Scuola di
Giurisprudenza

Corso di Laurea

Magistrale in Giurisprudenza

INSOLVENCY PROCEDURES
AND SHAREHOLDER RIGHTS

Relatore:
Chiar.mo Prof. Lorenzo Stanghellini

Candidata:
Diletta Lenzi

TABLE OF CONTENTS

Introduction

The purpose of this essay is to examine the role of shareholders of a company in financial distress among different jurisdictions.

Starting from an analysis of shareholders rights when the company is in ordinary conditions, I then focus on what happens when the company is in financial distress and when the company is subject to insolvency proceedings.

By doing so, I will limit my analysis to ordinary companies. Banks and other financial institutions as well as companies that carry on business in special regulated sectors will not be examined in the details.

Moreover, I will limit my work to the analysis of the western legal traditions, which share a tendency of innovation of insolvency law aiming to more flexible insolvency procedures, during the second half of the XX century.

New insolvency laws have been adopted at the end of the 1970s in the U.S.A. and in the 1980s and 1990s in some of the major European countries such as the U.K., France and Germany, later followed by Spain in 2003 and Italy in 2006.

Additional reforms have been provided as an answer to the financial crisis of the recent years. As stressed by the European Commission in its last recommendation of March 2014:

> at a time when the European Union is facing the biggest economic crisis in its history leading to record numbers of bankruptcies in most Member States, improving the efficiency of insolvency laws in the EU has become an important factor in supporting the economic recovery.

In recent years, an average of 200,000 enterprises went bankrupt each year in the European Union, resulting in direct job losses totalling some 5.1 million over three years[1].

Such data command new interventions, aiming at making reorganization procedures, which allow a company to maintain its business alive while restructuring its indebtedness, more efficient. In this context shareholders interests and rights come into play more than in case of liquidation proceedings, where the company and its managers are simply dispossessed.

---

[1] See Commission Recommendation on a new approach to business failure and insolvency, 12th March 2014, C (2014) 1500 final.

Moreover, as evidence suggests[2], failed entrepreneurs learn from their mistakes and are generally more successful the second time.

What will be examined is how shareholders are involved during a reorganizational proceeding, in relation to the plan content.

By doing so I will take as the main example of a flexible model the U.S. Federal bankruptcy system, which is widely considered the most developed in the world. The American bankruptcy regime is indeed characterised by risk taking, failure and starting over; << *and it might be the "starting over" aspect that most distinguishes American culture (and American bankruptcy law) from that of other jurisdictions* >>[3].

[2] Up to 18% of all entrepreneurs who go on to be successful have failed in their first venture. See Press Release of the E.U. Commission Recommendation of 12th March 2014.

[3] William J. Woodward jr, *Insolvency Procedures in the U.S.A.*, in *Profili storici, comunitari, internazionali e di diritto comparato*, V Volume of Trattato di diritto fallimentare e delle altre procedure concorsuali, Torino, 2014, at page 352.

1

Shareholders Rights During the Solvent Life of a Corporation

In my first Chapter, I will begin by describing the foundations of what will be the core of this dissertation.

First of all, I intend to try and clarify the unique but multi-faceted figure of a shareholder, what the precise role of shareholders actually is and what their rights effectively are in a solvent corporation. By mentioning a financially healthy life of a corporation I intend a company able to potentially fulfil all its obligations; the time of a corporation life when there is no shadow of an incumbent insolvency or financial crisis[4].

By looking at the controversial recognition of shareholders' rights, I am going on to define some relevant aspects that should be useful to clarify the role a shareholder has in a corporation.

First of all, I intend to outline what corporate governance is and the structure of corporations in general.

Consequently, after having ruled out the idea of a single status of being shareholder, I am going to analyse the single rights that a shareholder may have and how they change depending on several factors, such as the dimension of the corporation, the eventual opening up to a financial market or the role of a single shareholder compared to others; whether he or she is a majority or a minority shareholder or if he is also the manager or not.

Finally, I intend to focus my attention on the legal basis upon which these rights are justified and on the *ratio* of the distinguishing role of the shareholders, compared to all the other stakeholders of a corporation.

[4] What *insolvency* means and how this notion differs from the one of *crisis*, will be analysed in the next Chapter, paragraph 2.1., *The Notion of Insolvency*.

1.1. Who is a Shareholder?

A shareholder is the one who increases the equity of a company in any way permitted by law. For his provision, he receives the right to be part of the corporation and to play this particular role of shareholder. Moreover, he has the right to perceive dividends as an equityholder and this is usually the main aim behind the original decision to become a shareholder in the first place.

Besides, he entitled to take part in the main managerial decisions and has the right to withdraw from such a right too[5]. This means that when speaking about shareholders we do not identify someone in particular but we refer to a variable, unstable category whose members constantly change; a shareholder is nothing more than the owner of the share.

How this rights can be fulfilled and what they really consist of will be analysed in this chapter below.

1.1.1. Two Groups of Corporations

The role a shareholder plays in a corporation may significantly change in relation to the dimension of a company and especially regarding the adopted corporate governance's policy[6].

Two different main models of corporation can be defined and should be taken into consideration:

a. The first one refers to the traditional model of a more elementary company which is often identified with family management where the shareholder is also

---

[5] *See* paragraph 1.3. *Minority Rights*.

[6] Broadly speaking with expression *corporate governance* I intend to refer to the complex rules provided by a jurisdiction to regulate the agency problems of the business corporation. As stressed by S. Lombardo and P. Pasotti, in *Disintegrating the Regulation of the Business Corporation as a Nexus of Contracts: Regulatory Competition vs. Unification of Law* (ECGI Working Paper Series in Law, n.102/2008), << *from this perspective, the corporate governance system can be divided into three subsystems or groups of rules: corporate law regulating the agency problem between managers and shareholders (or the agency problem between controlling shareholders and minority shareholders), debtor/creditors law and bankruptcy law providing for the regulation of the agency problem between shareholders (agent) and creditors (principal) and, finally, securities regulation providing for a system of information disclosure related to the substantive regulation given by corporate law and debtor/creditor law and bankruptcy law* >>.

responsible for the execution of the management's decisions. In such a closed firm, a shareholder is still considered the manager. So the perfect match is obtained; he or she who risks is the one who reaches, takes and makes every decisions.

This could be positive under some points of view as there may not be so many problems concerning the lack of information, costs of control or agency problems[7].

However, such a business model can only thrive until the company is a small one. Beyond a certain size, growth management becomes more and more complex, it requires more investment time, staff with skils and specialised knowledge which means qualified and professionals managers.

Moreover, a company needs and should attract external investors to be able to expand safely and properly. Besides the corporation's growth one can be quite sure that another model of corporate governance may be achieved.

b. The second type of business model is characterised by the existence of a specific figure. There are professional managers and directors who run the company, take the daily decisions and fulfil them, while only the main choices are taken by shareholders.

The idea of the separation between property and control of a business was announced for the first time by Berle and Means in their book *The Modern Corporation and Private Property*[8]. Large corporations are directed by managers who are employees of the corporation[9], while the property is detained by several shareholders who have no active role in management.

Afterwards, this aspect became important in scholars' discussions on corporate governance and another important contribution to the subject was the one of

---

[7] The expression *agency problems* was born firstly on an economic stage. It refers to a situation where wealth of the subject so called *principal* depends from the behaviour of another one, so called *agent*. The main problem is to stimulate an agent to act not only for its own interest, but also for principal's one. For a detailed analyses of the argument, *see*, J. Armour, H. Hansmann and R. Kraakman, *Agency problems and legal strategies*, in *The anatomy of corporate law: a comparative and functional approach*, Oxford University Press, 2009, at page 35 and the following.

[8] A. Berle Jr and G. Means, *The Modern Corporation and Private Property*, New York, Macmillan, 1932.

[9] Today, not all managers are corporation employees and laws may provide for independent managers to place side by side with the employee ones.

William Baumol[10], immediately after the second half of the XX century and in the following years. All these works underline the separation between managers' interests and the shareholders' ones. While shareholders main purpose is to maximize profits and the value of a company, managers may aim for great results in a short period to show their efficiency or to receive higher salary whenever their fees depend on the increase of corporate profits. They may strive towards the corporation extension as soon as possible to obtain great results in a short time, but fast expansion could be risky in the long term and at worst it may even result in bankruptcy.

If managers are only the employees of a business and they are no longer equityholders, incurring excessive debts without considering the long-term consequences may be riscky as managers may aim for the maximization of sales in a short period[11].

The legal differences in the structure and regulations of a business enterprise are the consequence of several different factors which influence the development and evolution of legal procedures themselves.[12].

Furthermore, these two models of business change according to the level of the risk of management decisions, which may be affected by the concentration of ownership in the hands of a single shareholder or family. Shareholders may be against risky strategies of management as operations focus on technological innovation or on internationalization, whenever they have invested their entire wealth in a corporation.

However, shareholders' caution can also be an advantage for creditors who share with shareholders the same interest in the preservation of the capital of a business. Besides, the identity between shareholders and managers may also put creditors at a disadvantage because the value of the corporation also depends on the owners' personality. This strong relationship makes a reorganizational procedures less

---

[10] Between his several works, see one of its first approaches to the subject in *Business Behaviour, Value and Growth*, London, Macmillian, 1959.

[11] There are several remedies for this kind of conflicts, such as paying managers partially by stocks of the corporation, but this exceeds the context of this dissertation.

[12] J. Armour, *How do legal rules evolve? Evidence from a Cross-Country comparison of shareholder, creditor, and employee protection*, in The American Journal of Comparative Law, 57, 2009, at page 579.

satisfying in case of insolvency because one of the important values of a business is the training of their managers and employes; the so called *know-how* of an enterprise. On the other hand, if a business opens up to new assets, the consequent entrance of new shareholders can not only distribute the risk and make decisions more assertive but it may also reduce this identity of roles.

However, this is not a political choice; there is a moment in the life of a business when the split of ownership from management becomes inevitable for its survival.

This detachment is much more evident in public firms. Back in the nineteen thirties, Berle and Means stressed how the role of shareholders changes completely when a corporation has a scattered ownership. In this kind of corporation, shareholders must take a huge step backwards and share the stage with other stakeholders. They wrote:

> in the past, the ownership of business enterprises (…) has always (…) involved two attributes, first the risking of previously collected wealth in profit-seeking enterprise; and second, the ultimate management of and responsibility for that enterprise. But in the modern corporation, these two attributes of ownership no longer attach to the same individual or group. The stockholder has surrendered control over his wealth. He has become a supplier of capital, a risk-taker pure and simple, while ultimate responsibility and authority are exercised by directors and "control"[13].

In economics terms a corporation may be considered as several relationships between several juridical subjects which interact with each others through a complex set of connections producing agency relationships among parties and the related problems of agency costs, too. Particularly, what stands out is the different allocation of the property of the corporation in the hands of its shareholders.

In such a sets of relationship, shareholders, creditors, managers, employers, suppliers and customers have various claims depending on the corporate structure. Particularly, if one considers shareholders and creditors as the two main parties of a corporation it is possible to identify three main kind of agency costs, in a typical principal-agent relationship:

[13] A. Berle Jr and G. Means, *supra* note 8, at page 297.

monitoring costs by the principal, bonding costs by the agent and residual losses[14].

The aim of the economic theory of business which largely meant as statutory law and judicial enforcement, is to provide legal mechanisms that may be able to increase the value of the complex of the arrangements that parties who face a principal-agent relationship incur in order to maximize this value. The regulatory system provided by the regulation of the business corporation can be called *corporate governance*.

To conclude, it is clear how the corporate structure, its dimension and its governance have a huge influence of the shareholders' subjective positions and on each of their rights. Moreover, while more attention will be given to the minority shareholders' rights in a traditional corporation, because the majority of shareholders has a stronger power, in a larger corporation the ownership is spread out of and a dangerous conflict may be the one between the class of shareholders and the managers whose interests may differ.

1.1.2. The Right to be a Shareholder

As has been described in the previous paragraphs, the concrete role of a shareholder is strictly related to corporative structural features like the adopted model of corporate governance, the corporation dimension or the eventual opening to the market. Such characteristics critically influence the real position of shareholders in a company.

However, some questions are still considered controversial; who a shareholder is and what the implications of being a shareholder actually are.

During the second half of the XX century, several eminent scholars have dedicated books and articles to the analysis of the meaning of being a shareholder[15], while a general vacuum exists today regarding both positive law and scholars' works.

---

[14] S. Lombardo and P. Pasotti, *supra* note 6, at page 7.

[15] As some of main authors who wrote about shareholders rights between the XIX and the XX sec, I should mention the Italian V. Buonocore and Gian Carlo M. Rivolta, or the German K. Lehmann and K. Wieland.

However, these lack does not mean that the discussion has reached a satisfactory result which everybody agrees about. Indeed, the problem is still present but the complexity of the real world makes it difficult to outline a single definition of a shareholder's position in a corporation or a single role that a shareholder can play. Corporations are so different to one other and a single company is in such a continuous and fast transformation that is not possible to identify a uniform definition of shareholders rights.

An example in point can be the comparison of the roles of a shareholder in a corporation opened to the market or in a closed one.

First of all, one can clearly excludes the idea that shareholder rights are only those created for the utility of a single shareholder. This result was first achieved in Germany thanks to special legal provisions and secondly in Italy already in the middle of the XX century[16].

A theory regarding shareholders' individual rights evolved to describe any situation of shareholders' interests which were considered intangible by law; a prerogative that neither the statutory autonomy nor the decisions adopted by the corporations' bodies during the life of the corporation could modify. The above mentioned scholars moved in a different way to achieve the same result.

The Italian scholars tried to classify the single rights first and then looked at what was effectively an individual right, while the German doctrine adopted the opoosit procedure. However, they both started from the assumption that the main feature which makes a shareholder's right easy to identify was the existence of a legal provision to forbid corporative bodies to apply such decisions related to the shareholders' interests. Therefore, it was possible to talk about shareholder rights only with a provision of invalidation of a corporate act pursuant to the violation of a shareholder's interest.

By starting from this assumption, they moved on to look at the reality of the corporations and noticed how there were not any rights that could not be modified or at least influenced at all by a company decision, except one which is the one

[16] The German doctrine has plaied a central role in the discussion. Among the many, see K. Wieland, *Handelsrecht*, II, Die *Kapitalgesellschaften*, Munchen und Leipzig 1931. Between the Italian scholars, instead, a work of undisputed importance on the point is *Le situazioni soggettive dell'azionista*, of V. Buonocore, Morano Editor, 1960, but see also G.C.M. Rivolta, *La partecipazione sociale*, Milano, 1965.

that Vincenco Buonocore called *Diritto alla qualità di socio*, and which finds a correspondence of expression in the German *Mitgliedschaftsrecht* or *Teilhaberschaftsrechts*. All these terms do not have exactly prerogatives, but they all refer to a unitary right which can be called the *right to be a shareholder*.

However, the idea that shareholders obtain a right to perceive dividends from the corporation through their contribution is no longer valid today and shareholders do not obtain the right to have its contribution back by increasing corporate equity and neither do they have the right to perceive dividends, but they are only entitled to take part in corporate life, in the limits of its statute.

Anybody who decides to take part in a business, in this way submits himself to corporation's rules, and moreover to the majority rule which imposes on all shareholders each decision taken by only part of them[17]. By becoming a member of a company, shareholder agree to specific limitations which firstly include the majority rule and that is why their rights can be modified during the life of a company trough the decisions of the majority.

What I have called the *right to be a shareholder* refers to a uniform situation which simultaneously has both a property and corporate nature, and to something different from each claim that belongs to it and which is separately protected by. The *right to be a shareholder* has a mixed nature which is made up of administrative rights on one side and first of all the right to vote, while on the other side there are economical rights such as the right to perceive dividends. Moreover, being qualifying as shareholder gives both *erga omnes* rights and potential claims against the corporation itself. Consequently, in a company it is possible to identify many different *status* of shareholder as much as these single rights can be articulated individually and in relation to each other.

The constitutive act of a company usually allows the differentiation of *status* both at the entrance and during corporation's life, with the only limit of respecting legal provisions. Generally, countries belonging to the common law tradition seem freer than the civil law legal systems.

[17] The percentage necessary to approve a decision differs between subjects and countries. *See* paragraph 1.2.3. *The Right to Vote*.

However, the *right to be a shareholder* – the *Mitgliedschaftsrecht* or *Diritto alla qualità di socio* – cannot be named as a *status* which risks to recall a personal position. A shareholder's participation can be instead sold and generally traded on the market. The relevance of the issue cannot be detailed analysed in this context; however, a shareholder's participation cannot be merely considered as positive because to its dynamic nature which refers to shareholder participation in a business and to its economics results. Anyway, in time the shareholder's role in a corporation has been qualified as a *status*, an organizational position, a contractual position, or something similar to *universitas iuris* were recalled, but all these definitions are today too concise and do not give and satisfy description of such a complex reality[18].

In conclusion, it is impossible to ascribe a single, precise and technical meaning to shareholders' rights, as well as a use of the expression *subjective right* for describing a complex combination of economic pretences and governance's power is insufficient. In practice, what is possible is to examine all the several factors that influence the shareholders role in a corporation on the one side, as such the adopted corporate governance model and the entire single rights that a shareholder is entitled to on the other.

1.1.3. Shares, Bonds and other Financial Instruments

Traditionally, the *right to be a shareholder* is incorporated in shares which are always identical. The shareholder position in a corporation is always the same, independent of the number of stocks that he or she owns. This means that the stakes possessed are irrelevant for the qualification of a shareholder. At least, the number of stocks detained can influence the weight of the single shareholder on the corporation activity and consequently it can also influence the market value of that specific stake.

Indeed, the share is a fungible asset on the market as they are goods suitable for being traded at a certain price per unit. Equal shares grant equal dividends and voting rights (one-share-one-vote general rule) and the more the expectations on

[18] M. Maugeri, *La partecipazione sociale e attività di impresa*, Milano, 2010, at page 10/11.

pro rata distributions are reliable, the more the corporation is able to issue shares which will be exchanged on the market with the consequent increase of corporate equity.

However, there are exceptions to the *one-share-one-vote* general rule. Almost everywhere, provisions of law recognise a large freedom to statutory autonomy to create different categories of shares with different related rights but with equal rights for each category, with the only limit of respecting the conditions of law. Such differences may also refer to the right to perceive dividends, the participation in liabilities or the right to vote. However, the only technique to diversify the shareholders' position is the creation of special categories of shares.

Positive law confirms the rule for which every share gives its holder the same rights. On this point, the European Union Member States bound to Article 46 of the Second European Council Directive on commercial law which requires an equal treatment for shareholders <<*who are in the same position*>>[19]. This rule is applicable both in the case of repurchasing the company's own shares and in capital reductions. Such principle is also affirmed by another EU Council Directive on the right of shareholders in listed companies. Here Article 4 establishes:

> the company shall ensure equal treatment for all shareholders who are in the same position with regard to participation and the exercise of voting rights in the general meeting[20].

Some U.S. courts and legal scholars also require that share repurchases follow an equal treatment rule (capital reduction has little importance in the U.S.):

> (…) fiduciary principle requires fair conduct; equal treatment is fair conduct; hence, fiduciary principle requires equal treatment[21].

However, in recent years several authors have been questioning the fact that

---

[19] Second Council Directive 77/91/EEC on Company Law of 13th December 1976, as modified in 2012 by Directive 2012/30/EU.
See also Article 3 which, by describing the minimal context of a corporate statute, requires nominal value of shares or at least once a year their number (b), eventual number of shares without nominal value (c), shares transfer limitation (d), which kind of rights each class has (e), but see also Article 3(f) (g) (h).

[20] EU Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies.

[21] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law*, Harvard University Press , 1991, at page 110.

corporations cannot treat shareholders equally, as long as this non-equal treatment is still considered *fair*[22]. And fairness requires that a shareholder should only take into account other interests and should not prefer them to the detriment of his own.

Various categories of shares exist, with different market values. Indeed, the "price" of shares may be influenced by its controlling power over the management; it is not enough to divide the corporation's assets by the number of the existing shares but the power to influence the corporation's decisions that specific participation gives to its owners should also be taken into account[23].

A company will inevitably finance itself not only through the issuance of shares of various classes but also by taking out loans. Debt financing may vary under a qualitative and quantitative perspective: it may come from banks or from the capital markets for bigger companies, but also loans from directors and shareholders as well.

Generally, it is possible to sustain that a debt is economical and more flexible but it is also more demanding as it is a form of finance for corporations rather than equity stocks. It is cheaper because insolvency priority and contractual flexibility may reduce the risk to lenders, who may be persuaded to lend on better conditions; but it can be more demanding as those terms usually create an entitlement to payment of a fixed or fluctuating rate of interest, plus the repayment of principal if the corporation is doing well or not. While the declaration of a dividend on ordinary shares is usually a matter within the discretion of managers. The rate of interest a corporation has to pay for its debt depends on if it is able to offer a lender security for its loan and to the amount of the security offered[24].

However, it is evident how a clear contrast between equityholders and debtholders has been lost today. While traditionally there used to be only two ways of

---

[22] This is what has been argued by Nicola de Luca, in his article *Unequal treatment and shareholders' welfare growth: "Fairness" v. "Precise Equity"*, in *Rivista delle Società*, 2009, n° 54, at page 697 and the following.

[23] M. Ventoruzzo, *I criteri di valutazione delle azioni in caso di recesso del socio*, in *Rivista delle Società*, 2005, at page 309 and the following.

[24] P.L. Davies and S. Worthington, *Principles of Modern Company Law*, Sweet & Maxwell, 9th edition, 2012, at page 1177.

participating in a corporation's activity – the equityholder, represented by shares, and the debtholder, represented by corporate bonds – today we may have shares without any related rights to vote, or which may have a right to vote limited to fewer subjects. Furthermore, shares could be have been provided without any rights to perceive dividends, or the rule of participation in liabilities may be out of proportion with the contribution. There are also shares with a right to perceive dividends only in relation to one area of an ampler corporate activity; or shares of an open firm which are for their nature free to be traded on the market but where this freedom is limited for few years.

Besides, shares themselves are now only one of the several financing techniques available and all of them are characterised by the ability of expecting the dividends or similar results and the controlling power over management as well. A corporation may issue bonds and such debt securities may be traded on a public market, in the same way as shares are.

Several national legal systems, let corporations quite free to establish other ways of supporting corporate activity with the only limits of respecting the eventual national law provisions and of fulfilling the rule of equal treatment, as defined beforehand. All such positions may be characterised by the ability to make divisible claims on corporate assets and cash flows[25], and also by a different governance structures as well[26]. Shares and bonds are simply two different types of financing, represented by commercial claims on business[27]. Moreover, ashas been mentioned above, it is not rare for a shareholder to be a debtholder of the company at the same time. For all these reasons, it is easily understood how speaking about the values of debt makes sense also from a shareholder's point of view[28].

[25] M. Jensen and W. Mackling, *Theory of the Firm: Managerial Behaviour, Agency Costs, and Capital Structure*, in *Journal of Financial Economics*, 1976, n. 3, at page 305 and the following.

[26] O. Williamson, *Corporate Finance and Corporate Governance*, in *Journal of Finance*, 1988, n. 43, at page 567 and the following.

[27] S.B. Bainbridge, *Corporation Law and Economics*, New York, 2002, at page 64.

[28] R.A. Brealey, S.C. Myers and F. Allen, *Corporate Finance*, McGraw Hill, 2006, at page 652.

1.2. Shareholders' Rights

I now intend to deepen my analysis into the rights a shareholder has and those which can be shared by holders of corporate obligations or other financial instruments.

First of all, these rights can be divided into two different categories that may clarify the discussion. On one hand, *economic rights* which include not only the right to perceive dividends but also pre-emptive rights and the right to perceive the share value in case of liquidation. On the other hand, there are *administrative rights* such as the right to vote or the right to nominate and indirectly control managers[29]. However, several shareholders' rights have both an administrative and an economic content, so it is not my intention to focus extensively on the distinction. Moreover, some administrative rights relate to the number of stocks possessed; some can be exercised only over a minimum percentage, even though others are independent from this number. The latter are so called *minority rights* and they will be analysed later on[30].

Traditionally, main shareholders' rights can be identified as the right to perceive dividends and the right to vote. However, these are no longer the only rights that represent the shareholder position in a corporation. There is also the participation in liabilities, the right to be informed, especially in public firms and the right of withdrawal, and they all contribute to define the role of shareholders in a corporation and the value of this participation.

It is possible to find references to shareholders' rights in almost every national jurisdiction, where these may often be indirectly fulfilled through the protection of property rights or provisions which assure free-enterprise. Besides, the indirectly enforcement of shareholders' rights is also stated in the European Convention on Human Rights, i.e. by Article 1 of the First Protocol that regulates property and expropriation[31]. At the EU Level, we may look at the Council Directive on the

---

[29] Enrico Felli*, I diritti delle categorie di soci*, in Giorgio Berta (directed by) *La tutela dei soci*, G. Giappichelli, Torino, 2008, at page 171.

[30] See paragraph 1.3., *Minority Rights*.

[31] First ECHR Additional Protocol, Article 1, states that << (…) *No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law* (…) >>.

exercise of certain rights of shareholders in listed companies[32], of 2007, which applies only to listed companies but which is *de facto* implemented at a national level in relation to every kind of corporation.

1.2.1. The Right to Perceive Dividends

A business usually produces profits by producing products to sell on the market by using its factory and machinerys. Such a sale generates credit receivable from a customer; when the customer pays the company this is then able to pay its creditors. And only if there is any residual cash may dividends be distributed among corporate shareholders[33].

Generally, the right to perceive dividends is the main aim which is behind the shareholders decisions to take part in a corporation's activity. Investment is made with the hope of increasing personal wealth. Traditionally, shareholders have the right to perceive part of the corporation's assets only when the latter has already satisfied all its creditors. That is why they are the so-called *residual claimants*.

Consequently, shareholders are the ones that pursue the corporation's aim of producing new assets far more than other stakeholders and for this reason they want the most efficient management which is possible.

A percentage of corporation assets that belong to each shareholder relates to the stake possessed. As stressed before, it is possible to provide different categories of shares both on a quantitative and on a qualitative level. For example, there is a category of shares which receives dividends before another one. In this case, category *A* first receives assets up to a specific amount which has been previously established by the constitutive act of the corporation. Afterwards, the remaning assets are then distributed among the shareholders of category *B*, again up to a specific quantity. The eventual residual assets are finally distributed between both categories in the same percentage.

Moreover, a corporate statute can provide less used *tracking stocks* which give

---

[32] EU Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies.

[33] M. J. Roe *Corporate Reorganization and Bankruptcy (legal and financial materials)*, New York, 2000, at page 13.

their holders a right to receive assets produced by the corporation only in one specific area of its larger activity. However, the dividends cannot be usually distributed to the holders of these tracking stocks until the corporation as a whole has made dividends.

As residual claimants, the shareholders have the right to perceive dividends only after all the creditors have been satisfied. However, all legal systems authorise corporations to distribute dividends chronologically before all the corporation's creditors have been paid. This rule recognises a practical need without forgetting the equivalence between shareholders and residual claimants. Indeed, not all corporations develop with a specific aim that can be achieved in a certain given period of time, after which the corporation will be put into liquidation, it will pay all its credits and it will then distribute the eventual dividends between shareholders; for instance this may happen when a corporation has to carry out a specific work.

However, corporations often arise for a potentially undefined lifetime. In the first case creditors satisfaction could be respected in spite of the lengthy production times, while this is absolutely impossible for the second hypothesis, which is besides the habitual one. However, there is a risk of financial paralysis if creditors satisfaction should be totally fulfilled before being able to distribute assets among shareholders. And no one wish to take part in a corporation or risking moneys with such a long-term prospect of receiving eventual dividends. Therefore, it is also important to protect creditors from insolvency risk.

Shareholders are encouraged to request efficient management until they are residual claimants. If shareholders are given early grounds for satisfaction, they may no longer be interested in fulfilling all the creditors' legitimate claims.

This delicate balance has been resolved differently in the European Union and in the United States.

The E.U. member States allow shareholders to receive dividends chronologically before fully satisfying the corporation's creditors only on one condition[34]; the balance sheet of the financial year must show the existence of a verified *surplus*, which is the result of the difference between the equity of the corporation and its

[34] See Article 17 of the EU Second Council Directive 77/91/EEC, as modified in 2012.

legal capital[35]. The balance sheet is drawn up by the managers of the corporation who are at least nominated by shareholders and for this reason the balance sheet should evaluate assets prudently. This is the reason why the balance sheet includes a verification of the assets and distributive plan of the *surplus* and it also has to demonstrate the existence of enough resources to potentially fulfil all the creditors[36].

The ability of the minimum capital rule in actually protecting corporate creditors is highly doubtful and even some defenders of it admit that its purpose is not to protect creditors from the risk of losses but rather to point out the serious risk to the market. This indeed creates a barrier against the creation of dubious business with an unreasonable amount of backing by shareholders. Nevertheless, if there are any benefits they need to be considered against the disadvantage of preventing the formation of a potentially thriving company with some business idea but little or no assets. This may be proved by the increase of the incorporations of continental business in the U.K., where the national law does not require any minimum legal capital[37].

Moreover, within the EU the regulation of legal capital is related to law provisions limiting managers' discretion over the distribution of dividends or any other way of transfering corporate assets to shareholders. Indeed, according to Article 17(1) of the Second Directive, no dividends may be distributed among shareholders when net assets are lower or would become lower than subscribed capital plus certain reserves which may not be distributed (with the only exception of the case

---

[35] Legal capital is the aggregate nominal value of issued shares which is typically much lower than the actual issue price of these shares. In U.S. jurisdiction that permit "no par" shares, legal capital is initially set by a company's organizers, and may be any amount less than (or equal to) the issue price of a company's shares. Usually, the legal capital does not include reserves, although some jurisdictions require companies to set aside non-distributable reserves from current earnings as an additional hedge against shareholder opportunism. *See* J. Armour, G. Hertig and H. Kanda, *Transactions with Creditors*, in *The anatomy of corporate law: a comparative and functional approach*, *supra* note 4, at page 130, note 80.

