demonstrate that in firms with large boards the cost of debt is lower because this board size may increase the level of managerial monitoring and improve the financial accounting process.[301]

To summarize, supporters of small board size emphasize the fact that smaller boards may improve the quality of the decision-making process and improve the performance of the company. A board composed of 7-9 members is the optimal choice for preventing CEO to control the board and reducing the agency costs coming from free-riding directors. On the other hand, some scholars support large boards in enhancing the quality of the decision-making through the promotion of diversity. Moreover, Large boards seem to reduce the leverage and cost of debt, leading to better firm performance.

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[295] Lipton M., Lorsch J. W. (1992). A Modest Proposal for Improved Corporate Governance, *The Business Lawyer*, Vol. 48, No. 1, pp. 59-77. Available at: https://www.jstor.org/stable/40687360.
[296] Jensen M. C. (1993). The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, *Journal of Finance*, Vol. 48, pp. 831-880.
[297] Forbes D. P., Milliken F. J. (1999). Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups, *The Academy of Management Review*, Vol. 24, No. 3, pp. 489-505. Available at: https://www.jstor.org/stable/259138.
[298] Zahra S. A., Pearce J. A., supra note 291, at 311.
[299] Dalton C. M., Dalton D. R. (2005). Board of Directors: Utilizing Empirical Evidence in Developing Practical Prescriptions, *British Journal of Management*, Vol. 16, pp. 91-97.
[300] Berger P. G., Ofek E., Yermack D. L. (1997). Managerial Entrenchment and Capital Structure Decisions, *The Journal of Finance*, Vol. 52, No. 4, pp. 1411-1438.
[301] Anderson R. C., Mansi S., Reeb D. M. (2004). Board Characteristics, Accounting Report Integrity, and the Cost of Debt, *Journal of Accounting & Economics*, Vol. 37, No. 3, pp. 315-342.

2.5.2 Board Composition

Empirical research on the Board of Directors has highlighted that the composition of the board has a direct effect on the company's performance. The composition of the board generally indicates the proportion of inside and outside directors within the board. Outside directors are also considered independent directors or non-executive directors.[302] The presence of independent directors plays an important role in the board performance.[303] Outside directors who are independent and with no interests common with the managers, seem to monitor the management more effectively.[304] Since the CEO has less power to influence independent directors rather than inside directors, a high portion of outside directors on the board may positively affect the performance of the firm.[305]

According to this perspective, appointing more outside directors may improve the independence and the effectiveness of the board, and thus, the performance of the firm.[306] While insider directors have a good knowledge of the internal operations of the company, outsider directors, as experts in capital markets or corporate law, offer complementary knowledge to support insider directors in dealing with specialized decision problems.[307] Wan and Ong argue that outsider directors are more objective in their deliberation and are more willing to consider diverse group ideas in making their decisions. Also, they believe that outsiders bring more skills, knowledge, and diverse perspectives because of their provenance from different backgrounds and organizations.[308]

Of the same opinion is the European Commission that specifically believes that the board composition is fundamental for the company's success thanks to the role of non-executive

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[302] The definition of independence for independent directors varies across countries, particularly with regard to maximum tenure and independence from shareholders. The International Organization of Securities Commissions (IOSCO) identify a series of criteria for a director to be independent: 1) not to be a member, or an immediate family member of a member, of the management of the company; 2) not to be an employee of the company or a company belonging to the group; 3) not to receive compensation from the company or the group other than directorship fees; 4) not to have material business relations with the company or the group; 5) not to have been an external auditor of the company or a company in the group; 6) not to exceed the maximum tenure as a board member; 7) not to be or represent a significant shareholder. See IOSCO (2007). Board Independence of Listed Companies, Final Report, Technical Committee of the International Organization of Securities Commissions in consultation with the OECD.
Available at: www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf.

[303] Zahra S. A., Pearce J. A., supra note 291, at 311.

[304] Hermalin B., & Weisbach M., supra note 294, at 12.

[305] Isik O., Ince A.R., supra note 292, at 75.

[306] Fama E. F., & Jensen M. (1983). Separation of ownership and control, *Journal of Law and Economics*, Vol. 26, pp. 301-325.

[307] Id. at 314.

[308] Wan D., Ong C. H. (2005). Board Structure, Process and Performance: evidence from public-listed companies in Singapore, *Blackwell Publishing Ltd*, Vol. 13, No. 2, pp. 277-290.

directors or supervisory boards in overseeing the activity of executive directors or the management board.[309]

The OECD Principles of Corporate Governance believe that independent directors are likely to contribute significantly to corporate decision-making by bringing an objective view to the evaluation of the performance of the board and management.[310] In this sense, a sufficient number of independent directors should be assigned to the boards where an independent judgment to solve potential conflicts of interest is required.[311] Since non-executive directors are charged with the role to assure the integrity of financial and non-financial reporting, their presence can guarantee market participants that their interests are preserved.[312]

It seems that the company performance is likely to improve with the right balance of insider and outsider directors. The role of non-executive directors has been identified in preventing the undue exercise of power by executive directors, safeguard shareholders' interests in board decision making, ensuring competitive performance.[313] Thus, outsider directors may be found in a double position of holding management agents to account, and at the same time of contributing to strategic decision making.[314]

2.5.3 Board diversity

As we saw before, some scholars promote the relation between board diversity and firm performance. A board with a well-diversified membership in terms of race, gender, age, experience, skills, provides a wide range of counsel and advice the CEO may benefit from to improve the company decision-making. A large variety of studies show how the diversity on the board brings benefits to the company and, thus, is associated with improved firm performance.

According to Robinson and Dechant, the diversity on the board has several advantages including improving the understanding of the marketplace, fostering creativity and innovation involving a broader range of perspectives, and promoting internationalization and human

[309] European Commission, Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for more Engaged Shareholders and Sustainable Companies, COM (2012) 740 final, Strasbourg 12 December 2012, p. 5.
[310] OECD, supra note 198, at 52.
[311] Id.
[312] Id.
[313] Pye A. (2001). Corporate Boards, Investors and Their Relationships: accounts of accountability and corporate governing in action, *Corporate Governance: An International Review*, Vol. 9, No. 3, pp. 186-195.
[314] Id. at 191.

resources motivation.[315] In terms of labor market, Rose stated that a high degree of diversity on the board is a positive signal to potential job applicants that indicates that women and ethnic groups are not excluded from the highest positions, thus attracting well-qualified persons outside the typical circle from which board candidates are selected.[316]

Besides, the European Commission with the Action Plan 2012 promotes the board diversity as a useful corporate governance tool to enhance the transparency of the company. It supports the idea that board diversity brings different competencies and views within the board that facilitates the understanding of the corporate affairs and foster the objective and constructive challenge of directors' decisions.[317] On the other hand, insufficient diversity among the board's members could result in fewer ideas, less debate and challenges of directors decisions, and consequently, in less effective oversight of directors' or management board's actions.[318]

While conflict empirical evidence has been found in the relationship between board diversity and age and educational background of the board members, the gender representation theme has received growing attention due to increased concern on the point of gender parity.[319] Adam and Ferreira found a positive relation between female directors and firm performance. They found that female directors have better attendance records than male directors, and they are more likely to join monitoring and audit committees.[320] Accordingly, Bilimoria and Piderit state that female directors are likely to be employed on important board committees.[321] In 2018 McKinsey's report on diversity stated that companies with diverse boards are 33% more likely to have greater financial returns than their less-diverse industry peers.[322] In contrast, other studies found a negative relation between gender diversity and firm performance.[323]

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[315] Robinson G., Dechant K. (1997). Building a business case for diversity, *Academy of Management Perspectives*, Vol. 11, pp. 21-30.
[316] Rose C. (2007). Does Female Board Representation Influence Firm Performance? The Danish Evidence, *Corporate Governance: An International Review*, Vol. 15, No. 2, pp. 404-413.
[317] European Commission, Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for more Engaged Shareholders and Sustainable Companies, COM (2012) 740 final, Strasbourg 12 December 2012, p. 6.
[318] Id.
[319] Fernandez-Temprano M. A., Tejerina-Gaite F. (2020). Types of Director, Board Diversity and Firm Performance, *Corporate Governance International Journal of Business in Society*, Vol. 20, No. 2, pp. 324-342.
[320] Adams R. B., Ferreira D. (2008). Women in the Boardroom and Their Impact on Governance and Performance, *ECGI- Finance Working Paper No. 57/2004*, pp. 1-49. Available at: https://ssrn.com/abstract=1107721.
[321] Bilimoria, D., Piderit, S. (1994). Board committee membership: Effects of sex-based bias, *Academy of Management Journal*, Vol. 37, No. 6, pp. 1453-1477. Available at: https://www.jstor.org/stable/256795.
[322] McKinsey&Company (2018). Report Delivering through diversity.
[323] Fernandez-Temprano M. A., Tejerina-Gaite F., supra note 319, at 6.

However, although the female representation on the board has become a critical issue on the corporate governance framework and is growing exponentially year-by-year, the proportion of female directors has not yet reached a satisfactory level. In 2019 in the United States a milestone of 20% of women board representation was achieved for S&P 500 and Russell 3000 companies.[324] In Italy, the percentage of women in boards of Italian listed companies grew to 36% in 2019 but only 6% hold the position of CEO.[325] In 2018, California became the first state in the United States to impose to all public companies the mandatory representation of at least one woman on their boards.[326] In Italy according to the *Golfo-Mosca* lex 120/2011 public companies are required to reserve 30% of the boards' seats to the less represented gender.[327] Like the United States and Italy, also other countries have moved to guarantee greater inclusivity of the minorities on the boards and to promote diversity as a tool to enhance the firm performance.

2.5.4 Audit Committee Independence

In order to reduce information asymmetries and the resulting agency problems an effective audit committee that monitors the management is required. As established by the EU Directive 2006/43/EC, the principal roles of the audit committee are: a) to oversee the company's financial reporting process, b) to monitor the effectiveness of the company's internal control, the audit process, and the firm's risk management practices, c) to oversee the statutory audit of the annual and consolidated reports, to review and control the independence of the statutory auditor or audit firm.[328] Enhanced monitoring of financial reporting is achieved by ensuring the independence of the audit committee.[329] Beasley states that the independence of the audit committee reduce the opportunities for managers to manipulate financial statements and conduct financial fraud activities, thus enhancing the quality of the financial reports and improves the credibility and reliability of accounting and financial information.[330] Lee *et al.* found that independent audit committees are likely to demand high-quality auditors with high

[324] Joshi R. (2020). Board Diversity: No Longer Optional, *Truvalue Labs*. At https://corpgov.law.harvard.edu/2020/10/11/board-diversity-no-longer-optional/.
[325] https://alleyoop.ilsole24ore.com/2020/02/24/aziende-cda-donne/?refresh_ce=1.
[326] Joshi R., supra note 324.
[327] https://www.openpolis.it/parole/come-funzionano-le-quote-rosa-nelle-societa-quotate-e-a-controllo-pubblico/.
[328] European Parliament and Council Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, *Official Journal of the European Union*, L 157/87. Text available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32006L0043.
[329] Aldamen H. *et al*., supra note 289, at 977.
[330] Beasley M. S. (1996). An empirical analysis of the relation between the board of director composition and financial statement fraud, *Accounting Review*, Vol. 71, No. 4, pp. 443-465.

reputations.[331] The independence of the audit committee ensures that the decisions are in its hands and the management cannot exert its pressure over the committee easily.

Corporate governance codes all over the world establish requirements on the audit committee and its independence.[332] For example, the UK Corporate Governance Code sets out that listed companies should have at least two-three independent non-executive directors in their audit committee.[333] In the same way, in the United States, the Sarbanes-Oxley Act of 2002 imposes stock exchanges to implement rules requiring independent audit committees to monitor the company's accounting and financial reporting processes and audits of the financial statements.[334] In this sense, the SEC requires U.S. listed companies to have three or more independent directors on the audit committee with no mandatory presence of an audit committee financial expert.[335] As we already discussed in Italy the independence is a required quality the auditors must have.[336]

However, the appointment of independent directors in the corporate boards is not likely to improve the firm performance in every type of company in all countries.[337] In close companies and family-owned companies, the lower presence of independent directors can be explained by the fact that their presence can be viewed as an unnecessary interference and a threat to the power of controlling shareholders and their decision-making process.[338] In this sense, Leung *et al*. found a negative relation between audit committee independence and audit quality that will affect the performance in close and family-owned companies.[339]

In summary, audit committee independence is an effective mechanism that enhances the monitoring activities and audit quality in listed companies, especially where the separation of ownership and control is evident. In close companies and family-owned businesses, where the controlling shareholder and director typically is the same person and, thus, no agency problem arise between shareholders and managers, the presence of directors not related to the business

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331 Lee H., Mande V., Ortman R. (2004). The effect of audit committee and board of director independence on auditor resignation, *Auditing: A Journal of Practice & Theory*, Vol. 23, No. 2, pp. 131-146.
332 Bansal N., Sharma A. K. (2016). Audit Committee, Corporate Governance and Firm Performance: Empirical Evidence from India, *International Journal of Economics and Finance*, Vol. 8, No. 3, pp. 103-116.
333 Financial Reporting Council, The UK Corporate Governance Code, London 2018.
334 OECD, supra note 205, at 121.
335 Deloitte US, Audit Committee Resource Guide, Center for Board Effectiveness 2018.
336 Stanghellini L., supra note 251, at 110.
337 Leung S., Richardson G., Jaggi B. (2014). Corporate board and board committee independence, firm performance, and family ownership concentration: An analysis based on Hing Kong firms, *Journal of Contemporary Accounting & Economics*, Vol. 10, pp. 16-31.
338 Id. at 17.
339 Id. at 28.

and with different interests may have the effect to reduce the freedom of the shareholder-manager to conduct the company as he sees fit and then, resulting in missing investment opportunities and jeopardizing the business.

2.6 Chapter conclusions

This chapter was aimed at analyzing the corporate governance practices and features in public and close companies. We began the chapter by introducing the agency problem that arises in the relationships between the actors involved within the company. Then we have proceeded by analyzing the distinctions between two corporate governance mechanisms, the insider and outsider model, determined by different ownership structures and concentration of control. In this sense, we provided an analysis of the United States and Italy corporate governance frameworks, as an effective example of outsider and insider systems, respectively. The chapter concludes with a description of the internal corporate governance mechanisms used to resolve the agency problem. These mechanisms concerning the composition, size, diversity, and independence of the corporate boards, have been reviewed by comparing different studies aimed at analyzing the relationship of the different mechanisms with the firm performance. Despite the results obtained by researchers were discordant, we can confirm that these mechanisms have a great effect on corporate performance, driving the organization toward the objective to maximize shareholders' wealth.

CHAPTER 3: THE USE OF SHAREHOLDERS' AGREEMENTS AS A TOOL TO IMPROVE CORPORATE GOVERNANCE

Introduction

In the previous chapter, we analyzed the typical corporate governance instruments that ensure more effective control and management of the corporation. However, some corporate governance mechanisms, such as the independence of the boards and the board composition, are most suitable for publicly held companies while in close corporations their application becomes more complicated. Especially in the context of closely held companies the traditional rules of corporate law seem not to be appropriate for the needs of investors, who tend to rely on other instruments to tailor the relationship between each other. In this sense, it is common the use of shareholders' agreements to customize the terms of ownership and to waive some governing rules of law. Through these agreements, parties can contract among themselves over their votes or decide to maintain a continuum in the ownership structure, and thus, leading the business towards a certain long-term direction. Therefore, parties are likely to shape the control by the means of shareholders' agreements rather than through charters and bylaws, because the former not only are easier to draft or amend than the charter but also because shareholders' agreements empower shareholders to personally waive rights that cannot be removed by the charter and bylaws.[340] Besides, under the default majority rule or, even better, when a controlling shareholder is present, shareholders' agreements allow control sharing by guaranteeing minority representation on boards.

The present chapter will deal with an understanding of the legal treatment of shareholders' agreements. In particular, we will discuss the concept of shareholders' agreements along with

[340] Rauterberg G. (2020). The Separation of Voting and Control: The Role of Contract in Corporate Governance. Available at: https://ssrn.com/abstract=3637204.

the purposes of parties to enter into such a contract. Furthermore, we will discuss the main characteristics of these agreements, including the content that the contract may have, the persons — legal and natural — who can be parties to the shareholders' agreement, and possible classification of such agreements. Finally, we will analyze the use of shareholders' agreements in the context of closely held companies compared to public listed companies, trying to find a possible explanation of why shareholders' agreements are not so diffused in listed companies.

3.1 The Concept of Shareholders' Agreements

Viewed with suspicion and perplexity for a long time by the most conservative and traditionalist doctrine and jurisprudence, the shareholders' agreements seem, nowadays, to shine with a new light and relive, or rather live, a kind of second life, a second youth, considered, at long last, as a significant control tool and a relevant regulation instrument of corporate dynamics.[341]

Concerning its historical evolution, as already anticipated, shareholders' agreements had a troubled genesis due to the difficulty — as stated by the moderated doctrine and jurisprudence — to admit as valid and effective any agreement drafted within and then, potentially harmful to the company interest. In this way, it was believed that the company interest would be passed on the back burner, thus, giving space to the selfish interest of the individual.[342] Now, fortunately, the validity and the effectiveness of shareholders' agreements are recognized by the legislator which regulates certain aspects (duration, transparency, for example). For example, in Italy, all the aspects concerning shareholders' agreements are regulated in articles 2341-bis, 2341-ter, and articles 122,123,124 and 207 of D.L.gs. 24.2.1998, n.58).[343] It was understood that their function is multiple and that they have great relevance as instruments for the consolidation of ownership structures and the stabilization of the government of the company, allowing, through the commitment of the members who adhere to it, the formation of groups within the social structure able to play, thanks to the coordination of the action of participants, a significant role in society.[344]

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[341] Amati L. (2009). I Patti Parasociali: genesi, evoluzione e aspetti operativi, *Diritto e pratica delle società*, Vol. 12, pp.82-94.
[342] https://www.iubenda.com/it/srl/help/4876-cosa-sono-i-patti-parasociali.
[343] Marchini P. L., Lugli E. (2013). The Shareholders Agreements: Typologies, Diffusion and Influence on Corporate Governance of Italian Listed Companies, *Universal Journal of Accounting and Finance*, Vol. 1, No. 2, pp. 51-57.
[344] Amati L, supra note 341, at 51.

