Scope and nature of corporate law

• Traditional definition: increasing shareholders’ value.

• BUT, as with all branches of law, corporate law has a social scope.

• Increasing the wealth (in the broadest of meaning) of all corporate stakeholders: shareholders, employees, suppliers and customers.

• If possible, with positive externalities on third parties.
Scope and nature of corporate law

• Question: which interest should prevail to maximize shareholders’ value?

• Regulatory competition: who is competing? On which grounds? What for?

• Choice of jurisdiction: place of incorporation vs. real seat.

• Is there a race? Down to the bottom or up to the top?
Scope and nature of corporate law

- What forces shape corporate law? Corporate ownership, international competition, international coordination
- Law vs. contract: which one prevails?
- Gap filling role and updating.
- Mandatory laws and default provisions.
Sources of corporate law

- National legislation
- International conventions and treaties
- Macro-regional/federal laws and regulations (e.g. US federal laws and EU directives and regulations)
- National case law (common law vs. civil law on value of precedents)
- International tribunals’ case law
- Lex mercatoria, international practices
Sources of corporate law (2 of 2)

- Examples of non corporate law impacting companies:
  1. Stock exchange regulations;
  2. Self-regulation (e.g. category statutes like the English City Code on mergers and acquisitions);
  3. Bankruptcy and insolvency laws;
  4. Employments and social security laws;
  5. Criminal law (e.g. Legislative Decree 231/2011 in Italy)
Fundamental Characteristics of a Corporation

How we define a corporation?

- Corporate legal status.
- Liability limited to contributions.
- Freedom to transfer shares.
- Unified management acting under the guidance of an administrative body.
- Ownership of the company in the hands of the equity suppliers.
Main feature of the legal personality of a company is its separate patrimony, also called affirmative asset partitioning. That is the capacity of the company to have its own asset separated from those of other subjects (including the investors/shareholders), and therefore not available for attachment by creditors other than the company’s.
Corporate legal personality

• Entity shielding:
  (i) company’s creditors pre-emption right vis-à-vis the company’s assets (which are therefore an automatic guarantee for the company's obligations).
  (ii) Impossibility for shareholders to autonomously liquidate their participation, thus protecting the continuation of the company’s life notwithstanding claims from the shareholders’ personal creditors.

• Authority to establish contractual relationships and enforce the relevant rights
Shareholders’ limited liability has been introduced to incorporated entities only in the XIX century. Similarly to legal status for the company’s creditors, shareholders limited liability creates a sort of guarantee for the shareholders’ personal creditors. Owner Shielding
Liability limited to contributions

• The combination of entity shielding and owner shielding results in “asset partitioning”.

• Asset partitioning allows access to finance and results in reduction the cost of access to capital for both the company and the shareholders.

• Risk sharing and flexibility in risk allocation between equity-holders and debt-holders.

• Other forms of liability, e.g. tort
Transferable shares

Shares, in whatever form, are in principle transferable

- Effects: (i) a company’s life extends beyond the life of its shareholders; (ii) a company’s identity remains the same even if shareholders change and (ii) flexibility in monetizing the investment.

- Transfer vs. liquidation

- Connection with entity shielding (preserve value)

- All main jurisdictions include at least one type of company where the free transferability of shares is the default situation.
Transferable shares

• Most jurisdictions however also have forms of companies which, even if the participation can be transferred, suit “closed” companies (i.e. the shares are not intended to become widely spread)
  • e.g. SRL in Italy and GmbH in Germany
• How is this achieved? Pre-emptive rights, valuation methodologies, shareholders/directors consent, restrictions by categories
• By-laws vs. shareholders’ agreements
• How far can restrictions to transferability extend?
Transferable shares

• Situation changes in public companies
• Why?
• Can the transfer of listed shares be restricted?
• Safeguard fundamental principles: markets operation and investors protection
• Any special exceptions?
Delegated management acting under the guidance of an administrative body