[36] For the international rules on balance sheet *see* IAS, International Accounting Standards (1973-2000), IFRS, International Financial Reporting Standards (from 2001) and SIC, Standing Interpretations Committee, which are documents for the interpretation of both the IAS and IFRS rules. Available in Italian at www.irdcec.it/node/51.

[37] L. Enriques and M. Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, Harvard Law School, Discussion Paper No. 19, 7/2008 at page 22 and the following.

of a reduction of subscribed capital). Even if this does not protect creditors against risk, a public company will in principle be unable to give funds to shareholders if net assets fall below the subscribed capital, unless shareholders vote to go through a capital reduction procedure – that however includes certain safeguards for creditors[38]–. A reduction below the minimum capital amount is of course ruled out completely[39]. As a solution, Article 18 of the Directive established that distributions received must be returned whether the company proves that these shareholders knew of the irregularity, << *or could not in view of the circumstances have been unaware of it* >>.

However, two important clarifications have to be made. Firstly, the amount of net assets within the meaning of the Second Council Directive consist in a *balance-sheet test* on the basis of the last financial year's annual accounts. So, the extent of *capital maintenance* depends on the accounting rules applied. Secondly, it is not entirely clear what kind of transactions the prohibition applies to.

However, even if the Directive explicitly refers only to *distributions*, scholars generally agree that it also forbids the so-called *concealed distributions*. Such an expression refers to transactions by which corporate funds are given to shareholders indirectly for example through contracts entered into on unfair terms or by loans to shareholders with uncommonly low or no interest rates or purchases from shareholders at high prices.

One positive argument, can be found in Article 46 of the Second Directive which requires an equal treatment of shareholders under equal conditions. To be effective, indeed, such a provision should be interpreted as being indifferent to whether a distribution is made through a formal declaration of dividends or in any other way. This is what is sustained by the German doctrine and jurisprudence, for instance.

On the contrary, under English law, a distribution is normally defined as a transfer of assets without consideration. Similarly to German scholars, English courts have held excessive salaries of managers, the transfer at undervalue of real property to another company and a guarantee for another corporation within the same group

[38] See Articles 34-43 of the Second Council Directive 77/91/EEC, as modified in 2012.
[39] *Ibidem*, at Article 38.

to be unauthorized returns of equity.

However, the recent British Company Law Reform Bill should allow such a distributions as long as there are sufficient assets available to cover the difference between the asset's book value and the consideration received. This would not be acceptable in Germany instead.

Even if English case law on the issue is limited, British scholars appear not to see a connection with this operations and the Second Directive[40]. Moreover, it is obvious that the understanding of constraints on distributions imposed by EC law differs considerably among jurisdictions. For instance, hidden distributions do not appear to be much of an issue in other countries either.

Since restrictions on distributions, may result in a higer cost (i.e. when planning intra-group transactions to avoid violations of such rules) and it is risky for shareholders if the corporation goes bankrupt, the differences in the law may influence corporate decisions to some degree.

However, all such considerations can refer only on the European countries where corporate law is based on the notion of legal capital. In the U.S.A., the necessary and sufficient condition that makes a prior distribution of dividends possible is to pass the so called *solvency test*; corporate managers have to demonstrate the corporation will remain in a solvent state after the dividends' assignment.

The difference between these criteria is not totally clear and dual tendencies can be noticed in both directions. No distribution can clearly be made if corporation becomes insolvent; even if there were a *surplus*. This is why European systems use the solvency test technique or have at least opened a debate up; to face problems which could not be solved by the legal capital rule[41]. The latter in fact may impede dividends' distribution in a solvent corporation or admit it in case of

---

[40] For example, Vanessa Edwards discusses both the English and German cases in her treatise. See Vanessa Edwards, EC Company Law 69 (1999). The Rickford report discusses the issue only briefly within the context of German law. See *Jonathan Rickford, Reforming Capital. Report on the Inter- disciplinary Group on Capital Maintenance*, 2004 Eur. Bus. L. Rev. 919.

[41] However, the E.U. system affirms that also a minimum legal capital has a central role of investors' warning. This is the position adopted by the European Union Court of Justice in the case, *Centros Ltd. And Erhvers v. Selskabsstyrelsen*, 2000 and the Slim Report on the Second Company Law Directive, 2000. Available at www.europa.eu.int.

insolvency when the assets are greater than the legal capital[42]. On the contrary, in the U.S., the New York and the Delaware rules allow distributions only on a *surplus* basis, which consist in the difference between the corporation's equity and its legal capital. However, this is not the case in the American systems which have adopted the Model Business Corporation Act[43].

Both the European criteria and the United States ones have

advantages and correspond to the social and economic background

to which they refer[44].

And all of them have a common aim consisting in the limitation of every kind of *spill-out* of assets oriented to avoid the reduction of corporation's assets concerning damage of the creditors.

The right to receive dividends is not the only way shareholders can receive part of the corporate assets. The same result can be achieved trough the share repurchasing and the capital reductions as well. Both the latter in fact refer to hypothesis of *spill-outs* of assets, which enable the shareholders to receive money from the corporation in relation to their stocks. For this reason, the previously stated rules in relation to the right to perceive dividends apply in all these cases, too.

The basic idea is still the same; shareholders are residual claimants and cannot receive part of corporate assets in any way if the operation endangers the future creditors' satisfaction which is mainly due to distribution of dividends, as well as capital reduction which is usually authorised by the shareholders' vote[45].

1.2.2. Limited Liability

The limited liability of shareholders is the most distinguishing feature of corporate

---

[42] And that can happen because insolvency is not necessary related to the legal capital. On the point *see* L. Enriques and J. R. Macey, *Creditor versus capital formation: the case against the European legal capital rule*s, Cornell L. Rev. 1165, 2001.

[43] The Model Business Corporation Act was created in 1950 and drafted by the American Bar Association. It is influential and it is adopted by twenty-four states in the U.S.A.. It has been revised in 1984. The full test of the Model Business Corporation Act is available at http://users.wfu.edu/palmitar/ICBCorporations-Companion/Conexus/ModelBusinessCorporationAct.pdf.

[44] N. De Luca, see note 22, at page 699.

[45] See paragraph 1.2.3., *The Right to Vote*, for the details.

law. It refers to the fact that shareholders are not liable for the debts of a corporation and they are not risking anything more than what they originally contributed. On the other hand, a corporation is completely liable for all its credits.

Clearly, the limitation of owner liability is not a *right*, but because it is one of the main distinctive elements of the shareholders' role in a corporation, it is important to outline some of its content. Nevertheless, during history, the benefit of the limitation of owner liability has not always been related to corporate form. British law provided it for joint stock companies only in the middle of the XIX century, while in California, U.S.A, shareholders limited liability have been introduced only in 1931[46]. However, this benefit is an almost universal feature of the corporate model, today.

Together with the element of the legal personality, a legal limited liability makes it possible to separate a corporation's heritage from the single shareholder's one. This means that the personal creditors of the shareholders can claim on the shareholder's assets with no interference. Meanwhile, the creditors of the corporation are the only ones that can be satisfied with the corporation's assets.

> If limited liability were not the starting point in the corporate law,
> firms would create it by contract[47].

This may indeed be not hard to do in some countries such as the U.S.A., while in some civil law jurisdictions limited liability may be only admitted whether it is provided by law[48].

The general rule of shareholders' limitation of liabilities follows on from the fact that a corporation is a separate person. This is the reason why its members are not as such liable for corporate debts. Moreover, the rule of non-liability also applies to obligations other than debts.

The limitation of owner liability hands over the risk from shareholders to creditors. Moreover, it may be argued that more risk someone bears, more he or she should be able to monitor. This is how creditors are interested in controlling

[46] P.L. Davies, *Gower and Davies' principles of modern company law*, 6th ed., 1997, at pages 40 to 46.
[47] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 21, at page 41.
[48] For instance, see Article 2740 (2) of the Italian *Civil Code*.

the corporate managers. Besides, it is possible to notice how creditors, especially the most sophisticated ones such as banks or other finance corporations, may sometimes control management better than small shareholders of a public firm. However, limited liability may incentivise shareholders to take unlimited risks, but on the other side it makes the management function with other subjects too, which is an extremely important possibility because there is a moment in the life of a corporation when the distinction between ownership and management is no more a free choice but a need.

Moreover, limited liability lures more equityholders, who promotes free transfer of shares and gives manager incentives to act efficiently[49]. It also makes it possible to share risks of a corporate operation not only between equityholders, but also with debtholders as well. The latters participate mainly in the risk of the insolvency by accepting the limited liability feature. However, when someone decides to give credit to the corporation he consciously accepts all its features. And above all, limited liability may also be an advantage for creditors because corporate assets are reserved for their satisfaction only and might not be undetermined by creditors of a single shareholder.

Finally, it is possible to argue that owner liability represents a happy compromise between a favour for enterprises and creditors' protection[50].

From the shareholder's perspective limited liability is fairer the more the shareholder is far from the management:

> over the enterprise and over the physical property – the instruments of production – in which he has an interest, the owner has little control. At the same time he bears no responsibility with respect to the enterprise or its physical property. It has often been said that the owner of a horse is responsible. If the horse lives he must feed it. If the horse dies he must bury it. No such responsibility attaches to a share of stock. The owner is practically powerless through his own efforts to affect the underlying property. (…) Physical property capable of being shaped by its owner could bring to him direct

[49] *Supra* note 47, at page 42.

[50] Lorenzo Stanghellini, *La crisi di impresa fra diritto ed economia*, Bologna, Il Mulino, 2007.

> satisfaction apart from the income it yielded in more concrete form. It represented an extension of his own personality. With the corporate revolution, the quality has been lost to the property owner much as it has been lost to the employee trough the industrial revolution[51].

It is important to stress how the limitation of shareholder liability does not apply only to contractual obligations, but it also concerns involuntary corporate creditors. While the former negotiate for their will with a corporation and voluntarily accept the limited liability feature, this does not happen for the latter. For this reason, liability limitation may fail in front of involuntary creditors and shareholders should be held personally responsible on a pro rata base. Otherwise, involuntary creditors may be given priority over voluntary creditors in case of an insolvency procedure, but the feature of limited liability must stand.

Another solution proposed is to make it compulsory for corporations to purchase liability insurance. However, the problem of involuntary creditors has not been resolved and even if it is a very interesting issue, it does not lie within the scope of my work[52].

In conclusion, the final aspect to be discussed is the previously mentioned consideration that shares can differ also through the assumed liabilities. As underlined in the following chapters, the amount of debts could constrain corporations to reduce the legal capital. In these cases, two different categories of shares may differently support the weight of liabilities; therefore corporation must reduce the capital trough an elimination of shares of category *A* first, and then if it is still necessary, corporation must eliminate shares of category *B*.

Moreover, the limited liability feature raises a central role in case of corporation insolvency. Indeed, the protection of creditors prerogatives is perceived as particularly delicate in an insolvent corporation, especially when corporate governance mechanisms are inefficient. When shareholders are aware of an unlawfully modified corporation governance, their personal liability as *de facto*

---

[51] A. A. Berle and G.C. Means, *supra* note 8, at page 64.

[52] For a detailed analysis on this aspect *see* between the others Hansmann and Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, in *The Yale Law Journal*, n.7, 1991.

directors may be taken into consideration.

1.2.3. The Right to Vote

The right to vote in a general assembly is the right that better refers to the role of shareholder as *owner* of corporation. As *residual claimants* they are the ones who bear the risk to loose their provisions and to do not perceive any dividends. For this reason, shareholders are incentivized to make most efficient choices and to control managers. Indeed, managers are the real handlers of corporations, with the only limit of corporate object as it may be settled in the statute.

They are the ones who usually take any daily decisions, while only some main choices are reserved to the assembly of shareholders, by law or by statute. And this is true above all in public firms where we loose any identity between shareholder and manager is lost, and where

> the investors is "powerless". The managers, by contrast, know how the business is running and can conceal from investors information about the firm and their own activities[53].

However, shareholders as *residual claimants* are still the ones who have the most to lose from a wrong corporate decision, also in public firms. That is why they must be able to control corporation activities trough the right to vote, by taking or authorising all the main decisions. But what are these *main decisions*?

1.2.3.1. Topics Where Shareholder Vote is Needed

On the one hand, shareholders have the right to nominate and to dismiss managers; on the other hand they should be involved in fundamental corporate operations as mergers, liquidation, sales of assets or charter amendments.

Shareholders vote for any election of directors and managers. Usually the governance is structures in a single board which is extremely sensitive to the majority interests. Some jurisdictions allows the creation of a two-tier boards, such as France and Italy[54], and some others countries enforce it, such as Germany

---

[53] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 21, at page 1.

[54] In France the *société anonyme* is normally governed by a unique *conseil d'administration*, but the constitutive act can provide a two-tiers board's system with *à*

and the Netherlands[55]. In all these situations two boards are usually organized in a semi-hierarchical relationship with one controlling the other, but they are not on an equal level. However, also in a two-tier boards corporation, there is at least one board that is elected by shareholders[56].

The existence of a specific body delegated to management is one of the main features of corporate governance and this implies that shareholders may control their corporation only indirectly, except for small closed firms where shareholders may be directors as well. The right to select managers and the right to replace them is how the law protects shareholders and their interests.

The right to replace directors consists in the shareholder possibility of removing managers at the end of their mandate. The term of an office can be timeless or not and can sometimes have an end line fixed by law[57].

In the United Kingdom there is a lack of law provisions on the point and shareholders of a closed firm may appoint the board members for life[58] or replace the managers and directors in charge. The English, French and Italian law systems confer this right to the majority of shareholders[59] but their rights are less powerful than in the U.S.A, where the rule differs among the States, and than in Germany where the 75 per cent of the votes is required[60]. In the U.S.A., some States provide the default rule for which shareholders can remove managers with no cause[61], while others makes this rule mandatory also if then they limit its use by

---

directoire and a *conseil de surveillance*, *ex* Article 255-57 *Code de Commerce*. In Italy the traditional system is the one-tier board of a *consiglio di amministrazione* (c.d.a.) or a *amministratore unico*, but the statutory act can also pull along side of *c.d.a.* a *collegio sindacale* or a *comitato per il controllo della gestione* which is nominated inside of the *c.d.a.*; see Article 2380 *Codice Civile*.

[55] In Germany and in the Netherlands as well, this system pursues the aim of having a representation of employees' interests into one of the corporate boards.

[56] The only exception has been the Dutch *Structuurregime* which, before a reform of 2004, provides a board of directors composed by members not elected by the shareholders but nominated by the board of controller, for any quite large corporations.

[57] About the end line fixed by law, paragraph 102 *Aktiengesetz* provides five years for German corporations. Six years for the French ones are established by Article L.225-18 *Code de commerce*, instead. And three years are the maximum end line for Italian corporations (s.p.a.), *ex* Article 2383 (2) *Codice Civile*.

[58] P.L. Davies, see note 46, at page 307.

[59] *Companies Act* at paragraphs 303 and 368 (England); *Code de Commerce*, Article L. 225-18 and Article L. 225-103 (France); *Codice Civile*, Article 2383.3 (Italy).

[60] Paragraph 103 I *Aktiengesetz.*

[61] Paragraph 8.08 (a) of the *Revised Model Business Corporation Act*.

preventing shareholders to call the general assembly for this aim. Of course, shareholders vote on managers' salary, too.

Shareholders may be also involved in any major decisions on the activity of a corporation. Company law carefully individualise subjects where a shareholder intervention is required or at least encouraged. Further, the law rarely *imposes* on shareholders the duty of decisions but more often just *permits* it. This also happens because voting is expensive and as every cost, it is supported by corporations and indirectly by *residual claimants*.

A necessary balance on this issue is required to defend a shareholders' need to "protect" what they have risked in corporation by avoiding wrong decisions of management and on the other hand by the necessity to prevent a paralysis of corporation's activity which may occur if managers are authorised by shareholders for any every-day decisions.

Furthermore, every corporation with a huge number of shareholders will probably have high procedural costs whenever shareholders decisions are necessary.

Moreover final decisions may be unfavourable if small shareholders are not well informed and they may vote improperly.

At the same time, a shareholders general assembly is never forced to delegate all its power to the board of directors, not even if an efficient corporate structure requires a centralization of management powers in the hands of the board members. For all these reasons, not only main decisions generally requires a shareholder involvement but also there are not any jurisdiction which may exclusively allow managers to propose an operation related to corporate governance.

The *main decisions* are characterised by at least one of the following features:

a) an operation does not need a very specialized or technical judgment, which makes shareholders able to understand a situation and vote consciously;

b) an operation has so considerable dimension in relation to corporate assets which needs also an equityholders evaluation as residual claimants;

c) or an operation is able to potentially create a conflict of interests between managers and shareholders[62]. Here the latters must be able to check if managers correctly pursue company interests (also if conflicts are often *in re ipsa*)[63].

The existence of at least one of these features requests a shareholder vote. In practice, these operations consist not only in amendments to constitutive act, sales of corporate assets and modification of corporation structure, such as mergers or corporate divisions, but they may also consist in operations on the legal capital (in European law systems only) such as the dividends distribution, the repurchasing and other share issues, as well as the decision to begin an insolvency procedure, too.

Amendments of the constitutive act usually depend on the vote of shareholders. The *ratio* of this kind of provision is a common idea for which who decides to take part in a specific corporation should not have to face the on-going change of the corporate structure or of its main features. However, some jurisdictions exclude the need for shareholders consent for minor modifications. For instance, the U.S.A. quite often provides a so-called *blank check provision* which, if written into a corporation statute, gives to a board of directors the power to approve emissions of preferred stocks on its own initiative[64]. However, almost everywhere, the law allows a specification of some main features in the constitutive act regarding for instance the number of stocks issued, or their value when it is necessary, but also kinds of shares categories and their relative rights. The minimal content of statutory acts differ in each country.

The most significant contrast concerns the legal capital which is required for the European corporations only[65] and it is not provided in the U.S.A..

In case of a merger, absorbing company may incorporate assets of absorbed corporation, or corporations assets may be merged by creating a new corporations. In the E.U. system, the Third Council Directive imposes Member States to fix by

[62] See E. Rock, P. Davies, H. Kanda and R. Kraakman, *Fundamental Changes*, in *The Anatomy of Corporate Law*, *supra* note 7, at pages 183 and the following.

[63] V.E.B. Rock, *The logic and (uncertain) significance of institutional shareholder activism*, 79 in *George Town Law Journal*, 445, 1991

[64] This power is provided by the paragraph 151 (g) DGCL and also by other several States provisions.

[65] See Article 2430 *Codice Civile* (Italy); paragraphs 23 *Aktiengesetz* (Germany); paragraph 2 *Companies Act* (U.K.); and Article L. 210-2 *Code de commerce* (France).

law a minimal compulsory *quorum* consisting in

> (…) a majority of not less than two thirds of the votes attaching either to the shares or to the subscribed capital represented. The laws of a Member State may, however, provide that a simple majority of the votes specified in the first subparagraph shall be sufficient when at least half of the subscribed capital is represented. (…)
>
> 2. Where there is more than one class of shares, the decision concerning a merger shall be subject to a separate vote by at least each class of shareholders whose rights are affected by the transaction.
>
> 3. The decision shall cover both the approval of the draft terms of merger and any alterations to the memorandum and articles of association necessitated by the merger.[66]

However, some States requires higher majorities. In the U.S.A., the Delaware Rules and many States who follow the Revised Model Business Corporation Act demand an absolute majority of issued shares[67]. Then, German law provides that mergers must be approved by the 75 per cent of shares with voting rights[68]. In the U.K. the Third Council Directive has been transpose by law which has established the binding percentage of the 75 per cent as well, which must apply for any mergers, corporate divisions and related operations. Finally, both in Europe than in the U.S.A. systems, a specific majority is usually required for any corporations involved in a merger[69].

A corporate division is exactly the opposite operation of a merger. In case of corporate division, a company splits its assets in two and it allocates them partially or entirely, by resting afloat in the first case only.

Comparing to a merger phenomenon, corporate divisions are less regulated by law. Several Countries do not require a specific shareholders decision on the issue, as it happens in the U.S.A.. Furthermore, the E.U. Fourth Council Directive

---

[66] *See* Article 7 of the Third Council Directive 78/855/CEE.

[67] *See* paragraph 251 (c) DGCL and paragraph 11.04 (e) RMBCA.

[68] *See* paragraph 65 *Unwandlungsgesetz*.

[69] Several law orders may not require a shareholders vote when an incorporating corporation already possessed an high stock of the other corporation and if merger does not entail a modification of the constitutive act.

is less strict than the Third one and it leaves the single Member States freer to decide whether a corporate divisions might be regulated or not.

However, nearly all the main Countries have regulated it, but not always by making a shareholders' vote mandatory.

It is only possible to find a real lack of any provisions in the U.S.A.. Here, corporate divisions can be structured as trade of shares or as a share of dividends by stocks and both of them fit in with the management decisions' subjects.

However, there is a wide lack of protection which may be total or partial depending on jurisdictions and which is justified by the fact that a division is often a smaller operation compared to a merger but it is not such an easy operation to be immediately understood by shareholders who are not as well informed and knowledgeable as managers are. Moreover a corporate division may create less conflict of interest and there may not be any of the three features mentioned before which only legitimate shareholder interventions in the corporate management.

Corporate restructurings of the legal form also requires shareholder involvement which changes according to various mechanisms in each different jurisdiction. This operation may be characterised by all the three previously mentioned features: they may have considerable dimensions, they can create conflict of interest, and they may not require specialised knowledge which make able shareholders to consciously express a vote.

Another subject where a shareholders' vote may be required is sales of corporate assets. Sometimes, when a sale is total, it is followed by a corporate liquidation and the buyer acquires all the former debts of the company. In this case, sales of corporate assets look like a corporate division. That is why both the E.U. system and the American one require a mandatory vote of shareholders only for the extreme case of a complete sale of assets.

Finally, the vote of shareholders' general assembly is required for any operations related to the legal capital, in each jurisdiction where the latter must be determined by the constitutive act, only.

Operations on equity capital may be of three kinds: operations to reduce or increase legal capital, new issues of shares and distributions of capital by means

of share repurchase and dividends[70]. By requiring a shareholder's vote, company law generally wants to prevent a dilution of equityholders claim of cash flow or voting rights, as can happen with a merger. And the risk of dilution is whenever the corporation purchases new equity or its own shares. For these reasons, every time this risk arises, shareholders must be involved in decisions.
The aspect is different in the U.S.A. and in the European Union. The latter establishes that any reduction of subscribed capital must be subjected to at least a decision of the general meeting which must be approved by a majority of not less than two-thirds of the votes attaching to the subscribed capital represented[71]. The only case where such shareholders decision may be avoided is on a Court order. Moreover, the Second Council Directive established that Member States national laws must provide a rule for which a general meeting of shareholders must be called within the period laid down by national laws, every time there is a serious loss of subscribed capital. During this assembly shareholders must consider whether the company should be put into liquidation or whether any other measures should be taken. Furthermore, the amount of a loss deemed to be serious may not be set by national laws at an higher level than half of the subscribed capital[72].
On the contrary, in the U.S.A. the notion of legal capital is not considered as a measuring device of the shareholders rights. Consequentially, several American jurisdictions do not require a shareholder's assembly resolution to authorise a reduction of capital.

Both the European and North American jurisdictions instead regulate the opposite decision to issue new shares. The latter is in fact, as well as mergers, an operation that may upset the equityholder equilibrium and where a conflict of interests may arise. The situation is faced differently through the States. Between EU Member States the decision on any increase of capital can be delegated to

---

[70] For a detailed analysis of the subject, *see* E.Rock, H. Kanda and R. Kraakman, *supra* note 62.
[71] *See* Article 30 and Article 44 of the Second Council Directive, 77/91/EEC, as modified in 2012. Article 44, providing the two-thirds majority, permits to law of the Member States to lay down that a simple majority of votes attaching to a securities or a subscribed capital represented is sufficient when at least half the subscribed capital is represented.
[72] *See* Article 19 of the Second Council Directive 77/91/EEC, as modified in 2012.

managers' discretional decision by constitutive act provisions or general meeting decisions, which can also fix a maximum amount. There are only two limits.
First of all, an authorization must be published *ex ante*.
Secondly, a power of such body shall be for a maximum period of five years and may be renewed one or more times by the general meeting, each time for a period not exceeding five years[73].
On the other hand, the U.S.A. legal systems distinguish two different situations. The board of directors can take autonomous decision if increase of capital remains within the shares authorised by the constitutive act, but if the number of outstanding shares exceeds the authorised ones the operation must be approved by a qualifying majority of shareholders. However, American corporations do not often issue a number of shares major than the authorised one and in practice management takes the decision.
At the end of this analysis of main operations where shareholders vote is needed, it is possible to notice how in the U.S.A. these decisions are fewer than in Europe. Moreover, American shareholders cannot begin significant corporate operations if the board of directors are against the transaction. Otherwise, European systems often recognise that a bare minimum percentage of shares has a right to submit a decision to the general assembly[74].
All the operations mentioned above formally refer to shareholders as a unique category, however the majority of shareholders are obviously more influential than the minority who are protected by the fact that corporate law usually requires a quite high qualifying majority to approve some of the main operations[75] and a specific number of minority shareholders could even stop an on going operation.

[73] *See* Article 29 of the Second Council Directive 77/91/EEC, as modifies in 2012. This Article shall apply to issue of all securities which are convertible into shares or which carry the right to subscribe for shares. However it does not in case of conversions of such securities, nor to an exercise of the right to subscribe.
[74] For example, in Germany the Paragraph 83 *Aktiengesetz* mandates board of directors to prepare and implement a shareholders resolution falling within the skills of the shareholders meeting.
[75] About *quorum* of vote, see in Italy, Article 2368 and the following, as well as Article 2441 *Codice Civile*; in Germany, Paragraph 179, 182, 222 or 262 *Aktiengesetz* and others; in France Article L. 225-96 or L.225-129 *Code de commerce*; in the U.K. see Paragraph 378 (2) *Company Act*; and in the U.S.A. see Paragraph 251, 271, 275 or 242 *Delaware General Corporation Law*.

The United States' legal systems trust the protection of minority interests to the so-called *trusteeship strategy*, which allows only proposals which come from the board of directors. The latter is the only corporate power legitimated to subject decisions on significant actions to the vote of shareholders[76]. Indeed, decisions where a shareholders vote is required are not only the ones provided by law or by statute, but also the issues managers submit for general assembly approval.
In conclusion, in the U.S.A. there is a minor protection of the rights of shareholders as a category compared with European Union system, but the American legal system is more sensitive towards protecting minority rights[77].

1.2.3.2. Who Has the Right to Vote?

After the examination of the two different categories where a shareholders' decision is needed, I intent to analyse who has the right to vote. Usually, only shares have votes and almost every share has vote, but several are such exceptions.
The E.U. Members States fulfil the famous rule one-share-one-vote which invokes a concept of shareholder democracy. This rule means that each share has same weight and shareholder attending the assembly can influence a final decision according to the number of stocks he has. However, in almost every European State – with the only exception of Germany[78] – the general rule may be derogated by the statute, which can issue every kind of stocks; not only shares without any right to vote and share with a vote limited to some issue (i.e.. only for the ordinary assembly) but also shares with a right to vote that may be claimed only if a specific condition has occurred. Moreover, in closed firms is also possible to establish a threshold vote and to differ it in relation to the category of shares. For instance, every shareholders can vote only for 10 per cent even if they posses

[76] *See* paragraph 251 DGCL about the mergers. Moreover in this context, I would like to stress how the North American larger corporations tend to be widely held with a consequentially strength of managers powers in practice.
[77] *See* paragraph 1.3, *Minority Rights*.
[78] *See* Paragraph 12 *Aktiengesetz*. Germany has forbidden shares with cumulative voting only in 1998 with the *KonTraG*. Rather, Italy does not admit cumulative voting shares from 1942 as well – *see* Article 2351 *Codice Civile* – but it still admits shares without vote.

more equity; or again shares are worth one full vote until a specific percentage and after that they are worth half, etc. There are only two limits that statutory autonomy must respect: stocks with double right to vote are forbidden; and it is not possible to issue a number of shares with a related limited right to vote higher than half of the joint stock. By respecting these two limits, the statutory autonomy is free.

The one-share-one-vote general rule applies also in the U.S.A. but some States allows corporate constitutive acts to establish almost every kind of voting rights, such as cumulative voting or nonvoting stock. And all these different voting arrangements may be modified at any time by those who have the power to vote[79].

There are few off-limits features which apply to all the jurisdictions mentioned. First of all, sales of vote divorced from investment interests are forbidden. Secondarily, the accumulation of votes in a corporate treasury is forbidden as well; the right to vote must follow the residual claims[80]. However, some important legal systems as the U.K. or the Delaware ones in the U.S.A. seem to allow managers nomination by someone who is not a shareholder every time this is provided by the constitutive act.

Moreover, it is clear that not all equityholders must have a right to vote; it is the case of nonvoting stocks.

However shares with seriously limited voting rights and cumulative voting are rare[81]. The constitutive acts faculty to provide various voting structure is indeed based on the idea that who votes is the one who risks; this based principle is flexible but cannot be broken. If corporate autonomy interrupts the relation between risk and vote it thus exposes it self to the dangers of making illogical decisions and this applies from a proportional point of view (i.e. cumulative votes) but much more in case of real separations between voting right and equity interest.

[79] R.C. Lease, J.J. McConnell and W.H. Mikkelson *The market value of control in publicly-traded corporations*, 11 Journal Fin. Econ 439, 1983.

[80] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 27, at page 69.

[81] D.R. Fischel, *Organized exchanges and the regulation of dual class common stock*, U.Chi.L.Rev, 1987.

1.2.3.3. Mechanisms of Vote

Voting rights may assume a different role depending on the adopted mechanism of vote. The more corporations have a fractioned ownership the more the weight of single votes depends on coordination with other shareholders. In this case, the role of vote mechanisms is vital.