In order to better understand this topic, let us introduce, briefly, the definition of shareholders' agreements by explaining what we will talk about, their role, how they work, and what they are for.

3.1.1 Definition of Shareholders' Agreements

By definition, shareholders' agreements are real and complex agreements drawn up, during the foundation of the company or after its foundation, by two or more members — shareholders in fact — belonging to listed public companies or private firms. Using these agreements, shareholders — who are free to decide what or whether contract, whit whom to contract, and on what terms to agree in their contract[345] — thus, mitigate and regulate how they will have to manage their internal relationship, those with company directors and those with third parties eventually.[346] In other words, shareholders' agreement could be considered as a perfectly valid contractual tool that helps to regulate relationships inside the company among involved members and it should not be considered as a merely "gentlemen's contract". These agreements — obviously binding for those who sign them only — may contain provisions for non-compliance sanctioning the defaulting member by the payment of penalties[347] and generally are written contracts like any contract. These, however, could be oral contracts too although this latter may raise some questions related to their reliability and enforceability since involved parties could not be able to remember and perform what they have decided at the time of the agreement.[348] If this happens, parties will have to trust in their good faith only to avoid internal quarrels from which problems could arise.

Once furnished the definition of shareholders' agreements, now we have to take into consideration their contents. Indeed, agreements under study may have different contents — provided that they are not contrary to law, public order, or morality — and concern administrative positions, property rights, or passive legal situations. This means that, according to the aims of shareholders, these agreements deal with various subjects such as succession issues, deadlock situations, rights, and duties of shareholders, and so on. It is clear that there is

[345] Miliauskas P. (2013). Shareholders' agreement as a tool to mitigate corporate conflicts of interests, *International Journal of Private* Law, Vol. 6, No. 2, pp. 109-131. Available at: https://ssrn.com/abstract=2380629.
[346] Marchini P.L., Lugli E., supra note 343, at 54.
[347] https://www.iubenda.com/it/srl/help/4876-cosa-sono-i-patti-parasociali.
[348] Miliauskas P., supra note 345, at 112.

no limited list of aims of shareholders and each theme depends on the interests of parties.[349] The following paragraph of this thesis will face, thus, the aims of shareholders' agreements.

3.2 The Aims of Shareholders' Agreements

As for all other contracts, in shareholder agreements parties want to create, modify, and terminate their rights and duties. For this reason, parties pursue special aims depending on, as just said, the interests of shareholders as well as the kind of company. Generally, the aims of shareholder agreements may be classified into three major groups which are the following: 1) agreements used to concentrate control of the company; 2) agreements with the purpose to protect the interests of the minority shareholders; 3) agreements with other aims.[350]

As regards the first point, if in a company there are no controlling shareholders, the agreement can be used to concentrate voting power and reinforce the influence of contracting shareholders in the company. In this case, it might be supposed that the shareholder who owns more stocks than the others and then, who has most of the voting rights — although this latter should not have the controlling package — has more willing to stipulate the contract but, in truth, even the smallest shareholders take advantage from the contract since their interests will be taken into consideration during the business of the company. It is also true that by means of the shareholder agreement, relatively large members may influence, even exercise, votes of the smaller ones. The more the power in the hands of the relatively large shareholders increases, the more these latter obtain greater supervision over the management of the company; In this way, costs incurred while contracting with smaller shareholders are justified.[351] If on the one hand, several advantages and benefits are recognized to large shareholders, on the other hand, because of their small stake in the company and high costs related to the management control, small shareholders are not able to look at and inspect the management of the company.[352] In any event, if the minority shareholders are interested in long term ownership of the shares and participation in the company activities, they may negotiate with large shareholders to obtain greater protection of their interests and some extra rights such as the nomination of a member of the management body. In the case in which smaller shareholders believe that the relatively

[349] Id.
[350] Roos, C. M. (1977). Comparative Notes on Shareholders' Voting Agreements. *Scandinavian Studies in Law*, No. 15, p. 165-189.
[351] Garratt B. (2010). The Fish Rots from the Head: Developing Effective Board Directors, 3rd edition. London: Profile Books, p. 14.
[352] Baglioni A. (2011). Shareholders' Agreements and Voting Power: Evidence from Italian Listed Firms. *Applied Economics*, Vol. 43, No. 27, pp. 4043-4052.

large shareholders are acting against their interests, they can, however, invoke the provisions of the agreement to safeguard and preserve their interests or, even, withdraw from the contract, obviously if all mandatory requirements stipulated in the contract are met.[353] Naturally, cooperation between relatively large shareholders and the smaller ones is very important for avoiding this kind of situation and both of these must be aware of the positions held by each. A shareholders' agreement is a way of furthering the interests of each concerned party without discrimination and does not disadvantage or advantage anyone. Briefly, considering this first purpose of shareholder agreements, these are used to reinforce contracting shareholders or rather upgrade the position of involved members within the company.

The second aim of shareholder agreements is to protect the interests of minority shareholders. This purpose is achieved when a majority or a group of controlling shareholders stipulate the agreement with the minority shareholders allowing the latter to express their intentions and expectations during the general meeting of shareholders.[354] It could be assumed that, by stipulating the agreement with the minority, the majority shareholders are not willing to limit themselves, their controlling power in the company, or their benefits but, indeed, several situations prove otherwise. If a listed company, for example, is increasing its capital, majority shareholders will sometimes be asked to enter into shareholder agreement if the monetary contribution is significant, thus, these are obliged to collaborate with the minority to provide capital to the society.[355] In addition to this, the majority may conclude the shareholder agreement with the minority when the latter can influence the balance of power between two competing block holders. This may happen when two relatively large block holders compete for the control of the society and minority shareholders may effectively decide which one of them will take its control. In this case, the concentration of voting rights ensures minority shareholders more rights and better protection of their interests. In the event of which majority shareholders refuse to contract, shareholder agreement may still be concluded among minority shareholders.[356]

Besides these, it exists other purposes of shareholder agreements. The contractual relationship among shareholders could be used to maintain or change the *status* of the company for example. Members may decide or not — by exercising voting rights during the general meeting of

[353] Miliauskas P., supra note 345, at 113.
[354] Thomas K. R.; Ryan, C. (2009). The Law and Practice of Shareholders' Agreements, 3rd edition. London: LexisNexis, pp. 1, 23-24.
[355] Miliauskas P., supra note 345, at 113.
[356] Id.

shareholders — to alter the structure of the corporation, the number of members, the responsibility of the management body, and so on.

Another aim of shareholders' agreements could be to avoid deadlock situations. A deadlock situation happens when shareholders — whose power is equally released — are unable to agree on a particular topic linked to company management. Generally, this kind of situation is more common in non-listed companies and highly unlikely in listed-companies due to the ample shareholdings distribution even if it could occur in listed-companies too since two major block holders may not agree on the line to follow or the strategy of the company.[357]

Furthermore, by means of shareholder agreements, concerned parties may agree not only on the rules to follow or how company profits have to be distributed through voting rights but also on the investments; or even, shareholder agreements can manage succession issues, regulate the rights of shareholders to avoid future disputes or decide the dividend distribution policy.[358]

It is clear that there are several aims of shareholder agreements where each of them depends on different factors, such as the interests of involved parties, the kind of company, or its goals. They, in any event, are essential tools aimed at mitigating, managing, and regulating any conflicts, or disagreements between parties and safeguarding their interests.

Once discussed the concept and the aims of shareholders' agreements, the following paragraphs and sub-paragraphs will focus on general characteristics, subject-matters, parties, and forms of agreements.

3.3 Characteristics of Shareholders' agreements

Known as consensual contracts since they come into force by the will of concerned parties, shareholder agreements may be distinguished in bilateral and unilateral contracts, in onerous and gratuitous contracts, and fixed-term or indeterminate period contracts.[359] By definition, when parties of shareholders' agreements agree on a topic and have reciprocal rights and duties towards each other, we are faced with a bilateral contract. Instead, if this is not the case, we are faced with a unilateral contract. For example, when involved parties agree to vote according to the rules provided in the shareholder agreement, we can say that it is a bilateral agreement;

[357] Cadman, J. (2004). Shareholders' Agreements, 4th ed., London: Sweet & Maxwell, pp. 110-111.
[358] Miliauskas P., supra note 345, at 113.
[359] Miliauskas P., supra note 345, at 114.

contrarily, when a shareholder, for instance, obliges himself to vote by following the instructions given by another shareholder without considering reciprocal duties, this is an example of a unilateral contract.[360]

Shareholder agreements may be also distinguished in onerous and gratuitous agreements. For example, if there are provisions for performance contractual duties for a pecuniary consideration, we are talking about onerous agreements; if instead, a shareholder agreement is used to transfer voting rights without any consideration, we are talking about the gratuitous one.[361]

Finally, shareholder agreements may be concluded for a fixed-term or an indeterminate time. The duration of the contract depends on the aims pursued by shareholders and on the applicable law as well. It is interesting to note that each country has different rules to follow concerning terms and duration: in Italy, for example, a fixed term of shareholders' agreements cannot be longer than 5 years; in the UK and the USA, no rules limiting the term of shareholder agreements exist; in Belgium, shareholder agreements should have a fixed term even if a maximum term is not established, and so on[362]. Thus, according to the jurisdiction, there might be differences and restrictions related to the maximum term of shareholder agreements and each difference depends on the nature and the subject-matters of contracts.

3.3.1 Content of Shareholders' Agreements

Before entering a shareholders' agreement, parties have to agree on the content and object of the contract. The presence of certain matters agreed by the parties is indispensable for the validity and the qualification of the contract as shareholders' agreement.

Most European legislators — such as France, Germany, U.K., and so on — do not regulate the content of shareholders' agreements at the statutory level. However, in countries — Italy and Russia — where shareholders' agreements are recognized at the legislative level, the list of contents that can be the object of the shareholders' agreements are established by the norms regulating them.[363] Although the obligations contained in the norms of these two countries are

[360] Id.
[361] Id.
[362] Id.
[363] Zhornokui Y., Burlaka O., Zhornokui V. (2018). Shareholders Agreement: Comparative and Legal Analysis of the Legislation and Legal Doctrine of Ukraine, EU Countries and USA, *Baltic Journal of Economic Studies*, Vol. 4, No. 2, pp. 288-300.

quite similar, their regulation is different: while in Russia the obligations representing the content of shareholders' agreement have the nature of possibility, in Italy, instead, the parties are allowed to stipulate a shareholders' agreement only if the object of the obligation of the agreement are those prescribed by the art. 2341-bis of the Civil Code.[364] The article specifically identifies shareholders' agreements such agreements concerning (a) the exercise of voting rights in a company limited by shares, (b) limits on the transfer of shares, or (c) the exercise, jointly or otherwise, of a dominant influence over the company.[365] In the United States, the regulation of the content of shareholders' agreements differs depending on the jurisdiction: for example, in California, the subject matter of shareholders' agreements is typically limited to the governance of the corporation and the rights between shareholders themselves and towards the corporation;[366] whereas in others states, such as Delaware, New York, and Florida, there is no limitation on the subject matters of shareholders' agreement which may also concern non-company matters.[367]

Finally, even though in certain cases the content of shareholders' agreements is specifically defined by the legislator, whereas in other cases the parties enjoy greater freedom in establishing the object of the matter of the contract, the presence of content related to the company and the rights and duties of shareholders is a common condition for both cases to qualify the contract as a shareholders' agreement.

3.3.2 Parties to Shareholders' Agreements

As the name of the agreement suggests, the shareholders' agreement is a contract stipulated between shareholders of the company to regulate some aspects of their relationships. Therefore, at least one shareholder, to which the agreement is related, should be a party to the contract. If this condition is missing, the contract cannot be deemed as a shareholders' agreement. Generally, the agreement can be concluded only between shareholders, giving the possibility for the company to constitute a party as well.[368] Nonetheless, certain types of shareholders' agreements, like the relationship agreements in the UK, can be stipulated between the

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[364] Id. at 293.
[365] Civil Code art. 2341-bis Italy.
[366] Young D. (2018). IBA Guide on Shareholders' Agreements, California USA. Available at: https://www.ibanet.org/LPD/Corporate_Law_Section/Clsly_Held_Growing_Busi_Entprs/shareholderagreements.aspx.
[367] Ruiz X., Garcia M. (2018). IBA Guide on Shareholders' Agreements. Delaware, New York and Florida, USA. Available at: https://www.ibanet.org/LPD/Corporate_Law_Section/Clsly_Held_Growing_Busi_Entprs/shareholderagreements.aspx.
[368] Miliauskas P. (2013)., supra note 345, at 115.

controlling shareholder and the company itself.[369] Persons other than shareholders may be parties to the agreement depending on the aims and subject matter of the contract. For example, managers could be parties to the shareholders' agreement obliging themselves to comply with the provisions of the contract or granting shareholders the right to require for specific performance not regulated under the law.[370]

A party to the shareholders' agreement may be the company itself, especially in some of the following cases: 1) when shareholders want to commit the company to additional obligations; 2) to include not stipulating shareholders to undertake some obligations as shareholders group; 3) to bind the management to act according to what is stipulated in the agreement; 4) when the company owns its shares and contracts as a shareholder; 6) when relationship agreements are stipulated.[371]

The agreement can also be concluded by other parties, even not members of the management or the company itself, only when the subject matter of the contract is related to the functioning of the company and the relationship between shareholders and the company.[372] Conversely, the contract cannot be considered a shareholders' agreement if it stipulates that the shareholder is obliged to vote following the instructions of the outside party.[373] These provisions, usually included in contracts with creditors to protect their interests, prevent the contract to be deemed shareholders' agreement since they are not related to the legal relationships arising between shareholders or with the company.[374]

In summary, shareholders' agreements are contract stipulated between shareholders or between shareholders and other parties, having as object the functioning of the company or the legal relationships between the shareholders or their duties towards the company.

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[369] The relationship agreement is stipulated to protect minority shareholders and the market. Most of these agreements are concluded between the controlling shareholder and the company itself, according to which the majority shareholder obliges himself to the company to not expropriate the minority shareholders and extract private benefit. The majority shareholder also takes an obligation before the company, that all the trade and dealings with the company will be carried in good faith and following the best practices dominating in the market. See Miliuskas P., supra note 345, at 124.

[370] Cadman J., supra note 357, p. 4.

[371] Id.

[372] Miliauskas P., supra note 345, at 115.

[373] Id.

[374] Id.

3.3.3 Classification of Shareholders' Agreements

Little research was devoted to the classification of shareholders' agreements, and where it presents, has not found a common distinction between the different academics and scholars. However, generally, we may firstly classify the shareholders' agreements in the following categories according to what they are going to regulate: 1) voting agreement; 2) restrictions on the transfer of shares agreements; 3) lock-up agreements; 4) other types of shareholders' agreements.

Voting agreements concern the disposal of the shareholder voting right at the general meeting. They usually regulate the way according to which the voting rights of contracting shareholders are exercised. For example, the parties may decide on what decisions to vote in favor of a shareholder or they can decide to dispose of their votes in the same way as another shareholder.[375] Voting agreements may also provide for a preliminary meeting among contracting shareholders in which they can decide how they will exercise their vote on the decisions included in the agenda of the next general meeting.[376] Voting trusts, pooling agreements, proxy agreements belong to the voting agreements class in the United States and they may typically involve: (a) the transfer of the shares of a company and the voting rights attached thereto to another party for a specified period of time (voting trusts); (b) the pooling of shareholders votes and the consequent transfer to a third party that exercises the votes as a unit (pooling agreements); (c) the transfer of the right to a third party to vote on the behalf of the shareholder without any actual transfer of the shares (proxy agreements).

Shareholders' agreements are also used to limit contracting shareholders to freely trade their shares. The restrictions on the transfer of shares included in these agreements are aimed to stabilize the ownership structure of the company allowing shareholders to prevent the entry of unwanted shareholders, so determining with whom they will work.[377] Restrictions on the transfer of shares typically have the form of pre-emption rights in favor of other members. The pre-emption clause restricts the possibility to sell the shares outside a predetermined group of people. It provides that when the shareholder wants to sell its shares, he shall first offer them to

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[375] Giannini L., Vitali M. (2011). I patti parasociali, 2nd edition, Maggioli editore, p. 125.
[376] Joyce T., Shareholders' Agreements: a U.S. Perspective, in Bonelli F., Jaeger P. (1993). Sindacati di Voto e Sindacati di Blocco, Giuffrè editore, Milano 1993, pp. 353-376.
[377] Giannini L., Vitali M., supra note 375, at 132.

the other shareholders at a certain price determined in the articles of association or at a fair price.[378]

Like the restrictions on the transfer of shares, lock-up agreements have the function to maintain the *status quo* in the ownership structure of the company. They are employed as a part of the initial public offering (IPO) preventing shareholders to alienate their shares for a specific period of time.[379] The purpose is to avoid excessive selling pressure and to maintain the stability of the company's shares during the first few months following the IPO.

Along with the main types of shareholders' agreements mentioned above, other types of agreements are available to the parties. First, the securities lending agreement involves the transfer of the shares with the attached voting rights from the lender to the borrower; however, the latter, after having cast the votes in the general meeting, is compelled to return the shares to the legitimate owner.[380] Depending on the jurisdiction securities lending agreement is subject to different legal treatment. For example, in Belgium, the agreement is viewed as a loan of fungible things while in the United Kingdom as an interrelated sale of shares agreements.[381] Second, in the UK a common type of agreement is the relationship agreement. Often stipulated between the company and the majority shareholder, relationship agreement involves the undertaking of the majority shareholder to act or refrain from taking certain actions toward the company, or the limitation of the majority of his rights to control the company to benefit the minority shareholders.[382] This agreement moves from the voluntary decision of the controlling shareholder to limit his power ensuring that the interests of the minority and the company will be not expropriated to benefit the controlling shareholder. Finally, controversial is the classification of joint venture agreement among the other types of shareholders' agreements. The joint venture agreement, in which the parties agree to pool their resources and share risks and profit in accomplishing a specific task, is considered by some authors a shareholders' agreement.[383] Undoubtedly, restrictions on the free transferability of shares that can be included in a joint venture agreement make it not appropriate for publicly held companies, at least for those with no controlling shareholders. For this reason, the joint venture agreement is more

[378] All Answers Ltd. (2018). Restriction on Transfer of Shares. Available at: https://www.lawteacher.net/free-law-essays/finance-law/restriction-on-transfer-of-shares.php?vref=1.
[379] Giannini L., Vitali M., supra note 375, at 142.
[380] Miliauskas P., supra note 345, at 121.
[381] Id. at 121-124.
[382] Id. at 124.
[383] Thomas K. R., Ryan C. L., supra note 354, p. 17.

applied in close companies for which no active market is available to shareholders for the trade of shares.

