Rights of Minority Shareholders

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Milena Prisco

Studio Previti Associazione Professionale
Piazzetta Guastalla, 1,
20122 Milano
+39 02 795587

E-mail milenaprisco@previti.it

General Reporter

Ricardo Chacon, Chacon & Rodriguez S.C
Mexico City, Mexico
rchacon@chro.com.mx

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INTRODUCTION

A shareholder without voting strength or power to influence decision making on his own it's considered a minority shareholder. To be a minority shareholder could be tricky when it comes to protect your investment and its fruits. To avoid abuses from the majority, rules to protect minorities have been put in place in many jurisdictions. As for example, shareholder's agreements, the right of minorities to appoint a Director or other officers, rights to sell or buy shares at a fair value, the right to convene general assembly's, the right to get information from the management, etc.

Somehow, these rights may get in conflict with a fast decision making capability, impairing the management or the majority shareholders, which in turn may be a form of abuse from the minorities.

Therefore we would like to find out how these minority rights are handled in different jurisdictions.

1. Current scenario at your jurisdiction:

1.1. How and to what extent are minority shareholders protected in publicly and privately held corporations in your country, either as to legal or firm level protection?

The high number of big-sized family firms is traditionally one of the most known typical features of Italian capitalism, in which publicly held companies are not very much, most companies are closely held. It is a diffused common thinking that listed family firms are less transparent of publicly held companies, because of the excessive power of controlling shareholders, whose behaviors can be aimed to earn private benefits from the companies, at the expenses of minority shareholders, who suffer asymmetric information and ineffective control systems. Giving that minority protection is an important issue in company law, but at the same time a very difficult one.

First of all, it is worth noting that according to the Italian Law there is no such a definition of "the" minority shareholder, apart from the numeric characteristic that it owns less than 50% + 1 of the voting rights within a company [1].

The minority shareholders is protected at a different levels in publicly and privately held corporations on both legal and firm protection.

The Italian Civil Code governs the provisions in relation to the mechanisms protections regarding the *Società a responsabilità limitata* – S.r.l. (liability limited companies) and the *Società per Azioni* – S.p.A. (joint- stock companies), the latter can be listed subject to the Consolidated Law on Financial Intermediation Legislative Decree No. 58 of 24 February 1998 (the "Consolidated Law") and the Italian Financial Authority ("CONSOB") regulations.

According to Italian law, it is possible to ensure minority shareholder protection also by means of a shareholders' agreement ("SHA")[2]. It is worth underling that SHA are substantially private agreements between subjects binding only the subscribers of the same which implies that only the subscribers will be liable for the damages caused to the others subscribers and only a damage action is possible in case of breach of the relevant provisions [3]. At this level, minority shareholders can find a reasonable protection mostly in closely held companies where they can agree a wide range of mechanisms for the right of voice and the appointment of some of the governing bodies members.

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[1] A retail shareholder holding 15 shares in a listed company can hardly be compared with a third generation minority shareholder in a family owned SME holding 30% of the shares.

[2] Shareholders' agreements governing the exercise of voting rights in (i) S.p.A. unlisted companies (or their controlling bodies) cannot last more than five years, in (ii) S.p.A. listed companies or their controlling bodies cannot last more than three years, in (iii) S.r.l. if duration is not specified, each party has the right withdraw with a prior written notice.

[3] According to article 2341*ter* of the Italian Civil Code, shareholders' agreements relating to companies making recourse to the market of risk capital must be notified to the company and mentioned at the beginning of each shareholders' meeting Furthermore, according to the Italian Financial Act, shareholders' agreements signed between shareholders of listed stock . companies have to be also notified to the CONSOB, filed with the Company Register and published in abstract in the Italian daily press.

1.2. Do they have in essence real choices, or are the ones that are in the hands of the dominant group, either managers or major shareholders, or are they restricted to those that do not challenge the majority power, representing the status quo?