The first problem to avoid is the risk of the empty voting.

Such a risk may be avoided by two main techniques: voting by correspondence and voting by proxy. Almost every Country provides indeed at least one mechanism to enable shareholders to vote without join a general assembly.

Some jurisdictions, such as the France one, allow the vote by correspondence[82]. Moreover who is entitled to vote can vote by proxy. And voting by proxy can be requested by a third party who has the power involved in a decision, or by the authorities – banks typically – in which investors have entrusted their rights.

In case of proxy, the weight of each vote depends not only on the contents of proxies and their deadline[83] but also by the *quorum* required in general assemblies and eventual prohibitions on circular voting structure[84].

Of course, an easy voting mechanism encourages small equityholders to take part in decisions but at the same time an unconditional favouritism towards proxy mechanisms may subvert the aim of those who have the right to vote. This consists in giving voice to equityholders who can take decisions for the corporation growth better than others, as they are *residual claimants*.

During the groundwork of the 2011 Green Paper, it was stressed how the influence of proxy advisors raises some concerns.

Moreover, several professional investors may today need to appeal for the help of proxy advisors to be able to manage their portfolio. Consequently, such advisors may have an enormous influence on the exercise of voting rights by such investors. Investee corporations expressed concern about a lack of transparency in the approaches adopted by proxy advisors for the preparation of their advice. It is

---

[82] Article L.225-107 *Code de Commerce*.

[83] For example, in Germany proxies to banks are admitted for a period shorter than fifteen months. *See* paragraph 135 II *Aktiengesetz*.

[84] Most of the legal systems ban subsidiaries to exercise a right to vote related to their shares on their parent company.

also claimed that the analytical tecnique used by proxy advisors fails to take into consideration company-specific features as well as characteristics of national jurisdictions and best corporate governance practices.

Furthermore, proxy advisors are subject to conflicts of interest, such as when they even act as corporate governance consultants to investee corporations. Conflicts of interest also arise when a proxy advisor advises investors on shareholder decisions proposed by one of its clients[85].

In the U.S.A. there is not a federal provision on the point and most States allows firms to establish almost any voting practices they prefer, even a necessary quorum of less than half of the votes. Furthermore, each of these rules may be set or altered at any time by those with the power to vote. Moreover, proxy mechanisms are extremely important in the U.S.A., as well as in the U.K., which are countries characterised by public companies with widespread ownership.

> Ownership structure seems to influence the organization of proxy systems almost as much as codetermination shapes the organization of corporate boards[86].

The European Union does not regulate proxy advisors instead. And even if the proxy systems are less widespread in Continental Europe, as corporations are characterised by strong majorities of shareholders, there is need for regulating the proxy advisors influence on the exercise of vote, too.

Another element that influences the right to vote in practice is the choice of preferring a system of managers election which is mediate by a board of directors.

Moreover, the right to vote refers to an equityholders possibility of controlling whether managers are working in the interests of shareholders; it is their right to control the board of directors activity. Indeed, managers may attempt to run a business with other aims than profit. And in this context, the right to vote refers also to the shareholders right to require a board of directors to submit proposals to

[85] Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee Of The Regions, *Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies*, Strasbourg 12.12.2012, COM(2012) 740 final, at page 10.

[86] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 21, at page 45.

the vote of the assembly when a sufficient number of voters – but also a number of directors – request such a submission.

Finally, it is curios to notice how no jurisdictions give specific relevance to the moment of the assembly decision. Anywhere, it seems to produce the same results at every time weather it predates the operation or not.

1.2.4. Right to Withdraw and to Trade Share

The free portability of shares is one of the main features of corporate models. It allows corporations to exist and operate independently from single shareholders identities and to avoid complications which usually arise in case of withdrawal from a family corporation. This is also one of the reasons why talking about shareholders does not refer to a specific category but is referred to nothing more than the owners of shares.

Incorporation, with the resulting division of the business (owned by the corporation) from the stocks (owned by shareholders), greatly facilitates the transfer of the shareholders' interests[87].

Moreover, the right to withdraw – or the right to sell part of the own stock – gives shareholders an easy way of transformation of participations in cash, which is an aspect that may attract equityholders.

However, the frequent trade of shares may make it hard to maintain the balance of control on the corporate activity and the stability of corporation itself. And such risks may be balanced by both legal personality and limited liability.

These three aspects together maintain a corporation a resistant legal person, which may be run independently by its shareholders and which is able to trust investors and other stakeholders. Indeed, the latters would remain involved with corporations only if they may trust its stability.

Furthermore, each corporate legal system provides the *default* rule of a full portability of shares. Nevertheless, full portability does not mean freedom of transfer. Moreover, every States allows the limitation of the default rule by providing a specific kind of company – such as the Italian *società a responsabilità limitata* (s.r.l.)*,* the German *Gesellschaft mit beschrankter Haftung* (GmbH) or the

[87] P.L. Davies and S. Worthington, *supra* note 24, at page 46.

French *société à responsabilité limitée* – or by leaving a possibility to introduce limits to the trading of shares through the autonomy of constitutive acts.

A risk related to the repurchasing of shares is the unfair treatment of shareholders, which may depend on the prices of share trade. Fairness is essential to fulfil the interests of both the sellers and the other shareholders. And

> the price would be fair if the price accurately reflects the present discounted value of all expected future distribution by the firm[88].

The trading of shares is extremely complex when it involves related parties; when the purchaser of newly emitted shares is already the shareholder of such corporation, a concrete risk of a majority abuse runs.

More than in other operations, in this case share prices must be fair. Furthermore all the minority protection practices – that we are going to analyse in paragraph 1.3. – are applicable.

Finally, withdrawal rights are similar to trading ones and they can be exercised when specific conditions occurred. Such requirements may be provided by law as mandatory conditions or may admit derogations by constitutive acts which may also provide some extra requirements. The withdrawal shareholder has the right to perceive the fair estimate of his participation in the same amount he would have had in case of forced exclusion.

1.2.5. Right to be Informed

The right to be informed is connected to voting rights; shareholders must be fully informed to be able to make proper decisions.

This right may be divided into the right to receive information before a general assembly has been called and the right to be informed during voting itself.

This shareholders power acts differently among jurisdictions and it is strictly related to the types of companies; whether it is a listed corporation or a small firm. However, a proper full analysis on this point would exceed the content of this dissertation. Therefore, I may only limit my analysis on few aspects.

In the U.K. and in the U.S. financial markets are well developed and corporate ownership is extremely widespread compared to the Continental European

[88] N. De Luca, *see* note 22, at page 701.

Countries. Consequently, transparency of information is more essential in British legal systems than in Continental Europe where ownership concentration guarantees shareholders easy individual access to corporate information.

Boards of directors are usually well informed about corporate structure and activity as well as the majority of shareholders. Indeed, the latter may be managers at the same time but all are aware of the need to be periodically informed about the business trend.

On the other hand, a minority of shareholders may not be encouraged to do so in the same way or they may not be able to obtain inside information and might even be abused by the majority of shareholders. As it will be described in the next paragraph, the minority of shareholders still have the right to receive necessary information not only to understand the issues they must express their vote on but they also need to be able to check the behaviour of the majority of shareholders as well.

Consequently, the transparent access to information is extremely important in case of any related parties transaction where the abuse of the majority over the minority is more probable.

Moreover, the right to be informed is also a protection for all categories of shareholders and is seen as a safety measure which may help to avoid managerial abuse.

Current European regulations require corporations to comprise a note in their annual accounts about related parties transactions, stating the amount and the nature of the transaction[89]. Nevertheless, as this demand tends to be regarded as insufficient, the European Corporate Governance Forum has issued a statement on related party transactions recommending the introduction of common principles across Europe. The Forum proposed that transactions above a certain limit should be evaluated by an independent advisor and that the larger ones should be approved by shareholders. The 2011 Green Paper raised the question of providing more safeguard against related party transactions. Many have called for stronger protections. And the European Commission has considered how shareholders'

[89] See Article 43(1)(7b) of Directive 78/660/EEC and Article 34(7b) of Directive 83/349/EEC.

control over transactions with related party should be strengthened.

However, no jurisdictions requires a widespread and generalized shareholders consent for related-party transactions.

France and the UK seem to be most suitable countries which give stockholders a voice in related-parties transactions.

In France, company law requires shareholders ratification of any unusual self-dealing transactions which began during the prior financial year[90].

The risk of managerial abuses is more probably higher in listed corporations where corporate information contributes to outline the value of a corporation and the "price" that shares can be fairly traded on the market.Therefore, managers usually have the duty to provide information not only towards minority and shareholders in general but also towards the market itself. Such managerial responsibility is especially strict in the U.S.A. where corporate law establishes that every listed corporations must communicate each operation among the company and its managers when the value is higher than a specific amount[91]. Moreover the five highest managers' wages of every year should also be published. Furthermore, the jurisprudence of national courts have argued that managers who have a conflict of interests must communicate the nature of their interests as well.

On the contrary, the provisions about the issue are lesser at a European Union level. Within the E.U., listed corporations must periodically publish the total of managers salaries and every managers related transactions which exceeds the ordinary administration only. Some few aspects are then regulated by the International Accounting Standards [92] or by provisions of accountability information[93].

The need for an intervention to enforce the shareholders' right for information was stressed by the European Commission in 2012:

---

[90] See Articles L. 223-19 (SARL), L. 225-40 and L. 225-88 (SA) Code de Commerce. Generally, shareholders and managers with conflicts of interests cannot vote.

[91] This amount is fixed at 60.000 dollars; *see* the *U.S. Securities and Exchange Commission* (SEC), *Regulation S-K*, Item 402.

[92] *See* regulation CE 1606/2002 of the European Parliament and Council.

[93] *See* Article 43 (12) (13) and 44 of the Second European Council Directive, 77/91/EEC, as modified in 2012.

> as evidenced by the results of the 2011 Green Paper consultation, shareholders need clear, comprehensive and comparable information on remuneration policies and individual remuneration of directors. This can be achieved through basic harmonisation of disclosure requirements. (···) Currently, not all Member States give shareholders the right to vote on remuneration policy and/or the report, and information disclosed by companies in different Member States is not easily comparable[94].

1.3. Minority Rights

In this paragraph I intent to explore the main problems that the minority[95] of shareholders may have to face by exercising their rights.

In each legal system it is possible to find corporations controlled by a specific major shareholder or by a few major shareholders. This is certainly common in Continental European systems but corporations with a strong majority of shareholders may be found also in the U.K. or in the U.S.A., where public companies with a widespread ownership are usual[96].

Moreover, the separation of powers between shareholders and managers is clear in public firms but it is not so distinct in smaller private ones where major shareholders may be also managers as well. In all such cases, the protection of minority interests must be fulfilled.

First of all, there are several types of behaviour which should be avoided to safeguard minority rights, such as stock trade limitations. Indeed, a limited share trade may be provided to assure majority of maintaining its role.

Secondly, the common problem of minority protection could be faced by applying active solutions which are indeed pursued differently among various jurisdictions.

---

[94] Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee Of The Regions, *Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies*, Strasbourg 12.12.2012, COM(2012) 740 final, at page 9.

[95] With the term *minority* it is possible to refer both to the minority of shareholders in a single corporation, as well as in a group of corporations.

[96] On the issue, *see* V.F.Barca and M. Becht, *The control of corporate Europe*, 2001.

Positive law is generally reluctant to regulate this issue because shareholders can then protect their interests independently, not only by statute provisions or by shareholders agreements but also by the right to sell shares, *in extremis*. Furthermore, a regulation of this kind may potentially have enormous costs such as engagement procedures and these would be suffered by residual claimants. Therefore, legislators usually leave shareholders the autonomy of decision. Strict law regulation may also reduce investor attraction and impede some efficient operations.

As mentioned above, protection of a minority is related to the corporate structure. In France, ownership concentration and a corporate law that clearly support shareholders give them an undisputed power over corporation management. Indeed, in the U.K. and in the U.S.A. a scattered ownership reduces conflict between the majority and the minority of shareholders.

However, there are several complex operations related to minority interests.

First of all, during an election of the board of directors there is a concrete risk of having a board which does not represent the minority of shareholders and various solutions are adopted to avoid this. Some companies reserve a number of managers for the minority with a specific statute or law provision while others may achieve such an aim by limiting the vote of major shareholders or by increasing the weight of minority voting trough cumulative voting. The latter enables shareholders above a threshold to elect one manager and such a mechanism is similar to the voting list[97].

Moreover, the general rule of one-share-one-vote indirectly protects minority interests by preventing the creation of shares with a double right to vote and it avoids a majority which could run a business without being the holder of a proportional part of equity.

Another difficult aspect is the role of the minority in case of related party transactions where majority abuse may be significant. To face the problem, in the

[97] In Italy, the voting list is mandatory for the election of one manager in a public company, which does not represent the majority of the equityholders – Article 147 (3) T.U.I.F. In the U.S.A. while once the cumulative voting was common and mandatory, today it remains only among few States, as in California (at paragraph 708 (a) *California Corporation Code*). In Germany, instead, the cumulative vote is binding (see paragraph 101 *Aktiengesetz*.

U.S.A. minority must approve each kind of operation which involves other shareholders or managers. This solution however is in contrast with the majority principle empowered by all shareholders – minority included – when they have decided to agree to all corporation rules which also include the majority rule. Other legal systems define each corporate decision taken in conflict of interest as an *extreme unfairness* operation and they empower the minority to ask for the annulment of such decisions.

Moreover, unlike most other countries, French law acknowledges that the minority is entitled to ask for *expert de gestion*, how will examine the discussed operation and who will convey all the necessary information about eventual oppositions or claims to the minority.

To sum up, in front of a majority decision which may endanger minority interests it is possible to activate both *ex ante* solutions and *ex post* ones.

First of all, the minority of shareholders has a right to receive necessary information to be able to understand operations approved by the majority and to check them, as previously mentioned.

The right to a transparent access to information is important in case of related party transactions and above all it is required to protect widespread ownership. This is true in the British and in the American systems, while it is less important in Continental European corporations where ownership is less widespread and shareholders have an easier access to information.

Another *ex ante* measure for minority protection is the power of control which is exercised by managers. Some jurisdictions trust the board of directors to control the honesty and the reliability of any operations with related parties. First of all, Germany is the most trustworthy country which can be relied upon to accept and believe in this board of directors' role.

It is then followed by the U.S.A. legal system which always allows the chance of a judiciary re-examination on the base of the *entire fairness* standard.

Finally, some European systems as France or the U.K. provide the right to invoke the so-called *oppression doctrine* (U.K.) or the right to ask for an *expert de gestion* (France), instead.

However, no legal systems entrusts the protection of a minority to the board of directors only but other several solutions may be applied.
Furthermore, an ex post so-called *exit remedy* is common, which gives shareholders the right to force corporate dissolution every time there is a serious injustice towards shareholders' minority. This power was allowed in the U.K. and in Canada first of all, then in the U.S. but usually only in relation to closed corporations and only in few of the Continental European legal systems as such Germany, where it has been allowed only in a GmbH corporation[98].
Then, minority interests are indirectly safeguarded by a common rule which recognises the personal liability of shareholders every time they have acted as *de facto* managers[99]. Shareholders are not liable if they just monitor management or if they nominate board's members, at least in Europe. However, in the U.S.A., some National Courts try to protect shareholders from majority abuses by providing the so-called *utmost good faith and loyalty* measure[100].
In addition, minority protection is strengthened in case of significant corporate actions which involve the majority of shareholders such as mergers, increase of capital or the distribution of dividends. During such operations the minority risks much more than other shareholders because they are not the ones who take the decisions.
In case of capital increase, a minority may be upheld by pre-emptive right, which gives its owner the right to purchase new shares previously of a third party or other shareholders every time new shares have been issued. Such a pre-emptive right is proportional to the stock possessed and if exercised it permits its holder to keep corporate participation unchanged[101]. Furthermore, it discourages the

[98] This remedy is not generally admitted in Italy, instead.
[99] This issue has been already mentioned at paragraph 1.2.2. and it will be analysed in details during the next Chapter.
[100] *See* the Massachusetts Supreme Court Decision of 1975, *Donahue v. Rodd Electrotype of New England Inc*, available at http://masscases.com/cases/sjc/367/367mass578.html.
[101] On the point, jurisdictions differ. Among E.U. legal systems, the *default* rule confers shareholders a pre-emptive rights but it may be derogated by the statutory autonomy. See right Article 33 (1) of the Second Council Directive on Commercial Law, 77/91/EEC, which states <<*Whenever the capital is increased by consideration in cash, the shares must be offered on a pre- emptive basis to shareholders in proportion to the capital represented by their shares*>>. In the U.S. instead no pre-emptive rights occur without a specific provision of the constitutive act.

majority to emit new "dump" shares, as well. However, the pre-emptive right has a cost[102] because it delays the increase of capital and limits management ability to decide the issue of significant stocks and in this why it may reduces investments[103].

Finally, legal systems offer the minority a right to claim in front of a judge, in various situations. In France, for example, they can act for *abus de majorité*, in the U.K. for *unfair prejudice* and in the U.S.A. it is possible to claim a violation of the majority fairness whenever an operation in conflict of interest has occurred.

Furthermore, legislators must take into account the risk of empty voting when they may regulate the subject. Indeed, controller shareholders have invested substantial assets in the corporation and consequentially they have a strong interest in the results of its activity. On the other hand, minority of shareholders may not be interested in corporate management and may "forget" to vote. However, a corporation general assembly usually requires a *quorum* of voting shares which must take part in an assembly either personally or by proxy and an eventual large absence of shareholders may paralyse corporate activity.

1.4. Shareholders as *Residual Claimants*

Shareholders are the *residual claimants* of a company and they have the residual rights dividends distributions and of control over the management. All other stakeholders involved in a company life get fixed claims on the basis of ex ante fixed contractual terms.

In this paragraph I intend to outline why between any other stakeholders, shareholders are the only ones who nominate the board of directors and who vote to take or authorise main corporate decisions.

There are several subjects involved in a corporation's life: employers, suppliers, creditors, shareholders, consumers, local communities and all of them pursue different interests.

[102] In this context I intend to consider a *cost* also a *missed profit*.
[103] *See* article 29 of the II Council Directive, 77/91/EEC.

Employees are linked to and are directly involved in the financial survival of a company. This is why they generally assume a prudent approach[104].

Service providers are interested in the life of a corporation to ensure the purchasing power of a business, even though the link sometimes becomes more indirect, as service providers invest specifically for the need of their own clients too. When a corporation is no longer able to pay its orders, suppliers will loose both the commission and the investment and they will probably be unable to place such goods on the market.

Moreover, from the consumers' point of view they need to trust a corporation and the quality of the goods or services they offer in the long term and that is why they care about innovative corporation investments[105].

Debtholders care only about their credits and want the loan back plus the interest rates accrued. They look for cautious governance which reduces the risk of insolvency and for this reason they usually monitor corporations carefully. Above all, banks and financial corporations are the ones who more carefully monitor corporation balance sheets, all corporate public data and managers press conferences.

Finally, shareholders are considered equityholders and they take part to a corporation in order to perceive dividends. As stressed before, shareholders gain only what remains after the satisfaction of all corporate creditors such as suppliers and debtholders in general, with any existant residual revenue. However, if profits are produced, they belong to shareholders in form of dividends or assets which can be reinvest in the corporation itself so increasing the value of the stocks.

Shareholders are the only ones who do not have any contractual rights for reimbursement. Creditors have fixed claims and employees generally negotiate compensation in advance of performance. While shareholders are not entitled to the reimbursement of their provisions as they are *residual claimants*:

> the gains and losses from abnormally good or bad performance are
> the lot of the shareholders, whose claims stand last in line[106].

---

[104] In some countries – as Germany – employees are involved in the corporate governance, trough some represents in the main corporate bodies.

[105] In recent years, it is possible to notice a general growth of consumer interests also on corporate ethic, its impact on the environment, or such involvement in local communities.

Moreover, they place their provisions at the risk of the corporation while all the other stakeholders will be paid with a set reimbursement which does not depend on corporation activity results.

As residual claimants, shareholders may be the most incentivized to assure an efficient corporate activity in order to produce the maximum profits[107]. And this is also true in large public firms, where shareholders are less involved in corporate governance but they are still encouraged to choose good managers, to control them and in some cases remove them.

Moreover, it should be underlined that a higher risk usually implies more power. As shareholders are those who participate in corporate risk, more than others, then they should have a greater say in controlling the activity of a business[108]. That is why they have the right to nominate and to remove managers or why they have the right to be informed because they are the only stakeholders who stand the risk of insolvency.

However, shareholders may not have uniform interests. Business doctrine has underlined differences in shareholders' interests for years[109]. They often have different aims which could be savers, industrials, speculators and they may take part in corporate activity for a long time or not.

Whatever encourages someone to become a shareholders in the first place is irrelevant in this context. As *residual claimants,* all the shareholders are the ones who will receive most of marginal the gains and incur most of marginal costs.

Furthermore, because shareholders are entitled to the *residual right of control*[110] of the use of corporate assets, they can be also considered as *owner* of

---

[106] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 21, at page 110.

[107] *See* M.M. Blair, *Ownership and control: rethinking corporate governance for the twenty-first century*, Washington D.C., The Brookings Institution, 2005.

[108] This connection between risks and power is central in case of insolvency, when we can argue that creditors are risking their credits, and for that reason they should have more power. This concept will be analysed in the next chapters. On the contrary, in case of a solvent enterprise, the strength of all the decision power in shareholders' hands is totally justified, because creditors are here guaranteed trough a roomy heritage, instead.

[109] See for instance, Costi, *L'interesse sociale nella riforma del diritto azionario*, in *Diritto, mercato, etica. Omaggio a Piergaetano Marchetti*, Milano, Giuffrè, 2010, at page 253 and the following.

[110] O. Hart, *Firms contracts and financial structure*, Oxford, 1995, at page 30 and 50.

corporation. This is result of the traditional equation that relates the process of the power to affect decisions to the intrinsic risk of loss.

Naturally, this image of shareholders as *owners* of a corporation is more easily acceptable in a family corporation where shareholders are managers as well and they take the everyday decisions. However, it is harder to see them in relation to a make it in relation to a public firm whit a widespread ownership where shareholders have some rights to incentives and to exercise discretion. And even if the daily decisions are taken by managers they are monitored by those who have the power to remove them.

Even if several differences between corporations require flexibility it is still possible to identify a common figure of shareholders as the ones who take the main decisions about what must be produced, how it has to be produce, etc. They are the *owners* of a corporation, they are titled of the residual right of control and have the power to establish the best use of corporate assets in any situation which is not regulated by law nor by contract. The *owner* of corporation is the one who has the power to take the strategic decisions and who can exclude other stakeholders from making use of corporate assets; the *owners* of the corporation are the *residual claimants*[111].

However, if from a legal perspective shareholders are the one who control corporate activity, from an economic point of view it may be possible to recognize a different *de facto* power of control. This is what may happen in holdings or in a family corporation. And this is what frequently may happen in big corporations with a widespread ownership where shareholders may loose interest in corporate management. In this case, directors are the ones who *de facto* manage the corporation and who can exclude other stakeholder from it.

However, also even when the idea of *ownership* is extremely flexible, as in the previous example, shareholders are still the ones who have the residual power of control, because they can still remove managers and nominate new ones[112].

---

[111] Talking about *ownership* does not want to refer to the law notion of *property*. The property of all the corporate assets is not an essential aspect neither for shareholders role, nor for the organised structure which a corporation is. And almost never corporation is owner of the equipment or the warehouse involved in its activity.

[112] However, managers attempt to insulate themselves from the control of shareholders in order to carry out programs which they view as more important than profits. That is what

As underlined above in this chapter, directors and managers take the majority of the decisions. The shareholders' power of direction is not identified in the power of taking the daily decisions but in the right to nominate and remove managers. However, in some extreme situations shareholders may seem to be more like clients than owners. This is what may happen in large American corporations open to the market[113].

Moreover, the idea of corporate property has such a high number of variables that it can be more unrecognizable today than in the past[114].

What I intended to underline is that shareholders rights in a corporation are justified by the unique role they play in it, compared to other stakeholders.

The shareholder demand is the only one that has not a certain result but which depends on the corporation trend. That is why the law provides large power and important rights to shareholders lonely in all legal systems not just because they are *owners* of a corporation but because they and not other stakeholders, have everything to gain or to loose from the good or the bad management of a corporation[115].

1.5. Conclusions

In this Chapter I have tried to outline the role shareholders may play in solvent corporations in different jurisdictions. There are several common features that characterize the figure of shareholders and distinguish them from other stakeholders.

---

happened in the U.S. when both the *New York Times* and *Wall Street Journal* established governance structures which give their managers a substantial freedom to produce news at the potential expense of profit. *See* Frank H. Easterbrook and Daniel R. Fischel, *supra* note 21, at page 13.

113 An exemplary case is the fund of private equity Blakstone opens to the NY Stock Market, which clearly shows how some biggest listed corporations are moving from a *corporation* back to a *partnership*. Out of the U.S., another similar example has been the opening to the market of one of the biggest Australian law firm, Slater & Gordon, in Melbourne. On both the cases *see* G.Rossi *Proprietà, controllo e mercato: una triade scomposta*, in *Proprietà e controllo dell'impresa: il modello italiano stabilità o contendibilità?*, a conference on private and procedural civil law problems "Adolfo Beria di Argentine", National Centre on prevention and social defence, edited by Giuffrè, 2008. At pages 16 and 17.

114 This has been highlight by professor Rossi in his speech at the Curmayer conference of 2007. *See* G. Rossi, *ibidem.*

115 L. Stanghellini, *supra* note 50, at page 40.

Generally, anyone who increases corporate equity through its provision is qualified as a shareholder. Through the financial contributions shareholders obtain the right to take part in the company life within the limit of a corporate constitutive act.

Each shareholder has both administrative and economical rights. The latter principally consist in the right to perceive dividends which is usually the main aim behind the decision to become a shareholder, while the main administrative right may be identified in the right to vote informed about the *fundamental decision* of management and about the appointment and discharge of directors.

Corporate dividends correspond to the surplus resulting from the difference between corporate assets and its debts so in theory they should be only paid after all corporate creditors have been satisfied.

Shareholders are indeed the corporate *residual-claimants*, the ones who stay last in line to obtain some financial profits from a business and who have no certainty to obtain anything in result from their participation. However, both European and American jurisdictions pacifically allow the payment of dividends during the running of normal business even if every credit has not been completely paid.

Neverthless, corporate creditors cannot be damaged, hence no distributions can be made if the legal-capital rule (within the E.U.) or the solvency test (in the U.S.A.) have not been respected[116]. Moreover, in several jurisdictions such as Germany or the U.K., this limitation refers not only to dividends but also to every spill-out of assets.

As residual claimants, shareholders cannot indeed obtain part of corporate assets to the detriment of the corporate ability to pay all its due debts.

Therefore, it has examined how shareholders are the ones who incur more risk compared to other stakeholders, such as creditors, suppliers or employees. As they receive the marginal proceeds of the company, they are the ones who are more interested in business trend.

That is why shareholders are entitled to control and indirectly manage the corporation.

---

[116] However, it has been examined above how both such legal traditions are taking inspiration from the other criteria respictevely.

Such a control is exercised through the right to vote in a general assembly. Here shareholders may nominate and remove corporate managers who are the ones who take the daily decisions.

The direct involvement of shareholders may be required about every *fundamental* decision, through an *ex-ante* authorization or an *ex-post* approval. Such main decisions are the ones which do not need technical competences to be adopted or which concern large scale operations in comparison to corporate assets as well as transactions which can potentially create conflicts of interests between shareholders and managers.

Such transactions may be mergers as well as the emission of new shares, the modification of legal capital (among European Countries only) or amendments to the constitutive act. However, the specific regulations on such transactions may differ among jurisdictions.

As has been wonderfully summarized by Easterbrook and Fischel, shareholders, as being residual claimants,

> receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion. And although the collective choice problem prevents dispersed shareholders from making the decisions day by day, managers knowledge that they are being monitored by those who have the right incentives and the further knowledge that the claims could be aggregated and votes exercised at any time, leads managers to act in shareholders' interest in order to advance their own careers and to avoid being ousted[117].

Furthermore, the corporate constitutive act may provide different categories of shares with related different rights unless the same economical and administrative rights are guaranteed to any share of the same category. Therefore, there may exist as many categories of shares as there are mixed administrative and economical rights.

There are only a few limits provided by law which correspond to the central idea that the right to vote has to follow the residual claimants so voting rights can

[117] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 18, at page 68.

never be conferred divorced from investment. Generally, Continental Europe limits different voting arrangements more than in the U.S.A. where some States laws include even a type of share with cumulative voting rights.

Besides, shares are no longer the unique financial measures which entitles its holder to some financial or administrative rights.

Nowadays, bonds or other financial instruments might confer to their holder the ability of expecting dividends or a similar result with the related controlling power over the business.

Finally, the role shareholders play in reality may depend in the nature of the company itself.

> Legal diversity in the way in which the business enterprise is conceptualized and regulated is the consequence of a range of different factors coming together, at point in the development of market economies, to influence the evolutionary path of the law[118].

Traditionally, among European jurisdictions the property structure is concentrated and the identification between “debtor” and “shareholder” is strong. It is different in the U.S.A. where corporations have a larger and freer power of management to the detriment of shareholder involvement in main corporate decisions.

Moreover within Continental Europe financial markets are less advanced and corporate property may be less widespread than in the U.S.A. or even in the U.K., this may enforced a majority-minority shareholders conflict in Continental European countries while it may increase the shareholders-management one among the U.S.A. whit the related agency problems.

By concluding the analysis of the role shareholders play in a solvent corporation, it is noticeable what a variable and unstable category there are and their members may frequently change during corporation life.

Shareholders participation in a company is indeed incorporated in shares which may be traded on the market by their holder. A company is indeed a legal entity which is separated from its members.