A more detailed analysis describing the type and the regulation of shareholders' agreements in Italy and the United States will be provided in the next chapters.

3.4 Shareholders' Agreements in Closely Held Companies

As we already said before, in closely held companies shareholders are not just the residual claimants of the company in which they invest their money to receive a return on the investment; they generally serve as directors and managers in the company they provide funds. Since they do not have a diversified investment portfolio and, consequently, most or all of their wealth is invested in a single company, the stocks they own in the corporation represent the most of their estate.[384] In this context, the basic elements regulating the provisions contained in the charter, by-laws, general meeting of shareholders are not adequate to the complex set of relationships in which the shareholders in the closely held companies are involved.[385] For this reason, shareholders' agreements are used by shareholders to deal with the problems that usually arise in close companies and to model the corporate governance of the company to the needs of shareholders in this type of corporation. For instance, these agreements may: ensure continuity in the shareholder group by restricting the transfer of shares; provide the scheme for passing from one generation of shareholders to another; generate liquidity for shareholders through the use of buy-out agreements; and so on.[386]

In the past, agreements aimed at modifying the classic structure of functions and roles among shareholders, directors, and managers were viewed with suspicion by courts, which were uncertain about the validity and enforceability of this type of agreement in the context of close companies.[387] More specifically, in examining the validity of shareholders' agreements, courts ignored whether the agreements were stipulated in a close company or in a public company.[388]

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[384] Ghingher J. J. (1975). Shareholders' Agreements for Closely Held Corporations: Special Tools for Special Circumstances, *University of Baltimore Law Review*, Vol. 4, No. 2, pp. 211-244.
[385] Id. at 211.
[386] Id. at 212.
[387] O'Neal F. H., Thompson R., supra note 55, at 5:103-104.
[388] Bulloch S. N. (1986). Shareholders Agreements in Closely Held Corporation: Is Sterilization an Issue, *Temp Law Quarterly*, Vol. 59, No. 1, pp. 61-82.

Only recently, when courts have started to recognize the peculiarities of close companies, shareholders' agreements have been treated with more confidence.[389]

As we have mentioned before, in closely held companies the application of the traditional corporate governance rules, such as the majority rule and the separation of role between directors and officers, along with the lack of a public market for the trade of shares creates room for the majority opportunism against minority shareholders. The use of freeze-out techniques, preventing the minority group to participate in the management or benefiting from the earning of the company, makes minority shareholders vulnerable to the actions of the controlling shareholder. In this context, shareholders' agreements are employed to mitigate the effect of the application of restrictive traditional corporate norms to close companies.[390] Shareholders' agreements have the important role to protect the minority shareholders from the majority, by ensuring the participation of the former to the management of the company with important roles in the decision-making process.[391] Moreover, shareholders' agreements may be used to assure minority shareholders that the majority group will not take new corporate policies contrary to the interests of the minority continuing to pursue the desired policies.[392]

Another common provision included in close corporations' shareholders' agreements is that restricting or limiting the ability of the shareholder to voluntarily transfer his shares. This is explained by the fact that one of the primary goals of shareholders' agreements is to ensure the continuing in the shareholder structure and, as consequence, to prevent the entry of unwanted new shareholders.[393] For this reason, these agreements contain provisions providing the obligation of shareholders to first offer the shares to the incumbent shareholders or the company itself.[394] Following the continuity in the shareholder group, shareholders' agreements are used even in situations involving the involuntary transfer of shares, such as subsequently the death of one shareholder, the declaration of his bankruptcy, retirement, and so on.[395] They provide some method to retrieve the shares which have passed out to the shareholder for a reason that led to the involuntary transfer.[396] The most common method provided by the agreement is the mandatory or optional purchase of shares. Although mandatory buy-out provisions are the most

[389] Id. at 62.
[390] Hornstein G. D. (1950). Stockholders' Agreements in the Closely Held Corporation, *The Yale Law Journal*, Vol. 59, pp. 1040-1056.
[391] O'Neal F. H., Thompson R., supra note 55, at 5:2, 5:5.
[392] Ghingher J. J., supra note 384, at 221.
[393] Id. at 214.
[394] Id. at 215.
[395] Id. at 218.
[396] Id. at 219.

desirable, optional purchase provisions may be more appropriate to prevent shareholders to plan their retirement when they could obtain the highest price from the sale of their shares.[397]

Shareholders' agreements in closely held companies are more widely used compared to publicly held companies listed on a stock exchange.[398] Even in venture capital-backed private companies, these agreements are pervasively used to facilitate the control sharing among different investors, namely by empowering non-controlling shareholders to credibly ensure directorships over the long term.[399] Rauterberg found that 55% of companies conducting an IPO in the U.S. in the period 2013-2018 disclose that they have been or are party to a shareholders' agreement, but 40% of companies disclose the termination of shareholders' agreement as of the IPO.[400] According to this study, only 15% of companies conducting an IPO disclose that they will remain subject to a shareholders' agreement.[401] This confirms the common view that shareholders' agreements are widely diffused in closely held companies, but they are most likely subject to termination when these companies are going public.[402]

In the following subparagraph, we will try to find some possible explanations for the limited diffusion and use of shareholders' agreements in the context of publicly held companies listed on a stock exchange.

3.4.1 The Limited Use of Shareholders' Agreements' in Publicly Held Companies

It is clear that the specific features of closely held companies — the presence of few shareholders who serve also as directors and the lack of a public market for the trade of company's stocks which are mainly subject to restrictions on their transfer — reinforce the role of shareholders' agreements as a more appropriate tool for shareholders' protection.[403] On the contrary, in publicly held companies shareholders' protection is traditionally ensured with the periodic election of directors, the strict division of powers between shareholders and directors, and the compliance with the procedures related to the functioning of the company.[404]

[397] Id. at 220-221.
[398] Bulloch S. N., supra note 388, at 62.
[399] Rauterberg G., supra note 340, at 18.
[400] Id. at 22.
[401] Id. at 23.
[402] Id. at 22.
[403] Rossi G., Le Diverse Prospettive dei Sindacati Azionari nelle Società Quotate e in quelle non Quotate, in Bonelli F., Jaeger P. (1993). Sindacati di Voto e Sindacati di Blocco, Giuffrè editore, Milano 1993, pp. 51-74.
[404] Id. at 63.

Shareholders' agreements tend to alter the traditional rules on which the functioning of the public company is based, thereby turning into a threat to the protection of public investors.

This may explain the tendency of the general doctrine to analyze the issue of shareholders' agreements in the context of close corporations, giving little attention to the use of these agreements in publicly held companies. Ventoruzzo in his study tried to identify and explain the reasons why shareholders' agreements are not so used in U.S. listed companies compared to close companies. In particular, he comes up with five hypotheses: first, although often the ownership structure of public companies presents a blockholder, the presence of shareholders, each holding a no meaningful participation — less than 1% — prevent the formation of a controlling group; second, minority shareholders are usually institutional investors who do not want to limit their freedom in voting or selling their shares and, thus, they are not willing to enter into shareholders' agreements; third, the lack of extensive cross-holding among listed companies discourages major shareholders to enter into such agreements; forth, the protection of minority shareholders granted by legal rules and some provisions, like the mandatory disclosure requirement under the Williams Act of participations large than 5%, deter shareholders to stipulate shareholders' agreements; finally, the presence of legal devices enhancing the position of shareholders in the company, like dual-classes shares structures, may replace shareholders' agreements. [405]

However, in a context where the ownership structure is concentrated and the presence of institutional investors is not so large, shareholders' agreements in publicly held companies become more valuable. In fact, the concentration of the ownership is traditionally considered as one of the factors which prompts the greater occurrence of shareholders' agreements as instruments to stabilize the control of the company.[406] Furthermore, in systems characterized by concentrated ownership, the role of shareholders in making strategic decisions is predominant, since shareholders intensively and directly communicate with the management.[407] Thus, in presence of shareholders holding a relevant and homogeneous ownership stake, there

[405] Ventoruzzo M. (2013). Why Shareholders' Agreements are Not Used in U.S. Listed Corporations: A Conundrum in Search of an Explanation, *Penn State Law Research Paper No. 42-2013*.
[406] Id. at 4.
[407] Guaccero A., Patti Parasociali e Regole Statutarie: Una Prospettiva Comparata, in Ventoruzzo M., Mosca M. C., Carcano G. (2016). Regole del Mercato e Mercato delle Regole: il diritto societario e il ruolo del legislatore. Atti del Convegno Internazionale degli studi di Venezia (13-14 Novembre 2015), *Rivista delle società. Monografie-studi*, Giuffrè ed., pp. 283-305.

is a powerful incentive to define through shareholders' agreements — elements external to the corporate governance — the allocation of power in order to stabilize it.[408]

For instance, according to CONSOB 23% (86) of Italian listed companies were governed through a shareholders' agreement with the conclusion of 39 new agreements in 2019.[409] At the end of 2018, 10% of listed companies in Italy were controlled through a shareholders' agreement.[410] Nevertheless, the use of shareholders' agreements is experiencing a decreasing trend.

Finally, it is possible to observe that shareholders' agreements are still used as a tool to enhance corporate governance in Italy and countries with similar ownership patterns. What has changed during the years is the content of shareholders' agreements, passing from the voting control to the simple regulation of shareholders' behaviors.[411]

3.5 Chapter conclusions

This chapter provides an overview of the role of shareholders' agreements in the corporate governance of most closely held companies. Viewed in their infancy with suspicion, today shareholders' agreements are generally accepted to shape the control and ownership of the company. We defined them as a valid contractual tool that helps to regulate relationships inside the company among involved members. In particular, parties enter into a shareholders' agreement for different purposes of which the most common involve the concentration of control and the protection of the minority interests. Then, we described the common characteristics of shareholders' agreements, including the content, the parties involved, and a classification of these types of contracts.

We have seen that in Italy the legislator imposes shareholders' agreements to be concluded upon the content established by the law in the article 2341-bis of the Civil Code, while other in the other countries parties enjoy greater freedom in choosing the content of the agreement with the condition that this must be related to the relationship among shareholders or between

[408] Id. at 288.
[409] CONSOB (2020). Annual Report 2019, Rome 31 March 2020. Available at: http://www.consob.it/web/consob-and-its-activities/annual-report.
[410] CONSOB, Report on Corporate Governance of Italian Listed Companies 2019. Available at: http://www.consob.it/web/consob-and-its-activities/abs-rcg/-/asset_publisher/K2uhgZAhU021/content/2019-report-on-corporate-governance/718268.
[411] Lugli E., Marchini P. L. (2019). I patti parasociali e la loro diffusione nelle società quotate italiane, *Amministrazione & Finanza*, No. 7, pp. 35-44.

shareholders and the company. In fact, not exclusively shareholders may be parties of shareholders' agreements, but also other parties, such as managers, third parties, and the company itself may be parties of the agreement only if the contract involves the functioning of the company or the rights or duties of shareholders toward the company.

These agreements can be classified in voting agreements — concerning the exercise of shareholders' voting rights — restriction on the transfer of shares, lock-up agreements — which prevent shareholders to alienate the shares for a period of time — and other types of agreements.

These provisions are typically found in closely held companies. The traditional corporate rules of majority vote, the separation of ownership and control, and the impossibility to freely transfer the shares in a public market whenever shareholders want, create severe problems for close corporations. The use of shareholders' agreements mitigates such problems allowing shareholders to structure the control of the company and their relationships as they see fit.

After having analyzed the application of shareholders' agreements in closely held companies, we try to find some explanations relating to the limited use of them in the context of publicly held companies. Empirical evidence shows us how their use in listed companies is more common in countries where the ownership is more concentrated, like in Italy than in Civil Code countries where the ownership is more dispersed. Despite it is evident that shareholders' agreements are more suited to be concluded in close companies, where parties require more flexibility to structure the governance of the company and to regulate the relationship between each other, the application of these agreements in publicly held listed companies is not so rare. Clearly, in this context in which the majority rule and the free transferability of shares are essential for the correct functioning of the company, shareholders' agreements are more employed by shareholders to regulate their conduct toward each other.

CHAPTER 4: REGULATION OF SHAREHOLDERS' AGREEMENTS IN THE UNITED STATES

Summary: Introduction. — 4.1 Voting Agreements. — 4.1.1 Voting Trusts. — 4.1.2 Pooling Agreements. — 4.1.3 Proxy Agreements. — 4.2 Transfer Restriction Agreements. — 4.2.1 Right of First Refusal and Right of First Offer. — 4.2.2 Mandatory Sale Provisions. — 4.2.3 Drag-Along and Tag-Along Rights. — 4.2.4 Call Options and Put Options. — 4.3 Disclosure Requirements. — 4.4 Enforcement of Shareholders' Agreements. — 4.5 Chapter Conclusions.

Introduction

In the United States, agreements concluded between shareholders to regulate the relationships between themselves and towards the management body of the company are governed by special legislation. The fundamental rules governing shareholders' agreements may be found at the State Law level, with slight differences from State to State.[412] Hence, each State has adopted provisions in its corporation code regulating the shareholders' agreements.[413] Typical provisions included in shareholders agreements concern share transfer restrictions, the identity of directors, officers' salaries, arbitration to resolve disputes, dividend amounts.[414] Specifically, MBCA section 7.32 regulates shareholders' agreements in closely held companies. In particular, it permits shareholders agreements having as object: (a) the elimination or restriction of powers of the board of directors; (b) the authorization to distribute dividends whether in proportion or not to the ownership of shares; (c) the determination of directors and officers and the condition and terms for their selection and removal; (d) the exercise or allocation of voting power between shareholders and directors; (e) the establishment of terms and conditions of any agreement for the transfer or use of property; (f) the transfer to one or more shareholders or another person of the authority to manage the business or to exercise corporates powers, and to resolve deadlock situations among directors or shareholders; (g) the demand of dissolution of the company at the request of one or more shareholders or at the occurrence of certain events; (h) the determination of the exercise of corporate powers or the management of the company's affairs or the relationships between insiders within the company not contrary to public policy.[415] The original text provided for the termination of shareholders' agreements from the time when

[412] Joyce T., supra note 376, at 355.
[413] Kaal W. A., Shareholder Agreements – National Report of the United States of America, in Csach K., Havel B. & Mock S. (2017). International Compendium on Shareholder Agreements, eds. 2017.
[414] Bulloch S. N., supra note 388, at 61.
[415] Model Bus. Corp. Act Ann. § 7.32(a), 2016.

the company's shares were listed on a stock market. The revised version of 2016 eliminates this provision, but it keeps the requirement of unanimous shareholder approval, this is likely to make shareholders' agreement under section 7.32 MBCA practically unavailable to publicly held companies.

In this chapter we will analyze the most common types of shareholders' agreements concluded in the United States, namely voting agreements and transfer restrictions agreements. After having defined the characteristics of these types of agreements, we will explore the disclosure requirements of shareholders' agreements for public listed companies and the enforceability of such agreements.

4.1 Voting Agreements

As we already said, voting agreements are intended to regulate the exercise and disposal of shareholders' voting rights in the context of the general meeting. Delaware Code explicitly allows shareholders to conclude agreements among them related to the exercise of the voting rights attached to the shares held.[416] Thereby, shareholders are entitled to allocate their voting rights as they see fit, by agreeing to cast their votes under indications of one of them or the majority.[417] This means that the law explicitly legitimates contracts that allow shareholders to vote their shares as a unit unless they have the effects of limiting the discretion of directors, violating any statutory provision, or oppressing the other stockholders.[418] Voting agreements are particularly designed to alter the default system for electing members of the board of directors, by conferring on one or more shareholders the right to appoint one or more directors.[419]

In most early cases, U.S. courts deemed voting agreements invalid on the grounds that the power to vote was inseparable from the shares and that shareholders owe to each other a fiduciary duty to vote in the meetings in the best interest of the corporation.[420] However, today a positive trend toward the general validity of voting agreements has been adopted by courts.

[416] Del. Code Ann. tit. 8, § 218(c), 2005.
[417] Joyce T., supra note 376, at 361.
[418] Redfern L. H. (1947). Corporations: Shareholders' Voting Agreements: Drafting Precautions, *Michigan Law Review*, Vol. 46, No. 1, pp. 70-77.
[419] Rauterberg G., supra note 340, at 24.
[420] O'Neal F. H., Thompson R., supra note 55, at 5:12-5:13.

Among voting agreements, special provisions are addressed to voting trusts, pooling agreements, and proxy agreements.

4.1.1 Voting Trusts

A voting trust is concluded when shareholders transfer shares and the associated voting rights to a third party, called trustee, who votes in accordance with what has been established by the agreement.[421] Although the trustee becomes the legal owner of the shares, the shareholder usually maintains the economic benefit of the shares: in fact, any dividend received by the trustee is typically forwarded by the latter to the shareholder that retains beneficial ownership of the shares.[422] The economic benefit of the shares is usually demonstrated by a voting trust certificate provided by the trustee to the former shareholder.[423] At the end of the trust period, the shares are returned to the former shareholders, unless the agreement provides for a renewal of the contract at the same terms.