Minority shareholders do not have any right *per se* to challenge the majority power except for the rights to bring action against the directors which is allowed for any shareholder of S.r.l.[4] irrespective to the size of this participation and to monitor the directors conducts. The real strength of minority shareholders in relation to dominant group depends on the kind of companies where they are, the internal balance of interests, the size of their participation and the relevant rights in respect to the management of the company to the extent they are set forth by the By- Laws and/or by the SHA.

Their power to challenge the dominant group is not real in listed companies, however in S.r.l. and S.p.A. unlisted they might be in the position to monitor and to carry weight in the management of the company.

Indeed, there are certain minority rights in favor of qualified percentage of minority shareholders, for example special rights to appoint directors, which may encourage them to form a group to vote for a common candidate, veto right and the right to bring actions against the directors for certain unlawful conducts according to the Italian Civil Code.

The rights of appointment of the directors and the member of the board of statutory auditors and the veto rights can be qualified as special rights, which can be included at SHA and By-Laws levels and which be modified only by the favorable vote of qualified percentage (i) of the general shareholders meetings in S.r.l. (i.e. unanimous

[4] According to article 2476, third paragraph of the Italian Civil Code.

According to article *2393bis* of the Italian Civil Code, only shareholders representing 1/5 or the different percentage of the share capital (not exceeding 1/3) as per the By-Laws in the unlisted S.p.A and representing 1/40 or the minor percentage of the share capital as per the By-Laws in the listed S.p.A. are entitled to bring actions against directors.

vote except for different percentages set forth by the By-Laws [5]) and (ii) of special meetings of the shareholders of S.p.A. listed and unlisted[6].

In S.p.A. companies, minority shareholders can ask the court for special investigation whenever the directors are seriously suspected to have breached their management duties, causing damages either to the company or one or more of its subsidiaries [7]. The majority of doctrine and jurisprudence apply this tool to S.r.l. as well. In the most serious cases, the court can even discharge the directors and auditors and appoint a judicial administrator.

1.3. Has the law and precedents of your country evolved in ways that increase *minority shareholders* ability to defend against expropriation by those in control (misuse of assets, reallocation of profits, transfer pricing, etc.) ?

Italy has made considerable progress in recent years to promote and defend shareholder rights and to improve transparency. In particular, minority shareholders now have a direct role in selecting at least one member of the board and of the board of auditors in listed companies.

The current principles cover the issues quite well but that there is also a need to deal with emerging good practices in a future review and with some uncovered issues.

In view of the dominance of company groups in related party transactions, Italy has developed special rules and jurisprudence. There are as noted above special disclosure rules covering intra-group transactions. Under the Civil Code, executives must periodically report to the board about the company and its subsidiaries. Listed companies have to give subsidiaries instructions about prompt reporting to them. The board of the subsidiary must describe in the annual report the relationships with the parent company and

[5] Article 2468 of the Italian Civil Code.

[6] In S.p.A. listed and unlisted the By-Laws can provide special rights in favor of certain categories of shareholders who can vote on their rights in special meetings.

[7] Article 2409, paragraph 1 of the Italian Civil Code.

the other companies of the group and illustrate the effects of the group on the company's management and results.

Apart from that, the trend related to the unlisted companies is quite conservative even though the monitoring of courts on the management of the listed companies is increased expecially after scandals like Parmalat and Cirio. Still, article 148 of the Consolidated Law provides that the By – Laws of the company can set forth that the board of the statutory auditors shall be appointed in such a way that the less-represented gender shall obtain at least one third of the regular members of the board of auditors. This division criterion applies for three consecutive mandates.

1.4. Is the legal dimension the prevalent one in the Corporate Governance (CG) atmosphere, or is the firm level CG the common manner to protect minorities?

The legal dimension is actually the prevalent one to protect as much as possible the minorities because. Indeed, the Italian Civil Code provides some tools that give the minority shareholders the power to protect themselves directly. One of these defense measures is provided by article 2408. Pursuant to this article any shareholder can file a complaint with the board of auditors concerning facts he deems censurable. After having investigated the complaint, the board of auditors may convene a meeting with the board of directors if it, in the performance of its duties, notices censurable serious facts that need action. Therefore, one can say that the statutory board of auditors serves as an intermediary body between the minority shareholders and the board of directors.