[118] J. Armour, *How do legal rules evolve? Evidence from a Cross-Country comparison of shareholder, creditor, and employee protection*, in The American Journal of Comparative Law, 57, 2009, at page 598.

That is why it is why a company is able to enjoy rights and to be subject to duties which are not the same of those enjoyed or borne by its members.

2

When Insolvency Comes

In this chapter I intend to examine what happens when a corporation is insolvent. Whenever a corporation is already insolvent or whenever insolvency is imminent, common debt enforcement instruments result unsatisfactory to protect the creditors' interests. Insolvency increases a demand for alternative, efficient but proven legislative procedures, which provide satisfactory measures to resolve current insolvency issues.

Collective proceedings can be regulated by such courses of action and are aimed at achieving the best possible solution for the personal interests of all corporate creditors.

First of all, I intend to examine the notion of insolvency itself and why it differs from the more common concept of financial crisis. Afterwards, I will move into analysing insolvency proceedings themselves.

The dual insolvency system in the United States will be taken as an example in point to be compared with existent insolvency regimes within the European Union, as U.S. Law provides simple and extremely efficient insolvency measures, which may be used to help a corporation in financial distress.

These two alternative distinct proceedings are: liquidation under Chapter 7 and reorganization proceedings and reorganization under Chapter 11 between the distressed corporation and its creditors. First of all, liquidation proceedings will be examined in my discussion and then the restructuring ones will be assessed. Afterwards, the two procedures will then be compared.

Law among countries may also provide pre-insolvency measures, which provide early intervention whenever a corporation is in financial distress but not yet insolvent or close to insolvency. Pre-insolvency interventions will be analysed in the last paragraph of this chapter.

Finally, the way in which shareholders' rights change in case of insolvency and the newly acquired rights during insolvency proceedings will be properly examined in detail only during the next Chapter. By doing so, specific features of insolvency proceedings and reorganisation procedures will be further assessed from the shareholders' point of view.

2.1. The Notion of Insolvency

Every business has intrinsic elements of risk that may depend on its nature, on the market trend, on governance ability or on other several factors. However, it is undeniable that no business is totally free from the risk of failure.

This is an intrinsic element of entrepreneurship, which is taken into account by private stakeholders and lawmakers, as well. The risk of fiasco may be considered by future shareholders who decide to invest money in a specific business, by a manager who might incur personal liability if he voluntarily causes the crisis and even by creditors who finance a corporation. Moreover, lawmakers have to take into consideration the risk of failure by setting up specific rules in case of insolvency or in case of future financial crisis.

The notion of *insolvency*, indeed, has to be distinguished from the more general one of *crisis*. One refers to the latter every time a corporation is unable to achieve its goals due to every kind of factor, be it internal or external. It is then possible to split the concept of *crisis* into two: a financial crisis which is characterized by an imbalance of economic or financial elements and a non-financial crisis which points to the functioning of an organization. Moreover, it is possible to track down two different profiles of the notion of financial crises, too. On the one hand, a financial crisis may exist every time there is an imbalance in the balance sheet or a cash flow, while on the other hand, a corporation may be defined as being in crisis every time it is unable to regularly satisfy its obligations with creditors because it is no longer possible to pay them in full or within a deadline. The latter phenomenon is usually defined as *insolvency*.[119]

The state of insolvency is the necessary requirement to initiate a proceeding of crisis resolution for any modern legal order[120]. However, as a requisite, the meaning of insolvency may change a little among States depending on the type of

[119] A. Nigro, *La disciplina delle crisi patrimoniali delle imprese,* XXV of Trattato di diritto privato, by Mario Bessone, Giappichelli, Torino, 2012. At pages 4, 5.

[120] It is required by Article 631-1 of the French *Code de commerce*, by Article 5 of the Italian *Legge Fallimentare* or by Article 2 (2) of the Spanish *Ley Concursal.*

proceeding.

In the U.K., for example, the common meaning of insolvency is a simply inability to repay debts but the law defines two main further meanings. Firstly, for a court to order a company to be wound up and for an administrator to be appointed or to avoid various transactions, a cash flow test is usually applied. The latter refers to the corporation inability to pay its debts as they fall due[121].

Secondly, to be able to sue or disqualify directors and to compensate creditors, a company must be proved to have less value of overall assets than liabilities on its balance sheet.

The English law distinguishes between *debt,* as defined through the *cash flow test* required by Article 123 (1) of the Insolvency Act and a *liability,* which becomes relevant under Article 123 (2) that states:

> A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

The latter is the so-called *balance sheet test*. Such a test verifies if the value of the corporate assets is less than its liabilities and whenever the answer is affirmative they may be taken into consideration. The method for measuring assets and liabilities depends on accountancy practice.

A debt can be defined as a sum due and its quantity is a sum of money that can be identified easily by drawing up an account. If debts cannot be paid back in full, creditors compete with one another for a share of the remaining assets. That is why a legal system of priorities establishes the order among different types of creditor for satisfaction. The general rule provides a fair view of a company's finances.

Otherwise, in Germany, only simple insolvency is required for preliminary insolvency proceedings, while final insolvency proceedings will go ahead if the Court finds that the debtor is illiquid (Zahlungsunfähigkeit). According to case law, illiquidity does not exist in the event of certain limited temporary liquidity

[121] Article 123 (1) (e) of the U.K. Insolvency Act 1986, provides that a company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

gaps. The debtor is considered to be illiquid if it has stopped making payments as they fall due. The debtor can also file a petition personally on the grounds of pending illiquidity, i.e. if it is likely that the company will become unable to meet its payment obligations when they fall due in the future (Drohende Zahlungsunfähigkeit).[122]

Finally, in the U.S.A, *insolvency* in the European interpretation is similar of what Americans call *insolvency in the equity sense,* which is the corporation inability to fulfil all its obligations.

Differently than in Europe, such a concept is only important in case of a liquidation proceeding initiated ex Section 303 U.S. Code of 1978. When creditors start proceedings and the entrepreneur contests the application, the procedure may indeed start only if the debtor is generally not paying the debts and these become due[123]. This is the so-called *insolvency in the equity sense*.

In (more) general terms, one can say that the insolvency requirement is stricter in case of liquidation than in case of reorganization, where the show of insolvency might not be required. Indeed, law provisions that contain the state of insolvency as the objective assumption of the liquidation procedure usually describe this state as the debtor's demonstrated impossibility to regularly satisfy its creditors, which is proved by failure or other external elements.

Insolvency, as the needed requirement to begin a specific proceeding, does not refer to a *conclusive* inability to properly pay all the corporate creditors. What matters is that insolvency is current when the proceeding initiates.

Furthermore, it is possible to imagine a corporation which is unable to pay its creditors within the credit deadlines although it still has considerable assets, i.e. it owns several real estates. However, illiquidity will be an important warning also in those cases, because it will demonstrate that the corporation has not been able to find new finance in spite of the existence of a capital market. It is possible to conclude that insolvency itself does not ask for conclusive inability or for the lack of any kind of financial value of the distressed corporation. Nevertheless, it

---

[122] See *Insolvenzordnung* at Article 18, titled *Drohende Zahlungsunfähigkeit*, which means imminent insolvency.

[123] *See* Lorenzo Stanghellini, *La crisi di impresa fra diritto ed economia*, Bologna, Il Mulino, 2007, at page 121.

demonstrates that no one was inclined to continue supporting the corporation anymore and this may be a sign of the seriousness of the crisis[124].

To conclude, it is important to stress how insolvency today is no longer seen as lack of social value. It is generally understood that a corporate financial crisis does not necessarily depend on fraudulent behaviour of its entrepreneurs but it can be seen as the inevitable risk of every business that may be determined by the evolution of the area where the company acts or by the market trend, or by other several factors which may not always be controlled by the entrepreneur.

> Economic turbulence caused by fast development of trade and economic activity (…) made clear that the equation bankrupcty equal fraud had little empirical support[125].

However, Italy might be seen as an unstable example in point, as an individual who became bankrupt, until the law revision in 2006, lost the capacity to vote for five years after the liquidation sentence[126].

2.2. Benefits of Insolvency Law

Whenever a corporation is insolvent, a coordinate intervention is necessary.

More than other types of previously defined crises, insolvency may immediately influence external corporate relationships; dissatisfied corporate creditors will address debts enforcement instruments, which will usually be individual procedures as a foreclosure. Consequently, new conflicts of interests emerge. There will be creditors who claim for the payment of their due credits, the public interest of not seeing a large corporation destroyed with the huge social consequences such as employees' dismissals that may derive from it and there is

---

[124] Company ability to find new finance may not exclude the existence of a crisis whenever new loans are granted on the base of false or voluntarily neglected informations about the real financial situation of the company.

[125] P. Di Martino, *The historical Evolution of Bankruptcy Law in England, the US and Italy up to 1939: Determinants of Institutional Change and Structural Differences*, in *History of Insolvency and Bankruptcy from an International Perspective*, Edited by Karl Gratzer and Dieter Stiefel, (Södertörn Academic Studies, 38) Södertörms högskola, Huddinge, 2008, at page 265.

[126] The lost of voting capability provided by Article 2, d.p.r. 223/1967, has been modified by Article 152.1a*,* d.lgs. 5/2006, which adopted a stable jurisprudence of the Italian Constitutional Court (*see* judgment 43 of 1970). For a comparative analysis of the debtor status among European Countries see Lucio Ghia, *Lo status del fallito negli altri paesi della Comunità Europea*, in *Diritto Fallimentare*, 2003, I, at page 1249.

also the insolvent corporation interest which may change depending on the importance of the crisis.

Companies borrow money to finance machines and to expand factories, they pay employees, purchase raw materials and establish business relations so a corporation in financial distress is extremely dangerous for all such legal subjects. Therefore, new conflicts of interest may arise among creditors, who will compete amongst themselves to obtain insufficient assets before than others. There may also be new and different conflicts between shareholders and managers as well. That is why every time insolvency arises well organised action needs to be taken urgently. When a business is no longer in crisis but it is still insolvent public intervention is required to avoid the risk that the corporation continues its activity by creating new debts, and also to guarantee creditors as a whole. Indeed, only such a coordinated procedure may exclude the risk to violate the *par condicio creditorum*.

Furthermore, one should observe how the existence of efficient insolvency proceedings are important both in good and bad times, because they might secure loans and improve business relationships in general. This is what was affirmed by the European Commission in a note for the attention of LIME on the economic impact of rescue and recovery frameworks, in November 2013:

> On the one hand, they (efficient insolvency proceedings) can provide both creditors and debtors with the right incentives and promote a better assessment of the risk involved in lending and borrowing decisions. On the other hand, in a challenging situations in terms of private sector debt overhang, as is the case for several EU Member States, insolvency frameworks are crucial in smoothing the adjustment and minimizing its economic and social costs. Moreover, insolvency laws which foster a rescue and recovery culture are essential in encouraging business and persons to be entrepreneurial and to take economic risks. An efficient insolvency framework could be considered a gateway to potential business rescue instead of as a terminal proceeding for businesses ending in liquidation and to recovery from bankruptcy for

> entrepreneurs. Within this framework, insolvency regulation may be seen as a tool for fostering business dynamics[127].

Insolvency proceeding can be defined as << *government imposed collective asset-distribution system* >>[128] and three are their main benefits. Firstly, the reduction of strategy costs, secondarily << *an overall increase in the aggregate pool of assets available for distribution* >> and finally the improvement of administrative efficiencies. This is what has been highlighted by Derek J. Meyer which in one of his works explains:

> A collective system that treats identically all claimants with the same relationship to a debtor has three strategic advantages. First, instead of facing the possibility of recovering an uncertain amount under an "individualistic creditor's remedy system," the creditors receive a sum "certain." Second, when liquidation is inevitable, the strategic costs associated with a race to the courthouse are eliminated. Finally, a collective proceeding reduces variances in recoveries, which is a virtue to risk-averse creditors[129].

The protection of creditors' rights must indeed be the core of the law of obligations' and consequently of insolvency law, which may be considered as the regulation of that particular case of debt non-fulfilment, which business insolvency is about.

Inadequate efficiency in the fulfilment of credit rights may reduce trade by making transactions unsafe for all stakeholders[130]. Furthermore, it has been proved that this may provoke a boost under a financial perspective.

Today, the central role played by efficient insolvency law for the increment of business is a shared and hard to contest opinion, which is stressed by the International Monetary Fund as well.

---

[127] European Commission note for the attention of LIME: *Economic Impact of Rescue and Recovery Frameworks,* 28th November 2013, ECFIN/B1-B2.

[128] Jackson, *Bankruptcy, Non-Bankruptcy Entitlement and the Creditors' Bargain*, 91 Yale Law Journal, 857, 1982. At page 859.

[129] Derek J. Meyer, *Redefining the New Value Exception to the Absolute Priority Rule in Light of the Creditors' Bargain Model*, 24 Indiana Law Review, 417, 1990-1991. At page 430.

[130] F. Pasquariello, *Gestione e riorganizzazione dell'impresa nel fallimento*, in Quaderni di giurisprudenza commerciale, Giuffrè Ed., 2010, at page 2.

In IMF's opinion, the first general objective of insolvency law is

> the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner[131].

Moreover, insolvency law provides the set of rules which regulate the agency problem between shareholders and creditors when corporations are insolvent.

Traditionally, there are two main legal instruments involved in a distressed business. First of all, a liquidation proceeding that liquidates all its assets with the intent to proportionally fulfil all the creditors with the proceeding of the auction sale. Secondly, an alternative proceeding consists in an agreement with creditors which may have several contents. This is possible whenever this may give creditors better satisfaction – whatever this might mean – than in case of liquidation. This goal may be achieved by keeping the corporation operative or not. The first option is legitimate until keeping the business alive is economically viable. And this happens only if the corporation going-concern value exceeds its liquidation value[132]. Indeed, it is possible to imagine an insolvent corporation in a context where daily activity is lucrative and it is able to produce cash flow. More often, however, business progression may produce new losses and new debts, at least at the beginning. This is why stakeholders must carefully evaluate the real scenario before taking a decision between available options.

Nevertheless, insolvency itself does not require the managers' duty to interrupt the business but it requires a conservative management of the corporation which is not necessarily incompatible with the continuation of the enterprise. The core of the insolvency proceedings is the best fulfilment for creditors, and if keeping the corporation alive will in all probability generate new profits, it should be an option that the creditors should be able to choose. This chance will be evaluated – with all the related difficulties of predictability – in comparison with the results of a liquidation proceeding.

In this context, with the main aim of analysing shareholders' rights in an insolvent

---

[131] *Orderly and effective insolvency procedures*, Legal Department International Monetary Fund (IMF), 1999. Available at http://www.imf.org/external/pubs/ft/orderly/#genobj.

[132] H. Eidenmüller, *A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond*, ECGI Working Paper Series in Law, n.199/2013, at page 5.

corporation, cases of *imminent* insolvency should be also taken into consideration. The issue of this chapter is related to the tension between company law and insolvency law which may already appear before that insolvency has been externally revealed, indeed every time a crisis is on the horizon and tension between shareholders and creditors is building up. The period of time before the display of insolvency is another important moment of a corporation life and pre-insolvency rules are therefore necessary to prevent insolvency or at least to allow faster intervention to take place. Scholars and lawmakers are increasingly analysing this moment to elaborate new legal instruments which may prevent insolvency and may recover the company. Although the distinction between these two moments of the corporation life are not really clear-cut[133].

Finally, the recent financial crisis has emphasized how insolvency may be the consequence of a general market failure and this highlights the necessity of more efficient insolvency proceedings to better regulate and entrust the financial markets and to bail out the increasing number of distressed corporations. One should never forget that creditor protection is still clearly the main way to ensure that credit will still exist.

2.3. Insolvency Procedures

All insolvency proceedings, both liquidation and reorganization, share a common goal which is the realization of debtor's liability in the most efficient way. This aim may be achieved through a reduction of costs and an increase of the available assets as compared with individual debt enforcement.

While creation and liquidation are free operations in theory, in reality they are both expensive procedures; insolvency proceeding costs may include, for example, not only attorney fees, notification fees and publication fees, but also administrator fees, inspector fees, the cost of assets storage, preservation as well. Evidently, a collective proceeding may reduce procedural costs, and it also supports smaller creditors that might not be able to afford such a foreclosure. Furthermore, collective proceedings are essential to establish collaboration with

[133] See, L. Enriques and M. Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, Harvard Law School, Discussion Paper No. 19, 7/2008.

the debtor, oriented to the maximization of the corporate assets. Sometimes, indeed, it is only by working together with the entrepreneur that creditors may be able to fill informative gaps which is a central element to appreciate and maximise the corporate estate.

In case of insolvency there is a new agency problem where debtors are the agents and creditors are the principals[134].

In order to avoid the dispersion of value and that only some corporate creditors will be paid to the detriment of the *par condicio creditorum*, whenever a corporation is insolvent, individual proceeding in favour of single creditors are no more adequate. On the contrary, an insolvency proceeding would make it possible to save some value of the company to the benefits of all corporate creditors.

> The objectives of law are to maximize the ex post (insolvency) value of the insolvent firm in order to maximize the value for creditors and to minimize the ex ante probability of insolvency by providing managers with the efficient incentives to avoid it[135].

All these results cannot be achieved by individual debt enforcements. Moreover, from a purely procedural perspective, insolvency proceedings supply corporate creditors with an appropriate collective action instrument which includes individual actions too.

As previously mentioned, there are two main insolvency proceedings: liquidation and reorganization. The former consists in winding up corporate assets in order to satisfy creditors with the assets of a distressed corporation. In case of liquidation, the company is sold and creditors are satisfied according to their priorities. This proceeding is usually more respectful of the priority regime among creditors, provided by law and by credit contracts, but it presents a problem consisting in the loss of the corporate going-concern value.

To overcome this possible inefficiency of the liquidation procedure, a second type of procedure is provided to reorganise the company. In this case, creditors will be satisfied by debt restructuring, by the selling of some assets or by the acquisition of residual rights, in this case becoming shareholders of the restructured company.

---

[134] About what *agency problems* refer to see *supra* note 6.
[135] S. Lombardo and P. Pasotti, *supra* note 6.

In the past, when the economies were focused on trade market, liquidation seemed the only possible solution in case of insolvency. However, when we moved on to an industrial economy, remedies were needed. In this new scenario, the preservation of the organisational set-up became essential, and so it became vital to intervene at the first sign of a crisis, before the interruption of payments. To do so without discouraging business, alternative solutions to liquidation had to be provided. The first were the U.S.A. with the experience of the railway companies' crisis at the turn of the 19th century, which showed how liquidation of corporate assets might be totally incompatible with an industrial economy[136].

However, national jurisdictions usually provide liquidation as the default proceeding in case of a financial distress. A procedure of reorganization, indeed, usually needs to be approved by a large number of creditors in order to be applied. That is reasonable if one considers the fact that the eventual maintenance of a corporation will create new debts, and that these new lenders (the loans lent on the base of a reorganization plan) will be preferred to the existing ones. In Italy, for example, reorganization plans may be approved by the court only if the majority of the creditors with voting rights have approved the plan and the majority of consent has been achieved in each class of creditors whenever they exist. In the U.S.A. every class of creditors need to accept the plan as well[137]. German insolvency law, instead, asks for the majority of voting creditors agreeing to the plan and the sum of the claims of consenting creditors has to be more than half of the sum of the claims of voting creditors[138].

Moreover, while every State provides a liquidation procedure in case of insolvency, reorganization is not necessarily available in all countries. Furthermore, liquidation and reorganization may sometimes be separate proceedings and the petitioner must choose between the two, such as in the U.S.A. where these procedures are regulated by the American Code at Chapter 7 and 11 respectively. Otherwise, in other countries such as Spain, a single insolvency procedure exists and the company may be directed either to the liquidation or to

[136] G. Rossi, *Il fallimento nel diritto nordamericano*, Padova, 1965.
[137] See Chapter 11 of the Bankruptcy Code, Section 1129 (a) (7) and (8) (Confirmation of plan) and Article 1126 (Acceptance of plan).
[138] See Article 244 (1) *Insolvenzordnung*.

the reorganization track[139]. Besides, in several legal orders, after an initial attempt at reorganization, an insolvent corporation may end up in liquidation.

Before analysing various insolvency proceedings in detail I would like to stress once more the central role that insolvency law plays during the solvent life of a corporation, which might be particularly relevant in times of economic distress. The central role of debt enforcement instruments in general has also been emphasized by the European Commission. The latter has promoted an investigation into the economic impact of measures. By doing so, the European Commission has increased the efficienty of the national rescue and recovery frameworks on business demography. Consequently, 28 UE Member States legal orders have been analysed form 2003 to 2010 and the birth and death rates of firms have been calculated on different explanatory variables. The following results have pointed

> to the non-significance of rescue and recovery efficiency on firm creation decisions. Entrepreneurs do not appear to factor in the possibility to fail when starting up a new business, as birth rates are not affected by the typology of rescue and recovery frameworks. On the contrary, the survival of firms appears positively and significantly related to the easiness or availability of preventive procedures and reduced discharge periods. Highly accessible systems seem to provide a backstop for firm destruction, which might be particularly relevant in times of economic distress as it could ease the adjustment of investment and employment flows[140].

However, there is not a single answer to the insolvency problem and different solutions are adopted even among countries that share a similar common or civil law framework[141].

---

[139] S. Djankov, O. Hart and C. McLiesh, *Debt Enforcement Around the World*, ECGI Working Paper n.147/2007, in Journal of Political Economy, 116, 2008 at pages 1105-1149.

[140] European Commission note for the attention of LIME, see *supra* note 127, at pages 10 and 11.

[141] *Ibidem.*

2.3.1. The Role of Management during Insolvency Proceedings

The latter form of reorganization protects the corporation while it attempts to rehabilitate itself and that is why it may be useful only if a corporation still has a going-concern value. By doing so, the original management of the insolvent corporation may or may not retain control of the company during reorganization.

In case of insolvency, the board of directors sets new specific and limited goals, consisting in the satisfaction of due credits.

While during the solvent life of the corporation the board and the management should be incentivised by good corporate governance to pursue objectives that are in the interests of the company and of its shareholders, when insolvency proceedings initiate many insolvency laws recognize that the aims of management have to change as well and the law emphasises the priority of settlement of the creditors.

In this context, during the Uncitral V Working Group fortieth session, the convenience of common rules on management's behaviour in case of insolvency or pre-insolvency proceedings was debated[142], and it was inspired by American and English jurisprudence. Such legal systems tend to recognise an extension of the directors' duties in case of insolvency to the protection of the creditors' interests, for example by avoiding adventurous business. But by looking at other legal orders too, one common criterion may be found that is diligence duty, which establishes a minimal quality level for the managers' decisions based on some standards such as negligence or temerity. However, these kinds of general provisions are infrequent because they are not easy to define and to apply and also because they might be very risky. Indeed, financial operations are naturally uncertain and an ex-post evaluation may risk to paralyse the board of directors or at least to encourage them to work extremely carefully to the detriment of the creditors themselves. Fortunately, a manager responsibility out of the event of bad faith or of operation in conflict of interests is rare among all modern countries.

Furthermore, the provision of *wrongful trading* standards that managers and

[142] Uncitral V Working Group (Insolvency Law) report on the work of the meeting which took place in Vienna between the 31st October and the 4th November 2011, A/CN.9/WG.V/WP.100. Available at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

control's shareholders must respect is quite common, but only a few countries provide creditor legitimacy to claim against managers of a solvent corporation like Germany and Italy[143].

However, insolvency itself is not symptomatic of entrepreneur answerability, it does not always depend on unlawful or incompetent management. Also, insolvency may be only the consequence of the economic life of a sector where the corporation works, as has been proved by the economic crisis of the recent years.

As can be easily imagined, managers of an insolvent corporation have a harder job to balance stakeholders' various interests and motivations more than during a solvent life of a company. Shareholders of a corporation who do not usually share in any distribution in insolvency proceedings are interested in maximizing their own position by trying to trade out of insolvency or to reject any possible disposal of the corporation, hoping for a positive recovery, especially where the sale price would be able to satisfy only creditors right and would not leave anything left.

Such kind of operation may call for high-risk actions to raise value for shareholders, which may put interests of debtholders at risk. Those attitudes might also reflect indifferences for the successfully opportunities due to the limited liability protection or managers liability insurance whether the operation fails.

Proper provisions would incentivize management to maintain a useful business alive to minimize loss to creditors, and directors would be more likely to balance the lawful interest of all stakeholders by discerning hypothesis of bad administration from those concerning exogenous circumstances such as market conditions. Anyway, such provisions are not easily determined and an adequate balance is needed to avoid the risk of paralysing the business.

2.3.2. Automatic Stay

The initiation by the corporation (or by creditors) of a liquidation procedure or of reorganization might quite often cause a stay of eventual foreclosure proceedings while in other countries this does not happen.

143 *See* paragraph 93 *Aktiengesetz* in Germany and Article 2394 *Codice Civile* in Italy. Actually, this kind of claim is usually inititated only in case of insolvency.

A foreclosure stay guarantees an equal satisfaction of all creditors by respecting the legal order of payment. Moreover, the interruption ensures a fair allocation of the loss and its decrease which may be compromised if a lender claims against an insolvent corporation by consequently reducing the corporate estate. The stay of the enforcement actions responds to the need to allow time for negotiations with creditors and to address the holdout problem.

That is why several countries provide a stay of individual claims every time an insolvency proceeding has been initiated[144]. The latter might be general and automatic or only general but on request and through a specific judicial authority authorization.

The same Article 362 of the U.S. *Code*, which provides the *automatic stay* of individual debt enforcement claims, admits the same claims under a judge's decision based on the fact that <<*such property is not necessary to an effective reorganization*>>[145].

As in the U.S.A. and in Germany, the automatic-stay rule is applied to every British debt enforcement proceedings as well. This moratorium is central in keeping the corporate estate undamaged and in giving the corporation a breathing moment for the aim of reorganization. Moreover, today the moratorium includes criminal proceedings as was stated by the Court of Appeal in *Re Rhondda Waste Disposal Ltd*[146]. Here, the Environmental Agency claimed against Rhondda, a polluting corporation which had initiated an administration proceeding. In this case the Court required an expressed permission for Agency to be able to act against Rhondda, and in its judgment it stressed how the aim of the Insolvency Act was to provide several opportunities for the corporation to make proposals to

[144] See Section 362 *U.S. Bankruptcy Code* which provides the so-called *automatic stay* for the U.S.A. legal order; Article 51-168-201 of the Italian Insolvency Law, R.D. 267/1942 (*Legge Fallimentare*); Article L. 622-21 *Code de Commerce*, which provides the French *procédure de sauvegarde*; or Paragraph 89 of *Insolvenzordnung*, for Germany.

[145] See Chapter 11 of the U.S. Bankruptcy Code, Article 362, which imposes an automatic stay of the commencement or continuation, including the issuance or employment of process, of every kind of actions against the debtor or against the property of the corporation, as well as of any act to obtain possession or to exercise control over a property of the corporation and of any act to enforce a lien against property of the corporation and even it imposes an automatic stay of the commencement or continuation of a proceeding concerning a tax liability.

A similar opportunity is also stated in Article 104-*ter* of Italian Insolvency Law.

[146] Court of Appeal, *Re Rhondda Waste Disposal Ltd* (2001) (Ch) 57.

creditors, and criminal and civil proceedings would frustrate that.
However, what is generally important in those cases is to ensure a balance between the interests of debtors and of creditors. Interests that may be correctly matched only if the time of the eventual stay is taken into account, too. Nevertheless, in some countries, liquidation procedures may take place in tandem with or after foreclosure.

2.3.3. Common Features which Influence Efficiency of Insolvency Proceedings

Individual and collective ex-post proceedings may not be the only instruments of debt enforcement and in many cases *ex ante* mechanisms are provided by law, such as liability rules and disqualification for company directors.
For instance, the minimum capital requirements – for those countries which provide it – may serve to determine an *ex ante* protection to creditors. Corporate creditors may naturally benefit from a similar provision because this rule will in all probability anticipate the opening of an insolvency procedure, which therefore may facilitate a better satisfaction of creditors. Besides, the latter may take advantage of a shareholders' meeting that should be usually called in case of a minimal level decrease of the minimum capital to decide whether the corporation may be wound up or any other measures taken. Moreover, the rules in discussion safeguard creditors from a general unfair distribution of assets.
On another hand, one should note how the efficiency of debt enforcement does not only depend on the quality of the insolvency proceeding but it is also strongly related to the public sector performance in general,

> including tax compliance, legal formalism, corruption, and infrastructure quality. Debt enforcement looks a lot like other measures of the quality of government[147].

Furthermore, another factor that influences the positive outcome of an insolvency proceeding is *time*. Despite the difficulties associated with taking appropriate business decisions, financial decline usually occurs more rapidly than expected

[147] S. Djankov, O. Hart and C. McLiesh, *supra* note 139.

and, as the financial position of an enterprise gets worse, the options available for achieving a viable solution also decrease quickly. A number of jurisdictions encourages early action by imposing an obligation on a debtor to apply for formal insolvency proceedings within a specified period of time after insolvency occurs in order to avoid trading while they are insolvent.

Other jurisdictions consider the issue by concentrating on the duties of corporate managers during the time which precedes the beginning of insolvency proceedings and by imposing liability by continuing to trade when it was clear that insolvency could not be avoided. The reason behind these provisions is to create appropriate incentives for early action through the use of restructuring negotiations or reorganization. This should stop directors from externalizing the costs of the company's financial difficulties by placing all the risks of further trading on creditors.

The imposition of such obligations has been the subject of much debate. Those who believe that such an approach has advantages state that the obligations may operate to encourage directors to act prudently and take early steps to stop the company's decline. This should protect existing creditors from even greater losses and incoming creditors from becoming caught up in the company's financial difficulties. There are commentators who suggest that there are significant disadvantages, too. A law which presumes inefficient management based only on the existence of a financial crisis may make good managers leave a corporation and consequently, the chance to return the corporation to profitability through a reorganization procedure is missed. Managers trying to escape liability may close a viable business that could have survived. Anyway, whatever position is adopted, what is evident is that both liquidation or restructuring efforts should be undertaken as early as possible in order to save the greatest possible going-concern value.