Voting trusts are regulated by the Delaware code tit. 8 § 218 and by the Model Business Corporation Act § 7.30. They both contain similar provisions stating that to be correctly formed, the voting trust: (a) must be concluded by one or two or more shareholders; (b) must provide the transfer to the shares to the trustee or trustees; (c) expires after the term stated in the agreement; (d) must be disclosed to the company.[424] While the Delaware code provides that the agreement must be in writing, the MBCA does not explicitly state that the written form is required, although it can be understood from the context of the provisions.[425] While historically the MBCA imposed a statutory term of 10 years for the voting trust, the amendment of 2016 ratified the duration of the voting trust that is determined in the term of the agreement.[426] Thus, it followed the position taken by the Delaware code according to which the term is determined in the agreement.[427] The two codes impose different rules for the communication of the voting trust to the company. The MBCA states that the trustee has to prepare a list and send copies of this list and the agreement to the company principal office.[428] On the other hand, the Delaware code requires that a copy of the trust agreement be filed in the registered office of the

[421] Kaal W. A., supra note 413, at 7.
[422] Molano-Leon R. (2008). Shareholders' Agreements in Close Corporations and their Enforcement in the United States of America, *Vniversitas*, No. 117, pp. 219-252.
[423] Id. at 236.
[424] See Del. Code Ann. tit. 8 § 218(a), 2005. See Model Bus. Corp. Act § 7.30(a), 2016.
[425] Id.
[426] Model Bus. Corp. Act § 7.30(b), (c), 2016.
[427] Del. Code Ann. tit. 8 § 218(a), 2005.
[428] Model Bus. Corp. Act § 7.30(a), 2016.

corporation and be open for inspection of any stockholder of the corporation or any beneficiary of the trust.[429]

Despite the statutory regulation, voting trusts are not so employed in the United States context. This is due probably to the application of the federal law which treats the trust certificate as a security, and, thus, it must be subject to extensive continuous disclosure to the SEC.[430]

4.1.2 Pooling Agreements

Pooling agreements are set when shareholders agree to vote their shares according to what is stated in the agreement.[431] Pooling agreements do not involve the transfer of shares to a trustee and they typically involve: (a) voting shares for directors; (b) giving voting power disproportionate to the ownership of shares; (c) voting shares to pursue a particular corporate policy.[432]

As for voting trusts, pooling agreements are regulated by title 8 § 218 of the Delaware Code, while they are regulated by section 7.31 of the MBCA. They are generally treated as voting agreements and to be enforceable they must satisfy the following conditions: (a) two or more shareholders must be parties of the agreement; (b) the agreement must be in written form; (c) all participating shareholders must sign the agreement.[433]

Pooling agreements, concerning the issues discussed before, have been generally considered lawful and enforceable, contrary to such agreements aimed at selling shareholders' votes or compromise voting power to extract private benefit invalidated by courts.[434]

4.1.3 Proxy Agreements

Proxy agreements allow shareholders to confer irrevocable proxies with the power to vote their shares to one or more shareholders or another person.[435] The validity of irrevocable proxies has been questioned by courts, specifically on several grounds that they were contrary to the public policy by restricting the principal right of shareholders to vote their shares and that a proxy

[429] Del. Code Ann. tit. 8 § 218(a), 2005.
[430] Joyce T., supra note 376, at 362.
[431] Kaal W. A., supra note 413, at 7.
[432] Molano-Leon R., supra note 422, at 234.
[433] See Del. Code Ann. tit. 8 § 218(c), 2005. See Model Bus. Corp. Act § 7.31(a), 2005.
[434] Molano-Leon R., supra note 422, at 234.
[435] Id. at 235.

shall be revocable and subject to the statutory limitation on the duration unless it is coupled with interest.[436]

However, today irrevocable proxies are enforceable and regulated by the provisions contained in section 7.22 of the MBCA and section 212 of the Delaware Code. Both codes provide that shareholders may appoint a proxy to vote on his behalf by signing an appointment form or authorizing the electronic transmission to the person who will hold the proxy.[437] The proxy agreement must contain information demonstrating that the proxy was authorized by the shareholder.[438] The duration of the proxy is limited to 11 months for the MBCA and 3 years for the Delaware Code unless the proxy provides for a longer period.[439] The proxy is irrevocable if it states that is irrevocable and is coupled with interest, whether on the stock or on the company, strong enough to justify an irrevocable power.[440] The appointment of a proxy is effective when the signed form or the electronic communication is received by the inspector or by the person in charge to tabulate votes.[441]

Rarely used by itself as an agreement, the irrevocable proxy is generally applied to implement other shareholders' agreements or class voting arrangements.[442]

4.2 Transfer Restrictions Agreements

According to what has been said before, shareholders in close companies seek to restrict the transfer of shares for a variety of reasons, including to control with whom former shareholders are going to work, to prevent the entry of undesired shareholders gaining access to internal confidential information, and to limit the number of shareholders for administrative flexibility.[443]

Under the Delaware Code and the MBCA restrictions on the transfer of shares may be imposed by articles of incorporation, bylaws, and by shareholders' agreements.[444] The restriction shall not apply to the shares issued before the restriction unless shareholders holding those shares

[436] O'Neal F. H., Thompson R., supra note 55, at 5:64-5:65.
[437] See Del. Code Ann. tit. 8 § 212(c)(2), 2005. See Model Bus. Corp. Act § 7.22(b), 2005.
[438] Id.
[439] Id.
[440] See Del. Code Ann. tit. 8 § 212(e), 2005. See Model Bus. Corp. Act § 7.22(d), 2005.
[441] See Del. Code Ann. tit. 8 § 212(c)(2), 2005. See Model Bus. Corp. Act § 7.22(c), 2005.
[442] Joyce T., supra note 376, at 363.
[443] Corporation Law Committee of the Association of the Bar of the City of New York (2010). The Enforceability and Effectiveness of Typical Shareholders Agreement Provisions, *The Business Lawyer*, Vol. 65, pp. 1153-1203.
[444] See Del. Code Ann. tit. 8 § 202(b), 2005. See Model Bus. Corp. Act § 6.27(a), 2005.

participated or voted in favor of the restriction.[445] Delaware code expressly provides that restrictions on transfers of shares must be in writing,[446] whereas, although MBCA does not expressly provide for the written form, the requirement may be understood by the nature of the provision.[447] Both codes provide that a restriction on the transfer of shares is not enforceable against a person without knowledge of the restriction unless it is noted conspicuously on the shares certificate or is contained in the information statement.[448] Further, the Delaware Code and MBCA require that to be enforceable transfer restrictions must be concluded for a reasonable purpose including (a) maintaining the corporation's status, when it is dependent on the number and identity of shareholders, and maintaining any tax advantages; (b) preserving any statutory or regulatory advantage under federal or state securities law; (c) for every other reasonable purpose.[449] Finally, the law establishes the permitted types of transfer restrictions including (a) provisions that obligate shareholder to first offer to the corporation, other shareholders, or another person the restricted shares he intend to sell — for example, rights of first refusal, rights of first offer, tag-along and drag-along rights; (b) provisions obligating the corporation, shareholders, or another person to buy shares subject to the restriction agreement — for example, mandatory sale provisions; (c) provisions that require the corporation or shareholders to approve any proposed transfer of restricted shares; (d) provisions prohibiting the transfer of restricted shares to designated persons or classes of persons, if the prohibition is not manifestly unreasonable.[450]

In the following paragraph, we will discuss the regulatory requirements of the most common provisions adopted to restrict the transfer of shares, namely right of first refusal and right of first offer, mandatory sale provisions, tag-along and drag-along rights.

4.2.1 Right of First Refusal and Right of First Offer

The right of first refusal and the right of first offer are often included in shareholders' agreements to maintain the *status quo* in the ownership of the company by offering the opportunity to the corporation and/or former shareholders to purchase the shares that any

[445] Id.
[446] See Del. Code Ann. tit. 8 § 202(a), 2005.
[447] See Model Bus. Corp. Act § 6.27(b), 2005. [stating that "a restriction on the transfer or registration of transfer of shares is valid and enforceable…if…its existence is noted conspicuously on the front or back of the certificate or is contained in the information statement…"].
[448] See Del. Code Ann. tit. 8 § 202(a), 2005. See Model Bus. Corp. Act § 6.27(b), 2005.
[449] See Del. Code Ann. tit. 8 § 202(d)-(e), 2005. See Model Bus. Corp. Act § 6.27(c), 2005.
[450] See Del. Code Ann. tit. 8 § 202(c), 2005. See Model Bus. Corp. Act § 6.27(d), 2005.

shareholder wants to sell.[451] A right of first refusal ("ROFR") provides that the shareholder desiring to sell its shares must offer to the corporation and/or other shareholders the shares at the same price and terms received from a third party, and only if the corporation and/or shareholders do not exercise the option, the shareholder may offer the shares to outsiders.[452] Conversely, a right of first offer ("ROFO") provides that the selling shareholder first offer the shares to other shareholders and/or to the company, and, if the offer is refused or it wants to seek offers from outsiders, it may sell the shares to third parties at a price not lower or terms less favorable to those offered by other shareholders and/or the company.[453]

Delaware law explicitly states that ROFR and ROFO are enforceable if they are not unreasonable. However, some problems may arise in the application of these rights.[454] First, the ROFR requires potential investors to necessarily expose their offers that, if not implemented with a ROFO, the right can hinder the marketability of the restricted shares.[455] Second, if the right is applied not on all shares but some of them, it may discourage the purchase of shares by potential investors who would inevitably enter into a minority vulnerable position.[456] For this reason, these rights typically involve the offer of all the shares ensuring also that selling shareholders are not left with a too small ownership stake that is economically hard to sell.[457] Finally, another problem is created by the choice of the method used to determine the price at which the restricted shares are to be purchased. Although a variety of methods is available, each of them has some limitations in estimating the value of the company, and thereby the value of shares: if the appraisal method has the effect of ignoring the value of goodwill and intangible assets, the multiple method is complex to implement, because it requires future earnings projections to be made.[458]

4.2.2 Mandatory Sale Provisions

The mandatory sale provision requires a shareholder to sell its shares to the corporation or former shareholders about the occurrence of certain circumstances, such as the death, retirement, or termination of shareholder employment.[459] This provision is typically included

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[451] Corporation Law Committee of the Association of the Bar of the City of New York, supra note 443, at 1178.
[452] Joyce T., supra note 376, at 370.
[453] Corporation Law Committee of the Association of the Bar of the City of New York, supra note 443, at 1178.
[454] Joyce T., supra note 376, at 370.
[455] Id.
[456] Id.
[457] Corporation Law Committee of the Association of the Bar of the City of New York, supra note 443, at 1180.
[458] Joyce T., supra note 376, at 371.
[459] Corporation Law Committee of the Association of the Bar of the City of New York, supra note 443, at 1180.

in shareholders' agreements to preserve the ownership structure of the company to a limited group of shareholders.[460]

Mandatory sale provisions fall under the restrictions on the transfer of shares concerning the sale of the shares to the corporation or other shareholders regulated by section 202(c)(4) tit. 8 of the Delaware Code. Although some states like New York do not statutory recognize the types of transfer restrictions, courts held that mandatory sale provisions are lawful and enforceable, unless they are not reasonable.[461]

Gaps between the fair value of the shares at the date of repurchase and the value included in the agreement do not have the effect to invalidate the restriction itself, but often the intervention of courts in determining a more accurate value of shares was necessary.[462] However, disparities between the fair value of shares and their purchase price were not held by courts when they involved the repurchase of shares held by employees. This may be explained by the fact that employees typically receive shares of the company as a consequence of the employment and as an incentive to align their interests with the interests of the company.[463]

4.2.3 Drag-Along and Tag-Along Rights

A shareholder exercising a drag-along right may force other shareholders to sell their shares at the same terms and price offered to the selling shareholder.[464] These provisions are used also in corporate transactions such as mergers and sales of substantially of the company's assets to force the sale.[465] On the other hand, a tag-along right provides that selling shareholders propose other shareholders to sell a pro-rata portion of their shares at the same terms and price to the same purchaser.[466] Tag-along rights typically are used to give minorities the possibility to enjoy the control premium which can result from the sale of shares and to give the possibility to other shareholders of liquidating their shares at the same condition of shareholders exercising the right.[467]

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460 Id.
461 Id.
462 Id. at 1181. [stating that in the case Aron v. Gillman, 128 N.E. (1955) courts intervened adjusting the book value of the stock to reflect the fair value of the company's inventory and tax liability].
463 Id.
464 Id. at 1182.
465 Id.
466 Id. at 1185.
467 Id.

Although Delaware law specifically allows shareholders to sell their shares to the corporation, other shareholders, and other persons, case law concerning drag-along and tag-along rights is scarce. While courts generally not ruled the enforceability of tag-along rights, the discussion on drag-along rights is more complicated. The Delaware Court of Chancery in the case Shields v. Shields (1985) ruled the enforceability of shareholders' agreements forcing investors to sell their shares in the event of a merger.[468] The enforceability of drag-along rights permits shareholders to force the sale of the shares waiving legal protections, such as appraisal rights, disclosure obligations, that would be applicable in merger transactions.[469] Although courts generally enforce waivers of appraisal rights when shareholders are fully informed on them, neither Delaware and other state courts expressly enforced these waivers in the context of a drag-along sale.[470]

4.2.4 Call Options and Put Options

Shareholders' agreements typically include call and put options as rights to liquidate the ownership position in the corporation. Specifically, a call option is an agreement providing to a party a unilateral right to buy the ownership position from the counterparty at a determined time and a certain price previously fixed in the agreement or ascertainable by reference to a pre-determined formula.[471] On the other hand, a put option is the right of a shareholder to unilaterally require shareholder, group of shareholders, or the company itself to purchase its shares at a specific time and a predetermined price fixed in the agreement or ascertainable by a pre-agreed formula.[472]

Call and put options are typically exercised when specific circumstances arise, such as death, disability, insolvency of the shareholder, breach of shareholders' agreements, termination of the employment of employees holding a small ownership stake, and so on.[473] These options are commonly used in the sale of only part of shareholders' shares to ensure them to be not trapped

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[468] See Shields v. Shields, 498 A.2d 161, 168 (Del. Ch. 1985). [ruling that: "*Agreements between stockholders with respect to their stock may, of course, take any number of forms, see 8 Del.C. § 202, and it is conceivable that such an agreement could provide that in the event of a merger resulting in the signatories holding shares of another corporation that certain consequences would occur, including the forced sale by one party of the new stock to another party at an agreed upon price or a price fixed by reference to an agreed upon formula.*"].
[469] Corporation Law Committee of the Association of the Bar of the City of New York, supra note 443, at 1182.
[470] Id. at 1183.
[471] Pajic J. (2012). Share Transfer Restrictions and Exit Mechanisms in Shareholders' Agreements, *GSI Meridian*, pp. 21-24. Available at: https://www.goksusafiisik.av.tr/Articletter/2012_Summer/GSI_Articletter_2012_Summer_Article10.pdf.
[472] Id. at 22.
[473] Id.

in the company with a small holding unlikely to be sold; by exercising their put option right shareholders may easily sell their shares at better terms than that otherwise be obtained in the market.[474]

Another application of call and put options rights may be found in the purchase of minority shareholdings. In these transactions, the inclusion of puts and calls options allows the buyer to buy other shares to hold a more significant percentage of the share capital or to sell the shares back.[475]

As already mentioned before, Delaware law explicitly authorizes puts and calls options that are included in the obligations stated in section 202(c)(2) tit. 8 of the Delaware Code. It specifically provides the validity and enforceability of restrictions on the transfer of shares that oblige other shareholders, the corporation itself, or other persons, to buy shares subject to an agreement concerning the purchase and sale of restricted shares.[476]

4.3 Disclosure Requirements

As we already discussed, the phenomenon of shareholders' agreements in the United States has always been confined to the close corporations, on the other hand remarking a kind of incompatibility with the public listed companies. This incompatibility is due to several factors, such as the particular ownership structure of U.S. listed companies characterized by widely dispersed ownership, the large presence of institutional investors holding an ownership stake in the company, and the presence of an efficient system for protecting minority shareholders. All these factors — discussed in the previous chapter — discourage shareholders or make less meaningful the stipulation of shareholders' agreements in the context of public listed companies.

Moreover, the U.S. regulatory framework discourages the formation of relevant positions in the ownership structure of the company making it difficult the creation of agreements among shareholders aimed at influencing the corporate governance of the company. In particular, the federal regulatory framework imposes extensive disclosure requirements for relevant share participation in the company under the Regulation 13D of the U.S. Securities Exchange Act of

[474] Id.
[475] Id.
[476] See Del. Code Ann. tit. 8 § 202(c)(2), 2005.

1934.[477] Introduced by the Williams Act of 1968, Regulation 13D requires within 10 days from the purchase the filing of Schedule 13D with the U.S. Securities and Exchange Commission (SEC) when a person or a group acquires more than 5% of a class of company's equity shares.[478] An ownership stake of this dimension makes the holders "insiders" to public companies whose securities transactions fall within the type of those to be observed. In this context, the creation of a shareholders' agreement that aggregates more than 5% of the company's share capital would lead parties to the agreement to be considered insiders, who would be subject to strict disclosure requirements that can be harmful especially if they are institutional investors.

Therefore, differently from Italy, in U.S. legal framework a specific regulation of shareholders' agreements disclosure has not been developed. Clearly, close companies are not obliged to publicly disclose shareholders' agreements, despite they must file the charter with the Secretary of State.[479] The MBCA, which before the revised version of 2016 expressly limited its provisions to close corporation, provides only for internal confidentiality of shareholders' agreements. Section 7.32 provides that the existence of the agreement shall be noted on the front or back of each certificate of outstanding shares or on the information sheet required, and the failure to note its existence does not affect the validity of the agreement but entitles the party who, at the time of purchase, did not have knowledge of its existence to require the rescission of the purchase.[480]

A provision regulating the disclosure of shareholders' agreements in listed companies can be found in Section 12(2) of the Securities Exchange Act of 1934. However, the text of the provisions refers only to voting trusts agreements requiring that, at the time of registration of shares of companies listed in a domestic stock exchange, the issuer must disclose "voting trusts agreements with respect to, the issuer and any person, directly and indirectly, controlling or controlled by, or under direct or indirect common control with the issuer".[481] The law provides the full disclosure of the voting trust, as if it were statutory documentation, even in the close companies.[482] The provision concerns exclusively voting trust agreements and no reference is

[477] Joyce T., supra note 376, at 356.
[478] Fed. Reg. 17 CFR § 240.13d-1 – Filing of Schedules 13D and 13G.
[479] Rauterberg G., supra note 340, at 22.
[480] See Rev. Model Bus. Corp. Act § 7.32(c), 2016.
[481] See Securities Exchange Act of 1934 § 12(2).
[482] See Rev. Model Bus. Corp. Act § 7.30(a), 2016. See Del. Code Ann. tit. 8 § 218(a), 2005. Cited in Guaccero A., supra note 407, at 297.

made for other classes of shareholders' agreements. Therefore, the regulation cannot be compared to that of art. 122 T.U.F. for shareholders' agreements in Italian listed companies.