- Shareholders’ decisions on corporate choices feasible as long as number of the same remains relatively small and changes in participation are not frequent
- Larger corporations (with fast changing shareholders) need to delegate functions to an administrative body
- Impact of degree of control (dispersed shareholdings vs. tight control)
Delegated management acting under the guidance of an administrative body

- Main principles of administrative bodies:
  1. Separation from operative management;
  2. Formal separation from the shareholders;
  3. Appointed by the shareholders;
  4. To be a collegiate body (important exception in closed companies with possibility of a sole director);
  5. Decisions are collegial, irrespective of different roles
Ownership of the company in the hand of the equity suppliers

- Companies are “owned” by shareholders
- What do we mean? Own what?
- With limitations (e.g. liquidation), cfr. definition of corporate law
- Main features of the company’s ownership:
  1. The right of shareholders to control the company; and
  2. The right to share the company’s profits (and losses?).
Ownership of the company in the hand of the equity suppliers

• Which principles apply?
• Control through majority principle
• Any exceptions there?
• Distributions proportional to contributions (anything else?)
• Exceptions: classes of shares, cooperatives, foundations and no-profit.
The governance of corporations

- Shareholders have their rights in the company guaranteed primarily through the powers to appoint/remove directors.
- Corporate law regulates shareholders’ control over the company by setting the rules of the shareholders’ decision making process.
- The importance of voting delegation EU vs USA/UK
- In smaller companies corporate choices are made mainly by shareholders. As the size of a company grows, decision-making is delegated to managers.
- Choices may be heavily impacted by the regulations specific to that sector. This has a deep impact on managers’ choices (e.g. consumers protection in retail and distribution)
The governance of corporations

- So called “agency issues”, what are they?
- Shareholders vs. directors.
- Minority shareholders protection.
- Company vs. other stakeholders
- Strategies to reduce agency issues costs
- Regulatory strategies vs. governance strategies
- ex ante vs. ex post
- Regulatory: agent constraints/affiliation terms
- Governance: appointment rights/decision rights/agent incentives
Creditors’ protection

• Why protecting creditors?
• Creditors’ protections is also a form of guarantee for all stakeholders undertaking a relationship with a company.
• It is common to all EU jurisdictions (with certain exceptions for the UK) to set rules on initial minimum corporate capital, corporate capital to be maintained during the company’s life and distribution to the shareholders.
• There is discussion on the actual usefulness of such tool (e.g. often at the time of bankruptcy the corporate capital has long gone…).
Creditors’ protection

• In the USA (and in an increasing number of countries) no rules specify requirements on corporate capital.

• Creditors are instead guaranteed through standards set for the actions of a number of players (managers, external accountants, controlling shareholders, privileged creditors) which have sort of fiduciary duties vis-à-vis creditors.

• E.g.: UK Company Directors Disqualification Acts of 1986.
Protection of other stakeholders

• Safeguards are also granted to internal and external stakeholders to the company.

• Labour and employment laws, general consumer protection regulations, rights of suppliers (e.g. retention of goods).

• Depending on the sector in which the company operates regulation may provide specific protections (e.g. consumers, employees).

• Protection may be given to the market in general when the company has a large size and widespread ownership (e.g. is a listed company).

• Purpose: achieving a balance that supports creation of value
Extraordinary transactions

• Decision process particularly significant when it relates to most significant steps/actions
• What are extraordinary transactions?
• High scale transactions if compared to the size of the company; or
• A transaction the evaluation of which implies strategic views and purposes; or
• A transaction which may, at least potentially, create a conflict of interest for managers (or shareholders).
• examples
Extraordinary transactions

• Mergers (de-mergers) and acquisitions (private/public).
• Disposal/acquisition of assets.
• Capital increase (or decrease).
• Creation and placement of new shares (to shareholders or in the market).
• Distributions to shareholders (through new shares or dividends).
• Additional issues may arise in relation to third parties, depending on the nature of the transaction and the sector in which the company operates (e.g. employees in case of merger).