Moreover, two elements may worsen the situation: risk-shifting incentives of shareholders and managers in the vicinity of insolvency and the rapid decline of a corporation's on-going value once it approaches insolvency[148]. That is why almost every country provides deadlines that a debtor must meet whenever it is compulsory to start insolvency proceeding[149]. As stressed by the European Commission, deadlines are a central issue which might need to be levelled among EU Member States because

> while overly tight deadlines may adversely affect this ability, long deadlines may delay the granting of relief under insolvency proceedings and undermine the efficiency of proceedings for all creditors[150].

Indeed, uniform European rule imposes liability on managers of insolvent companies for trading while they knew or should have known that insolvency was more probable than not, unless they can show that they took all reasonable steps to avoid insolvency. Finally, there are several factors associated with choosing the appropriate insolvency proceeding.

Managers and shareholders will take the more advantageous chance from their perspective into consideration to maintain a certain control over the corporation and to eventually face insolvency through corporate law instruments of restructuring. There are many options available. A debtor may keep the assets and he may continue to administrate the business under the court control or with the supervision of a practitioner appointed by or outside the court, i.e. elected by the creditors committee, which facilitates the continuation of the operation by the debtors. It is still possible that the debtor will be deprived of day-to-day business operations which will be taken over by a practitioner.

The court involvement may also influence the result of an insolvency proceeding. Unlike foreclosure, both liquidation and reorganization are court-supervised procedures; the judicial control may be an on-going oversight, an ex-ante

---

[148] See H. Eidenmüller, *Trading in Times of Crisis: Formal Insolvency Proceedings, workouts and the Incentives for Shareholders/Managers, in European Business Organization Law Review*, 2006, at pages 239-258.

[149] These timelines may differ among countries, from two weeks to two months. And the *dies a quo* may be the moment when the corporation becomes insolvent as well as the date it becomes aware of insolvency or the time when it ends to pay creditors, depending on national law provisions.

[150] Communication from the Commission to the European Parliament, the Council, and the European Economic and Social Committee: *A New Approach to Business Failure and Insolvency*, COM (2012) 742 final.

authorisation or an ex-post approval. Indeed, a court supervising on foreclosure procedures is typically less involved.

Generally, court participation is needed to ensure the legality of the procedure and especially of acts having legal effects on third parties.

The approaches among countries may differ. Some proceedings ask for a limited court involvement, limited to appoint the insolvency practitioner or to confirm the plan while others require a full participation from the beginning of the procedure to the end and including the creditors vote in court and the designation of the practitioner. There are also halfway solutions which permit negotiations and voting outside the court while the latter will be involved from the launch of the procedure.

When insolvency cannot be overcome through debt restructuring, new loans, extraordinary transaction (i.e. mergers) or through an agreement with creditors, liquidation will be inevitable. Sometimes liquidation is indeed the only remedy to a financial crisis. However one must start from the assumption that the destruction of a business is generally a social loss for all stakeholders, from the employee's perspective[151] as well as from the creditors perspective, because liquidation will never be able to save all the business value. This is generally true because each liquidation procedure naturally does not usually consider the going-concern value, but it is also specifically true in relation to some kinds of corporation of the last generation with small real assets while its heritage is composed by intangible goods. For example, let us just imagine the liquidation of the Google Company: compared to its general value, its availability to an auction sale would obviously prove unsatisfactory. In all these cases, the continuation dimension appears the only one that would provide a significantly positive solution every time this kind of proceeding is able to interrupt the race for assets and the destruction of a viable firm.

[151] Amost everywhere, employee representation rights and employment protection legislations may provide alternative rules to ensuring job security. *See* J. Armour, *How do legal rules evolve? Evidence from a Cross-Country comparison of shareholder, creditor, and employee protection*, in The American Journal of Comparative Law, 57, 2009, at page 579 and the following.

2.4. Debt Enforcements Among Countries

Generally, legal orders are oriented towards the creation of the most efficient insolvency proceeding both at a national and at a supranational level. Possible inefficiency may derive from long delays of the proceedings, high procedural costs but also from excessive piecemeal sales of viable corporations.

Moreover, it may be related to structural features of debt enforcement such as poorly structured appeals, business interruptions during liquidation proceedings and inefficient voting among creditors.

Finally, inefficient proceedings may predict underdeveloped debt markets where failures of debt enforcement discourage lending. More efficient proceedings should therefore allow the preservation of the value of corporate assets as much as possible in order to maximize the creditors' satisfaction.

Consequently, an efficient insolvency regime is essential because it represents a key policy area with potential huge influence on financial stability. As it has been underlined in the conclusions of the European Commission note on the Economic Impact of Rescue and Recovery Frameworks of November 2013, insolvency law might be

> a cushion for the impact of private sector deleveraging on growth, a spur to entrepreneurship and a buffer for the survival of viable firms in financial difficulty.

2.4.1. Liquidation Proceedings

When a corporation no longer has capital to run the business properly, there needs to be a procedure to run the company to an end, which can be achieved by liquidation. Such procedure is conceived to guarantee, that before the corporation ends, all its pending obligations are satisfied as much as possible and any existent surplus value is then distributed to shareholders according to their rights.

Originally, liquidation could not be considered one of the entrepreneur's remedies to overtake a financial crisis, while it was more a general enforcements of the corporate obligations which is managed by an independent receiver and is aimed at satisfying creditors' interests.

Conventionally, liquidation proceeding was also considered as a punitive context. Today indeed, it still possesses the essential nature of liquidation but it is also a proper instrument in the hand of the debtor. Furthermore, the distinction between a liquidation proceeding and other types of remedy as corporate operations and the sale or rent of the company is no longer clear-cut. Today, a hybrid proceeding with a context of liquidation and reorganization as well is quite common[152].

In the European Union, insolvency law is still a matter of Member States' national law and no relevant substantive harmonization of EU insolvency rules has been adopted at the EU level until now. The main source on the issue is the Council Regulation n.1364/2000 on Insolvency Proceedings, which became legal on 31st of May 2002. However, the latter is able to regulate only the event of a cross border proceeding. In the Preamble of the Regulation itself it is possible to read:

> the Regulation acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community[153].

Whenever an insolvent corporation presents assets and business in several European States, it is quite difficult to identify the Member State which has the jurisdiction to open the procedure. The European Council Regulation (EC) No 1346/2000[154] on insolvency proceedings (so-called EIR) recognizes the law which will regulate the insolvency proceedings as the law of the State where the court opening the procedure is seated and it has introduced a useful distinction between the main proceedings, and secondary ones[155]. The former may be opened in the Member State where the debtor has the centre of his main interests. In parallel with this main proceeding, the directive permits the opening of secondary proceedings in the Member States where the debtor has an establishment, while

[152] An example might be the Italian *concordato fallimentare*, which is one of the possible conclusions of the liquidation proceeding where the auction sale's procedure is replaced by a plan approved by creditors. *See* Article 124-159 *Legge Fallimentare*, as modified in 2006, 2007, 2012 and 2013.

[153] Preamble (11) of the Council Regulation on insolvency proceedings, (EC) No 1346/2000 of 29 May 2000, so-called European Insolvency Regulation (EIR).

[154] Council Regulation on insolvency proceedings (EC) 1346/2000 of 29th May 2000. The Regulation applies in all Member states with the exception of Denmark which has a special regime for judicial cooperation under the Treaty on the Functioning of the European Union.

[155] *See* Article 3 EIR.

the secondary proceeding will affect only the assets located in that State. The centre of main interests, so-called COMI,

> should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties[156].

Further, Article 4 provides the *lex fori concursus*, by stating that

> the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened.

Then, Articles 5 to 15 provide a number of exceptions to the previous criteria. Moreover, the Directive introduces the principle of mutual recognition of insolvency proceedings (Articles 16-26) and provides rules for the coordination of main and secondarily proceedings (Article 27-38). Every creditor who has a domicile or residence in one of the European Member States has the right to lodge his claim in each of the insolvency proceedings pending in the European Union.

The COMI rule is unambiguous when an enterprise is active in one country only, leaving no option for forum shopping. By contrast, international groups or firms with operations in different countries have a margin of variation to plan insolvency proceedings in one of the E.U. countries[157].

Nonetheless, the concept of *centre of main interest* itself is ambiguos[158].

---

[156] See the EIR Preamble, , (EC) No 1346/2000, at paragraph 13.

[157] Here the risk is about a fraudulent transfer to a regime independently from where the insolvency proceedings are carried out. Shareholders and managers possess linked information that allows them to judge whether the corporation is eligible for bankruptcy and possibly to win the race for filing because creditors are not yet aware of illiquidity is approaching. Moreover, shareholders and managers will have better knowledge than creditors in which States a favourable case for COMI can be initiated and what alternatives are available. Sensible corporate directors with advanced counsel should capable to use forum-shopping instruments to their advantage. However, it is probably related to who the creditors are or if insiders will succeed in the way explained. Indeed, whether the firm is closely monitored by a financial institution the advantage may be non-existent. Furthermore, in many cases certain groups of sophisticated creditors may be better informed on the financial situation of the debtor company as well as on the forum shopping chances, than other groups. The first might even enter coalitions with the corporate directors to the detriment of other creditors. It is likely that forum shopping will be to the detriment of tort creditors who are unable to adapt their credits.

[158] Even if the legal uncertainty has since been reduced by a series of judgments rendered by the European Court of Justice: Case C-341/04, Eurofood IFSC Ltd, 2006, ECR I-3813; Case C-396/09, Interedil, 14 (2011) Neue Zeitschrift für das Recht der Insolvenz

Within the European Union, corporations are free to develop wherever they prefer and so they are free to choose different jurisdictions. This choice may be influenced by the applicable insolvency law which, as stressed above, is central in solvent businesses as well. Until the end of the 1990s, regulatory competition was properly examined only in the U.S. because the regulatory environment did not allow any in the European Union. This changed since March 1999 with the ECJ Centros decision which affirmed the European corporation's right to incorporate in any EU Member State wherever their activity is run and so avoiding Member States from applying their own corporate law to such corporations, unless few exceptions. Recently, corporations have begun to enjoy this new development, choosing the advantageous English law in several cases[159]. Independently of this corporate law development, the EU adopted the EIR one year later.

In the recent years, private parties' freedom in choosing the law which applies to insolvent corporations have been increased among European Member States. Europe has so become closer to the American system. However, a main difference still exist:

> while creditors are a concern of corporate law only to a very limited degree in the US, EU Member States have traditionally tried to protect corporate creditors by corporate law. And while the US debate on regulatory competition is almost exclusively focused on the relationship between shareholders and managers, the relationship with creditors cannot be ignored in its European analogue. At the same time, since both corporate law and law are concerned with creditors, the two levels of regulatory arbitrage need to be dealt with as two sides of the same coin[160].

However, on December 2012 the European Commission proposed a package of

und Sanierung (NZI), 990; Case C-191/10, Rastelli Davide, 15 (2012) NZI, 147. And see also H. Eidenmüller, *supra* note 133.

[159] See J. Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, 58 *Current Legal Probs,* 2005, at page 369 and 386, which provides the data on the so-called "GmbH limited", a German businesses incorporated as English privated limited companies.

[160] L. Enriques and M. Gelter, *supra* note 37, at page 5.

measures to modernise the EIR[161]. Even though the Commission believed that the COMI concept was working quite well, it suggested revisions to the EIR so that the COMI concept could be planned on the basis of the existing jurisprudence of the European Court of Justice[162]. Furthermore, the Commission suggested that courts should be able to refuse the opening of secondary proceedings whenever it was not necessary to guarantee the rights of local creditors. Secondary proceedings are indeed seen as able to reduce the efficiency of the entire process by adding more costs of administration, so being fair until is balanced with the protection of local creditors interests.

Furthermore, the Commission believed that the publicity of proceedings should be strengthened and procedures for the filing of claims improved[163].

Moreover, the Commission underlined how an improvement of a regime of standard forms for the lodging of claims should be introduced[164], as well as a coordination of multiple insolvency proceedings relating to different members of the same group of companies[165].

Finally, in the view of the Commission, a more comparative analysis is needed in order to prepare the ground for harmonising substantive insolvency laws of Member States. The Commission should identify the precise areas in which the approximation of national insolvency laws and procedures would be necessary and feasible, and it should not be too intrusive to the national legislation and insolvency systems[166].

---

[161] IP/12/1354, MEMO/12/969. On 5th February 2014, the European Parliament voted in favour of the Commission's proposal, which now has to be agreed by Ministers in the Council in order to become law (MEMO/14/88). In parallel, the Commission launched a public consultation on a European approach to business failure and insolvency in July 2013 (IP/13/655).

[162] It will revise Article 2 (1) of the EIR.

[163] It was also suggested to provide ad hoc interconnected electronic registers in each Member States where the main court decisions in cross-border insolvency cases could be published.

[164] It will revise Article 41 of the EIR.

[165] Such issue is not currently regulated by the EIR even though it is an hypothesis where cross-border profiles may potentially acquire a maximum relevance. On the point, the Commission suggested that liquidators and courts involved in different main proceedings should not only cooperate and communicate with each other but also ask for a stay of the other respective proceedings whenever it may be suitable.

[166] See Commission Staff Working Document, accompanying the Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD (2012) 416 final, at page 44.

Hopefully, new interventions by the Commission may eventually reduce uncertainty[167]. With such an aim was born the new Commission Recommendation on a New Approach to Business Failure and Insolvency of 12th March 2014[168].

However, at the moment every single European legal order should be examined to have a comparative view of the role shareholders play during insolvency proceedings.

Generally, national insolvency proceedings presuppose the debtor insolvency and it may require the divestment of the debtor and the appointment of a liquidator.

In Italy, for example, insolvency is specifically required to initiate a liquidation proceeding by Article 5 of the *Legge Fallimentare*[169] which may commence on the debtor's initiative as well as on the creditors one or even by a public authority. In addition, in the case of corporation's initiative, insolvency must exist but it does not necessarily have to be already shown. Whereas the current and manifested state of insolvency is required when the proceeding has begun under the initiative of creditors or by a public authority (whenever it is possible). Once liquidation proceeding has been opened, the debtor no longer has any control over the business and individual creditors' claims are interrupted. A receiver is then appointed by the court which has the management of the insolvent assets and he or she will have to take an inventory to preserve the corporate assets. This may be increased through debt collection and all the other claims the debtor is entitled to. Afterwards, the liquidator will settle the corporate assets to pay all the corporate debts. Creditors will be satisfied in respect of the priority order regulated by law.

A certain seriousness of financial crisis is required under German insolvency law as well[170] which provides a unitary insolvency proceeding that can be divided into

---

[167] And it will face and resolve problems as the forum shopping issue. This interesting theme is discussed also in S. Lombardo and P. Pasotti, *supra* note 6. See also L. Enriques and M. Gelter, *supra* note 37, at page 4 and the following.

[168] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

[169] *Legge Fallimentare* R.D. 267/1942. See also the judgment of the Corte di Cassazione n. 9856 of 2006, which requires the debtor inability to face with ordinary instruments the corporate's debts also if no creditors already claim a foreclosure or another type of individual debt enforcement's procedure.

[170] German insolvency law is governed by the Insolvency Code which became legal in January 1999 and it has since been amended several times. The last major reform being

a *preliminary* proceeding and the *final* proceeding[171]. Both commence when the initial financial crisis of the corporation has led to a situation of insolvency.

On one hand, a final insolvency proceeding may be initiated if the debtor is illiquid. However illiquidity does not exist in the event of certain limited temporary liquidity gaps but the corporation is deemed to be illiquid if it is unable to pay its debts when they fall due. On the other hand, final insolvency proceeding may begin if the debtor is not illiquid but it is over-indebted, for example if the corporate assets do not cover its liabilities. However a corporation is considered over-indebted whenever its liabilities exceed its assets on the balance sheet test, and no matter if a positive forecast exists or not. Nevertheless, if such a situation exists, it may influence the continuation or liquidation value upon which a debtor's assets are then valued. Moreover, the debtor corporation itself can file an early petition if it has an illiquid heritage and if it is reasonable to think that the company will become unable to pay its due debts at a future date.

Filings for insolvency by creditors are also possible and common, while the Insolvency Court is not entitled to initiate insolvency proceedings *ex officio*. Normally, the appointed court will nominate a preliminary insolvency administrator and a preliminary creditors' committee. The first has to preserve the corporate assets and to supply the court knowledge of the convenience to open final insolvency proceedings or not. The time period between the filing and the court decision whether to open final insolvency proceedings is called preliminary insolvency proceeding (vorläufiges Insolvenzverfahren). During that time, creditors' committee can appoint an insolvency practitioner and the court may even decide to transfer the management of the insolvent corporation completely to such administrator.

On the base of the evaluation of the preliminary administrator, the Court opens the final insolvency proceeding if grounds for insolvency exists, and the debtor's

---

the Act for the Further Facilitation of the Restructuring of Companies (ESUG) which largely came into force the 1st March 2012.

[171] Special rules apply in case of insolvent specifically regulated entities, e.g. banks (in particular, Sections 46 to 47 German Banking Act [Kreditwesengesetz, KWG]), payment institutes (Section 16 Payment Services Supervision Act [Zahlungsdiensteaufsichtsgesetz, ZAG]) or insurance companies (Section 88 German Insurance Supervision Act [Versicherungsaufsichtsgesetz, VAG]).

assets is able to cover the costs of the insolvency proceedings. Otherwise, the beginning of the proceedings will be denied because of insufficient assets.

Afterwards, the Court normally appoints a final insolvency administrator who is responsible for the management of the debtors' assets and businesses. It is the custom that the same person who is nominated as preliminary administrator is also nominated as final administrator and both are under Court supervision.

The final administrator has the power to make transactions which bind the corporate assets. The corporation may be maintained as a going concern at least until the first meeting of creditors has occurred, under the final administrator management who has also to draw up a report for the creditors' meeting. This has to be held at the latest three months after the beginning of final proceedings and it decides whether the corporation is to be liquidated or if the business should continue and the company restructured.

A valid conclusion is reached whether it is approved by creditors that represent the majority of the value of the corporate credits, but subordinated claims do not have the right to vote.

If the administrator needs to interrupt the business or parts of it during the three months (at latest) of waiting, the consent of the Insolvency Court is required[172].

If it is decided that the insolvent company will not be continued, the corporate estate will be winding up and the profit shared to creditors by respecting the legal or contractual priorities.

In France, the notion of insolvency is not mentioned[173]. It is replaced with the more restrictive definition of *cessation des paiements*, the interruption of payment, which however consists in the debtor's inability to pay overdue debts. In such a case liquidation proceedings will be initiated and the appointed liquidator will convert the corporate assets in cash to pay creditors respecting the order of priorities. The procedure is deemed closed whenever there are no more due debts

[172] To prevent major creditors abuses against minor ones, to force them to accept a certain operation, the judge can revoke a creditors' meeting decision if it hinders the common interest of all creditors.

[173] French bankruptcy law has been recently modified. The first law goes back to 1985 but it has been updated by the *Loi de sauvegarde des enterprises* of 2005[173], which came into force on 1st January 2006.

or when insufficient assets do not allow further new settlements[174].

In the United Kingdom, liquidation still remains the most frequent solution for insolvent firms, even though the law is aimed at implementing a "rescue culture" to recovery corporations and this has been viable since the 1982 Cork Report[175]. The essential aims of liquidation are to close the business and to wind up the assets to pay creditors and shareholders if any assets remain. The corporations can initiate a *voluntary liquidation* through its shareholders or directors, while corporate creditors may force it with a *compulsory liquidation*.

A voluntary winding up may occur whether liquidation is approved by the 75 per cent of corporate members with voting right. Otherwise a compulsory liquidation may begin if managers, the corporation, some stockholders or creditors file for winding up to the court. To be able to present a petition, creditors must have evidence to be in debt with the corporation, and that the debt is due[176].

Independently from the type of liquidation, if voluntary or compulsory, the administrator is able to place a corporation into winding up by realizing an asset sale; whether the liquidator is not an administrator, he or she will be nominated by the tribunal and generally on creditors' majority advice and may be removed by the same majority[177].

As in almost all other countries, the corporate value in case of liquidation must always be distributed in order of credit's priority, as provided by law or by contracts; firstly the "super prior" credits, such as liquidator's fee, employees and pensions, then secured creditors, following by the floating charge holder,

---

[174] J.M. Lucheux and O. Puech, *France: Bankruptcy and Insolvency Law and Policy* in *The Law of International Insolvencies and Debt Restructurings*, ed. J.R. Silkenat, C. D. Schmerler, Dobbs Ferry, NY: Oceana, 2006, at pages 143-160.

[175] *See* the *Insolvency Act* of 1986 and the *Insolvency Rules* of 1986, as well. Central are also several laws and case law relating to property labour and bank such as the *UK Banking Act* of 2009. Another proceeding is available only for a fixed list of companies, like utility projects or railway companies. It is named *administrative receivership*. To remember is that in the U.K. insolvency law refers only to corporations formed under the *Companies Act*, of 2006.

[176] Indeed, in *Mann v. Goldstein,* the court held the liquidation petition was not the right place to verify the existence of the debt, and it would be an abuse of process to continue. Mann v. Goldstein, (1968) 1 WLR 1091, High Court.

[177] See Chapter 7 of the U.S. Bankruptcy Code, Section 702 and even Section 701 about an interim trustee. See between the many, P.L. Davies and S. Worthington, *supra* note , 9th edition, 2012, at para 1179 and the following.

unsecured creditors, deferred debts, and finally the shareholders. The respect of the payment order is a liquidator's duty to the corporation and not to individual creditors and neither shareholders. As a person in a fiduciary position, he or she should not have any conflict of interests or gain unlawful advantages.

However, one could generally affirm that liquidators have a wide amount of discretion about the administration of liquidation. He or she must preserve the corporate assets and increase it if possible to pay creditors and it may be realised by conducting new lawsuit, either to stop transactions started by the insolvent corporation or by charging the former managers.

Finally, in the U.S.A., insolvency proceedings are regulated both at a national and at a federal level. However, as financial transactions and relationships are usually trans-boarder and private law is limited within the boarder of each State, federal insolvency law assumes a central law. The main law regulation on the subject is the U.S. Federal Code[178].

Moreover, the *forum shopping* phenomenon may be quite common. Two are the main viewpoints of a debate which has developed since 1990[179]. Some scholars have suggested that forum shopping between different federal insolvency tribunals has enabled corporate debtors to guarantee that insolvency proceedings are carried out efficiently[180]; while others maintain that forum shopping is radically ruining the insolvency system which could harm creditors and only benefit the managers who have conducted corporations into insolvency[181].

In the U.S.A., if a corporation is so indebted or has such serious difficulties that it is no more able to continue its business operations, it is likely to wind up and apply for the liquidation proceeding under Chapter 7 of the U.S. Federal Code. In this case, the corporation stops all the operations and goes entirely out of business.

---

[178] For a complete analysis of federal insolvency proceedings in the U.S., *see* M. J. Roe *supra* note 33.

[179] For a more detailed analysis of the issue *see* L. Enriques and M. Gelter, *supra* note ---.

[180] R. K. Rasmussen and R. S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 NW. U. L. REV. 1357 (2000); D. A. Skeel, jr., What's So Bad About Delaware, 54 VAND. L. REV. 309 (2001); M. Cole, Delaware is Not a State: Are We Witnessing Jurisdictional Competition in Bankruptcy? 55 VAND. L. REV. 1845, 1859-76 (2002).

[181] L. M. LoPucki and S. D. Kalin, The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom", 54 VAND. L. REV. 231 (2001).

The control of the bankrupt company is transferred to a trustee who is appointed by creditors to sell the corporation's assets and to fulfil the debts to both creditors and investors with the profits of the auction sale. Administrative and legal fees are paid first and the residue is for creditors' satisfaction. The creditors who pose the smallest risk are paid first. Secured creditors, indeed, have their credits supported by collateral, such as a mortgage. They will so get satisfied firstly whenever the corporation goes bankrupt; but if the value of the collateral is insufficient to repay them in full, they will be treated together as unsecured creditors for the rest of their credit. Unsecured creditors, such as suppliers, will be paid only if there is any money left after the satisfaction of secured credits. They will be notified of Chapter 7, while other stakeholders do not have such rights because they commonly do not obtain anything back for their contribution; nevertheless, if also unsecured creditors are paid in full, stockholders should be informed and they should then have the chance to apply for a claim.

To sum up, it is noticeable how several main features are valid all among the legal orders mentioned above. Almost everywhere, the liquidation proceeding is under court supervision and the insolvency court also nominates or at least supervises an independent liquidator who has the aim to convert a corporation's assets into cash to pay as much credit as possible, by respecting of the order of priority provided by law or by contract. Moreover, after the proceedings have been distributed, the corporation may be removed from the register and dissolved, and any residual claims of the creditors are essentially of no value.

On this regard, may be interesting to have a look at the current Spanish insolvency law[182]. It dates from July 2003[183] but it entered into force only the 1st September 2004. Before, Spanish insolvency law was based on two main proceedings. The so-called *quiebra* could be initiated by both the insolvent corporation and creditors and required the appointment of a creditors' representative who had to take control over the corporation to essentially liquidate its assets and paying creditors. This procedure was complex, inefficient and can last up to 25 years. The other proceeding was essentially a restructuring procedure to avoid eventual

---

[182] G. Falcone, La riforma concorsuale spagnola, Milano, 2006.
[183] *Ley concursal*, No 22 of 9th July 2003, already modified in 2009.

liquidation.

When the new insolvency regime became legal, Spain had an impressively low number of insolvency proceedings in relation to the number of existing companies[184]. Similarly to Germany, the new Spanish insolvency regime provided a unique procedure which was initiated by both debtor and creditors as well[185].

They have since been encouraged to open the proceeding earlier, through different instruments which may be considered as an *unicum* in Europe; while a solvent corporation *can* initiate a proceeding as long as the inability to pay credits is imminent the corporation *must* file within two months from the actual insolvency.

Firstly, insolvency is presumed by Spanish law whenever tax, social security contributions or salaries have not been paid for more than 3 months.

Moreover, if the corporation does not apply for a proceeding in the prescribed time, it is presumed that insolvency is not without fault and this may entail managers' personal liabilities.

Thirdly, the filing is simplified because to be completed it only required a list of creditors and assets and a short description of the corporate conditions.

Finally, if creditors file for a proceeding and debtor does not, the management of the corporation will be taken over by a creditor administrator appointed by the court.

In conclusion, one should also notice how, among every jurisdictions, once a company goes into liquidation, the distinction between shareholders and creditors becomes difficult to draw more than usual: the members' interests will, in effect, have become purely financial interests deferred to those of creditors[186].

---

[184] Out of 35 countries in Europe, America and Asia, Spain had the lowest formal bankruptcy rate, of 0.02%, only close to Peru (roughly double the Spanish rate) and Portugal (about four times the Spanish rate); in S. Claessens and L. F. Klapper *Bankruptcy around the World: Explanations of Its Relative Use*, in *American Law and Economics Review*, 2005, vol. 7 no. 1.

[185] Since its entry into force in September 2004, around 87% have been voluntary filings on the debtor's initiative. Dates from the *Consejo General del Poder Judicial*; *see* M. Celentani, F. M. García-Posada and F. Gómez, *The Spanish Business Bankruptcy Puzzle*, Working Papers 2010-11, Departamento de Economía Universidad Carlos III de Madrid, available at http://edirc.repec.org/data/deuc3es.html.

[186] P.L. Davies and S. Worthington, *supra* note 24, at page 1272 and the following.

Finally, it should be mentioned that insolvent corporations might sometimes be important enough for politicians or judges to encourage them to preserve the business in the public interest, whenever it is admitted by law.

2.4.2. Reorganization Proceedings

A *resource-based view of a firm* is essential in today's insolvency law as it highlights the important connection between the increased value, the resources, the corporate skills and the long-term know-how of a company in financial distress. This view believes that there are some corporate factors which can be considered as a competitive advantage for the corporation but which may be barely trading on the market and as long as a company keeps the inner strength of its human and commercial resources together it may provide it with a better chance of financial survival than separating and potentially losing all its know-how.

That is why, in alternative to the default procedure of liquidation another insolvency proceeding is provided among jurisdictions.

As recently defined by the European Commission, reorganization proceedings consist in changing the composition, conditions, or structure of assets and liabilities of debtors, or a combination of those elements, with the objective of enabling the continuation, in whole or in part, of the debtors' activity.

Reorganization proceedings may reduce amount of the debt or its interest rate, or it may postpone the payments and may modify the priorities or even transform the debtholders into equityholders. The latter instrument may be applied in real through several legal instruments of commercial law such as mergers or creation of new corporations, and it will be analysed in fuller details in the next chapter. However, all these solutions work at their best only if the debtor remains involved in the financial difficulties of the business life.

What is important is to keep the definition of the value of a company separated from the value of its assets because the former may still continue to exist while the second may already be destroyed.

To cite Mark J. Roe analysis of the United States reorganization procedure:

> Reorganization problems link to technological and engineering

> changes that became prevalent at the end of the 19th century. (…) Business financial and reorganization were simple when an entrepreneur typically financed his or her own operations from saving and earnings. But by the end of the century, large enterprises required commitments of capital larger that that which any single saver (or small group of savers) could provide. The capital built not simple operations that could be shut down nearly costlessly, but long-lived assets (…) which even when currently unprofitable might have long-run value[187].

The so-called *privatization* of insolvency proceedings is an acceptable alternative to liquidation everywhere. It can be used when the absence of a single solution to a company in financial difficulty is presumed and when there is a direct personal financial involvement in a company which may also involve all stakeholders who are directly interested in finding a viable solution[188].

Such a reorganization to maintain the business alive may be not only in the creditors' interest but it may also fit the public interest to preserve the corporation or part of it which is totally legitimate until the preservation is not a disadvantage for the corporate creditors.