4.4 Enforcement of Shareholders' Agreements

As we saw before regarding voting agreements, historically U.S. courts have been reluctant to validate shareholders' agreements concerning the exercise of voting rights in the meetings. The same inclination has been adopted in ruling the enforceability of shareholders' agreements concerning directors' decisions. The invalidity of such agreements is basically due to the violation of the corporate mandatory rule vesting directors with the exclusive authority to manage the affairs of the corporation, and any agreement having the effect of altering the allocation of management powers shall be deemed invalid.[483]

However, today the tendency of courts is moved toward a general acceptance of shareholders' agreements both concerning voting rights and directors' powers. Generally, shareholders' agreements should be enforceable if they do not affect other shareholders, creditors, and third parties. Instead, limits and duties can be set regarding the conduct of the controlling shareholder towards minority shareholders.[484] Nevertheless, the law provides for statutory prerequisites shareholders' agreements must comply with to be enforceable. Specifically, the MBCA and Delaware Code establish the requirements for the enforceability of shareholders' agreements.[485]

The MBCA in section 7.32 specifies the following requirements shareholders' agreements must have to be enforceable: (a) the agreement shall be set forth in the articles of association or bylaws and approved by all shareholders, or in a written agreement signed by all shareholders at the time the agreement is concluded;[486] (b) the agreement shall be unanimous;[487] (c) the agreement shall be known by the corporation.[488] The amendment to the MBCA of 2016 has removed the 10 years term on the duration of the agreement, giving to parties the flexibility to determine the duration of the agreement that must be set forth in it.[489]

Similarly, Delaware code tit.8 sections 350, 351, and 354 provide the following requirement for shareholders' agreements enforceability: (a) the agreement shall be set forth in the certificate

[483] O'Neal F. H., Thompson R., supra note 55, at 5:2, 5:23.
[484] Guaccero A., supra note 407, at 292.
[485] Molano-Leon R., supra note 422, at 243-245.
[486] See Model Bus. Corp. Act § 7.32(b)(1), 2016.
[487] See Official Comment Section 7.32(b) Model Bus. Corp. Act (2005).
[488] Id.
[489] See Official Comment Section 7.32(b) Model Bus. Corp. Act (2016).

of incorporation if shareholders unanimously vote that the management of the corporation vests in the hands of shareholders rather than directors,[490] or a written agreement among shareholders approved by the majority of them entitled to vote if the purpose of the agreement is to restrict the power of directors;[491] (b) the corporation must be a close corporation.[492]

We can conclude that shareholders' agreements are generally enforceable. However, a doubt arises concerning whether they should be enforced like other agreements or not. Differently from other contracts, a breach of a shareholders' agreement typically results in courts ordering a specific performance rather than awarding damages.[493] The reason stands in the high speculative nature of damages which makes them an inadequate remedy for breaches of shareholders' agreements.[494] The application of injunctive relief is allowed to the recurrence of specific circumstances, including the situation when the compensation remedy is inadequate to restore the damage suffered by the injured party.[495] In this sense, courts commonly provided for the following remedies[496]: (a) voiding corporate actions and decisions taken in violation of the agreement; [497] (b) reforming the agreement, or articles of incorporation to reflect the agreement;[498] (c) voiding the transfer of shares;[499] (c) ordering an accounting;[500] (d) ordering for compensatory and punitive damages.[501] Moreover, the U.S. legal framework acknowledges, through national statutory rules, provisions that expressly allow the specific execution of voting agreements.[502]

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490 See Del. Code Ann. tit. 8 § 351, 2005.
491 See Del. Code Ann. tit. 8 § 350, 2005.
492 See Del. Code Ann. tit. 8 § 343 - 344, 2005.
493 Kaal W. A., supra note 413, at 17.
494 Id.
495 Guaccero A., supra note 407, at 299.
496 Kaal W. A., supra note 413, at 18.
497 Zion v. Kurtz, 50 N.Y.2d 92, 428 N.Y.S.2d 199, 405 N.E.2d 681 (N.Y. 1980), [court held that no business activities could be conducted without the consent of the minority shareholding, and thus, voiding any action taken in contrast to this provision].
498 Zion v. Kurtz, supra note 497, [courts held that the articles of incorporation should be reformed to reflect the existence of the shareholders' agreement including provisions that restrict directors' management authority].
499 Scheurer v. Scheurer, 311 Minn. 546, 249 N.W.2d 181 (1976), [court enforce the voting agreement stipulated between Scheurer and his sons that reserved the father the exercise of voting rights attached to shares until his death, even if the shares were transferred to sons; as result, the court rescinded the original share transfer transaction].
500 Wasserman v. Rosengarden, 84 Ill. App. 3d 713, 40 Ill. Dec. 430, 406 N.E.2d 131 (1st Dist. 1980), [minority shareholder participating in a shareholders' agreement requested an accounting and corporate dissolution against his two fellow shareholders as a result of a breach of shareholders' agreement].
501 Sankin v. 5410 Connecticut Ave. Corp., 281 F. Supp. 524 (D. D.C. 1968), [court provided for punitive and injunctive relief and compensatory damages against shareholders who breached the agreement and the corporation].
502 Guaccero A., supra note 407, at 299.

4.5 Chapter Conclusions

The present chapter was aimed at analyzing the regulation of shareholders' agreements in the United States framework. Each U.S. state regulates these agreements with the provisions contained in its corporate code, with slight, but not relevant differences from one to another. In this chapter, we have explored the two most applied codes, namely the Model Business Corporation Act and the Delaware Code, that represent the referring point for the statutory codes enacted in the other states. The most common types of shareholders' agreements concern the exercise of voting rights in shareholders' meetings and the restrictions applied to the transfer of shares. The former, voting agreements are concluded between shareholders to alter the default rule of the majority, thus, they specifically grant parties, who enter into the contract, the power to vote as a unit to take resolutions on matters decided at the shareholders' meeting. For these particular features, they have viewed with suspicion from the courts which in almost all cases have ruled their invalidity. Although in recent cases, the view of courts has moved to a general acceptance of the validity of voting agreements. Among voting agreements, we discussed voting trusts, pooling agreements, and proxy agreements to whom the U.S. corporate law addresses specific provisions. Both Delaware Code and the MBCA set the requirements these agreements must comply with to be deemed as valid. Voting trusts and proxy agreements involve the transfer of the voting right to a third party, but if in the former, who receives the shares becomes the legal owner of them but the economic benefit is still in the hands of transferring shareholders, on the other hand, the latter solely grant a third party the right to vote on the behalf of the shareholder who owns the shares.

Shareholders' agreements including provisions that restrict the transfer of the shares are used by parties to maintain the *status quo* of the corporation and control the composition of the group of shareholders. Provisions typically regulated by these agreements involve: a) pre-emptive rights for the company or remaining shareholders to buy the shares offered by the selling shareholders — right of first offer and first refusal; b) mandatory sale to the corporation or former shareholders upon the occurrence of certain events — mandatory sale provision; c) minorities' rights to sell the shares at the more convenient conditions offered to the majority shareholder — drag-along and tag-along rights; d) rights to require the purchase or sale of the ownership stake at a certain time and conditions — call and put options.

Regarding disclosure requirements, since shareholders' agreements were thought in the context of close corporations, the U.S. legal system does not provide for specific regulation of the disclosure requirements that are remanded to the SEC. This is because participations of shareholders who entered into an agreement among themselves are considered as a unit and, thus, exposed to the strict rule 13D of disclosure requirements for relevant share participation. Hence, this limited the stipulation of shareholders' agreements in public listed companies.

Finally, the chapter concludes with the description of the requirements needed by the law — the MBCA and Delaware code specifically — to rule the enforceability of shareholders' agreements.

CHAPTER 5: REGULATION OF SHAREHOLDERS' AGREEMENTS IN ITALY

Summary: Introduction. — 5.1 Voting Agreements. — 5.2 Blocking Agreements. — 5.2.1 Drag-Along and Tag-Along Clauses. — 5.2.2 Pre-Emption Agreements. — 5.2.3 Some Considerations about the Validity of Blocking Agreements. — 5.3 Controlling Agreements. — 5.4 The Regulation in Listed and Close Companies: The Discipline of T.U.F. and Civil Code. — 5.5 Shareholders' Agreements Disclosure — 5.5.1 Disclosure Requirements for Listed Companies. — 5.5.2 Disclosure Requirements under art. 2341-ter. c.c. — 5.6 Enforcement of Shareholders' Agreements: Invalidity and Breach. — 5.6.1 Invalidity of Shareholders' Agreements. — 5.6.2 Breach of Shareholders' Agreements. — 5.7 Chapter Conclusions.

Introduction

The Italian context has been always permeated by the presence of agreements concluded between shareholders in a corporation with the purpose to stabilize the corporate management and the ownership structure of the corporation. However, before 1998 this presence has been only encountered in a practical way, while in the legislative framework no provisions regulating shareholders' agreements were provided.[503] Indeed, the comprehensive regulation of shareholders' agreements (*patti parasociali*) was first introduced in 1998 with the Consolidated Law on Finance (TUF) — namely, the legislative decree 58/1998 — but only regarding listed public companies.[504] Particularly, articles 122 and 123 include first of all a definitive and express recognition of the legitimacy and validity of shareholders' agreements, meant as instruments for the development of the private autonomy of shareholders in flexibly designing the organizational structure of the company.[505] The legislator wanted to ensure the transparency of agreements' content by imposing a mandatory disclosure with the aim of making investors more aware of their investment decisions and encouraging the development of the market.[506]

Consequently, the reform of company law of 2003 has established the recognition of shareholders' agreements in the context of the Civil Code, regulating these agreements in both close companies and not listed companies that resort to capital markets.[507] Articles 2341-bis

[503] Giannini L., Vitali M., supra note 375, at 9.
[504] Marchini P.L., Lugli E., supra note 343, at 36.
[505] Giannini L., Vitali M., supra note 375, at 64.
[506] Id.
[507] Id. at 85.

and 2341-ter of Civil Code determine the object of shareholders' agreements, as well as the duration and the transparency through disclosure requirements. Especially, shareholders' agreements stipulated in close corporations are only subject to the provisions of article 2341-bis c.c., while agreements concluded between shareholders in companies that resort on capital markets, in addition to the provisions of the abovementioned articles, are regulated also by the provisions of article 2341-ter c.c. in terms of disclosure requirements.[508] Agreements concluded in listed public companies are still regulated by the provisions of article 122 TUF.[509]

Article 2341-bis c.c. states that shareholders' agreements can be stipulated in any form in order to stabilize the ownership structure or the governance of the company and have as object: (a) the exercise of voting rights in the company or in companies that control them; (b) the limitation on the transfer of shares in these companies or in companies that control them; (c) the exercise, even jointly, of dominance on the aforementioned companies, may not have a duration longer than 5 years and they shall be deemed to have been concluded for such duration even if the parties provided for longer duration; these agreements shall be renewable upon expiry.[510] Article 2341-ter c.c. provides for companies that resort from capital markets the obligation to communicate the agreement to the company and disclose it at the beginning of each general meeting.

Article 2341-bis c.c. identifies three types of shareholders' agreements, namely voting agreements (*sindacati di voto*), blocking agreements (*sindacati di blocco*), and controlling agreements (*sindacato di gestione*), that will be treated later in the following paragraphs. In this chapter we also discuss the disclosure requirements for listed companies and, to conclude, we analyze the enforceability of such agreements.

5.1 Voting Agreements

As defined by the United States jurisprudence, voting agreements, identified as *"sindacati di voto"* in the Italian context, are contracts entered between shareholders to bind the contracting parties to exercise their voting rights in the general meeting in compliance with the decisions taken according to what established by the agreement.[511] These agreements may simply bind contracting parties to a preliminary mutual consultation before each meeting or may bind them

[508] Marchini P.L., Lugli E., supra note 343, at 36.
[509] Id.
[510] Civil Code art. 2341-bis Italy, 2003.
[511] Marchini P.L., Lugli E., supra note 343, at 37.

to vote according to what has been preventively decided by the majority.[512] Through the application of voting agreements parties are allowed to form a corporate control group and to ensure continuity in the current conduct of business.[513] Voting agreements can be stipulated permanently or for a single meeting, and the exercise of voting rights according to the agreement can be referred to all meetings' resolutions or just for specific resolutions as for the election of directors.[514] Voting agreements may also be distinguished in: (a) unanimous voting agreement (*sindacato di voto all'unanimità)* concluded for a limited period of time according to which shareholders agree unanimously to cast votes in a certain manner; (b) majority voting agreement (*sindacato di voto a maggioranza*) in which the decision is taken with the majority of shareholders.[515]

Among voting agreements can be included shareholders' agreements providing for a preventive consultation of contracting parties. Differently from simple voting agreements, their provisions are not related to the exercise of voting rights during the meeting, but instead, they provide for a preventive consultation about how contracting parties are going to cast their vote in the next meeting. This agreement aims to enhance the awareness of parties about social and economic decisions before the meeting, while parties remain free to cast their vote as they see fit.[516]

For a long time, Doctrine and Jurisprudence have considered voting agreements unlawful based on the traditional theory formed of two main arguments.[517] First, the nature of the voting right determines its non-transferability and the impossibility to separate it from the ownership of the share.[518] Hence, shareholders cannot divest themselves of the right to vote neither through the sale of the vote nor partially committing themselves to exercise it in a pre-determined way.[519] Second, the application of voting agreements could have undermined the proper functioning of shareholders' meeting since they have the effect of altering the balance between power, risk, and responsibility which is the basis of the autonomous decision-making process that a shareholder should follow.[520] According to this doctrine, the possibility of taken decisions before and outside the meeting would result in a violation of statutory rules stating that shareholders' will should be formed during the meeting, and even of the majority rule

[512] Giannini L., Vitali M., supra note 375, at 125.
[513] Marchini P.L., Lugli E., supra note 343, at 37.
[514] Id.
[515] Giannini L., Vitali M., supra note 375, at 128.
[516] Marchini P.L., Lugli E., supra note 343, at 8.
[517] Jaeger P. G. (1989). Il problema delle convenzioni di voto, *Giur. Comm.*, I, pp. 201 ss.
[518] Id. at 209.
[519] Id.
[520] Giannini L., Vitali M., supra note 375, at 126.

attributing the control of the company to a person who does not own the majority share of capital.[521]

Moreover, the admissibility of voting agreements deliberating to the majority has been challenged because of their attitude to circumvent the majority rule underlying the meeting resolutions.[522] Through these agreements, the minority is allowed to impose on shareholders who effectively constitute the majority thanks to their prevalence in the agreement.[523] In this way, Ascarelli, despite being an advocate of the legitimacy of voting agreements, introduced a limit on the validity of them, denying it to agreements deliberating to the majority.[524] However, the art. 93 (1)(b) TUF indirectly provides for the validity of voting agreements deliberating to the majority since they allow a shareholder, who entered into an agreement with other shareholders, owning enough voting rights to exercise a dominant influence on the general meeting to effectively control the company.[525]

In asserting the validity of voting agreements, De Gregorio did not support the indistinct validity of them, but rather he affirmed the need to first ensure that the content of a voting agreement has been determined according to the interests of the company, its application does not injure the person against whom it was assumed, and, lastly, it does not breach a particular statutory or legal rule.[526] This approach introduces a new perspective in the context of voting agreements, passing from the complete denial of their validity to their admissibility, submitting them to an assessment of their compatibility with the public interest and the corporate functioning rules.[527]

The validity of voting agreements was first recognized by the sentence of the Court of Cassation n. 9975 of 20 September 1995.[528] The court held that the obligation arising from an agreement designed to determine in advance methods for appointing directors and auditors, operating outside the organizational structure, does not prevent shareholders to freely determine their will when voting in the meeting, nor deprives this body of the power of appointment.[529] In this sense,

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[521] Id.
[522] Id. at 129.
[523] Jaeger P. G., supra note 517, at 232.
[524] Ascarelli T. (1937). In tema di diritto di voto con azioni date in pegno e di sindacati azionari, *Foro it.*, I, c. 18; cited in Jaeger P. G., supra note 517, at 217.
[525] Giannini L., Vitali M., supra note 375, at 129.
[526] De Gregorio A., Delle società e delle associazioni commerciali, in Bolaffio *et al*. (1938). Il codice di commercio commentato, IV, Turin 1938, nn. 318, p. 425; cited in Jaeger P. G., supra note 517, at 219.
[527] Jaeger P. G., supra note 517, at 219.
[528] Giannini L., Vitali M., supra note 375, at 129.
[529] See Cassazione Civile, Sezione I, 20 September 1995, n. 9975. [providing that: "*non è esatto, in particolare, che, vincolando con dei patti parasociali la propria libertà di voto, i soci finirebbero per svuotare l'assemblea*

the commitment made by a shareholder to cast its vote differently from what established in the agreement does not affect the functioning of the company and the resolution taken by the meeting; it has relevance only for the eventual contractual liability towards the other parties of the agreement for the violation of the same.[530] In the same way, the sentence of the Court of Cassation n.14865 of 23 November 2001 states the validity of voting agreements in the measure that they do not have an illegitimate influence on the functioning of the meeting, since they do not prevent shareholder to freely allocate its vote during the meeting.[531]

Nevertheless, any doubt about the validity and enforceability of voting agreements, and more generally shareholders' agreements, has been definitively dispelled by Italian legislator with articles 122 and 123 TUF before, and articles 2341-bis and 2341-ter after, has determined their validity and enforceability in all limited companies.[532] However, the provisions introduced by these articles do not solve the traditional uncertainties regarding shareholders' agreements. The discipline regulating such agreements can be viewed as incomplete since it is limited to regulate only the duration of the agreement for all limited companies and the disclosure process for public listed companies and companies that resort to the capital market.[533] No mention is made for what concerns the way participants in a voting agreement should take decisions. Since shareholders' agreements are grounded on the principle of private autonomy — enshrined in art. 1322 c.c. — the choice of how the majority should be formed lies in the contractual freedom of participants in the agreement, provided, of course, that it is compatible with the imperative norms set out by the legal system.[534] Nonetheless, the method according to which the majority should be determined in a voting agreements does not have any effect with respect to the

delle funzioni e dei poteri che ad essa la legge attribuisce…Il vincolo nascente dal patto di sindacato opera su un terreno che è esterno a quello dell'organizzazione sociale e non impedisce in alcun modo al socio di determinarsi all'esercizio del voto in assemblea come meglio egli creda, sicché il funzionamento dell'organo assembleare non è in questione. Il fatto che il socio medesimo si sia, in altra sede, impegnato a votare in un determinato modo ha rilievo solo per l'eventuale responsabilità contrattuale nella quale egli incorrerebbe - ma unicamente verso gli altri firmatari del patto parasociale - violando quell'accordo…"].