However, at a firm level any defensive mechanisms can be applied on the basis of SHA which depends on the contractual strength of minority shareholders in terms of "self defense".

In addition, under the slate voting system (the so called *Voto di Lista* system), at least one seat on the board of directors must be reserved for a minority shareholder representative who is elected from the minority slate of candidates with the highest number of votes. The objective of the *Voto di Lista* system is to protect the rights of minority shareholders from shareholders with a controlling interest in the company,

which is common in Italy. Although the slate voting system entitles minority shareholders to the minimum one board seat, their representation is not proportional, as majority shareholders has the power to elect the remaining seats on the board.

Therefore, while we can see the benefits of guaranteeing minority shareholders a seat at the table, it is not predictable how much influence they can actually wield in a group of majority shareholder elected directors.

1.5. What is the role of ownership concentration in the protection of the minority?

High ownership concentration and limited contestability of control keep being key features of the Italian listed firms as shown by the data on control model and ownership structure at the end of 2013 [8]. Almost 70 percent of the companies (accounting for about 64 percent of market capitalization) are majority controlled either by a single shareholder (holding more than half of the ordinary shares – 'majority controlled companies'), or by a shareholder playing a dominant role even owning a stake lower than 50 percent ('weakly controlled companies'). The trend of ownership concentration however, over the latest years, is slightly decreasing. Basically the ownership concentration does not play a protective role in favor of the minority shareholders.

1.6. Is benchmarking used as a mechanism for minorities to select the country or firm better suited to risk profile and protection from rights deprival?

There is not a prevalent rule in this respect, it depends on case by case basis.

1.7. Is the formation of group dynamics among dispersed shareholders working in your country?

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[8] See the Consob 2014 Report on the corporate governance in the listed companies. It is worth noticing that Families play the major role as 'ultimate controlling shareholders' in 61 percent of the firms (around 30 percent of total market capitalization), especially smaller companies operating in the industrial sector.

Formation of group dynamics among dispersed shareholders can work rarely at listed companies level, indeed these dynamics can be implemented in closely based companies by virtue of SHA in terms of exercise of voting rights on certain strategic or material decisions both at board and shareholder meetings levels.

As far as the listed companies, the Italian setting is described as a market with highly concentrated ownership structures due to the presence of family or State-run small and medium-sized companies belonging to pyramidal groups, in this contest minority shareholders dynamics are very rare. One of the typical dynamic is represented by the slate vote mechanism. Shareholders holding between 0.5%-4.5% of a company's share capital are entitled to present a slate of candidates (*Voto di Lista*)[9]. Minority shareholders are able to aggregate their holdings to reach the threshold required to present such a slate. But rather than elect individual directors, shareholders are asked to vote for a slate of candidates. If only one slate is presented, board members will be selected from this list. Where multiple lists are presented, members will be selected from the different lists on offer in line with the company's by-laws.

In unlisted companies set up on the basis of pyramid structure, one of the most important instruments to protect minority shareholders is the right of withdrawal. This right provides minority shareholders with the ability to withdraw from the corporation when the parent company transforms its legal type or changes its corporate object in a way that materially and directly affects the subsidiary's economic conditions [10]. The shareholder of a subsidiary is similarly entitled to withdraw when the parent company was held liable towards the same shareholder for mismanagement of the subsidiary [11]. The withdrawal right is also triggered, in unlisted companies, when the company becomes or ceases to be subject to the direction and coordination of another company,

[9] See paragraph 1.4.

[10] Article 2497-quarter, paragraph 1(a) of the Italian Civil Code.

[11] Article 2497-quarter, paragraph 1(b) of the Italian Civil Code.

provided the investment risk in the company's capital is materially altered and there is no public tender offer by the new controlling shareholder.

1.8. What is the role of market liquidity in the *minority shareholders* exit option?

Some legal tools are provided to entitle the minority shareholders exit from listed and unlisted companies due to market liquidity effects.