Consequently, a predictive judgment upon the feasibility of the reorganisation plan is necessary to be able to choose an alternative proceeding to liquidation. Obviously, it is impossible to foresee certain positive results but such a proposal should be able to offer something more rational than a mere hope.

Therefore, when considering the best interests of corporate creditors, if a company has still some value, restructuring proceedings should always be attempted before liquidation. The loss of any business and the winding up of a company always has a financial cost that may be reduced or avoided by applying a restructuring procedure. However, before deciding which is the best solution to adopt, the potential waiting time lost by attempting reorganization should be taken into consideration as both procedures have benefits and drawbacks.

Another important feature of each proposed reorganisation proceeding is the

[187] M. J. Roe, *supra* note 33, at page.

[188] F. Guerrera and M. Maltoni, *Concordati giudiziali e operazioni societarie di "riorganizzazione"*, in Riv. Delle Società, 2008, 53.

duration of the plan together with the risk of failure of the operation. However, one cannot exclude a reorganisation plan which is centred upon an uncertain operation which does not depend on the debtors' will, such as the debt collection of a corporation's contentious credit. The main intention should be to avoid a reorganizational plan that lasts longer than the corresponding liquidation proceeding.

However, an eventual auction sale might sometimes be faster and more economical than reorganization whether markets are in general downturn. In that case, possible future buyers of businesses in difficulty are likely to be financially indigent themselves, so decreasing the payment which could be reached in an auction sale[189].

In case of liquidation proceeding shareholders and managers lose the power to control the corporation but this may not happen in the case of reorganization. That is why a reorganization plan must be approved by creditors (the percentage of vote and the regulation of eventual categories of creditors differ among States) who have to consider the plan as a positive solution for their better fulfilment. Indeed, during the solvent life of a corporation shareholders show the greatest interest in the business trend because they are the residual claimants who may perceive dividends only if all the corporate creditors have been paid[190]. On the other hand, when a corporation is insolvent it is economically considered to be in the hands of the creditors when the capital has run out and any further commercial activity is only in the interest of the corporate creditors who only may receive some of the corporate value[191].

During a period of financial crisis, the main aim of insolvency is to maximise corporate assets to make the corporation able to pay off all its debts. A prudent form of management should then be put into place, which is aimed at the best realisation of the corporate creditors' interest. However, the preservation of corporate asset integrity should not impede new transactions, as they are sometimes indispensable.

---

[189] See J. Armour, *supra* note 159, at page 101.

[190] About the required conditions to perceive dividends before than all corporate creditors have been paied, *see* Chapter 1 at paragraph 1.2.1., *The Right to Perceive Dividends*.

[191] It is rare (even if not impossible) that an insolvent corporation would be able to distribute some of remain assets to its shareholders after a reorganisation proceeding.

2.4.2.1. Reorganization Procedures in the U.S.A.

The prototype of reorganisation proceedings is the American insolvency procedure under the U.S. Chapter 11. The U.S. Code of 1978 already in its original version provides the reorganization procedure that gives shareholders and creditors the possibility of negotiating a satisfactory solution to a financial crisis through the new allocation of rights on the corporate assets and the business. A plan of reorganization may then provide any kind of solution about the future of the business and the debtors' management usually remains in control of the corporation during the proceedings.

The proposal of reorganization needs to be approved by every class of creditors with the right to vote. However, if an agreement is not concluded a judge's decision may make the plan binding for all the class of creditors even for those who have voted against the plan. It is the so-called *cram down*, and this is possible only if the plan << *does not discriminate unfairly* >> but it is << *fair and equitable* >> and it respects << *each class of claims or interests that is impaired under, and has not accepted, the plan* >>[192]. In addition to this, the plan needs to be approved by at least one class of *impaired* creditors[193]. Moreover the plan cannot unfairly discriminate against some creditors[194].

However, a judge's intervention is also required when every class of creditors approve the plan. In this case, the judge has to approve the proposal of reorganization and this is possible if

> each holder of a claim or interest of such class (…) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title (of the U.S. Code) on

[192] See Chapter 11 of the U.S. Bankruptcy Code, Section 1129 (b). What *fair and equitable* means is described in Section 1129 (b) (2). See also an interesting hypothetical case of cram down elaborated by Mark J. Roe in one of its work; *supra* note 33, at page 373.

[193] Creditors are defined *impaired* whenever they are not fully satisfied under the plan of reorganization.

[194] See K.N. Klee, *All You Ever Wanted To Know About Cram Down Under the Bankruptcy Code*, in 53 Am. Bankr. L.J., 1979, at page 133 and the following.

such date[195].

After the plan has been confirmed, its provisions bind

> any entity (…) and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan[196].

Moreover, with the confirmation of the plan all corporate property is placed into the hands of the debtors free of any debts that have arisen before the date of the confirmation, even if claims have not been accepted.

Consequently, as it can be understood, a reorganization proceeding under Chapter 11 of the U.S. Law offers a greater chance of keeping a firm in operation and the current management in control. Furthermore, in order to be approved, it simply requires a provision of a better solution in comparison with the unsatisfactory alternative of liquidation results. A better solution is obtained every time the value of the liquidation may be equal or less than the reorganizational one, which may increase in value by new investments or by taking advantage on the going-concern value. This shows how reorganization is the preferable proceeding according to American insolvency law. Indeed, the U.S. system also shares the idea that the most efficient answer for an insolvent corporation should derive from a debate among creditors and shareholders, and it is confirmed by the American scepticism on the financial professionals' valuation of the corporate value[197].

U.S. reorganization proceedings have expanded widely out of the U.S.A., that may be due to the rich diversity of legal options available under Chapter 11, and several countries have since taken the American choice as an example to elaborate their own remedies to insolvency.

2.4.2.2. Reorganization Procedures in Europe

The orientation of the German system is in favour of negotiation among all

[195] See Chapter 11 of the U.S. Bankruptcy Code, Section 1129 (a) (7),
[196] See Chapter 11 of the U.S. Bankruptcy Code, Section 1141 (a).
[197] See M. J. Roe, *supra* note 33, at page 161.

stakeholders, as well. The system was put into effect by the recent reform introduced by the *Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* (ESUG; the Act for the Further Facilitation of the Restructuring Companies), which became effective in March 2012. Such reform quickened and eased the implementation of restructuring solutions such as the change of debtholders into equityholders and the *cram down* opportunity. On the whole, it significantly improved the creditors' position over the assets of the German corporations in case of insolvency proceedings.

The so-called *Eigenverwaltung* (self-administration proceeding) is comparable to Chapter 11 of the Code but, as previously stated, the German insolvency law provides just one proceeding which consequently makes it much easier for reorganization proceedings to unfold into a liquidation than it would in the U.S.A.. When the Insolvency Court has to open a final insolvency proceeding, self-administration proceedings may be initiated whether the debtor has applied for it and if there are not known circumstances that may have detrimental results for creditors. The preliminary committee of creditors is able to impose the tribunal to approve a proposal for self-administration whether it is resolved by common consent.

Therefore, today managers are authorized by law to apply for a moratorium, as long as the corporation has not finished cash, and to apply for maintaining the debtor in possession during the process. This may give managers enough time to contract and draw up an insolvency plan without being subject to any claims by creditors or directives from shareholders. Generally, the debtor is left in possession and the management remains in charge. However, the debtor is counselled and monitored by an insolvency trustee appointed by the Court, which retains certain rights such as the right to challenge transactions.

To be effective, self-administration may require the debtor to achieve the approval of its main creditors and the installation of new governance with experience in reorganizational procedures.

The Court can subsequently revoke the order of self-administration whether specific conditions occur, for example if the meeting of creditors adopts a motion.

Today, the *Insolvenzordnung* facilitate the instrument of reorganization which is able to overcome the debt-equity relationship of an insolvent corporation by providing a swap of creditors into equityholders against the will of existing shareholders. Before 2012, indeed, this kind of reorganization required the shareholders' consent but today shareholders are simply considered as a group of stakeholders and they are treated in the same way. Consequently, their consent may be overruled every time they are unable to prove that the plan stops them from receiving any proceeds or when creditors may receive what they are titled to in the plan.

The U.K. legal order has been inspired by the U.S. Chapter 11, too. Since 2002, the U.K. Insolvency Act contains revised *administration proceedings* for corporations to propose a debt reduction to creditors when this appears as a remedy for financial distress[198]. For example, managers may propose that each creditor accepts 60 per cent of its credit immediately and the rest will be paid over the following 7 years thanks to the profit of a newly restructured with new marketing strategies.

As in the U.S.A., the heart of the U.K.'s administration proceedings is to rescue a company wherever possible. An authorised insolvency administrator is appointed; his or her main aim is to rescue the company and to manage the affairs, business and property of the corporation. Business recovery is the primary concern; whenever corporations are able to be saved they should be saved, which means restructuring the corporation by maintaining all or the most of the business alive and intact. Such a new emphasis on business recovery should guarantee that viable corporations are conserving and jobs are then protected. However, in spite of common-law origins, under the U.K. law nothing similar to *cram-down* exists and the administration procedure remains predominantly voluntary.

If rescue is impossible the administrator may reach a different conclusion than an immediate winding up, by continuing to trade for a while and selling the corporation as a going concern. Such a strategy may produce better results for the

[198] *Administration* has replaced the previous *receivership procedure*, by the Entreprise Act of 2002 which came into force on the 15th of September 2003. The old procedure thus may apply to corporations where the floating charges were created before 2003. About an intresting comparison between the old and the new procedures, *see* J. Armour, *The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the U.K.*, in *Review of Law and Economics*, 8, 2012, at page 101.

creditors than an immediate winding up.

If neither of these objectives is possible then liquidation proceeding may be initiated. Furthermore, the Enterprise Act established special, limited conclusions by enabling the administrator to carry the restructuring procedure directly to a creditors' voluntary winding up where there are value to be distributed to unsecured creditors or to end the corporation where it has no assets left to assign to creditors.

Therefore, lawmakers' favour with the administration proceedings to the detriment of the liquidation proceedings is clear. This has also been emphasized in *Re Transbus international Ltd* where the rules about reorganization proceeding has been underlined as being the more adaptable, economical and comparatively informal alternative to liquidation[199].

The flexibility of such proceedings is confirmed by the possibility of the administrator to sell the whole assets of the corporation which may even been realised *before* the creditors meeting takes place. This might be a consequence of the so-called *pre-packaged administration*[200]. This is a practice that was developed in the United States around the 1980s and after 2002 it also became very widespread in the U.K.. Generally, corporate managers negotiate with the main secured creditors to sell the business to a buyer immediately after entering administration.

On the one hand, a quick sale without employing any lawyers or wasting any time or company heritage through formalities may be a benefit because it keeps the business running and maintains the employees in their jobs. On the other hand, potential damage may derive from the absence of broader consultation as unsecured creditors are given no voice and they may not obtain any satisfaction at all[201].

---

[199] Re Transbus international Ltd, [2004] EWHC 932 (Ch),

[200] See the Statement of Insolvency Practice n. 16 which is entitled *Pre-Packaged Sales in Administrations* (SIP 16).

[201] See V. Finch, *Pre-packaged administrations: bargains in the shadow of insolvency or shadowy bargains?*, in Journal of Business Law, 2006, at page 568-588. In the U.K. High Court Judgment of 2009 regarding Hellas Telecommunications (Luxembourg), Judge Lewison remarked that a pre-packaged administration is not usually defined as abuse of an administrator's power so indirectly approving the pre-packaged administration practice (U.K. High Court, Hellas Telecommunications (Luxembourg), II SCA [2009]

Moreover, the observation that John Armour has made by comparing the new administration procedure with the old *receivership* should be mentioned. He stressed how

> the very high costs awarded under administration imply that, in many cases, the professional running the case is effectively the residual claimant. In turn, this provides an alternative, and less benign, explanation for the increase in gross recoveries under the new regime: it is because, with weak monitoring from unsecured creditors, insolvency practitioners have themselves become the residual claimant in UK bankruptcies: they have a strong incentive to maximize the recoveries that will go to pay fee income[202].

At the moment, administration is the preferable insolvency procedure since the Enterprise Act.

The same demand for an adequate protection of all the creditors is perceived in France as well. The French reform of 2006 introduced the possibility of forming commission of creditors in safeguard and in reorganisation procedures as well to let creditors free to play a more active role in the processing of the proposal. Two committees can be formed; one for all lending institutions and another for main suppliers[203].

The main purpose of the 2006 reform was to support restructuring rather than insolvency proceedings. Moreover, French legislators drew inspiration from the U.S. Chapter 11 through an implementation of the existing proceedings, and managers are now incentivised to initiate a restructuring procedure before a

---

EWHC 3199 (Ch)). Moreover, a conclusion was rather reached that applicants for a pre-packaged administration should provide enough information to enable the court to understand the sale and to evaluate that the sale is not a serious and additional disadvantage for unsecured creditors (Re Kayley Vending Limited [2009] EWHC 904 (Ch). But see also other interesting law cases about pre-packed administration as Court of Appeal, Revenue and Customs Commissioners v. Maxwell, [2010] EWCA Civ 1379.). Anyway, the law uses the expression, what the administrator thinks subjectively and what could be the most suitable solution when different solutions have to be taken into consideration such as winding down or selling a business, so placing the administrator in a comparable situation to a corporate directors.

[202] J. Armour, *supra* 198, at page 132.

[203] Such opportunities is compulsory for large corporations, for example for firms with more than 150 employees or a turnover of €2 million or more. However, such instruments are available to smaller enterprises, too.

corporation stops paying its due debts. Moreover, the reform adopted the practice whereby a legal representative of the corporations ask for support from an expert nominated by the court, the so-called *mandat ad hoc*.

Furthermore, to facilitate reorganization towards the alternative of liquidation, the 2006 reform also intervened to protect those creditors who participate in corporate rescue. Indeed, in the past they used to be summoned for damage for the abusive extension of credit but the law states today the assumption that creditors are not responsible for their corporate credits which were born later than insolvency occurs. Such a presumption may however be invalidated under some conditions[204].

Another legislative reform was passed in March 2012 which increases financial protection proceedings and enable the insolvent corporation to reorganize its financial indebtedness in two months if the plan is approved by two-thirds of corporate financial creditors. Such agreement is possible until the company has a total balance sheet over a specific amount[205]. The same phenomenon has also emerged in Spain where the Spanish Insolvency Act was recently amended in 2011[206] and it trys to conduce Spanish insolvency law always closer to the U.S. example of Chapter 11.

Before the Amendment of 2011, insolvency law in Spain did not provide any kind of reorganization proceeding where a plan approved by the majority of creditors is able to bind all the dissenting one, and neither it offered any kind of protection against debt enforcements of single dissenting creditors. That was why several Spanish corporations pursued an insolvency law implementation in a more creditor-friendly attitude, closer to the U.K. insolvency regime as well.

The reform faced such provisions by introducing a procedure for obtaining court approval for a plan able to bind the dissenting creditors if such plan does not

---

[204] Such as in case of fraud or whether securities are accorded to value which is not proportionate to the related credit.

[205] On the whole, an increase of the number of the conciliation proceedings can be noticed after the legal intervention on the reorganization proceedings of 2006, which has made such proceedings more flexible.

[206] The reform has been introduced by Law 38/2011 of October 2011 (so called "The Amendment") which became effective on 1st January 2012. This Amendment follows the reform of March 2009.

impose a *disproportionate sacrifice*, as evaluated by the court[207]. However, the new regime does not really provide a stay with certain effects nor the stay is automatic and it does not supply with any sort of cram down for dissenting creditors.

Finally, there have been numerous reforms to the Italian insolvency law as well[208]. The innovation of the Italian *concordato preventivo* was inspired by the U.S. Chapter 11 and it clearly modified the nature and the purpose of the proceeding. Before 2006, the main goal of such proceedings was winding up, as in the case of liquidation proceedings from which it differed only for the modality of fulfilment. After the reform, the *ratio* has changed and such restructuring proceedings today are aimed to the rescue of a corporation which is in financial crisis or insolvent.

However, the proceedings maintain some characteristics that make it far different from the U.S. model. First of all, the Italian reorganization may be initiated only by the debtor[209], while Article 1121 of the U.S. Code under Chapter 11 declares that <<*any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee*>> file a plan if certain conditions are respected[210].

Moreover, the debtor's demand for a *concordato preventivo* must be accompanied by several documents required by law, i.e. the balance sheet of the last three years,

---

[207] It is the Formal Refinancing Agreement and it has to be approved by at least 75% of corporate credits. Dissenting secured creditors are usually excluded. The court may also provide a stay of the debt enforcement proceedings for a period no longer than three years.

[208] In 2005, 2006, 2007, 2010 and 2012, 2013. The first interventions have introduced the pre-insolvency proceeding called *piano di risanamento attestato,* the debt restructuring agreement (*accordo di ristrutturazione dei debiti)* and a more efficient regulation of the restructuring proceedings so-called *concordato preventivo*. These three proceedings together may be called pre-bankruptcy procedures.

[209] See Article 161 Italian *Legge Fallimentare.*

[210] Indeed, the application is admissible only in the following cases: (1) a trustee has been appointed under this chapter; (2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan. See also Chapter 11 of the U.S. Bankruptcy Law, Article 1121 (e) which provides the conditions for a small business to file a plan.

a list of the corporate creditors and by the report of an independent expert appointed by the debtor to guarantee the truthfulness of the plan and its feasibility, with all the difficulties associated with such prognostic judgments.

Then, in 2010 the reorganization procedure was made easier through the provision that new finance provided by the plan was defined as super senior which means that such debts will be satisfied in priority over existing creditors in case a liquidation procedure over the corporate assets will initiate[211].

In Italy, there is a clear-cut distinction of roles. When the company is insolvent, liquidation proceedings may be initiated independently from a debtor's will, but whenever a financial crisis does not create full insolvency, power is limited in the debtor's hand, who alone may propose an alternative to a liquidation proceeding. In this case, shareholders' property over the corporation is strictly guaranteed unless the extreme hypothesis of insolvency occurs. This is demonstrated by noticing how not all the restructuring techniques admitted under the U.S. Chapter 11 are lawful under Italian insolvency law.

2.4.2.3. Different Techniques to Reorganize a Company in Financial Distress

As previously mentioned, there are three different procedures involved in reorganizing a corporation in financial distress.

a. First of all, debts can be renegotiated through financial instruments which may delay debts due or reduce the related interests.
b. Secondly, a financial crisis may be faced through instruments of corporate law such as mergers with solvent corporations or the sale of part of the business as well as its rent. Furthermore, the corporation may be refilled through new equity by shareholders or third parties.
c. Finally, creditors may be satisfied through corporate participations. Their credit may be compensated with shares of the existing corporation or of a new company where the assets of the insolvent corporation has been conferred without the related liabilities (or with part of them). This is what

[211] Precisely, not the entire new finance but only its 80 percent may be satisfied ad super prior. See Article 111-bis *Legge Fallimentare*.

can properly be defined as *corporate reorganization*.

Each reorganization proceeding may provoke a drastic alteration of the corporate nature by establishing a new financial or corporate arrangement. Here the law must balance the creditors rights to satisfy their credits with the shareholders' property rights over their participation in a corporation with a specific nature and features.

Moreover, the interests of all the other stakeholders must be taken into consideration and balanced with the shareholders rights. For instance, whenever someone wishes to take over a business and to appropriate the know-how of a corporation it should be also taken into consideration an eventual shareholder's interest in taking over the business as well as the creditors' interests to sell the business to the highest bidder. Although, it is not always possible to clearly compare two different offers; a proposal may be highly advantageous for some classes while it may be negative for others and vice versa.

A potentially extreme conflict of interests may be created whenever the debtor has denied his consent over a plan of reorganization which does not simply renegotiate debts but which satisfies creditors with new stocks, and such denial can legally be overtaken by a judge's decision. This solution may be compared to the winding up of corporate assets where creditors are satisfied in cash, but in the previous hypothesis creditors are "paid" through a proportional participation in a recovered corporation. This avoids corporate value being eventually lost in an auction sale.

However, what remains uncertain is the legitimation of such techniques. A swap of creditors into equityholders against the will of existing shareholders may subvert the property right regime if it is realised without the debtor's consent. Moreover, property rights are usually safeguarded at a Constitutional level. However, whenever a corporation is already insolvent or close to insolvency, those who are more at risk may no longer be the shareholders but are the corporate creditors who could now be defined as the real *residual claimants*. Therefore, the factors previously underlined at the end of chapter one should be applicable in this case as well[212]; creditors of an insolvent corporation do not have

[212] See Chapter 1, Paragraph 1.4., *Shareholders as Residual Claimants*.

the certainty of receiving their credit back and their satisfaction is strictly related to the results of the insolvency proceedings. It is for this reason that they are the ones who could "manage" the proceeding better than other stakeholders and shareholders as well. In case of a corporate reorganization, the corporation could be managed better in their hands than by the original shareholders. To sum up, to more risk should correspond having more power.

Corporate reorganization without a debtor's consent may be effected in two different ways.

The simplest and oldest one was elaborated in the 1870s in the U.S.A. in the case of the previously mentioned railway companies[213]. It was then improved until the current version which is regulated by Chapter 11 of the U.S. Code which allows the creation of a new corporation where the assets of an insolvent one are transferred. Creditors will then acquire the shares of a NewCo for compensation of their credits against the insolvent company. They then become shareholders of a solvent corporation without paying anything, but only through the sacrifice of their credits. Creditors do not usually "acquire" the participation at a price proportionate to their credits. However, they will benefit from being part of a solvent firm that has a real value. The existence of the remaining value is the prerequisite for any reorganization procedure otherwise liquidation is the obvious ending. Furthermore, a NewCo does not need to be totally devoid of debts but some creditors may still remain debtholders. Moreover, the same solution may be achieved without the constitution of a NewCo whether the law permits it or not as happens in the U.S.A. where a large freedom in corporate management makes it possible to issue new stocks without respecting the pre-emptive rights or using every kind of instrument to obtain the same result. In several European states the creation of a NewCo appears as the only chance to realise a reorganization of this kind because the issue of shares should be proportional to the increase of capital and the latter may be not possible over a certain threshold of liabilities[214].

---

[213] See above, Paragraph 2.2., *Benefits of Insolvency Law*. See also D.A. Skeel jr, *Debt's Dominion: A History of Bankruptcy Law in America*, Princeton University Press, 2001.

[214] Moreover, some legal orders require a specific shareholders' vote to increase corporate capital and this may impede such proceedingsof corporate reorganization. However, out of Europe nothing is required and law may admit an increase of capital without the

Secondly, a similar result may be achieved by enabling creditors to acquire new shares of the insolvent corporation and these stocks should be issued through an increase of capital after contextual cancellation of the existing shares. Creditors should then be able to obtain new stocks in compensation for their credits. However the result will be the same of the first technique; debtholders will be transformed into equityholders of a solvent corporation. The increase of legal capital may also cause problems as shareholders may not have any interest in approving it. Moreover, in the EU, at least, an increase of legal capital must be approved by shareholders, as stated in Article 29 of the Second Council Directive about corporate law[215].

Nevertheless, a third type of corporate reorganization technique may be found in the Argentinian legal order. Here Article 48 of the *Ley de consursos y quiebras*[216] admits a coercive auction of the shares of an insolvent corporation where the price of stocks is directly paid to the insolvent corporation's creditors. It is as if the shares of the insolvent corporation are coercively transferred to corporate creditors who may either chose to accept the price of the auction sale or to maintain the stock and give up their credit, so becoming shareholders of a corporation without or with fewer debts.

However, this option may be strongly in contrast with the right of property because the owner of the participation that is coercively transferred is not the corporation but it belongs to the shareholders and the latter may not be insolvent even though he or she will be deprived of property rights[217]. This is why Argentinian law established that original shareholders should perceive compensation if an expert has evaluated that the stock has a value higher than zero.

However, a proceeding of this kind is difficult to imagine in Europe as well as in the U.S.A., where property rights are strongly guaranteed.

---

shareholders authorisation. See Article 29 of the Second Council Directive 77/91/EEC, as modified in 2012.

[215] However, the Directive does not cover any type of firms. Consequently, there are not any limits at a EU stage on the possibility to increase the legal capital of an insolvent corporation without the shareholders' consent, beyond the corporations covered by the Second Council Directive.

[216] *Ley de consursos y quiebras*, law n. 24,522 of the 20th July 1995.

[217] L. Stanghellini, *supra* note 50, at page 209-211.

On this point, the European Court of Human Rights, in *Scordino v. Italy*, highlighted how Article 1 of Protocol 1 ECHR may be interpreted as contained three principles: the first rule has a general nature and it <<*enunciates the principle of the peaceful enjoyment of property*>>; the second one <<*covers deprivation of possessions and subjects it to certain conditions*>>; and a third rule which <<*recognises that the Contracting States are entitled, amongst other things, to control the use of property in accordance with the general interest*>>[218]. A *fair balance* is considered by the Court, between the general interests of the community and the needs of the safeguards of the individual's fundamental rights. In paragraph 93 the Court requires

> a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure applied by the State, including measures depriving a person of his possessions[219].

Following such judgments an expropriation of shareholders stocks may be hard to legitimate also in terms of *the public interest* as has been stressed by the same Court in *Dennis Grainger and others against the United Kingdom*. Here, in Paragraph 36, the Court refers to the previous Scordino Case and stresses how:

> because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is in the public interest on social or economic grounds, and the Court will generally respect the legislature's policy choice unless it is "manifestly without

---

[218] *Scordino v. Italy*, n.1 GC, no.36813/97, ECHR 2006-V, at paragraph 75. Here the Court refers to its previous judgments (*See*, *James and Others v. the United Kingdom*, 21 February 1986, § 37, Series A no. 98, which partly reiterates the terms of the Court's reasoning in *Sporrong and Lönnroth v. Sweden*, 23 September 1982, § 61, Series A no. 52; see also *The Holy Monasteries v. Greece*, 9 December 1994, § 56, Series A no. 301-A; *Iatridis v. Greece* [GC], no. 31107/96, § 55, ECHR 1999-II; and *Beyeler v. Italy* [GC], no. 33202/96, § 106, ECHR 2000-I.) about the interpretation of Article 1 of Protocol 1 of the European Convention on Human Rights which establishes the right of every natural or legal person to the peaceful enjoyment of his possessions from which no one shall be deprived except in the public interest and by respecting the law conditions and the general principles of international law.

[219] *Scordino v. Italy*, n.1 GC, no.36813/97, ECHR 2006-V, at Paragraph 93.

reasonable foundation"[220].

Finally, with reference to compensation for original shareholders whenever such operation is admitted, the Court clarifies again how Article 1 of Protocol 1 of the European Convention on Human Rights does not guarantee the right to a full compensation in all circumstances and even a total lack of compensation might be considered legitimate in *exceptional circumstances*[221] where it might not upset the fair balance required by the norm. However, this case law refers to the Northern Rock, which is a U.K. bank, and the 2nd Council Directive of Corporate Law does not cover banks[222]. This has been one of the first cases where the Court of Strasburg has had to face reorganization without the debtors' consent and with the related shareholders' right to compensation that has been denied.

Finally, I would like to point out how all the issues debated above exist independently whether the original shareholders are totally excluded from the business or if they only assist to a reduction of their participation in favour of the corporate creditors.

2.4.2.4. Common Features of Insolvency Proceedings which May Increase Efficiency

It is possible to notice how in the last few years almost every European country has gradually moved towards making restructuring insolvency proceedings far more flexible than in the past and they are involving creditors and third parties far more in the plan of rescue and financial survival of a corporation. Insolvency laws have been recently improved in some of the main European countries, such as Germany, Italy and Spain. These reforms have collectively strengthened the rescue culture for companies in financial distress and they bring them much closer to the Anglo-American style of debt enforcement regime.

It is therefore possible to sum up, underline and assess some common insolvency features which show how efficient such proceedings may be.

---

[220] Dennis Grainger and others against the United Kingdom, no. 34940/10, ECHR, 2012-IV, at paragraph 36.

[221] See Article 1 of Protocol 1 ECHR, at paragraph 37.

[222] The national and European sources of law which applies to banks are different. See for example the U.K. Banking Act, 2009.

The first feature is whether insolvency is handled by a special court which is the case in common law countries but also in countries as Germany. Such a specialized court has lower costs, provides a shorter duration of the case and it is far more likely that corporations will continue as a going concern, but if an ordinary judge were to be appointed he or she may not necessarily be an expert in legal valuation techniques. This is why almost every insolvency proceeding foresees the appointment of a receiver or administrator who is gifted with specific knowledge and legal skills and who will work alongside the debtors for the best result possible. The only difference is whom he or she is appointed by and what his or her specific role and powers effectively are.

Another common feature among European countries is that the law does not usually allow restructuring proceedings to go ahead before a company actually goes into liquidation, even though such a measure would make the insolvency procedure faster and may also give better satisfaction to the creditors.

Moreover, there is a mechanism of automatic stay in both common law countries and civil law ones which protects an insolvent corporation from debt enforcing when proceeding commences.

However, other qualities of insolvency proceedings that may increase efficiency do exist which may differ among countries. For example, not all legislators are able to apply something similar to the U.S. *cram-down system* or the German *Obstruktionserbot* as such measures are unavailable to them.

In the U.K., a judge has no power to over-rule the creditors' rejection of a reorganization plan. The absence of such a rule is based on the idea that corporate reorganization may be left in the hands of stakeholders without any authoritative intervention whatsoever. Consequently, U.K. insolvency law enables creditors to propose an alternative plan of reorganization. The role of creditors is indeed another aspect which characterises insolvency proceedings; for instance, if creditors have the right to appoint or to dismiss the administrator or whether an administrator is paid according to the market value of the estate.