530 Giannini L., Vitali M., supra note 375, at 130.

531 See Cassazione Civile, Sez. I, 23 November 2001, n. 14865. [providing that: "*i patti parasociali e, in particolare i cosiddetti sindacati di voto sono, nella loro varia tipologia accordi (quindi) atipici volti a disciplinare, in via meramente obbligatoria tra i soci contraenti, il modo in cui dovrà atteggiarsi (su vari oggetti) il loro diritto di voto in assemblea. Il vincolo, che da tali patti discende, opera, pertanto, su un terreno esterno a quello della organizzazione sociale, per cui non può dirsi, senza confondere i due diversi piani del rapporto parasociale e del rapporto sociale; nè che al socio, stipulante un tal patto, sia in alcun modo impedito di determinarsi all'esercizio del voto in assemblea come meglio creda, nè, quindi, che il patto stesso ponga in discussione il funzionamento dell'organo assembleare… Non sussiste il paventato effetto di svuotamento dei poteri assembleari riconducibile al patto parasociale e ciò conduce ad escludere che possa per quel motivo sostenersi la tesi della invalidità, "per principio" dei patti parasociali…*"].

532 Giannini L., Vitali M., supra note 375, at 132.

533 Fiorio P., Commento agli articoli 2341-bis e 2341-ter, in Cottino G. *et al*. (2004). Il nuovo diritto societario, I, Zanichelli, Bologna 2004, p. 132.

534 Costi R. (2004). I patti parasociali ed il collegamento negoziale, *Giurisprudenza Commerciale*, Vol. 1, pp. 200-212.

purpose for which the agreement has been stipulated; in this sense, even a show of hands majority rule is able to pursue the aims of voting agreements by promoting personal relations, even if it has the effect of eliminating the rule stating the correlation between voting power and risk assumed.

5.2 Blocking Agreements

In practice, voting agreements are often complemented by blocking agreements acting, in this case, as integrative clauses that restrict the ability of contracting shareholders to sell, neither wholly nor partly, their shares or that include pre-emptive clauses to other participating shareholders.[535] Blocking agreements, or more properly "*sindacati di blocco*", are the counterparties of agreements establishing restrictions on the transfer of shares analyzed in the United States context. As for the latter, these agreements are contracts stipulated by shareholders who commit themselves to not alienate or limit the transfer of shares for a determined period of time.[536] Blocking agreements is functional to the need of maintaining the stability and uniformity of corporate ownership structure, keeping unwanted investors from getting in.[537]

As other shareholders' agreements, they have a binding effect only among the contractual parties and have no relevance towards third parties and the company, to the point that a breach of the agreement has not incidence on the validity of the alienation of shares related to the agreement, but rather it determines the incurring of compensation for damage borne by breaching shareholder towards other parties to the agreement.

However, blocking agreements do not only involve the ban on the alienation of companies' shares, but other restrictions are also included. In fact, besides these agreements governing the inalienability of shares (*patto di inalienabilità)* the law recognizes other two types of transferring shares rights agreement, namely pre-emption agreement (*patto di* prelazione) and approval agreement (*patto di gradimento*).[538]

[535] Jaeger P. G., supra note 517, at 253.
[536] Giannini L., Vitali M., supra note 375, at 132.
[537] Marchini P.L., Lugli E., supra note 343, at 37.
[538] Giannini L., Vitali M., supra note 375, at 133.

5.2.1 Drag-Along and Tag-Along Clauses

As in the United States, in Italy shareholders' agreements are likely to include tag-along and drag-along clauses in restricting the transferability of shares of participants in the agreement. Both rights involve the joint alienation of shares that can be justified by the purpose to obtain more favorable economic conditions from the transaction than those received from separate alienation or to maintain the relationship among participants in the agreement preventing the entry of outsiders. As we already mentioned before, the tag-along clause, also known as "piggy back", allows minority shareholders to sell their shares at a percentage proportional to that in the sale of the majority shareholders at the same conditions offered to the latter. The clause that, according to the cases, can be substituted or may be provided for as an alternative to pre-emption, just allows minority shareholders to obtain the same conditions offered to the majority shareholder in the sale of shares, who maintains the dominant position in the transaction, preventing minority shareholders to interfere in the transaction influencing the outcome.[539] The application of the clause allows minority shareholders to obtain an increased value for the stake held, since the same conditions offered to the majority shareholder are applied for the minority stake as well, and also, it allows them to avoid a working relationship with an unwanted majority shareholder.[540]

While the tag-along clause was thought to protect the interest of minority shareholders, the drag-along clause is designed to protect the majority shareholders. This clause confers to majority shareholders the right to negotiate not only the sale of its shares but also the participation of other shareholders who oblige themselves to sell them to the same buyer and at the same conditions. The application of the drag-along clause is more common in acquisitions regarding the entire participation share and where institutional investors are involved. In fact, the application of the drag-along right allows institutional investors, even if holding a minority stake, to liquidate at a control premium their investment by selling their shares to a third party, thus realizing their expected return on investment.[541] The clause is particularly useful also for the majority shareholder since, giving the buyer the possibility to purchase the entire ownership stake, it may be willing to offer a higher price than what it would have offered to purchase only the majority of shares.

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[539] Pedersoli A., Sindacati di Blocco: Validità, Tipi ed Effetti, in Bonelli F., Jaeger P. (1993). Sindacati di Voto e Sindacati di Blocco, Giuffrè editore, Milano 1993, pp. 232-242.

[540] De Matteis L. (2017). La clausola di trascinamento inserita nello statuto di una società a responsabilità limitata e criteri redazionali, *Giur. Comm.*, No. 4, pp. 639-686.

[541] Id. at 640.

The application of the drag-along clause allows potential investors to purchase a greater portion of the company's share capital and to obtain the control of the company, avoiding the rights granted to minority shareholders in terms of qualified majority requirements, veto rights upon meetings' resolutions, and appointment rights of members in the board of directors.[542]

The decision taken by the Court of Milan in 2018 has supported the corporate nature of this clause since it promotes the corporate structure's homogeneity and the cohesion between the shareholders.[543] Based on this guidance, it has been supported the opinion according to which the drag-along clause tends to protect the corporate interest and promote the homogeneity of the corporate structure by avoiding obstructive actions by the minority shareholders that otherwise would lead to an improper company's functioning.[544]

In this sense, the limited duration of shareholders' agreements stated in the art. 2341-bis c.c. has made it necessary to give statutory relevance to the drag-along clause by advocating its real effectiveness — contrasted to the binding effect of shareholders' agreements — particularly in the case of limited liability companies.[545] The inclusion of the drag-along clause in the charter provides real effectiveness to the clause which may be enforced *erga omnes*, even against the transferee who is aware of the existence of the clause included in the corporate charter.[546] The prevalent orientation requires the unanimity of shareholders for the inclusion of this clause in the charter of companies limited by shares.[547] Although a part of doctrine argues that the quorum for the inclusion can be reached even by the majority, this orientation seems to be of difficult application, especially in limited liability companies that assume a marked personalistic nature.[548] This principle is consistent with the jurisprudential orientation which has required the unanimity of shareholders for amendments of the corporate charter concerning a substantial modification of the shareholders' rights and duties.[549]

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542 Id. at 641.
543 Malimpensa E. (2010). L'obbligo di co-vendita statutario (drag-along): il socio obbligato ha davvero bisogno di tutela? (nota a Trib. Milano, ord., 31 marzo 2008), *Riv. Dir. Soc.*, No. 2, pp. 370-391. [The author quotes the pronouncement of the Court of Milan according to which: "*L'interesse alla base di siffatta clausola…può però rispondere anche ad un interesse sociale nella misura in cui mira anche a disinnescare a priori la conflittualità interna alla società che potrebbe essere alimentata dal peso in concreto della quota di minoranza e da un possibile abuso del potere di controllo, e quindi a garantire l'omogeneità della compagine sociale e la coesione dei soci*."].
544 De Matteis L., supra note 540, at 642.
545 Id. at 643.
546 Malimpensa E., supra note 543, at 386.
547 De Matteis L., supra note 540, at 648.
548 Id. at 650.
549 Id. [The author cites the decision of the Court of Treviso of 17 June 2005 which held the invalidity of a meeting resolution adopted by the majority of the votes concerning the amendments of the corporate statute of a

The doctrine has taken opposite positions about the conditions that should trigger the application of drag-along clauses. While a part of it and the common practice sustain the activation of the clause with the intention of the majority shareholder to sell its entire ownership stake in the company,[550] on the other hand, the other part argues that the clause should activate at the reception of a written offer from a third party concerning the purchase of the 100% of the share capital of the target company.[551] The latter opinion can be supported by two arguments:[552] first, the conformation of the minority shareholder to the drag-along clause based only on the mere intention of the majority shareholder to sell the shares, prevent them to activate statutory mechanisms that should arise subsequently; and second, the condition to transfer the entire company's capital has its fundament in the necessity to separate the conditions that activate tag-along clauses, that often accompany drag-along clauses, so that the doubt related to which of the two clauses should trigger the sale of minority shareholders can be resolved.[553]

The parties can decide to appoint a third independent party, an arbitrator, to determine the purchase price. Besides, dragged shareholders are granted the right to require the assessment of the price offered by a third party, whose timing of the procedure shall be coordinated so as to avoid that the period during the assessment is performed could jeopardize the success of the drag-along process.[554]

5.2.2 Pre-Emption Agreements

Pre-emption agreements included options similar to the rights of first offer and rights of first refusal discussed concerning the United States environment. They typically provide that, if a shareholder desires to sell its participation in the share capital, it is obliged to first offer that to other shareholders or the company itself at the same contractual conditions received by a third party; if other shareholders or the company do not redeem the pre-emption clause, the selling shareholder may sell its shares to outsiders.

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limited liability company with the aim to include the obligation for shares to make a deposit for the company or to issue guarantees to banks.]

[550] See Santangelo S. (2011). Le clausole di "co-vendita" e di "trascinamento" nella S.r.l., *Fondazione Casale*, Available at: http://www.fondazionecasale.it.

[551] De Matteis L., supra note 540, at 658.

[552] Id.

[553] Id. at 659.

[554] Id. at 663.

Furthermore, the practice has shown that pre-emptive clauses may be articulated in different ways[555]: (a) simple pre-emption between contracting shareholders; (b) pre-emption that is first exercisable by one group of participants, and then by other participants or group of participants; (c) pre-emptive clauses providing that the majority of participants, once they become aware of a shareholder wanting to sell its shares, suggest a third person to whom the selling shareholders may contract with. The last pre-emptive clause is commonly applied in agreements known as approval agreements in which are reserved to majority shareholders the possibility to choose a potential investor willing to take over the ownership position left free by the selling shareholder. This clause — regulated by art. 2355-bis c.c. for limited companies — allows former shareholders to maintain the homogeneity of the corporate ownership structure, preventing the entry of individuals who can undermine this homogeneity because of their personal qualities that can be valued subjectively by the body in charge of that or objectively according to specific parameters established by the statutory clause.[556] The failure to receive the approval entails the inefficiency of the transaction and the impossibility to introduce the buyer in the shareholders' register.[557]

5.2.3 Some Considerations about the Validity of Blocking Agreements

Despite restrictions on the transfer of shares deriving from agreements concluded between shareholders in a corporation, on the one hand, have helped to stabilize the ownership structure of companies adopting them, on the other hand, they have been always discussed about their validity since no legislation upon such matter has existed. The essential characteristic of the share is its transferability, but nevertheless, this characteristic can be limited. Art. 2355-bis c.c. confirms the nature of free transferability of the share, and states that the corporate charter may contain provisions restricting the free transferability of shares and for a period no longer than 5 years it can forbid the transfer.[558] The restrictions can be included by amendment of the charter by a resolution taken by the majority of extraordinary meeting or can be contained in shareholders' agreements. In the first case, the provisions have the effect of binding all the shareholders, leaving to the dissenting shareholder the possibility to withdraw from the company; whereas, in the second case the restrictions are applied only to shareholders who take part in the agreement and the possible breach of such restrictions does not compromise the

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555 Pedersoli A., supra note 539, at 238.
556 Scorzolini A. (2018). Le clausole di gradimento. Available at: [https://www.iusinitinere.it/le-clausole-di gradimento-9185](https://www.iusinitinere.it/le-clausole-di-gradimento-9185).
557 Id.
558 See Civil Code art. 2355-bis, Italy 2003.

validity of the transfer, but it results in compensation for the damage caused by breaching shareholder. The article limits the application of restrictions in the cases of registered shares and failure to issue shares certificates.[559] As regards other cases, no limits should be imposed on the transferability of shares; specifically, *Borsa Italiana s.p.a.* imposes the free transferability of shares of listed companies prohibiting any provision that limits their alienation. Instead, while the integration of such provisions in the charter of companies that resort to the capital market can be discussed, increasingly common is the adoption of shareholders' agreements limiting the free transferability of shares.

5.3 Controlling Agreements

Article 2341-bis c.c., in defining the object that a shareholders' agreement can assume, specifies that by the means of the agreement shareholders may be able to exercise a dominant influence on the management of the company. These agreements are acknowledged by the Italian legislative landscape with the name of *sindacati di gestione*. Their content is not conceived for the exercise of voting rights in the meeting as for voting agreements, but rather they encompass the administration of the corporation.[560] Controlling agreements are concluded to specifically grant contracting shareholders, looking for certain stability, a dominance in conducting the business of the company or controlled companies. Parties to the agreement oblige themselves to agree on several administrative decisions and to ensure that the management body implements such decisions.[561] Typical decisions concern appointments to corporate offices or offices of controlled companies, the company's commercial strategy, investment plans, criteria for profit distribution.[562]

As provided in art. 2341-bis (c), which specifically allows shareholders' agreements to be stipulated with the purpose to exercise a dominant influence on the management, no doubts about the validity of these agreements should arise. Of the same opinion is the sentence of the Court of Milan of 2 July 2001 that recognizes, within the shareholders' agreements category, agreements through which shareholders ensure that directors, appointed with their votes, comply with the administrative policies shareholders have decided for and replicate them in the appropriate places.[563] However, different views neglecting the validity of controlling

[559] Id.
[560] Marchini P.L., Lugli E., supra note 343, at 38.
[561] Giannini L., Vitali M., supra note 375, at 139.
[562] Marchini P.L., Lugli E., supra note 343, at 38.
[563] See *Giur. It., 2002, p. 562.* [Court of Milan, 2 July 2001, expressly stated: "*rientrano nella categoria dei patti parasociali comunemente definiti sindacati di gestione gli accordi con cui i soci si impegnano a fare in modo*

agreements are not totally absent in doctrine and jurisprudence. Particularly, scholars[564] and courts[565] supporting the invalidity of such agreements have deemed that they have the effect of removing from the hands of directors the exclusive power to manage the corporation laid down in article 2380-bis c.c. Although the principle of exclusivity of the management function in the hands of directors does not have a mandatory nature in the context of limited liability companies, where shareholders may reserve to themselves the authority to manage the business, it creates more concerns for companies in which the separation of powers between shareholders and directors is stressed. However, this orientation seems to ignore the fact that directors are always subject to the direction of shareholders without that their authority and responsibilities are violated.[566]

Even if the legislator recognizes under art. 2341-bis (c) agreements that influence the actions of the management, this does not mean that they are always allowed, but instead, as courts have shown in practice, it is necessary to assess their validity and conformity with the fundamental corporate statutory rules on a case-by-case basis. These agreements are generally recognized also for listed companies with art. 122 TUF, which expressly allowed agreements having as object or effect, the exercise, even jointly, of a dominant influence on such companies for a period of time no longer than 3 years.[567] As provided for the other shareholders' agreements, they must be communicated to the CONSOB, otherwise, they should be void. In this sense, the two regimes that regulate shareholders' agreements in listed companies and all other companies converge towards the common recognition of the validity of controlling agreements.

che gli amministratori nominati grazie ai loro voti si conformino a pattuizioni riguardanti la gestione societaria, replicandole nelle sedi opportune e dandovi esecuzione: in tali ipotesi i soci non svolgono alcuna attività gestoria all'interno della società e le loro pattuizioni possono essere attuate soltanto se e quando siano recepite ed attuate autonomamente dagli organi preposti della società."].

564 See Abriani N., Articolo 2380 bis, in Cottino *et al*. (2004) Il nuovo diritto societario, II, Zanichelli, Bologna 2004, p.675.

565 See Cassazione Civile, Sez. I, 24 May 2012, n. 8221. [stating that: "*i patti parasociali, pur vincolando esclusivamente le parti contraenti e non potendo incidere direttamente sull'attività sociale, devono ritenersi illegittimi quando il contenuto dell'accordo si ponga in contrasto con norme imperative o sia idoneo a consentire l'elusione di norme o principi generali dell'ordinamento inderogabili, ma non quando siano destinati a realizzare un risultato pienamente consentito dall'ordinamento… La differenza tra sindacato di voto in assemblea e sindacato di gestione, che induce a ravvisare in questo secondo caso una situazione immanente di conflitto per il solo fatto della adesione al patto parasociale, non appare invero collegabile ad una diversa forza vincolante del patto nell'un caso rispetto all'altro, bensì all'incidenza del sindacato di gestione su comportamenti di soggetti che, a differenza dei soci, sono investiti inderogabilmente di una funzione, hanno cioè l'intera ed esclusiva responsabilità della gestione dell'impresa sociale, nell'interesse della società ed anche dei terzi che con essa vengano in vario modo in contatto.*"].

566 Giannini L., Vitali M., supra note 375, at 141.

567 Consolidated Law on Finance (TUF), art. 122.

5.4 The Regulation in Listed and Close Companies: The Discipline of T.U.F. and Civil Code

Given the different needs between public listed companies and not listed companies — including close companies and public companies that resort to the capital market — the legislator wanted to separate the legal framework regarding shareholders' agreements for the two groups of corporations.