Over last decades material reforms have been enacted in favor of minority shareholders of listed companies in order to allow the exit in case of global takeover bids (see article 106 of the Consolidated Law)[12] and of squeeze – out events (see article 108 of the Consolidated Law)[13]. The remaining cases provided by the law for the exit options are grounded on the withdrawal right of the shareholders of unlisted companies which depends on specific mandatory legal cases which are not related to market liquidity (e.g. material decisions concerning the purpose of the company or its organization or special rights of the minority) and which are not commonly used by the shareholders because they require the liquidation of the shareholdings which may impact the assets and the equity of the companies.

1.9. Have legal reforms in your country given tools to majority to use compliance as an instrument to somehow "legalize" minority expropriation?

Law no. 116 of august 11, 2014 (converted, with amendments, from law decree no. 91 of June 24, 2014) entitles companies to amend their articles of association to allow the grant of up to two votes per share to shareholders who have held their shares

[12] Article 106, 1 paragraph of the Consolidated Law reads: "Anyone who, following acquisitions or increased voting rights, holds a stake greater than the thirty percent threshold or holds more than thirty percent of the voting rights of the same, promotes a takeover bid addressed to all security holders for the totality of the securities admitted for trading on a regulated market in their possession."

[13] Article 108, 1 paragraph of the Consolidated Law reads: "If as a result of a global takeover bid, the bidder becomes holder of at least ninety-five per cent of the capital represented by securities in an Italian listed company, the bidder shall be committed to squeeze-out of the remaining securities should any other party so request. Where more than one class of securities is issued, the commitment to squeeze-out shall subsist only for classes of securities for which the ninety-five per cent threshold is reached."

continuously for at least two years. these superior voting stocks are sometimes referred to as "loyalty shares."

The Law also provides that until January 31, 2015 resolutions to amend the articles of association to incorporate these increased voting rights have only required a simple majority vote rather than the supermajority requirements normally required to amend a company's articles. Furthermore, such resolutions will not include any withdrawal right as contemplated by the Italian Civil Code. The new regulation, stating that such a scheme deprives minority institutional investors of their right to vote with the same weight of controlling shareholders, resulting in disproportion between the capital invested and the voting rights recognized. Being a relatively recent development, it remains to be seen how other institutional shareholders will react to the new regulation.

2. Looking forward at your jurisdiction:

2.1. What is the way to avoid *minority shareholders* from suffering mayor shocks, -if applicable in your country- due to restrictive visions as to minority rights, without falling into abuses of minority rights? Is it possible to harmonize both?

Minority protection can theoretically take various forms and degrees both in listed and unlisted companies. One can consider in increasing order of implication: (i) their right to be informed; (ii) their right to be consulted; (iii) their right to challenge majority decisions; and (iv) specific minority rights such as monetary compensation rights, withdrawal rights.

Typical minority shareholder rights are:

- the right to vote on the election of directors and of members of the statutory auditors for listed companies[14];

[14] These rights are provided by corporate statute provisions for listed companies. Indeed, Article 147-*ter* of the Consolidated Law provides that minority shareholders are entitled to appoint at least one member of the board of directors and two when the board is composed of more than seven members, this director

- the right to amend the By - Laws;
- the right to request additions to the agenda in writing[15];
- the right to vote on major corporate events such as mergers, liquidation, or the sale of substantially all the corporation's assets;
- the right to take action against directors and the right to claim material breaches of directors before the board of the statutory auditors;
- the right to annual stockholder meetings;
- the right to call special stockholder meetings; and
- the right to inspect books and records and the list of shareholders.

Minority shareholders in certain cases can contractually secure greater rights by By-Laws and/or by SHA than the corporate statute explicitly allows.

2.2. Is *minority shareholders* activism taking place in your country, and to what extent?

Activism can be seen in the participation to the shareholders meetings of the listed companies which is recently increased by virtue of the so called "record date rule[16]", the active solicitation of proxies[17] and the *Voto di Lista*.

This activism rarely is practiced by shareholders minorities in the unlisted companies.

2.3. What is the trend in your country for the protection of *minority shareholders*?

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must be independent; article 148 of the Consolidated Law entitles minority shareholders to appoint at least one member of the statutory auditors.