Furthermore, the efficiency of a reorganization plan may also be influenced by the suppliers and the customers' possibility to rescind contracts with an insolvent corporation without receiving any penalties themselves This rule prevails in

economically poorer countries, which unfortunately only prolongs a case so preventing companies to maintain the business alive and it is connected with a lower efficiency. Moreover, some States also limited dismissals from an insolvent corporation, and this may reduce the chances of business survival or the efficiency of a plan of reorganization.
Finally, it does not seem to make any difference if a corporate team of directors continues in management during insolvency proceedings or not.
The Appeal process is another important measure, which underlines the efficient quality of insolvency law. It is noticeable how such a measure may prove not only to be favourable for insolvency proceedings to maintain the business on-going during the appeal, but also for the same judge to judge the appeal as well. Consequently, these efficient provisions directly influence and may prevent any eventual delay in the proceedings.
The above mentioned wide-ranging description of insolvency measures in some Eurozone countries makes it clear how laws have been introduced and also reformed with the aim of improving restructuring procedures and also to introduce adequate instruments to face the current financial crisis. This has been mainly achieved not only by promoting "cram down" mechanisms, by helping debt-to-equity swap and by following the American example of keeping a debtor in possession of assets, but also by promoting pre-insolvency measures.

2.4.3. Liquidating or Reorganizing

When any enterprise finds itself in financial difficulty, the legal authorities in charge have the responsibility of deciding what kind of provisions should be put into place to face and to overcome a financial crisis.
Their initial judgement should be to decide if a restructuring measure of any sort could be attempted for the commercial survival of a company or if the only viable choice left is to start the liquidation process to recover eventual assets; it is necessary to examine what may be achieved from the debtor's assets on the basis of two alternative courses of action, the liquidation and the continuation of the business in order to its reorganization.

In case of liquidation, the debtor is put aside by removing him from corporation control and by appointing a receiver for such a role. Originally, a liquidation proceeding was the only one available for corporation in difficulty and an entrepreneur who was unable to pay the corporate due debts was blamed for the crisis and no further opportunities were given to him to save the corporation. The cultural approach towards a financial crisis has slowly changed and the debtor is no longer considered automatically responsible for the demise of the company, but it is now understood that insolvency may be the result of the natural risk of any business. This is also emphasized by the new stricter lending rules which have changed after the recent financial crisis and which make it possible to initiate insolvency proceedings today against corporations which could have been restructured *in bonis* in the past.

Moreover, it has been noticed how a liquidation proceeding may lose some value to the detriment of the creditors. Indeed, during the necessary period of time to definitely liquidate the assets, all investments may be blocked and this may seriously destroy some of the corporate value and it consequently may damage the interests of the creditors.

Furthermore, the liquidation proceeding consists in the selling of corporate assets in return for money which may not attract the best offer, but only an offer from whom has enough cash. This proposal may be extremely risky when the sale involves patents or vaguely definable business *know-how*[223].

Moreover, another aspect against liquidation is that if a debtor is given an instrument which maintains him in possession or which leaves him some advantages, he may be encouraged to discover the financial crisis himself before insolvency is evident and cannot be avoided anymore. And as stressed above, shareholders or managers may take advantage of this informative asymmetry between the latter and their corporation creditors and if an early discover of the financial crisis needs to be promoted with consequently favourable results for all the stakeholders, the debtor should in my opinion be encouraged to request for the opening of the proceeding.

The following problem is to find the correct, specific combination of insolvency

[223] See L. Stanghellini, *supra* note 50, at page 184 and the following.

measures which will maximize the value of a corporation to the full. Indeed, when an enterprise is in financial distress, considering which kind of provisions should be initiated to face the crisis, the first judgment should be on the valuing of whether a restructuring of any kind would be tried or if liquidation should immediately start;

> it is necessary to consider what may be obtained from the debtor's assets on the basis of two alternative courses of action, the liquidation and sale of the property and continuation of the debtor as an operating entity[224].

Then, the problem is to elaborate the particular combination that may maximize the value of the corporation. The prime criterion of choice should be *the best interest of the creditors*.

However, which kind of proceeding fulfils the best interest of corporate creditors might be not very easy to define. Indeed, a corporation may be considered as something beyond the value of its factors of production such as raw materials, barns, machineries, or a brand name. Starting up a business, making it expand and increase in value require not only financial backing and time but also energy, other human resources and skills as well. Such collective factors make up the so-called *know-how* of a company that is extremely hard to be converted into a mere lump sum.

Consequently, it is quite clear that such an additional value of social, reciprocal interaction exists in any company and it is a combination of financial and personal resources such as employees ability. If the business life of a company is unfortunately interrupted and its assets are taken over, any eventual future income or return may be less than expected[225]. However, it is also important to point out how conservative law provisions which pursue the safeguard of the social corporate value of a company are generally fair until the corporation has an on going-concern value, otherwise creditors will be damaged by any kind of proceeding except from liquidation. Indeed, several protective laws exist which address such an issue by making managers responsible for any abuse or detriment

[224] M. J. Roe, *supra* note 33, at page 40.

[225] G. Bosi and S. Trento, *Il governo dell'impresa: economia e diritto della corporate governance*, Bologna, Mulino, 2012, at page 59.

produced while keep on trade the business when insolvency has been predicted, anticipated or not effectively prevented.

Maintaining a business alive remains an important purpose of any kind of legal proceeding and liquidation process. Only a part of the business of an insolvent corporation may eventually be liquidated while other parts may be kept in operation because they still have some on going value left to exploit. The entire business may also be kept in business with the aim of selling the whole operation to a potential buyer through the provisions of a plan of reorganization or through the liquidation of the entire assets in an auction sale where the debtors are able to follow the approved plan. This type of hybrid insolvency proceeding can be defined as being halfway between reorganization and liquidation procedures which make the evaluation of the *best interest of creditors* especially difficult to assess. It must also be stressed how the result of such a restructuring proceeding may consist in keeping a corporation out of the market which *might* be recovered and which may not have been *already* rescued.

Nowadays, the reorganization of a company no longer refers only to private interests in obtaining the best result for final liquidation but there is also a public interest in keeping a business running until it does not damage the corporate creditors. As mentioned at the beginning of this chapter, insolvency involves creditors as well as other stakeholders.

However, there is still a financial interest:

> while a going concern sales via an auction may be quicker and cheaper than reorganizations (Baird, 1986), if the economy is in a general downturn, then potential purchasers of distressed businesses (likely competitors) are themselves likely to be liquidity constrained, depressing the prices that can be achieved in an auction (Shleifer and Vishny, 1992)[226].

Furthermore, time is a main factor to be taken into consideration when a reorganized debtor as an operating entity has a higher value than the final corporate winding up operation. The question is: how many years should be considered to be able to evaluate the results of reorganization properly? This issue

[226] J. Armour, *supra* note 198, at page 105.

is mentioned once again by Mark J. Roe who underlines the fact that a single answer to such a question is not yet available:

> the value derivable from this debtor as an operating entity is dependent in large part upon the amount of earnings to be obtained from the property as reorganized and the length of time for which such earnings will be available[227].

However, other uncertain factors also lie behind the evaluation of what should be the best insolvency proceedings to be put into place. Evaluation involves not only forecasting the future economic trend of the economy in certain specific markets where the corporation in difficulty trades, but also what the future prices of a corporation's products may be and the cost and availability of the raw materials that it may need.

Discounting the present value of the corporation is the first step to understand which solutions should be *in the best interest of the creditors*. After that, a reasonable economic forecast of its future expected income should be calculated, even though it is impossible to be exact in the matter and any expected future income may only be defined as highly *probable*.

Moreover, it has also been assumed that creditors know or may know from the start whether a gradually sale or keeping the business alive is productive, but such knowledge is more often than not inaccessible and the alternative of liquidation should be remembered as an instrument which may promote the most efficient way to face a corporation in difficulty[228]. This is why insolvency proceedings other than liquidation may provide further incentives for debtors; because legislators have the need to strongly encourage the fair and correct behaviour of the debtors[229].

Finally, the question spontaneously arises as to who should have the knowledgeable right and be really responsible for choosing the most suitable proceedings to be initiated in case of financial difficult of a company?

Who should decide whether to choose a liquidation or a reorganization process of

---

[227] M. J. Roe, *supra* note 33, at page 40.

[228] S. Djankov, O. Hart and C. McLiesh, *supra* note 139.

[229] L. Stanghellini, *Creditori "forti" e governo della crisi d'impresa nelle nuove procedure concorsuali*, in Fallimento, 28, 2006, II, at page 378.

insolvency and who should decide what the exact contents of an insolvency plan should actually be?

Such vital and pertinent issues will be further discussed in the following chapter from the stakeholders' point of view in various different countries.

However, it may generally be said that the liquidation versus reorganization and corporate restructuring dilemma should be resolved by agreement with the corporation and its creditors under court supervision, on regard of stakeholders' interests as well[230].

Although, it may be pointed out that evidence suggests that the vast majority of corporations in financial distress are finally liquidated and not saved or restructured[231].

Professor Horst Eidenmüller analyses the European Commission's proposal for a reform of European insolvency law[232] and criticises what he has called the misguided Commission's *restructuring euphoria*. He believes that a rescue/liquidation decision should be taken solely on the basis of the relationship between the going concern value of a business and its liquidation value. Moreover, he disagrees with the Commission's opinion that reorganization should be reserved for companies <<*in honest bankruptcies*>> and that <<*action could be taken to differentiate more between honest and dishonest bankruptcies*>> [233] because distinguishing between *honest* and *dishonest* bankruptcies would surely involve a difficult and sensitive inquiry in practice and he interprets such a declaration as being an out-dated view of the problem.

In conclusion, we may argue that one should not strive for insolvency

---

230 F. Guerrera and M. Maltoni, *supra* note 188, at pages 21-22.

231 Regarding this point, one may analyse the data provided by the Amadeus database (available at https://amadeus.bvdinfo.com/version-2013228/home.serv?product=amadeusneo) as well as the more recent data provided for Germany in 2013 by *Zeitschrift für das gesamte Insolvenzrecht* (*Zeitschrift für das gesamte Insolvenzrecht* (ZInsO), Issues No 4-9, 2013) which was elaborated by Horst Eidenmüller, in one of his works in 2013; see H. Eidenmüller, *supra* note 133. According to this data, liquidation is still considered the most widespread type of insolvency proceedings.

232 Such opinion has been expressed by the Commission in several official documents, between the others see Communication from the Commission to the European Parliament, the Council, and the European Economic and Social Committee for a new approach to business failure and insolvency, 12/12/2012, COM (2012) 742 final.

233 See COM (2012) 742 final, at paragraph 5.

reorganization as the only alternative to maintain a business in difficulty alive. Whenever there is not any going-concern value left, this measure could be extremely damaging for corporate creditors who will then have to share the insolvent assets with the titles of the new credits after the opening of the reorganization proceedings.

At the same time, however, I do support the European Commission's *restructuring euphoria* which believes that reorganization might be improved by offering incentives to those correct and fair debtors which may also help to anticipate the opening of the proceedings. Moreover, insolvency proceedings should be made far more flexible by leaving creditors more space for eventual negotiation towards the *best* solution possible for all. Indeed, in some countries dissenting creditors are forbidden to present an alternative proposal of reorganization. In Italy, for instance, creditors can only choose between accepting a specific plan of reorganization proposed by the debtor or deny the proposal, ordinarily with the consequence that a liquidation proceeding will be initiated. These and other kind of such "act of coercion" by the shareholders should be avoided.

2.5. Pre-Insolvency Procedures

During the meeting in Vienna on November 2011, the Uncitral V Working Group observed:

> Despite the potential difficulties associated with taking appropriate business decisions, financial decline typically occurs more rapidly than many parties would believe and as the financial position of an enterprise worsens, the options available for achieving a viable solution also rapidly diminish. A number of jurisdictions address the issue of encouraging early action by imposing an obligation on a debtor to apply for commencement of formal insolvency proceedings within a specified period of time after insolvency occurs in order to avoid trading whilst insolvent[234].

[234] Uncitral V Working Group (Insolvency Law) report on the work of the meeting which took place in Vienna between the 31st October and the 4th November 2011,

These words stress how the role played by the pre-insolvency proceedings is central and critical at the same time. Indeed, only a rapid intervention may assure the success of a plan of reorganization. Besides, liquidation is generally satisfactory when the business is stopped earlier rather than later.

The central role pre-insolvency proceedings should play in the future has been even underlined by the European Commission in its Recommendation of March 2014[235].

The Commission indeed asks Member States to facilitate the restructuring of companies in financial distress at an early stage, before starting formal insolvency proceedings, and without lengthy or costly procedures to help limit recourse to liquidation. Debtors should be able to enter a process for restructuring their business without the need to formally open court proceedings.

Among countries, several are the provisions of company law which operate in favour of creditors such as norms which impose a reduction of the corporate legal capital whenever liabilities go below a certain amount[236], or provisions which regulate liabilities for managers. Such provisions incentivise an early application to insolvency or to pre-insolvency proceedings, if there are any, and they may interrupt a managers externalization of the costs of the corporation's financial troubles which place the risk of further trades on existing creditors.

Indeed, to be able to initiate an insolvency proceeding, a company must be insolvent or insolvency must be imminent and the company should produce a certificate or other expert evidence as proof of financial distress. Alternative preventive procedures make it possible to reach an agreement between a distressed corporation which is not already insolvent and its creditors.

Pre-insolvency proceedings are aimed at avoiding the beginning of insolvency proceeding and through them legislators are provided with screens for viable corporations. Moreover, it must be never forgotten how more alternative

---

A/CN.9/WG.V/WP.100. Available at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

[235] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

[236] For istance see the Italian Civil Code, R.D. 262 of 16th March 1942, at Article 2446.

proceedings cater better for the different needs and situations[237].

Pre-insolvency rules are not properly an issue for U.S.A. law, while in Europe creditor protection has always been a central aspect of corporate law and pre-insolvency provisions may be seen as an instrument to enforce creditors' interests. Consequently, many national insolvency laws within the E.U. provide something more than insolvency proceedings to engage a corporation financial crisis. The latter are usually characterised as *quasi-collective* proceedings which take place under the supervision of court or an administrative authority. It gives a corporation in financial crisis a chance to prevent the beginning of an insolvency proceeding through a reorganization at a pre-insolvency stage[238].

An efficient example of such a procedure may be the British Corporate Voluntary Arrangements (CVA), which is even mentioned by the European Commission as an example of an optimal hybrid procedure[239].

When financial crisis occurs, directors might propose an arrangement for less repayment of corporate credits, hoping to reduce costs compared with other proceedings and consequently to increase overall returns. Until the Enterprise Act of 2002, the CVA was uncommon, because each creditor had the power of veto over the plan. This changed in 2002 when in the case of a small corporation[240] a plan is approved by 75 per cent of creditors but it is binding for all of them. All happens under the supervision of a practitioner but the management remains in control.

The Commission has stressed how

> the (…) rationale of the CVA is that it offers creditors a better return than they would realise if some other form of insolvency procedure were to be commenced in relation to the company.

However, this solution remains quite rare, especially in case of large enterprises.

In Spain as well the Amendment of 2009 was also based on the improvement of

---

[237] This has been stressed by the European Commission in its note for the attention of LIME mentioned above at note 127.

[238] Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM (2012) 743 final, paragraph 4.

[239] See Commission Staff Working Document Impact Assessment, SWD (2014) 61 final, at page 9-10.

[240] See Section 1A of the *Insolvency Act*.

pre-insolvency debt restructuring agreements. The Amendment introduced an exception to the previous rule and such a new provision gives additional time to the debtor if it informs the court that he or she has started negotiations with its creditors. During this additional time, the distressed corporation may be able to settle a plan for an agreement (*propuesta anticipada de convenio*) or a proper formal refinancing agreement with its creditors (*acuerdo de refinanciación formal*), taking place out of the court. However, the stay of enforcements does not apply during such additional time.

On the contrary, a stay of debt enforcements and of every pre-emptive claim are provided by the Italian pre-insolvency proceeding regulated by Article 182-bis *Legge Fallimentare*. In case of financial crisis (even if it is not already real insolvency), directors may first work towards a creditors' agreement. Article 182-bis regulates the so-called *accordo di ristrutturazione dei debiti*[241] which admits an out of court agreement with at least 60 per cent of the creditors until the debtor is able to fully pay all the creditors out of the arrangement in 120 days. The latter would have effect only after the ex-post registration by a judicial authority which has the duty to control the conformity between the agreement and law provisions[242]. By doing so, the Tribunal is assisted by an independent expert appointed by the debtor who has to prepare a report about the feasibility of the plan both in theory and in real.

This proceeding seems very advantageous for every stakeholder. On one side, debtor is supported by the option of an early intervention as soon as financial distress appears thanks to the stay of debt enforcements. On the other side creditors can be bound by the proposal only if they voluntarily agree and dissenting creditors have the right to present an opposition within 30 days from the publication, otherwise they are going to be paid if the agreement is approved.

Furthermore, voluntary agreements have been enhanced by the reform of 2006 in France. The French system offers proceedings available to insolvent business as well as to company which have been in a state of suspension of payments for less

[241] *Legge Fallimentare* (R.D. 267/1942) at Article 182 bis.

[242] The agreement does not necessarily need to treat all the creditors equally but it can provides different payment with the only limit of the respect of the legal order of payment. Such agreements are properly defined *pre-insolvency proceedings*.

than 45 days and for corporation suffering foreseeable financial distress.

The court may appoint a conciliator on request of a manager, who may assist the corporation comes to arrangement with its creditors. Then the agreement may be approved by a court judgement that will be published without disclosing the content of the agreement between the company and its creditors. Otherwise, the plan may be simply certified by the president of the court, so maintaining the procedures and the proposal entirely private.

The opening of such proceeding may be also filed by corporations who are not already unable to pay due debts, but which can show that they are experiencing troubles which may conduct to insolvency.

On the contrary, early out-of-court restructuring is not possible in several European countries, such as Bulgaria, Hungary, Czech Republic, Lithuania, Slovakia and Denmark. And where it is an option, procedures can be inefficient or costly, reducing incentives for companies to keep afloat.

Finally, we should mention how the European Insolvency Regulation[243] does not apply to pre-insolvency proceedings. Indeed, the European Commission in May 2013 proposed to amend the EIR by *extending its scope to pre-insolvency and hybrid proceedings*[244]. An intervention in the same direction has been solicited by the Commission Recommendation on a new approach to business failure and insolvency, of March 2014.

However, on the improvement of pre-insolvency procedures scholars are divergent.

Those who recognise that pre-insolvency intervention has advantages underline how such provisions may encourage managers to operate prudently and to early stop the business as soon as the decline is perceived. This attitude protects previous creditors from greater losses and eventual new creditors from being

---

[243] European Insolvency Regulation on insolvency proceedings, (EC) No 1346/2000 of 29 May 2000.

[244] European Commission proposal for a Regulation on insolvency proceedings: Impact Assessment (SWD (2012) 416, SWD (2012) 417 (summary)) for a Commission proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings (COM (2012) 744).

The Commission proposal for the amendment of that Regulation should extend the scope of the Regulation to preventive procedures which promote the rescue of an economically viable debtor and give a second chance to entrepreneurs. However, the proposed amendment does not tackle the discrepancies between those proceedings in national law.

involved in a corporation in financial distress.

Other scholars, instead, believe that provisions that presume mismanagement based only on the fact of financial distress often cause otherwise knowledgeable and competent managers to leave a company and the possibilities to rescue that company and return it to profitability is missed. There is a possibility that managers looking for a way to avoid liability will prematurely close a viable business that otherwise could have survived, instead of trying to trade out of the corporation's difficulties. Anyway, the introduction of such provisions has been the central topic of continuing discussion, as stressed by the European Commission Recommendation above mentioned[245].

2.6. Conclusions

To sum up, all the above discussion highlights the central role of debt enforcement regulations. Loans are an essential ingredient of entrepreneurship, and the only way to ensure the existence of a loan is by protecting it.

During a solvent life of a corporation, the holder of an expired credit may claim against the corporation to obtain a full satisfaction. When the debt payment is not voluntary, the same results may be achieved through foreclosure, which may or may not involve a court. However, creditors of a solvent company are left free to independently enforce their claims.

On the contrary, a collective regulation of financial crisis is necessary whenever a corporation is in financial distress or if it is already unable to pay its due debts. The corporate inability to pay its due debts is indeed what can be properly defined as *insolvency*. Anyway, this concept may vary a little among countries and depending on the single insolvency proceeding.

Collective proceedings are aimed to avoid a deterioration of corporate value and to protect every creditor in respect of the *par condicio creditorum*. There are two basic procedures used around the world:

a. when a corporation is in financial distress but it still maintains a going concern value, a *reorganization* may be initiated. Such proceedings maintain

[245] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

links with debtor and the possession of the corporation and are aimed at elaborating a restructuring programme that may have a triple context.

Firstly, it is possible to renegotiate the nature, the amount or some features of the credits owed with the creditors.

Secondly, several measures of corporate law may be used to reorganize the corporation in financial distress such as mergers or a reduction of the legal capital as well as sales of part of the business.

Finally, creditors might be satisfied through stocks of both a new or existing solvent corporation and this is what is properly called *corporate reorganization*. Here we have a conversion of creditors into equity-holders.

All such proceedings are characterised by a plan of reorganization, which is usually prepared by the corporate directors (if shareholders approve the plan, if they may propose a new one, and similar issues will be treated in the next chapter). Sometimes, a reorganization proceeding is useful to preserve corporate value but it may lead to subsequent liquidation.

b. Whenever the level of financial crisis is very high or there is not any going-concern value left, the only possible intervention is to immediately interrupt the corporation's activity and to appoint a liquidator who will take possession of the insolvent company and will wind up its assets. This proceeding is named liquidation proceeding, and it aims to the corporate creditors' satisfaction through the profits of an auction sale.

When a corporation no longer has the funds to work properly, there is a need to bring the existence of the legal entity to an end; this process is liquidation or winding up and this is drew to guarantee than earlier the corporation ends all its unpaid obligations are met as far as possible and any existent assets left are then distributed to corporate creditors, according to their agreed entitlement.

Moreover, several *hybrid instruments* between liquidation and reorganization exist and legislators of recent years have promoted *pre-insolvency proceedings* as well.

All procedures are time consuming, costly and for their nature inefficient because rarely they will be able to entirely satisfy all the corporate creditors. In this context, a right choice among different proceedings and the speed of such decision are essential.

Generally, reorganization proceedings are applicable only if they offer a better solution in comparison with liquidation and this may happen only if the results of the reorganization is likely to be higher than the alternative winding up. The choice should indeed be aimed at the realization of *the best interest of the creditors*.

However, because a lack of information is unavoidable and creditors could be damaged by a late intervention, debtors should be encouraged to start proceedings or at least start off a dialogue with creditors as soon as the state of financial distress is perceived. And there is no better incentive than maintaining the business alive and the debtor in control.

Furthermore, the best interest of the creditors may be balanced with the shareholders interest to be part of the corporation which has a specific nature and which should not be totally freely changed by a reorganization.

Moreover, it can be concluded that the speed of intervention as well as the regulation of new financing are other essential components of the success of an insolvency proceeding and they can be crucial for an insolvent corporation as well as at a pre-insolvency stage. New rescue financing helps corporate recovery by enabling the company to continue its business as well as meeting its debts. However, such new financing may create super prior credits in case of an insolvency proceeding and consequently they may drastically damage the existing creditors. This is the reason why these operations should be usually authorised by a court or by an administrative authority. Otherwise, a similar result may be obtained through the deviation from the absolute priority of a secured creditor that many countries legally admit.

Moreover, one can conclude that insolvency law is strictly connected not only with other legal areas, market regulations and lending market trades, but it is also influenced by various political approaches on the subject adopted among countries and between common-law and civil-law traditions, too. Interconnections between the efficiency of insolvency proceedings and other institutional variables have been analysed in the interesting work of Djankov, Hart and McLiesh of

2007, who analysed debt enforcements mechanism in 88 countries[246]. Such authors listed several features which may influence an insolvency proceeding such as public sector performance as tax law, formalism of judicial procedures, corruption, or infrastructure, as well as instruments of creditor rights and information sharing and the quality of governments[247]. Other features depend on objective standards of public regulation like the regulation of entry or the regulation of labour markets.

Furthermore, what I have been able to conclude by looking at insolvency regimes among countries is that efficiency may be reduced by legal provisions which provide an interruption of corporation activity as well as the application of rules which allow customers and suppliers to rescind contracts while the corporation has to initiate an insolvency proceeding. Besides, the same negative result may be obtained by long-lasting appeals and by the prohibition to continue the proceeding during the appeal.

In conclusion, by looking at the above examination of insolvency proceedings among countries belonging to both common-law and civil-law tradition, I have attempted to sum up the differences and similarities of such insolvency measures. In general, one can notice how debt enforcements proceedings are more efficient in the common law countries than in the civil law ones. The former seems to have comparatively more flexible proceedings which leave free space for all stakeholders to negotiate what they believe to be the best solution under public supervision.

In civil law countries where rehabilitation measures of firms may be more rigid, several distressed corporations end up in liquidation. In these countries, insolvency proceedings have long been seen as yet another instrument of public enforcement rather than a specific course of action to overcome corporate insolvency.

However, laws are fortunately changing as it can be seen by the more recent law reforms in almost every civil law country. Although liquidation is still considered

---

[246] S. Djankov, O. Hart and C. McLiesh, *supra* note 139.

[247] See indeed R. La Porta, F. Lopez de Silanes, A. Shleifer, R. W. Vishny, *Agency Problems and Dividend Policies around the World*, in The Journal of Finance, 55, vol.1, 2000.

the most widespread insolvency proceeding, European Union member States are appreciating the potential enormous advantages of reorganization procedure always more, becoming closer to the common-law regime of insolvency law.

It is evident how the current Eurozone financial crisis is still as unpredictable as unprecedented. There is no doubt that however it resolves itself, it will throw up many further tests for European restructuring and insolvency legal structures, particularly if one or more member states leaves the EU as a result. This in turn is likely to create a whole new series of challenges, which may require a further wave law reforms. The European Commission wishes for such innovations:

> the discrepancies between the national restructuring frameworks, and between the national rules giving honest entrepreneurs a second chance lead to increased costs and uncertainty in assessing the risks of investing in another Member State, fragment conditions for access to credit and result in different recovery rates for creditors. They make the design and adoption of consistent restructuring plans for cross-border groups of companies more difficult. More generally, the discrepancies may serve as disincentives for businesses wishing to establish themselves in different Member States[248].

Moreover, even at the national level the recent reforms of insolvency law among Member States jurisdictions demonstrate that the EU Member States are welcoming flexible and quick legal innovations which will continue to provide rescue and recovery proceedings to face corporations in financial distress[249].

---

[248] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

[249] J. Houghton, R. Agostinelli, H. Diogo Amengual, F. Grell and I. Pallarés, *Insolvency Reforms in Europe*, LMA News, July 2012, at page 21.

3

Shareholders Rights in Case of Insolvency

What I intend to discuss in this final Chapter is how shareholders' rights change when a corporation is in financial distress and how they are involved in insolvency proceedings.

Indeed, all the shareholders' rights set out in Chapter 1 are rightful when the company is able to satisfy all its corporate creditors. As already highlighted, both the right to perceive dividends as well as the right to indirectly manage a corporation by exercising the right to vote are legitimated as shareholders are *residual claimants* of the corporation; they are the only ones who take on the risk of the business and who may not receive any eventual satisfaction from their participation.

However, when insolvency occurs, a corporation is unable to regularly fulfil its obligations. Creditors then involuntarily take part in the risk of failure since credit satisfaction is now strictly linked to the positive result of any insolvency procedures;

> once the equity cushion has been lost, the risk of further losses shift from shareholders to creditors who have become the residual claimants[250].

Hence, in case of insolvency, corporate creditors may be seen as *forced residual claimants* as they will only be paid with the residual assets of insolvency proceedings[251]. Therefore, if the equation more-risk-more-power which was stated in Chapter 1 remains valid, one should reasonably be able to ask the extent to which creditors should be involved in a corporation in financial distress and how shareholders' rights may be limited or conditioned in case of insolvency proceedings.

---

[250] L. Stanghellini, *Directors' duties and the optimal timing of insolvency. A reassessment of the "recapitalize or liquidate" rule*, in Il diritto delle Società Oggi. Scritti in Onore di G. Zanarone, Torino, 2011, at page 733 and the following.

[251] To be accurate, residual claimants are only those creditors whose credits are not fully covered by the overall value of the corporate assets.

When a proceeding has been initiated the management and the main decisions regarding corporate assets should be left in the hands of the proper *residual claimants*, the corporate creditors. This is why for instance, creditors consent is needed to begin a reorganizational proceeding and why a prudent running of the business is required by law in case of insolvency.

This would also allow creditors to monitor the corporation activity more carefully and to avoid taking on new risks which could create further new debts to the detriment of the previous corporate creditors. And

> impowering the creditors of insolvent firms is, with various degrees and flavors, the goal of bankruptcy proceedings[252].

However, corporations which could previously be recovered *in bonis* may become insolvent today due to the current financial crisis and the stricter lending regulations. More often than not, insolvency proceedings start when a corporation still has a going-concern value and the crisis may be faced with reorganization procedures which may include mergers, recapitalization or other kinds of operations which modify the ownership structure of the corporation and where shareholders also have a direct interest.

Consequently, a single solution does not exist which balances the property rights of shareholders with the creditors' interest to interfere in the business life of an insolvent corporation, as they are all sharing the risk of liquidation.

Hence, several legal issues then spontaneously arise in any legal order.

Firstly, how should shareholders be treated during insolvency proceedings. Should they have the right to oppose feasible solutions which follow the best interests of the creditors but which may also dispossess them or should they still maintain corporate stocks if all creditors are not fully satisfied?

Furthermore, one may argue if stockholders should still be entitled to have the power to remove an appointed receiver or to dismiss directors when they are still in charge of an insolvent corporation. In addition, it is also controversial whether a final meeting resolution is actually needed to approve a reorganization plan or whether shareholders should be able to challenge such a plan or not.

---

[252] L. Stanghellini, *supra* note 250, at page 735.