As regards the type of shareholders' agreements allowed by the law, the two legal frameworks converge at the same point providing for agreements: (a) having as the object the exercise of voting rights; (b) restrict or limit the transfer of shares; (c) having as the object or effect the exercise, even jointly, of a dominant influence on the company or companies that control them. Although art. 122 T.U.F. seems to include a wide range of agreements, namely those concerning obligations of preventive consultation for the exercise of voting rights and those providing for the purchase of shares or financial instruments, they can be implicitly found respectively in point a) and b) of article 2341-bis c.c.[568]

Both two articles provide an exhaustive list of disclosure requirements that parties must comply with to properly communicate the presence of shareholders' agreements so that they can be deemed valid. There is no doubt that these norms are more stringent under the provision of art. 122 T.U.F., since the transparency of shareholders' agreements is of fundamental importance for listed companies whose shares are traded in exchange markets. In these companies, where shares are freely traded, the communication of shareholders' agreements affecting the ownership and control structure of the company empowers investors to make informed investment and disinvestment decisions. A deeper view of the disclosure requirements under T.U.F. and Civil Code will be provided in the following paragraph.

Different is the duration of shareholders' agreements laid down in two norms. Art. 122 T.U.F. stipulates a three-year term for shareholders' agreements entered in public listed companies, whereas art. 2341-bis provides for a period of five years for agreements stipulated in not listed companies.[569] They commonly state that in the case in which shareholders' agreements have been concluded for a longer period than that established by the law, they are considered to be concluded for the legal term, unless parties decide to renew the agreement upon expiration. If

[568] Giannini L., Vitali M., supra note 375, at 107-108.
[569] See Consolidated Law on Finance (TUF), art. 122., and Civil Code art. 2341-bis, Italy 2003.

the agreement has been concluded for an indefinite period, each contracting party can withdraw from the contract with six months' notice.

5.5 Shareholders' Agreements Disclosure

As we already discussed, shareholders' agreements often have the effect of altering the ownership structure and the management of the company with the aim of stabilizing the administration and corporate control. This situation requires the adoption of transparency rules that specially listed companies must comply with in order to prevent information asymmetries relating to the internal structure of the company that may comprise the proper functioning of the market.[570] Provisions in terms of disclosure of shareholders' agreements have been introduced by the Consolidated Law on Finance (T.U.F.), specifically for public listed companies with stringent norms regulating the transparency of such agreements, and then they were followed by disclosure requirements addressing close companies that resort capital in the market introduced by the company law reform of 2003.[571] The separation of regulatory regimes can be explained by the different role that disclosure plays in the context of close and public companies: while in close companies it serves to outline the separating line between rules governing the company and those regulating shareholders' agreements to preserve the interests of non-stipulating shareholders, in public companies the disclosure responds to market needs of communicating transparently the existence of agreements that may influence the corporate structure and control to empower investors to make informed investment and disinvestment decisions.[572] Shareholders' agreements transparency is ensured by communication requirements, whose non-compliance leads to sanctions.

5.5.1 Disclosure Requirements for Listed Companies

Article 122 T.U.F. regulates shareholders' agreements disclosure for public listed companies. It specifies that are subject to disclosure obligation the agreement of any type having as object:[573] (a) the exercise of voting rights in listed companies or in companies that control them; (b) the preventive consultation for the exercise of voting rights in these companies; (c) limits on the transfer of shares or financial instruments giving rights to their purchase or subscription; (d) the exercise, even jointly, of a dominant influence on these companies. These provisions do

[570] Filippelli M. (2019). La trasparenza dei patti parasociali nelle società per azioni, *Rivista delle Società*, Vol. 2, pp. 453-510.
[571] Id. at 463.
[572] Chionna V. V. (2008). La pubblicità dei patti parasociali, Giuffrè, Milano 2008, p. 45.
[573] Consolidated Law on Finance (TUF), art. 122 (1) and (5).

not apply to shareholders' agreements comprising holdings less than the minimum threshold stated by art. 120 (2) T.U.F. (3% of share capital).[574] The abovementioned agreements within 5 days from their stipulation must be[575]: (a) communicated to CONSOB — the public authority responsible for regulating Italian financial markets; (b) published in excerpt in the daily press; (c) filed with the business register of the place where the company has its registered office; (d) communicated to the listed companies. Mandatory disclosure is also required for amendments, declarations of withdrawal, tacit renewal, or early termination.[576]

The peremptory time limit of 5 days from the stipulation of the agreement affirms the interest to guarantee prompt and complete information on which investors base their informed investment decisions in a context not influenced by information asymmetries. In the case of oral agreements, the identification of the date when the 5-days term shall run is a bit more complicated. A major part of jurisprudence considers that the contract should be deemed to have been concluded when the agreement is perceived as legally binding by the parties, even if this standard is not easily applicable.[577]

Any possible failure to comply with the disclosure requirements mentioned before shall determine the invalidity of the agreement and the right of vote attached to the listed shares, for which the disclosure has not been performed, is not exercisable.[578] The legislator intended to protect the general interest related to the transparency of shareholders' agreements by establishing their invalidity as a consequence of failure to disclose them, rather than providing for inefficacy.[579] In the case of inefficacy, the disclosure of the agreement would be necessary only in the event of disagreement among the members. Instead by providing for not curable invalidity of the agreement, the legislator wanted to provide incentives for immediate disclosure.[580]

In this sense, the doctrine has been expressed against the theory proposing the regularization of not disclosed shareholders' agreements. Particularly, the legislator did not include in the

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574 Id. art. 122 (5-ter).
575 Id. art. 122 (1).
576 Filippelli M., supra note 570, at 465.
577 Id. [The author argues that in this scenario, where the shareholders' agreement is recognized as such when parties perceived that are bound by the same, as long as contractual negotiations are underway any eventual conduct of the parties is not considered under the area of shareholders' agreements, and thus not subject to mandatory disclosure. Additionally, the author states that parties could simply prolong negotiations to elude disclosure requirements.].
578 Consolidated Law on Finance (TUF), art. 122 (3) and (4).
579 Giannini L., Vitali M., supra note 375, at 73.
580 Id.

original provision the regularization of void agreements notwithstanding that this process is applicable in specific circumstances identified by the law. Additionally, by allowing that the agreement may be curable, this could incentivize shareholders to keep as secret as possible the agreement until contrasts between parties have emerged.[581]

Art. 122 T.U.F. expressly prohibits the exercise of voting rights related to shares for which disclosure requirements of shareholders' agreements concerning them have not been fulfilled. As result, shareholders' meeting resolutions taken with the vote of no legitimate shareholders can be challenged even by the CONSOB.[582] The length of the suspension of the right to vote is not determined by the legislator, however, the consensus recognizes it until the shareholders' agreement complies with the requirements in terms of disclosure.[583] The suspension has temporary nature and thus, is not referred to as an indefinite period.

5.5.2 Disclosure Requirements under Art. 2341-ter c.c.

The disclosure of shareholders' agreements in companies that are not listed in an exchange market is regulated by art. 2341-ter c.c. The legislator with the company law reform of 2003 wanted to introduce a distinction between public companies that resort in the capital market, and close companies that cannot issue financial instruments in the public.[584] Art. 2341-ter applies only to companies that resort in the capital market, expressly excluding close companies from disclosure obligations. The legislator considered the issue of shareholders' agreements disclosure related only to companies that trade securities in public markets, and thus, in close companies, where the corporate management is in the hands of a limited number of shareholders that control and limit the entry of new investors at their discretion, the presence of shareholders' agreements does not undermine the stability of corporate powers.[585]

The transparency of shareholders' agreements having the effect of altering the ownership structure and the administration of the company is realized with different instruments with respect to those used for listed companies, and generally, the disclosure system for companies

[581] Filippelli M., supra note 570, at 471.
[582] Id. at 472.
[583] Giannini L., Vitali M., supra note 375, at 75.
[584] Id. at 98.
[585] Id.

that resort in the capital market is less burdensome and complex than that applied for listed companies.[586]

Art. 2341-ter states that shareholders' agreements in companies that resort in the capital market[587]: (a) shall be communicated to the company; (b) shall be declared before any shareholders' meeting; (c) the statement shall be transcribed in the minute; (d) the latter shall be filed in the office of the business register. The communication of the agreement can be made by any shareholder participating in the same, regardless of its participation share in the capital, and it has a liberatory effect for other parties.[588] Third parties become aware of the agreement since the filing of the minute containing the statement that declares the existence of a shareholders' agreement in the business register.[589] In the article, there is no indication stating if the communication should regard the entire content of the agreement or an indication of its essential elements, such as shareholders identity, number of shares included in the agreement, mutual duties, and so on. The doctrine seems to prefer the opinion supporting communication as close as possible to the real content of the shareholders' agreement, thus, preventing any doubts on the privacy and matters regulated by the agreement.[590]

The failure to disclose shareholders' agreements at the opening of the meeting deprives parties of the agreement of the voting right and resolutions adopted with their vote may be challenged under what provided by art. 2377 c.c.[591] These resolutions can be challenged by dissenting, abstained or, absent shareholders, directors, and members of the board of auditors.[592]

The legal regime identified by art. 2341-ter is consistent with the rules concerning the invalidity of shareholders' meeting resolutions. Even though the rigidity of the sanctions provided for the failure to disclose shareholders' agreements as stated by the norm cannot be questioned, the legal system referred to art. 2341-ter appears less strict than that laid down by art. 122 T.U.F. for listed companies which provide for the invalidity of the agreement in breach of appropriate communication.[593]

586 Filippelli M., supra note 570, at 476.
587 See Civil Code art. 2341-ter, Italy 2003.
588 Giannini L., Vitali M., supra note 375, at 101.
589 Id.
590 Id. at 103.
591 See Civil Code art. 2341-ter, Italy 2003.
592 Giannini L., Vitali M., supra note 375, at 105.
593 Id.

5.6 Enforcement of Shareholders' Agreements: Invalidity and Breach

As we have mentioned before, shareholders' agreements' validity has been recognized through the increasingly frequent and explicit legislative provisions regulating the field of these agreements. However, the legislative recognition has not prevented courts to ascertain, on a case by case basis, that such agreements did not infringe mandatory rules or was contrary to imperative principles, with a view to establish their validity.[594] In this paragraph, we analyze the causes and cases of invalidity of shareholders' agreements and then, the consequences to the breach of the agreement by shareholders.

5.6.1 Invalidity of Shareholders' Agreements

The invalidity of shareholders' agreements in the Italian legal framework is found in the incompatibility between purposes pursued by contracting shareholders and the social benefit.[595] As we have already seen, the contrast with binding provisions of the law shall determine the invalidity of the agreement. This is particularly the case of agreements including confidentiality clauses — so-called *patti segreti* — with the aim of concealing the corporate ownership structure. Any agreement including such clauses has to be deemed invalid because in contrast with one of the principles of the corporate reform of 2003 that requires the transparency of agreements entered by shareholders affecting the ownership structure and governance of the company.[596]

Similarly, shareholders' agreements binding the contracting parties to vote in contrast with the interests of the company should be declared invalid.[597] This the opinion of the Court of Cassation with the sentence n.7030 of 27 July 1994, which held the invalidity of the agreement, which commits contracting shareholders not to vote the corporate liability action against the leaving shareholder and former director, on the ground that the content of this agreement is contrasted with imperative corporate rules and the interests of the company.[598] In this particular

[594] Id. at 147.
[595] Id.
[596] Id.
[597] Id.
[598] See Cassazione Civile, Sez. I, 27 July 1994, n. 7030. [providing that: "*Il patto con il quale i soci di una Srl s'impegnino nei confronti di un terzo, socio uscente ed ex amministratore unico della società, a non deliberare l'azione sociale di responsabilità nei confronti dello stesso, abdicando all'esercizio del diritto di voto pur in presenza dei presupposti dell'indicata azione, è affetto da nullità, in quanto il contenuto della pattuizione realizza un conflitto d'interessi tra la società ed i soci fattisi portatori dell'interesse del terzo ed integra una condotta contraria alle finalità inderogabilmente imposte dal modello legale di società, non potendo i soci, non solo esercitare, ma neanche vincolarsi negozialmente ad esercitare il diritto di voto in contrasto con l'interesse della società, a nulla rilevando che il patto in questione riguardi tutti i soci della società, né che la compagine sociale*

case, the court considered the application of the agreement as an infringement of the rules governing the formation of shareholders' resolution of waiver of the directors' corporate liability action, and at the same time contested the content of the agreement creating a conflict of interest with the company, preventing the latter to exercise claims resulting from the corporate liability action.[599] Invalid are also agreements indirectly having external efficacy — towards third parties — of voting provisions, because of their contrast with the fundamental principle providing for an exclusive internal efficacy of shareholders' agreements.[600]

Furthermore, the jurisprudence considered void these agreements having as result the distribution of the entire company's assets in the context of the liquidation process. The reason stands in the fact that shareholders, by proceeding to the voluntary distribution of the company's assets among themselves, violate the rules laid down to guarantee creditors and the company itself protections during the liquidation process.[601] Additionally, courts expressly prohibited agreements through which shareholders, directors, and liquidators intended to sell off company's assets at a price far below their market value, in violation of the duty imposed by the law to fulfill their role of liquidators with the diligence of good housekeeping.[602]

Moreover, shareholders' agreements violating the prohibition of the so-called *patto leonino*[603] set out in art. 2265 c.c. have been declared void if they provide against the return of the initial capital contribution of receding shareholders without cause, and its equal allocation to shareholders parties of the agreement by way of compensation for damages.[604]

To conclude, the assessment of shareholders' agreements' validity is based on the legitimacy of interests that shareholders intended to pursue by binding their conduct to what was provided for in the agreement. Thus, the purpose and content of these agreements must be decided for a

sia limitata a due soci aventi tra loro convergenti interessi (nella specie, coniugi)."]. Extract available at: https://www.brocardi.it/codice-civile/libro-quinto/titolo-v/capo-v/sezione-iii-bis/art2341bis.htm.

599 Giannini L., Vitali M., supra note 375, at 148.

600 Id. at 149.

601 Id.

602 See Cassazione Civile, Sez. I, 22 Dicember 1989, n. 5778. [stating that: "*Il contratto con cui i soci di una società a responsabilità limitata, in qualità anche di amministratori e liquidatori, si impegnino reciprocamente a svendere i beni sociali per un prezzo irrisorio, in favore di terzi, ovvero di loro stessi, integra un patto parasociale contrario agli interessi della società e quindi affetto da nullità, anche in relazione alla violazione delle norme imperative che impongono nelle operazioni liquidatorie criteri di chiarezza e la diligenza del buon padre di famiglia*."].

603 The so-called *patto leonino* involves the total exclusion of the shareholder from the participation to the company's risk or earnings, or both of them. See Civil Code art. 2265-bis, Italy 2003.

604 Giannini L., Vitali M., supra note 375, at 149.

reasonable and worthwhile interest of the parties that must not be in contrast with the best interest of the company, and more in general with the public interest.

5.6.2 Breach of Shareholders' Agreements

Doctrine and jurisprudence have quietly debated about what consequences must produce a breach of shareholders' agreements. It has long been clear that shareholders' agreements have an exclusively binding effect, which means that they only bind contracting shareholders and have no mandatory effect on the companies and other non-contracting shareholders, who remain external to agreements.[605] Namely, shareholders' agreement is not enforceable against the company and other shareholders who take no part in the agreement, in the application of the principle stating that the contract does not have an effect on third parties except in cases determined by the law.[606] The binding effect implies that shareholders acting contrarily to what is determined in the agreement are exposed to the damages action brought by other parties.[607] Thus, jurisprudence providers for no remedies other than compensation for damages when a shareholder fails to comply with the provisions of the agreement.[608] Given the binding effect of the agreement, parties are always free to exercise their rights as they see fit, aware of the fact that a possible exercise of the right in contrast to the provisions of the agreement results in a breach of it and, as consequence, other parties may require compensations for that breach. While shareholders' agreements bind only stipulating parties and have effect only between them, on the other hand, statutory rules have real effectiveness, in the sense that all shareholders — current and future — are bound and, any corporate act approved with the vote of shareholders who committed themselves through an agreement to vote in a different way shall remain in force and not challengeable.[609]

It has been debated whether compensation for damages was the most suited remedy for injured parties in a breach of shareholders' agreement. If compensation for damages is able to effectively give full relief to injured parties, then it would constitute the desired remedy parties will be willing to receive. However, fair monetary estimations of damages for breach of the

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[605] See Cassazione Civile, Sez. I, 21 November 2001, n. 14629. [providing that: "*il patto cosiddetto parasociale con il quale alcuni soci concordino tra loro condizioni e modalità di sottoscrizione di un aumento del capitale sociale vincola, per definizione, esclusivamente i soci contraenti, e non anche la società che è, rispetto al patto stesso, terza.*"].
[606] See Civil Code art. 1372, Italy 2003.
[607] See *Giur. It., 2002, p. 562.* [Court of Milan, 2 July 2001, expressly stated: "*Il socio inadempiente a un sindacato di gestione è obbligato a risarcire agli altri soci aderenti allo stesso patto parasociale un danno pari al mancato utile provocato dal suo inadempimento*"].
[608] Guaccero A., supra note 407, at 299.
[609] Giannini L., Vitali M., supra note 375, at 151.

agreement are often not easy to be determined by judges, and it is also true that under these conditions injured parties may prefer the enforcement by judges as consequences of the breach of the agreement.[610] Nonetheless, the violation of a shareholders' agreement does not produce the invalidity of the resolution taken by the vote cast by breaching shareholders, hence a forced execution would not be admissible. The Court of Rome supported this opinion with the sentence of 20 December 1996, in which pronounced the inadmissibility of enforcement ordered by the judge to vote in accordance with the agreement as an offense against the right to freely determine itself in the meeting.[611]

In support of the real effectiveness of shareholders' agreements is the decision taken by the Court of Genoa of 8 July 2004, which has expressly admitted the application of art. 700 c.p.c. providing for an emergency measure of the specific remedy of a shareholder performance in a shareholders' agreement.[612] The court recognizes the admissibility of an emergency measure which provides for specific remedy in cases where, before the meeting, shareholders parties to the voting agreement realize that one or more participating shareholders do not intend to comply with the decision passed by a majority of the participants in the agreement.[613] In this case, by voiding the registration of the transfer of shares in the shareholders' register in breach of an agreement limiting the transfer of them and pre-emptive clauses, the court recognized that the effectiveness of shareholders' agreement is not limited to the relationship between contracting shareholders, but it extends to the company.[614]

Finally, since jurisprudence did not give an unequivocal opinion on the matter, in a first attempt injured parties may request the enforcement of specific performance by the judge in order to

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[610] Rescio G., I sindacati di voto, in Colombo G. E., Portale G. B. (1994). Trattato delle società per azioni, 3rd ed., Torino 1994, p. 555.
[611] See *Giur. Comm., 1997, p. 119.* [Court of Rome, 20 December 1996, expressly stated: "*non è ammissibile un ordine impartito dal giudice di votare in un certo modo in assemblea o di astenersi dal votare in modo difforme dal patto parasociale, in quanto ciò contrasterebbe con il diritto dei soci di liberamente determinarsi in assemblea… patti sindacali hanno efficacia solo obbligatoria fra i contraenti ed esterna alla società di cui non alterano struttura ed ordinamento istituzionali, e, pertanto, se disattesi, non incidono negativamente sulla validità delle delibere assembleari.*"].
[612] Giannini L., Vitali M., supra note 375, at 156.
[613] See *Giur. Comm.*, 2007, I, p. 235. [Court of Genoa, 8 July 2004, stating that: "*Qualora vi sia fondato sospetto di violazione di un sindacato di blocco, nonché di una clausola di prelazione statutaria, il giudice, in via cautelare, può vietare l'iscrizione nei libri soci del trasferimento della partecipazione sociale… Va accolta la domanda cautelare che ordini al socio (e alla società fiduciaria che detenga le relative partecipazioni), inadempiente agli obblighi scaturenti da un sindacato di voto e di blocco e che abbia posto in essere una cessione in violazione di una clausola di prelazione statutaria, di esprimere il voto in assemblea in conformità alle delibere adottate a maggioranza dagli aderenti al patto di sindacato*."].
[614] Giannini L., Vitali M., supra note 375, at 157.

respect the content of the agreement, and then, if it is refused, they may demand compensation for damage.[615]

5.7 Chapter Conclusions

As made for the United States context, this chapter intended to investigate the regulation of shareholders' agreements according to the Italian legal framework. The first regulation of shareholders' agreements was introduced with the Consolidated Law on Finance of 1998 limited to public listed companies. It governs the content and disclosure requirements Italian listed companies must comply with if their shareholders regulate their relationship by the means of an agreement. Shareholders' agreements were recognized also for not listed companies with the reform of the Civil Code of 2003 with provisions similar to those already designed for listed companies. Both art. 122 T.U.F. and 2341-bis c.c. identify three types of object shareholders' agreements may assume, which concern: a) the exercise of voting rights; b) the limitation on the transfer of shares; c) the exercise of a dominant influence on the company.

