GIANNI & ORIGONI

Capitalism Revisited - Responsible Enterprise

Session 2: Corporate Control

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Control Enhancing Mechanism «CEM»

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CEM and Contractual Freedom

- Since 2001, proposals in doctrine and European legislation → Searching corporate structures based on participation of shareholders encouraging a long-term vision and aimed at greater involvement of investors.

- Departing from the traditional principle “one share, one vote”.

- CEMs: a way to increase holding of voting rights based not only on cash flow rights.

Legislature's Attitude and Impact

On the one hand, the widest statutory autonomy of companies is guaranteed in choosing their shareholding structure.

On the other hand, transparency rules on the use of multiple voting shares or other mechanisms for strengthening control (in order to avoid excessive deviation from the "one share, one vote" that could result in abuse of power and majority abuse) are imposed.

Doctrine position → a way to safeguarding corporate control of companies preventing risks of falling in the hands of a few with a modest financial engagement by completely altering the balance between power and risk; practical difficulties may arise (e.g., counting constituent and deliberative quorums).

Historical perspective of CEMs in Italy

- **Art. 2351 of R.D. March 16, 1942, No. 262** → multiple voting shares may not be issued;
- **Law of June 7, 1974, No. 216** → Introduction of savings shares (trust relationship between ownership and management is interrupted);
- **Art. 154 of Law of February 24, 1998, No. 58** (“**TUF**”) → promotes the decrease in voting rights specifying how it must be balanced by patrimonial privileges (shares without voting rights);
- **Corporate Reform of 2003** → quantitative limitation of voting power (e.g., cap imposition, scaled vote);
- **Law Decree June 24, 2014 No. 91 (“Decreto Competitività”)** → amends art. 2351 allowing *i)* for closed companies the issuance of shares with multiple voting; and *ii)* for listed company the issuance of shares with increased voting (loyalty shares);
- **Article 127-quinquies TUF** → the articles of association of a listed company may establish that increased voting rights may be attributed, up to a maximum of two votes, for each share belonging to the same subject for an uninterrupted period of no less than twenty-four months
- **Art. 127-sexies TUF** → allows companies newly listed on regulated markets to maintain shares with multiple voting shares issued before the admission trading (ultractivity).

Recent Reports and Recommendations at National Level

- Ministry of Economy and Finance Green Book "*La competitività dei mercati finanziari italiani a supporto della crescita*", to enhance the process of the reform of the Italian capital market and increase the attractiveness of the Italian system, supporting growth and investments, in line with the objectives of the National Recovery and Resilience Plan (PNRR), in line with OECD analysis provided for in the "Capital Market Review Italy 2020", Creating Growth Opportunities for Italian Companies and Savers" (link).

- Among others, proposals to intervene on the competitive aspects of corporate rules to facilitate offers on the secondary market and evaluate changes to the domestic regulations on multiple voting share structures, also taking into account the experience of other countries.

Multiple-voting Shares

Multiple-voting Shares

Multiple-voting shares issued before the start of trading on a regulated market maintain their features and rights (max 3 votes).

Wide autonomy in the articles of association is left but no further increases in voting rights in favor of single share categories are permitted; no loyalty shares can be issued (pursuant to Article 127-quinquies).

IPO and Multiple-voting Shares

The majority shareholder:

- maintains shares with multiple voting rights no longer issuable post listing, untied to minimum ownership tenure and thus immediately endowed with up to three votes as opposed to only two votes for the loyalty shares;

- can raise capital from the market keeping voting rights not proportional to the number of shares held, thereby remaining in charge of the management of the issuer.

Considerations

Art. 2351, para. 2 of the Civil Code stipulated that the issuance of limited voting shares and shares without voting rights can in no way exceed the limit of 50 percent of the share capital, in fact ensuring the holder of multiple voting shares (issued by the same company) control of the company with 12.5% of the capital + 1 share.

Increased (Loyalty) Voting Shares

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Increased Voting Shares or (Loyalty Shares)

Unlike multiple-voting shares, increased voting shares do not constitute a new category of shares within the company.

Ratio - The privilege of having voting rights increased is:

- not reserved only to certain shareholders;
- not related to the share itself, but to the “loyalty" of the shareholder;
- does not belong exclusively to holders of "certain" shares, but to all shareholders who meet the criteria set forth in the law and by-laws (e.g., holding the shares for 24 months);
- not to be considered a violation of the principle of equality of shareholders, since such a "privilege" of increasing votes is actionable by all shareholders and is related to fixed circumstances which can be easily met by all shareholders.

Effects

Enhancing the retention of investment, long-term equity, deterring shareholders from short term approach, and providing them with stronger monitoring power within the company, all with the indirect purpose of reducing share price volatility and make stock prices formation more efficient.

Tender Offer and Increased Voting Shares

The risks of opportunistic use in order to strengthen the positions of dominant shareholders are real and present in the case of mandatory takeover bid → The legislator had to amend the TUF with appropriate adjustments (art. 106 of TUF).

Therefore, take over bid obligation may arise:

1. when you do not benefit from increased voting rights and come to hold more than 30% of the share capital; and
2. in the case of holding shares with increased voting rights and the 30% threshold in terms of exercisable votes is exceeded (except the case of "passive crossing" due to the reduction of the total amount of voting rights whether the threshold in terms of share capital is not exceeded too).

It follows that the **30% threshold** is not to be referred to the share capital as an expression of the number of shares held by the shareholder, but rather to the **"securities" held pursuant to art. 101-*bis*, par. 2, TUF** e.g., *"financial instruments carrying voting rights, also limited to specific topics, at ordinary or extraordinary shareholders' meetings"* (including purchases and increases in voting rights owned by parties acting in concert).

Italian Trend

Italian Trend and Regulatory Arbitrage

While the loyalty shares system is quite used in the Italian market, the **multiple voting shares** (MVS) are not so frequently met in the new listing on Italian Regulated Market (only few cases, interesting recent De Nora and Phyllogen examples);

In our experience the actual market trend shows the **increasing demand of CEM's mechanisms** by means of capital structure especially in Euronext Growth Milan (easier to achieve);

Long term investors (not passive investors) are interested in companies with multiple voting shares having regard to the nature of controlling shareholder/manager skilled and capable to develop long term projects without the threat of hostile takeovers.

Italian Trend and Regulatory Arbitrage

- **MVS: stability instrument or defence tool?**
- The **increasing move of large Italian companies** from the Italian stock exchange as well as the choice of foreign legal systems by many large listed companies are **phenomena attracting** increasing attention (latest ex Exor);
- Assonime proposals in order to create a **more flexible and attracting system** (e.g., board election - in Italy based on slates - tailored on the ownership structure of the company (e.g., board lists based on transparent criteria, staggered boards, board self-evaluation, direct election of single members);
- Permitting the issuance of MVS in the official market is an appropriate tool to enhance new listing in Italy? → recent proposals of introduction of MVS for companies already listed in "Decreto Rilancio" (to be issued with a whitewash mechanism) aborted due to critical aspects on a provision basically aimed at blocking the companies flight rather than creating a long-lasting and efficient instrument;
- By the way, competition between systems must be based on harmonization at European level on efficiency of **corporate control market**, **strength and accountability** of the supervisory authorities, on **legal certainty and speed of administrative procedures** and not on a drastic change of the structure of the Italian corporate system.

Thank you