[15] Article 126a of the Consolidated Law provides this right which is expressly granted to shareholders who, individually or jointly, represent at least 2.5 % of the share capital.

[16] The record date rule was recently implemented by the Legislative Decree no 27/2010 (Implementation of Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies), allowing shareholders to sell their shares within the period between the registration date and the date of the meeting.

[17] This system consists of a request made to more than 200 shareholders for a proxy, accompanied by a specific voting intention or by recommendations, declarations or other indications likely to direct the vote. Solicitation is carried out by the promoter by means of the publication of a prospectus and a proxy form. in such a case, the proxies may only be granted for a meeting that has already been called, remaining in effect for subsequent meetings if appropriate. Proxies must not be granted 'carte blanche' and must indicate the date, the name of the person nominated and the voting instructions. the representative may also be elected for a limited number of voting proposals indicated in the proxy form, or for certain items on the agenda.

The trend is to improve the minority shareholders rights protection mostly at listed companies level and especially in terms of rules concerning transparency of the decision-making processes of group companies' boards and disclosure of the membership of a corporate group, however the mechanisms of enforcement are not enough to guarantee a real protection of minority shareholders.

2.4. What is the impact of the Sarbanes-Oxley Act (SOX) in your country, as a canon to regulate domestic capital markets and CG?

The SOX is not applicable to the Italian companies.

2.5. Do you think it advisable to rescue the concept of "Popular Capitalism", as defined in the fifties by the great jurist Joaquin Garrigues, in view of the present circumstances regarding status of minorities?

It would be advisable to the extent minority shareholders would have a real protection also in terms of participation and voice in the decision making process at least concerning material transactions which might impact the value of their shareholdings.

2.6. What should be the role of minorities as to the flaws of executive pay packages that reflect structural problems in underlying governance agreements, as pointed out by Lucian Bebchuk, Harvard Law Professor ?

At the end of 2010, Italy introduced for listed companies a regulation requiring companies to publish a remuneration report and to submit a remuneration policy to a mandatory non-binding shareholder vote the so called Say on Pay system (SOP).

Interestingly, despite the negative correlation between ownership concentration and dissatisfaction, the level of dissent recorded in Italy is not particularly far from what found in other countries, where ownership is more disperse. Indeed, descriptive statistics show that in the first year of SOP implementation in Italy an average of 5.1% of the attending shareholders voted against (or abstained on) the company's

remuneration policy[18]. Ownership concentration matters as the prevalence of controlling shareholder structures largely reduces dissent. In fact, dissent is higher in widely held firms and negatively correlated with the equity stake held by the largest shareholder. Dissent is largely due to the presence and engagement of institutional investors.

3. Precedent cases at your jurisdiction:

3.1. Please report some recent judicial cases regarding *minority shareholders* issues.

Italian rules of civil procedure and professional regulation of attorneys do not provide for instruments that might encourage the use of mechanisms to protect minority shareholders rights. The average length of a civil law suit in Italy is a discouraging factor to the decision of finding redress in court. As a consequence, shareholders prefer simply to exit the company and sell their shares on the market rather than to engage the directors in costly, uncertain, and potentially protracted litigation. In unlisted, closely held companies, shareholders might have more incentives to use the lawsuit, as the (minority) shareholders cannot simply exit the company by selling their shares.

The high-profile scandals at Parmalat and at Cirio have shown the weakness of the minority shareholders protection enforcement. A part from that and from the directors liability, the Italian jurisprudence evidences like over the decades it is constant the trend to protect minority shareholders of closely held companies against the abuse of the majority. This happens in the case of majority shareholders adopt strategies to make decisions with the intention to damage or to dilute the minority shareholders. In these events, the jurisprudence condemns these conducts by invalidating resolutions of the shareholders meetings to the extent the minority shareholders prove the willful or the

[18] M. Belcredi, S. Bozzi, A. Ciavarella, V. Novembre "*Say on Pay in a contest of concentrated ownership – Evidence from Italy*", reading Quaderni di Finanza (CONSOB).

misconduct and the abuse of the majority shareholders forward the minority shareholders[19].

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