The first type of agreements — voting agreements — concerning the right to vote in the meeting has experienced a turbulent evolution in the Italian legal landscape. Firstly, they were deemed illegal on the ground that their admissibility would have determined the division between the voting right and the ownership of the shares, along with the effect that they would cause in altering the proper functioning of the meeting which promotes the determination of shareholders' will inside and during the meeting. Moreover, even shareholders' agreements deliberating to the majority were viewed negatively from the doctrine since they have the effect of circumventing the majority rule by allowing minority shareholders to combine their ownership stake to control the company. Only in recent years, the validity of votings agreements was recognized first by jurisprudence and then, with art. 122 and 123 T.U.F. and art. 2341-bis and 2341-ter c.c.

As we already saw, blocking agreements include restrictions on the transfer of shares of shareholders participating in the agreement to maintain the stability of the ownership structure of the company. Agreements may restrict the ability of shareholders to transfer the shares by simply forbidding or limiting the alienation of shares, or they may provide for pre-emptive clauses or drag-along/tag-along rights which grant remaining shareholders particular rights. Of particular relevance, drag-along clauses allow minority shareholders to obtain the same

[615] Id. at 158.

conditions offered to the majority shareholder by a third party. The clause permits minority shareholders to realize a control premium in the sale of their shares that otherwise would have been difficult to obtain. The jurisprudence in a recent decision affirmed the nature of the drag-along clause as a tool to promote the homogeneity and cohesion between shareholders.

Third, controlling agreements involve the exercise of a dominant influence on the company. They ensure certain stability in the corporate structure allowing shareholders who entered into the agreement to determine the actions to be taken in the administration of the company. Although they may be seen as an attempt to remove the management power from the hands of directors, art. 2341-bis (2) expressly provides for their validity.

Our analysis continues with the comparison of the provisions contained in art. 122 T.U.F. and art. 2341-bis respectively for listed companies and not listed companies. After having discussed the differences between the two legal regimes, we provide an overview of the disclosure requirements under art. 122 T.U.F. and art. 2341-ter c.c. Certainly, strict rules are established by art. 122 T.U.F. for listed companies since the higher need for transparency that is required by active investors on the market who want to be aware of the existence of agreements having the effect of altering the ownership structure of the company to enable them to make informed investment or disinvestment decisions. Instead, art. 2341-ter is applied only to companies who resort to the capital market since the disclosure responds to the need of insiders rather than of outside potential investors. On the other hand, close companies are not required to disclose the existence of shareholders' agreements.

Lastly, the chapter concludes with the description of the causes that determine the invalidity of shareholders' agreements and the consequences of a breach of them. Besides the invalidity declared for the failure to comply with the disclosure requirements established under art. 122 T.U.F. and art. 2341-ter c.c., are deemed invalid such agreements that contrast with the social benefit. This means, that all the agreements whose content is incompatible with the interest of the company must be considered invalid. The violation of what is established in the agreement by a contracting shareholder does not have the effect of voiding the resolution taken by the vote of this shareholder in the general meeting. This means that shareholders' agreements have a binding effect only among the parties to the agreement and they do not affect the outcome of the resolution even if the shareholder decided to cast its vote differently from what was established in the agreement. Hence, injured shareholders cannot require the enforcement of the judge for the breach of a shareholders' agreement, but rather the only reasonable remedy is represented by the compensation for damages. This remarks the binding effect shareholders' agreements produce only within shareholders who take part in the agreement, contrary to statutory rules included in the articles of association or bylaw which have the effect of binding all shareholders in the corporation.

CONCLUSION

The recognition of the validity or invalidity of shareholders' agreements by the case law, especially in the United States, has actually triggered the efforts of lawmakers to draft statutes aimed at meeting the special need of close corporations. Until that moment, closely-held companies were subject to the traditional corporate law, whose rules were drafted having the needs of public corporations in mind. Furthermore, courts often applied partnership rules to resolve close corporations' issues following the concept that the particular features of close companies have resembled those of partnerships in a certain way. However, the rules have proved to be largely inadequate for close corporations because of their restricted flexibility and costly measures shareholders in this type of corporate organization have to adopt. For this reason, states started to enact close corporations statute including provisions specifically suited for those companies characterized by a limited number of shareholders who often participate actively in the management of the corporation and whose shares cannot be sold in a public securities market and are typically subject to restrictions on their transferability. Differently, in Europe, the close corporation legislation derived from the close corporation statutes that every State enacted, rather than through the case law as in the case of the United States. Here, there have been attempts to regulate the close corporation at the Community level by establishing a common form of close companies that SMEs may use to easily conduct business within the EU. Even if results were not those expected, these efforts showed the growing importance that specific rules addressed to close corporations only have for the EU legislator.

The close company's features discussed in the work are likely to create agency problems between the majority shareholder and minority shareholders who are exposed to the opportunistic behavior of the former. The information asymmetries arising from the agency relationship in both close and public companies are reduced by the mechanisms of corporate governance which tend to align the interests of the agent with those of the principal. In fact, corporate governance consists of a system of principles and rules that provides the guidelines for an efficient internal organization of the company, so as to reduce and manage conflicting interests arising between insiders and all stakeholders. Especially in the case of public companies, corporate governance systems were structured differently depending on the country of reference and on the ownership structure of companies in those countries. The outsider system, typical of the Anglo-Saxon countries is characterized by the presence of dispersed ownership in public companies, great presence of institutional investors, separation of control between shareholders and managers. In this system, the agency relationship that is likely to arise is that between shareholders and directors who hold the exclusive power to manage the company. Thus, the corporate governance mechanisms are aimed at reducing the information asymmetries between the two constituencies and aligning the interests of the managers with those of the shareholders. On the contrary, the focus of the insider system, diffused in the Continental European countries, is the protection of minority shareholders since even the ownership structure of public companies is characterized by a great presence of a majority group and less presence of institutional investors. Hence, among this structure, corporate governance mechanisms are adopted to reduce the agency problems that the majority shareholder is likely to cause through an opportunistic behavior against minority shareholders.

Given the differences described in the two abovementioned systems, we can identify the common part and in what differ the corporate governance frameworks of the two countries — Italy and the United States — under this study. While in the United States the Board of Directors is structured according to the one-tier-rule, with one board vested with the power to manage the company and internally supervise the actions of directors; in Italy, shareholders are likely to adopt a two-tier board, where the role of supervising the directors' actions and ensuring the proper organizational, administrative, and accounting structure of the company is vested in the hands of a Supervisory Board. Moreover, given the presence of a majority controlling shareholder in the Italian listed companies, the law gives minority shareholders some protections. In fact, it provides for the mandatory representation of minority shareholders in the BoDs for Italian listed companies. The same provision does not apply for U.S. listed companies since their ownership structure is widely held among a large number of shareholders and mainly institutional investors. In both countries, a mandatory audit of the annual financial statements and accounting books of listed companies must be performed by an external audit firm. In Italy, close companies are not required to have their financial statements audited, unless they draft consolidated financial statements, or when exceed for two consecutive years the threshold established by the law. Also, in the United States, although private companies do not have the obligation to have the financial statements audited, they may undergo an external audit for financial market reasons.

Moreover, public and close companies may dispose of internal and external corporate governance mechanisms to better solve the agency problems and align the interests of the parties. Undoubtedly, internal corporate governance mechanisms such as size, composition, and diversity of the board, and independence of the audit committee, are more appropriate to improve the corporate governance of public companies. On the contrary, in close companies, shareholders shall take measures more suitable for their needs to custom the relationship among themselves and towards the company. Instead of modeling the relationships and the control of the company through the amendment of the charter or bylaws, shareholders are more likely to stipulate shareholders' agreements that empower them to waive some rights that otherwise cannot be removed by the charter and bylaws. Shareholders' agreements are written or oral contracts between shareholders in a company through which they can decide how to dispose of the voting rights or to maintain a continuum and stability in the ownership structure. Generally, shareholders enter into these for a variety of reasons including a) the concentration of control of the company by pooling their votes; b) to ensure the stability of the ownership structure restricting the opportunity to enter or leave the company; c) to protect the interests of minority shareholders guaranteeing them to express their expectations and intentions during the meeting; d) to avoid deadlock situations, and so forth. Thus, the content of shareholders' agreements typically involves the exercise of voting rights in the company meeting or the limits on the transfer of shares. Shareholders' agreements can be concluded with parties other than shareholders only under the condition that one party must be a shareholder of the company. Hence, the company itself or the management can be a party to the shareholders' agreement. In the specific case in which, the content of the agreement concerns the functioning of the company or the relationship between shareholders, even an outsider may enter into such an agreement with shareholders.

It is clear from this work that shareholders' agreements respond perfectly to the needs of shareholders in close corporations. In a situation, characterized by the presence of few shareholders who also take a management position and hold shares subject to restrictions on their transfer, the shareholders' agreement is a powerful tool to ensure the protection of the contracting parties. As result, it is not surprising that shareholders' agreements are widely diffused in the context of close companies. On the other hand, the traditional corporate rules of the separation between ownership and control and the periodic election of directors ensure shareholders in public listed companies with a fair degree of protection. Moreover, the application of restriction on the transfer of shares would go against the free transferability of shares that constitutes an essential protection instrument for the needs of public investors. Empirical evidence has shown the limited use of shareholders' agreements in public companies, along with the tendency of shareholders to terminate agreements between themselves as the company going public. This phenomenon is marked in frameworks like the United States, where the ownership structure is widely dispersed. This pattern of ownership structure prevents shareholders to enter into shareholders' agreements to concentrate the power to control the company. In addition, institutional investors, who hold a large part of the share capital of U.S. listed companies, have no incentive to specifically restrict the transfer of their shares since from their alienation they realize the return on their investment. Shareholders' agreements in public listed companies are more common where the ownership of the company is more concentrated, as it is in Italy. Here, despite shareholders' agreements are experiencing a decreasing trend, they are used more to regulate shareholders' behavior rather than to concentrate voting power.

In the last part of the work, we provide an analysis of shareholders' agreements' regulation in the United States and Italy. We intend to analyze the legal treatment of these agreements in the two countries chosen as the reference of, respectively, common and civil law. It is desirable to conclude the analysis by discussing the similar points and the different features of the two legal systems in regulating shareholders' agreements.

We have already acknowledged as shareholders' agreements in the U.S. are not subject to a single regulation as it occurs in Italy, but rather each State provides its own corporation code with slightly different provisions governing shareholders' agreements. Apart from this notice, the starting point in this comparative analysis seems to be represented by the corporate form to which early legal recognition is addressed. Before the revision of 2016, the MBCA provisions were exclusively directed to close companies, with the condition that, from the moment the shares are listed in a stock exchange, the agreement authorized by section 7.32 MBCA ceases to be effective. Conversely, in Italy, shareholders' agreements experienced the first legal recognition in the context of public listed companies with the Consolidated Law on Finance. The introduction of provisions aimed at regulating shareholders' agreements in listed companies responds to the need of the Italian legislator to guarantee the transparency of the ownership structure of the company for the proper functioning of markets. Only later with the corporate reform of 2003, the legislator introduced provisions for shareholders' agreements concluded in limited liability companies and companies that resort to the capital market.

Both Italian and U.S. legislators allow shareholders to conclude agreements having as object the exercise of voting rights in the shareholders' meeting and/or restrictions on the transfer of shares. However, in addition to these two objectives, art. 2341-bis of the Italian Civil Code expressly allows shareholders to enter into an agreement to exercise a dominant influence on the company, controlled or controlling company. Differently from the Italian regulation, the U.S. law system contains provisions specifically drafted for three types of agreements that fall within the voting agreements, namely voting trusts, proxy agreements, and pooling agreements.

Moreover, while the Italian legislator wanted to separate the regulation of shareholders' agreements in listed and close companies by providing for a different duration and disclosure regimes, no distinction was made in the U.S. legal framework among shareholders' agreements concluded in public and close companies. As regards the duration of shareholders' agreements the U.S. legislator in the revision of the MBCA of 2016 removed the 10 year-term of the agreements, thus empowering shareholders to determine the duration of the shareholders' agreement which must be indicated within the same agreement. Conversely, in Italy, shareholders' agreements have a duration no longer than 3 years for listed companies and 5 years for limited liability companies and companies that resort to the capital market.

In the United States, shareholders' agreements' disclosure rules are not so detailed as the Italian legislator wanted to provide. As we got to explain before, this can be justified by the limited diffusion that shareholders' agreements have in U.S. listed companies. Little provisions can be found in the Securities Exchange Act of 1934 which establishes the obligation to disclose participation of more than 5% of the company's equity shares. Shareholders in listed companies, however, are obliged to disclose the existence of shareholders' agreements by communicating them to the SEC. On the other hand, the Italian legislator built a complete and complex disclosure regime to which listed companies and companies that resort to the capital market are subject. Of course, according to the different role played by the disclosure in the two types of companies, the rules established by art. 122 T.U.F. for listed companies are stricter than those set out by art. 2341-ter for companies that resort to the capital market. Art. 122 T.U.F. requires that shareholders' agreements comprising more than 3% of the share capital, within 5 days from the stipulation, must be communicated to the authority responsible to regulate the Italian financial market (CONSOB), published in excerpt in the daily press, filed with the business register of the place where the company has its registered office and communicated to the company. Instead, shareholders' agreements which fall under the provisions of art. 2341-bis and 2341-ter must be simply communicated to the company, declared before any meeting, and filed within the minute in the office of the business register. In both cases, the failure to comply with the disclosure requirements determines the unavailability of voting rights and the challenge of the resolution adopted by these defective votes.

In both jurisdictions, shareholders' agreements have been seen with mistrust by the jurisprudence who often declared their invalidity, as contrasted with fundamental corporate rules. Particularly, voting agreements were challenged on the opinion that their application would violate the inseparability of shares with the voting rights attached to them and jeopardize the proper functioning of the meeting allowing shareholders to determine their will outside the place where it must be defined. However, today, these opinions have been overcome and the general approach recognizes the validity of shareholders' agreements. The U.S. doctrine and jurisprudence generally rule the validity of shareholders' agreements unless they negatively affect other shareholders, creditors, and third parties. The law requires that, for their enforcement, shareholders' agreements must be unanimous and set in the articles of incorporation or bylaws. In this sense, the necessary condition required by the U.S. legislator for their enforceability is the knowledge of shareholders of the existence of shareholders' agreements. On the other hand, the Italian legal framework provides for the invalidity of shareholders' agreements when they contrast the binding provisions established by the corporate law. In this sense, courts rule the validity of shareholders' agreements if they are concluded for the best interest of the company and they do not infringe the public interest.

Different are the remedies for the breach of shareholders' agreements adopted by the U.S. and Italian jurisprudence. In the United States, courts typically order a specific performance for the breach of shareholders' agreements. Injunctive relieves are also granted upon the occurrence of specific circumstances. Conversely, for the Italian jurisprudence, the only remedy available for a breach of shareholders' agreements is constituted by the compensation for damages. This position was taken by considering the binding effect that these agreements have only among contracting parties, and thus, any shareholder who wants to vote in violation of the agreement is liable only towards other injured parties with no effect on the resolution taken by this vote. Although there have been cases in which courts ruled for specific remedies in emergency situations, the common attitude defines the compensation for damages as the legal remedy for breach of shareholders' agreements.

This work still opens up different opportunities for future research. The unsolicited request for the disclosure of shareholders' agreements in closely-held companies does not provide room for conducting empirical research on the agreements concluded in these companies. For this reason, future research could focus on shareholders' agreements of U.S. and Italian public listed companies, analyzing different aspects, including how the ownership structure of the company is influenced by the conclusion of a shareholders' agreement, the relationship between firm performance and shareholders' agreements, the effects of the disclosure on the sentiment of markets, the role of pyramidal structures and multiple voting shares for the private ordering of U.S. and Italian listed companies.

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