Moreover, it is questionable whether a decision of the shareholders' general meeting is really required to issue new shares of the corporation undergoing insolvency proceedings or can new shares be issued on the base of a decision of the board or by that of the representative of the insolvency proceedings?

Furthermore, as stressed by the OECD Principles of Corporate Governance, basic shareholders rights should include the right to transfer shares, the right to obtain relevant information about the business and the right to elect and remove members of the board. Besides, shareholders should also have the right to participate in and to be sufficiently informed about any decisions concerning fundamental corporate changes. They should be also allowed to authorise the issue of additional shares and extraordinary transactions.[253]. It is however possible to argue that shareholder rights may be limited in case of insolvency.

In this Chapter, I intend to go on by analysing how these issues can be faced and resolved in different countries in relation to those companies undergoing liquidation proceedings (Paragraph 3.2.) or to those undergoing reorganizations (Paragraph 3.3.). The redefinition of *rights* in general is therefore the core of any reorganizational procedure where a general agreement between debtors and creditors are reached under court supervision.

Moreover, the shareholders' role in a corporation may be influenced by debt restructuring which can be achieved without a full formal insolvency process as well as by a previous situation of distress irrespective of whether formal insolvency proceedings have started or not.

3.1. The Eve of Financial Distress

The eve of a financial crisis is usually better discernible by the company itself than by its creditors; only the directors may have the correct and precise knowledge of corporate structure and its business and only they may fully

[253] The OECD Principles of Corporate Governance has been elaborated by the Organisation for Economic Cooperation and Development firstly in May 1999 and then revised in 2004. It is not a binding document and does not aim to the elaboration of detailed prescriptions for national legislations. On the contrary, they seek to identify objectives and suggest various means for achieving them. Their purpose is to serve as a reference point and policy maker can use them to examine and develop national legal and regulatory framework. About the discussed issue *see* at page 18.

understand when a crisis is imminent. Hence, before a company is properly insolvent, directors may have the duty to refer shareholders about a forthcoming crisis.

The larger the corporation and the more widespread is the ownership, then the stronger is the duty to do so as shareholders are less involved in a corporation's life and may not have noticed any foreseeable financial distress. Shareholders may indeed be interested in preventing the beginning of an insolvency proceeding but to be able to intervene they should be informed about the crisis as soon as possible.

In every country, ordinary shareholders' general meetings are periodically held by managers, once or twice per year and special meetings can be even called by the request of a certain percentage of shareholders or by the board of directors. Managers should indeed call the meeting as soon as they perceive the existence of a financial distress to enable shareholders to take the necessary decisions to resolve the crisis. Otherwise, a general meeting may also be requested by a shareholder himself who is first aware of the existence of the crisis. Anyway, this is more common in smaller corporations with a narrow property structure where the identification between debtor and shareholder is stronger.

Within the European Union, Article 19 of the Second Directive on company law requires:

> 1. In the case of a serious loss of the subscribed capital, a general meeting of shareholders must be called within the period laid down by the laws of the Member States, to consider whether the company should be wound up or any other measures taken.
> 2. The amount of a loss deemed to be serious within the meaning of paragraph 1 may not be set by the laws of Member States at a figure higher than half the subscribed capital.

Therefore, if shareholders are informed about the crisis in time, they could then be able to search for and put corrective solutions into place which could prevent eventual insolvency. A positive outcome could therefore depend on whether a corporation is closely held or it is a listed company in regulated markets, as the latter has legal obligations of mandatory disclosure of inside information[254].

Moreover, the rules of legal capital may be no longer an advantageous procedure as the minimum amount of capital in large corporation may be so low in comparison with the overall assets, that a decrease in revenue may reveal an already advance financial crisis where the only solution left is to wind up the company.

Consequently, a shareholders' general meeting is an essential step in overcoming a situation of financial distress as it might be able to prevent the opening of an insolvency proceeding[255]. However, shareholders may be able to wait for intervention only if the prerequisites for the opening of insolvency proceedings do not exist and if no one has already filed for such procedures. Alternatively, they may prefer to intervene in advance to reduce the risk of insolvency. And such an intervention may even be brought about by implementing elements of company law[256]. On the one hand, one or more shareholders can decide to finance the corporation themselves while on the other hand a decrease of the legal capital may be voted. Furthermore, financial distress may even be resolved through a merger with a solvent corporation or by issuing new shares when this is allowed by law so involving new shareholders in the business[257].

In case of financial distress, a reduction of the subscribed capital may become mandatory.

[254] Within the European Union, see Article 6 (1) of the Council Directive 2003/6/EC on market abuse.

[255] About the directors' duties in front of a financial crisis see between the many Lorenzo Stanghellini, *supra* 250.

[256] Among countries has been perceive the necessity of coordination between company law and insolvency law. See for example U. Tombari, *Principi e problemi di diritto societario della crisi*, in Rivista delle Società, 58, 2013, at page 1138. Here the author expresses his desire for the elaboration of what he defines *diritto societario della crisi* which may be translated as the "company law of the financial crisis" and which is nothing more than an ad hoc regulation of such instruments of company law which are normally applied during insolvency proceedings.

[257] About the best debt-equity relation in corporations in financial distress, see between the many a recent article of G. Ferri jr, *La struttura finanziaria della società in crisi*, in Riv. Dir. Soc. 2012, 477.

The aim of such provisions might be to make the legal capital correspond to the real finance situation of the corporation[258].

In the European Union, Article 40 of the Council Directive 77/91/EEC, requires a decision taken by the general meeting unless compulsory withdrawal is at least authorized by the statute. The decision of the general meeting can be passed over if the compulsory withdrawal << *has been unanimously approved by the shareholders concerned* >>. After the shareholders authorization, the terms and manners of withdrawal may be decided by the board of directors.

However, in case

> of a reduction in the subscribed capital by the withdrawal of shares acquired by the company itself or by a person acting in his own name but on behalf of the company, the withdrawal must always be decided on by the general meeting[259].

Finally, even if the company is not insolvent, creditors must be protected from a reduction of capital. Indeed, Article 36 provides certain safeguards for creditor whose claims antedate the publication of the decision to make the reduction who should << *obtain security for claims which have not fallen due by the date of that publication* >>[260].

Therefore, creditors should be adequately safeguarded under conditions laid down by the laws of member States;

> the laws of the Member States shall also stipulate at least that the reduction shall be void or that no payment may be made for the benefit of the shareholders, until the creditors have obtained satisfaction or a court has decided that their application should not be acceded to[261].

---

[258] Undercapitalization can be *real*, where the company has no resources to perform the activities for which it was created; or *formal*, where the company has resources to perform its activities but those resources do not come from capital but from loans, generally granted by insiders.

[259] Article 41 of the Second Council Directive on company law, 77/91/EEC as modified in 2012.

[260] See Article 38 of the Second Council Directive on company law, 77/91/EEC as modified in 2012.

[261] Article 36 of the Second Council Directive on company law, 77/91/EEC as modified in 2012; but see also Article 37.

The reduction of the subscribed capital through the withdrawal of shares may even be voluntarily. In such a case the capital reduction must be approved by the shareholders' general meeting and it must respects the rule stated by the Second Council Directive. Here, Article 34 provides:

> Any reduction in the subscribed capital, except under a court order, must be subject at least to a decision of the general meeting acting in accordance with the rules for a quorum and a majority laid down in Article 44 without prejudice to Articles 40 and 41(…)[262].

Furthermore, Article 44 states that any decision related to the legal capital can only be adopted if it is taken by at least the majority of not less than two-thirds of the votes which refer to the represented subscribed capital. However, each member State may adopt a lower majority of votes << *when at least half of the subscribed capital is represented* >>[263].

A higher majority of the eligible votes of shareholders is required in the U.K. to approve the reduction of capital[264] and it should also be supported by a solvency statement[265]. According to Article 643 of the U.K. Company Act 2006, such a statement consists in the prove that the corporate management has formed the opinion that there are no reason to believe that the company << *could then be found to be unable to pay (or otherwise discharge) its debts* >> and that each directors agrees to the following:

> (i) if it is intended to commence the winding up of the company within twelve months of that date, that the company will be able to pay (or otherwise discharge) its debts in full within twelve months of the commencement of the winding up; *or*

---

[262] The Article than continues by regulating the publication's form and it goes on this way: << (…) *Such decision shall be published in the manner laid down by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC. (2) The notice convening the meeting must specify at least the purpose of the reduction and the way in which it is to be carried out* >>.

[263] Article 44 of the Second Council Directive on company law 77/91/EEC.

[264] See Article 626 of the Companies Act 2006 which requires a special resolution of the company to regulate the reduction of capital in connection with redenomination (so without any issue of new stocks). Such a special resolution is the one passed by a majority of voting not less than 75% of eligible votes of shareholders voting, as stated by Article 283.

[265] See Article 642 of the Companies Act 2006.

(ii) in any other case, that the company will be able to pay (or otherwise discharge) its debts as they fall due during the year immediately following that date (…)[266].

Moreover within the E.U., whenever there is more than one class of shares, the final decision of the general meeting on the reduction of the subscribed capital shall be voted separately and should be approved by at least each class of shareholders whose rights are directly affected by the transaction[267].

Regarding shareholders' new funds, they are free to provide financial backing as long as they have previously completed their provisions. Otherwise the amount left, subscribed but unpaid, must have been provided before insolvency proceedings begin.

In March 2014 the European Commission underlined how allowing new financing is an important element of restructuring procedures[268]. Moreover, in some countries shareholders do not have much choice left whenever legal capital has to be reducing under a minimum amount.

Among some jurisdictions indeed, the inability to refund the corporation may have the only alternative of liquidation[269]. In such a case, corporation can be wound up or it can be transformed into another type of firm which does not require the (or which require a less) minimum legal capital whenever it is admitted by law; otherwise new equity should then be provided.

Whenever shareholders provide new funds undergoing proper reorganizational proceeding, these may be treated as super prior credit over the existing ones. In Italy, for instance, Article 182-*quater* LF, admits the satisfaction in advance (in the limit of 80% of its amount) of new funds of shareholders over corporate creditors when the provision of such new funds has been included in the plan of reorganization. Italy bankruptcy law requires even a court confirmation of such a priority; what the law wants to avoid here is the risk that new funds with priority over existing corporate creditors are provided as *de facto* new equity.

---

[266] Article 643 of the Companies Act 2006.

[267] See Article 35 of the Second Council Directive on company law 77/91/EEC as modified in 2012.

[268] See Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

[269] This is what happen, for instance, in Italy.

Besides, new funding, the reduction of legal capital and extraordinary transactions of company law which modify the nature or the structure of the firm – such as mergers – may resolve financial distress and therefore prevent insolvency.

Out of reorganization proceeding, such interventions are normally approved by the general meeting and cannot be arranged by directors independently. As analysed in the first Chapter indeed shareholders must be directly involved in fundamental corporate operations such as mergers, corporate division, liquidation, sales of assets or charter amendments, and every other modification of the corporate structure. Such a general rule may change in case of the opening of reorganization procedures as will be discussed below[270].

Finally, another procedure to overcome financial distress might be when the company agrees to new equity. The entrance of new shareholders may then permit to shared out the business risk and this may have a positive effect on the long-term life of a corporation.

As already stressed within the E.U., every intervention on legal capital must be approved by shareholders' general meeting. The ratio is still the same: even though voting is considered a cost, it is preferable to involve shareholders, as residual claimants, in any kind of the main decisions which are able to change or radically influence their participation in a company.

On the contrary, in the U.S.A. the Model Business Corporation Act generally authorizes directors to issue new shares[271], whitin the amount fixed by the corporate statute.

Generally a minimum price at which specific stocks have to be issued does not exist so there can be no *watered stock* responsibility for issuing stocks below an arbitrarily fixed value. The price at which stocks are issued mainly involves other shareholders, whose powers might be reduced if managers issue new stocks at a very low prices or for overvalued property. However, such an issue cannot be addressed by an arbitrary doctrine which establishes a minimum price for new stocks, but it should involve honest and impartial judgments by managers.

Furthermore, when there is an increase of the legal capital, it is not compulsory

[270] See Paragraph 3.3.5. *Extraordinary Corporate Transaction When Facing a Financial Crisis*.
[271] See Paragraph 6.21 of the Model Business Corporation Act.

for shareholders to make new contributions but they should do so if they are interested in maintaining the same percentage of equity of the company, with the related powers.

As mentioned above, in the European Union every alteration of the legal capital must be approved by the general meeting. However, it is debatable that shareholders of unlisted companies, who are not subject to the mandatory disclosure of inside information, can avoid the disclosure of any loss by contributing new funds up to half of the subscribed capital. This also enables them to avoid going through any form of capital increase. Moreover, one should notice how Article 44 of the Second Council Directive reserves the right to decide on capital increase to shareholders, but it does not established that every kind of contributions must take the form of a capital increase.

Therefore if all or some stockholders agree to invest funds in the corporation, for instance, through renouncing their right to debt reimbursement by the company, they might do so without a general meeting decision as long as this does not involve the issue of new equity.

Finally, preventive procedures exist which should be put into place before the opening of an insolvency proceeding. For instance, during preliminaries in Germany a general prohibition to have corporate assets available (*Verfügungsverbot*) may be imposed, so that every transaction must be authorised by the receiver[272]. Such provisions are still available in Germany and may help the corporation to prevent insolvency and to avoid the opening of insolvency proceedings.

However, even if the eve of financial distress a company is not obliged to initiate proper procedures, it can be encouraged to adopt adequate remedies to avoid the financial distress. By doing so shareholders should therefore be directly involved as their rights might already be affected.

3.1.1. The Right to Perceive Dividends

The first shareholders' right to be affected by a situation of financial distress is the right of receiving dividends on their investment. As already discussed in the first

[272] See Paragraph 21 Insolvenzordnung.

Chapter[273], the payments of dividends may also be allowed during the life of a corporation until such distribution is not to the detriment of creditors rights.

All legal systems authorise corporations to distribute dividends chronologically before all corporate creditors have been paid but only if certain conditions are satisfied to ensure a fair distribution, so respecting all creditors' interests.

In the European Union, Article 17 of the Second Council Directive allows dividends distribution chronologically before fully satisfying corporate creditors only when the balance sheet of the financial year shows the existence of a verified *surplus* which is the outcome of the difference between the equity of the company and its legal capital. Furthermore, no dividends can be distributed to shareholders when net assets are (or would become) lower than the subscribed capital plus certain reserves which may not be given out except in the case of a reduction of subscribed capital.

The central duty of directors in case of financial distress is to avoid the unfair decrease of corporate assets to the detriment of the corporate creditors.

Therefore, if an unlawful payment of dividends is made without respecting the rule according to Article 17, shareholders must return the distributions received whenever

> the company proves that these shareholders knew of the irregularity of the distributions made to them, or could not in view of the circumstances have been unaware of it[274].

Furthermore, a corporation is generally incapable to distribute dividends if net assets are reduced below the subscribed capital unless shareholders vote to go through a capital reduction procedure. Moreover, even if the Directive explicitly mentions *distributions*, some national legal orders, such as Germany or the U.K., extend the same regime to concealed distributions or every kind of transaction through which corporate assets are transferred to shareholders indirectly, such as unfair contracts like loans to shareholders with very low or no interest rates.

Therefore, if the European rule is to be effective, it does not matter whether distribution is made through the official declaration of dividends or in any other

[273] See Paragraph 1.2.1. *The Right to Perceive Dividends*.

[274] See Article 18 of the Second Council Directive on company law, 77/91/EEC, as modified in 2012.

way.
To further enforce the creditors protection against the unfair distribution of dividends, European countries have admitted that financial distress may not be necessarily reflected by the amount of legal capital, even though they are traditionally attached to the idea of it. Hence, if this is the only criterion which allows distributions, a paradox may occur whereby distributions are authorised only because assets are larger than the legal capital even though the corporation is unable to pay its due debts because the lack of liquidity. That is why European States have started to look overseas to the American *solvency-test* technique; to so be able to face problems which could not be solved with the legal capital rule.
In the U.S.A. indeed, to be able to legally pay dividends, corporate directors must show how the company will remain solvent after the assignment of dividends. Such a limit to dividends distributions in case of financial distress is what has been called the *solvency test*.
Besides, the New York and the Delaware rules place a criteria similar to the European one side by side to the solvency test, by allowing distributions only on a *surplus* basis, which still consists in the difference between corporation equity and its legal capital. The Model Business Corporation Act correctly balances such rules by forbidding any distribution to shareholders after it comes into force. When:

> (1) the corporation would not be able to pay its debts as they become due in the usual course of business; *or*
> (2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution[275].

Moreover, almost all the American States have applied the older Uniform Fraudulent Conveyances Act or the newer Uniform Fraudulent Transfers Act and the federal Bankruptcy Code. Such provisions cover transactions where the debtor

---

[275] Paragraph 6.40 of the Model Business Corporation Act.

did not receive the << *reasonably equivalent value of exchange* >> and << *for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction* >>[276]. The rule is interpreted broadly to also include dividends and share repurchases[277].

3.1.2. The Right to an Informed Vote

A situation of financial distress may also affect voting rights. If the right to perceive dividends can probably be seen as the main reason behind a decision to take part in a corporation, then the right to vote may be seen as fair compensation for such participation. Hence, the right to take the main decisions of management and the right to nominate and remove directors may also be influenced by a financial crisis or insolvency as well.

Therefore, two general questions spontaneously arise during a situation of financial distress; whether shareholders should be allowed to authorise insolvency proceedings or should they at least be involved in the corporate decision to file for insolvency proceedings and which is the destiny of shareholders' general meetings undergoing an insolvency proceeding.

Generally, shareholder involvement in an insolvent business is related to a traditional approach to corporate governance systems which differs in various countries.

In the U.S.A., shares are usually broadly held and management is very strong, while in Europe controlling shareholders are dominant and equityholders in general have greater power to begin major changes[278].

---

[276] Uniform Fraudulent Transfer Act, s 4(a)(2)(i).

[277] See Robert Charles Clark, *Corporate Law*, Boston, 1986, at page 88-90. But see also Marcel Kahan, *Legal Capital Rules and the Structure of Corporate Law: Some Observations on the Differences Between European and U.S. Approaches*, in *Capital Markets And Company Law* (Klaus J. Hopt & Eddy Wymmeersch), 2003. Moreover, see for example *Mellon Bank N.A. v. Metro Communications Inc.*, 945 F.2d 635 (3d Cir. 1991), where was discussed the "reasonable equivalent value" requirement in the context of an LBO.

[278] As analysed in Chapter 2, the U.S.A. provides fewer safeguards to shareholders as a whole but it offers more protection to minority shareholders. On the contrary, in Europe the power of controlling shareholders is generally not limited by the board. However, minority are usually protected from changes of the legal capital through pre-emptive rights.

Moreover, it is possible to define two categories of insolvency regimes; the *manager-driven* and the *manager-displacing* systems[279]. The adoption of one system rather than another influences the shareholders' role in a corporation in financial distress.

The typical model of a manager-driven system is the American one. The board of directors possesses powerful motives to be able to apply for reorganization while still remaining in complete charge so it is able to attempt to turn around the finances of the company.

On the other hand, European insolvency proceedings, including British ones, are seen as manager displacing because the company can be wound up and sold off in part by a receiver. In such cases,

> directors are not rewarded with the "carrot" of prolonged control over the corporation, but threatened with the "stick" of liability in the case of a late filing. However, it appears that this stick does not work effectively, as the case placers are usually creditors[280].

3.1.2.1. The Right to File for Insolvency Proceedings

The different adopted system then influences the traditional managerial role of a company and the amount of independence left to directors; therefore it influences shareholder power to independently file for insolvency proceedings.

In those American States which have adopted the Delaware scheme, a liquidation procedure requires the consent of shareholders who represent the simple majority of those possessing all the outstanding shares together with the approval of the board of directors too.

Liquidation proceedings without any involvement of directors can be put into place, according to the Delaware system, only if the shareholders reach a unanimous decision.

Moreover, in the U.S.A., shareholders are simply considered as one of the several categories of *claimants* and are consequently allowed to vote together with other groups of creditors. Therefore, a reorganizational plan can eventually be filed by

[279] See L. Enriques and M. Gelter, supra note 37, at page 54.
[280] *Ibidem* at page 55.

managers or creditors, without any approval whatsoever of the shareholders, even if the plan may involve a loss of shareholders control over the corporation.

On the other hand, European States are more sensitive towards shareholders involvement.

European countries usually link a *debtor* with *the board of directors* whenever the law deals with *debtor filing* for insolvency proceedings. Consequently, shareholders are not necessarily asked to express their will about the decision to file for insolvency proceedings.

However, what differs is the way shareholders are *indirectly* involved in such a decision. As we have seen, there are laws which provide directors with the duty to hold a shareholders' general meeting whenever there are proper reasons for winding up a business[281]. Law provisions also exist which require shareholders consent for fundamental operations, such as a merger or operations on legal capital which may be very usefull during a reorganizational procedures. In fact, it is assumed that in case of *fundamental decisions*, shareholder rights should be taken into consideration, through ex-ante authorizations or ex-post controls.

All such provisions may achieve the same result of involving shareholders in the on-going financial crisis of a company.

Nevertheless, if illiquidity or over-indebtedness exists and if a corporation is without any proper administration, then the corporate shareholders (and also the corporate supervisory board) have the personal duty to file for insolvency proceedings.

Germany and the U.K. have elaborated general criteria for determining decisions where a shareholders' involvement is required. In the U.K any *significal transactions* should be submitted to the ex-ante approval of shareholders[282]. However, British insolvency law does require the approval of 75 per cent of shareholders with voting right to be able to start voluntary liquidation[283].

---

[281] See for example Article 2449 (2) of the Italian Civil Code which states << The directors, when there was an event giving rise to the dissolution of the company, can not undertake new operations. (...) They must within thirty days convene a meeting for the resolutions relating to the liquidation >>.

[282] See Chapter 10 of the U.K. Listing Rules (LR) which applies only to listed companies.

[283] See Chapter 2, paragraph 2.4.1., *Liquidation Proceedings*. Moreover, some jurisprudence has highlighted how companies can never completely impede the right of a

In Germany, shareholder power is restricted to those situations listed by law[284] which do not include filing for insolvency proceedings while it includes every operation regarding legal capital (n.6) and the dissolution of companies which are indirectly linked to restructuring procedures and winding up respectively. However, the same provisions state that an annual shareholders meeting can be held only if it is required by the board of directors so *de facto* limiting shareholders powers[285].

Other European countries have a different approach such as Italy, where *ad hoc* provisions identify a list of competences of the general assembly[286] plus the possibility of the constitutive act to extend such list.

However, voting for filing insolvency proceedings is not included in such competences so the decision to file for insolvency proceedings is taken by the management unless the constitutive act expressly requires a shareholders vote[287]. In the case of a *concordato preventivo*, a correct recovery plan should be prepared by the board of directors, as well. However, Italian insolvency law also requires shareholders approval for all equity transfers to those creditors undergoing reorganization proceedings.

In Spain, no shareholders authorisation is needed to file an insolvency procedure either.

The issue of limiting the discussed decision to the consent of shareholders is part of a wider discussion in most countries about what may be considered *fundamental* in corporate decisions.

In this context, the differences among jurisdiction are also affected by transactional flexibility.

In the U.S.A. and the U.K. where proceedings are more flexible, the systems are under pressure to prefer an *ex post* standard of shareholders intervention while in

single shareholder to present a petition on the general meeting (*Re Peveril Gold Mines Ltd*). However, in the Court of Appeal then create an extra-statutory requisite that a shareholder must have a sufficient amount of money (£75 was enough) invested before presenting a petition (*Re Rica Gold Washing Co*).

[284] See Paragraph 119 Aktiengesetz (AktG), entitled Rights of the Shareholders' Meeting.

[285] See Paragraph 119 (2) AktG.

[286] See Articles 2364 and 2365 of the Italian Civil Code on the competences of the ordinary and extraordinary assembly respectively.

[287] See Article 152 (2) *Legge Fallimentare*.

continental Europe transactional flexibility is constrained so shareholders' involvement is usually *ex ante*[288].

Furthermore, what is similar among various countries is the different amount of shareholder involvement in relation to the type of insolvency proceedings. In such a case, indeed, nothing more can be done to resolve the financial crisis and insolvency may be the only solution left to the company. In such a circumstances a lesser shareholders involvement might be more understandable than in the case of reorganization proceedings.

In case of reorganization indeed the company might merge and the whole property structure may have to be restructured too.

In this hypotesis it is hard to imagine the total indifference of shareholders involvement, especially in Europe where shareholder "ownership" is safeguarded more than in the U.S.A.[289]. Such protections and the ways shareholders are treated during reorganizational proceedings clearly define the role shareholders have and what property rights are within a specific legal order.

Comparing to managers, shareholders of an American corporation have less power than managers in Europe and some scholars in the U.S.A. do support the need to enforce of shareholder power starting from the assumption that their current power is limited to the right to nominate and dismiss directors;

> the U.S. corporation can be regarded as a completely *representative democracy* in which the members of the polity can act only through their representatives and never directly[290].

On the contrary, such a feature can be seen as an inevitable consequence of diffuse ownership structure, which is typical of American firms, and this might prove to be also advantageous for the corporation itself because decisions may be taken by competent subjects.

[288] See E. Rock, P. Davies, H. Kanda and R. Kraakman, *Fundamental Changes*, in *The Anatomy of Corporate Law*, *supra* note 7. At page 223.
[289] See below Paragraph 3.3. *Reorganization Proceedings*.
[290] Lucian Bebchuk, *The Case for Increasing Shareholder Power*, in Harvard Law Review, December 2004, at page 2.

3.1.2.2. Shareholder Right to be Informed About the Filing for Insolvency Proceedings

Insolvency laws often fail to recognise the shareholders' general rights to file for insolvency and they do not allow them the proper right to be notified about the start of insolvency proceedings either even if the duty of giving such information exists in those companies listed in regulated markets.

In the U.S.A., stockholders have to be notified about the Chapter 7 procedure only if they are entitled to receive something from the winding up of the business. Therefore, as previously mentioned, shareholders are treated in the same way as any other stockholder of a corporation and do not have to be notified about Chapter 7 because they do not usually receive anything in return for their investment.

In the U.K. the petition for compulsory liquidation must be published within 7 days in the *London Gazette*, the official journal for UK business announcements.

In Italy, in the same way, shareholders are not notified of the start of any insolvency proceedings and a court decision about liquidation or a reorganizational plan has to be published in the public registry of business organizations. However, shareholders have still the power to request information like during the solvent life of the corporation and they are also entitled to ask to examine the relevant company books too. They also have the right of intervention in a shareholders meeting too even if *de facto* they cannot take advantage of such opportunity during a liquidation procedure because it is improbable that general assembly will be held during a winding up anyway.

In Spain, shareholders are not involved in the beginning of insolvency process either. However, in case of a listed company, the beginning of insolvency proceedings may be defined as *relevant information* and as such it must be disclosed by a security authority and be published on the corporation webpage as well[291]. Like Italian shareholders they would then be able to investigate further

[291] See Article 82 (3) of the Security Market Act, Act n. 24 of 28 July 1988. Where Article 82 (1) provides << Relevant information shall mean information the knowledge of which may reasonably encourage an investor to acquire or dispose of securities or financial instruments and which, therefore, may have a significant influence on the security's or financial instrument's price in a secondary market >>.

into those situations which are not directly or indirectly connected with the issues included in the agenda of the shareholders' general assembly[292].

3.1.2.3. Shareholders' General Meeting during Insolvency Proceedings

The rights of governance are not affected by the beginning of a reorganization procedure where a corporation maintains automatically the possession over its assets and the current management maintain its powers as well.

On the contrary, in case of liquidation, exercising such rights may be unlikely as a general meeting is not usually held and the management of corporate assets remains in the hands of a receiver appointed by the court so all directors are no longer able to wield their powers. The only possible exception to this may be the right to approve the final balance when winding up.

It must be pointed out that financial distress does not formally invalidate a shareholders' general meeting and it can be requested by shareholders whenever it is admitted by corporate law[293].

---

[292] See Spanish Answers to the *Questionnaire on Insolvency and Company Law*, Research project coordinated by the World Bank, Banca d'Italia on behalf of the Global Forum on Law, Justice and Development, 2013-2014. << The Spanish Supreme Court has stated that the right to obtain information is one of the fundamental rights of a shareholder and therefore such right must be interpreted in the broadest terms (STS [1st] 26 September 2001 (RJ 2001, 7492)). The right of shareholders to obtain information is so fundamental that, if it is ignored, the resolutions of the shareholders' meeting can be avoided (STS [1st] 29 July 2004 (RJ 2004, 5469)). The courts have clarified that the important right of shareholders to request information also exists in an insolvent company, but the courts have added that the disclosure of data cannot prejudice the interests of the company, and especially, that the exercise of the right to receive information cannot be used to create unnecessary obstacles for the company (STS [1st] 31 July 2002 (RJ 2002, 8437); SAP Madrid (Secc. 28) 16.2.2009 [AC 2009, 858]). The Supreme Court has indicated in several important cases that the right to information cannot be used "*as an instrument to obstruct the corporate activities, to overcome corporate interests in favour of the special interests of the shareholder seeking the information, where there is no true and real necessity*" (SSTS [1st] 13 April 1962 (RJ 1962, 2025) and 26 December 1969 (RJ 1970, 496)). Therefore, the exercise of the right to request and obtain information must not create situations that block or hinder the normal functioning of the company, and the right must be exercised in good faith (STS [1st] 4 October 2005 (RJ 2005, 6911)). The courts have developed a doctrine that bans "abuse of right' in the exercise of the shareholders' right to receive information (SSTS [1st] 31 July 2002 (RJ 2002, 8437) , 8 May 2003 (RJ 2003, 3888), 10 November 2004 (RJ 2004, 6722), *inter alia*). The general concept of "abuse of right" is found in article 7.2 of the Civil Code, which is generally applicable to all private law, including company and insolvency law >>.

[293] See Chapter 1, at paragraph 1.2.3.1. Topics Where Shareholder Vote is Needed.

In principle, a general meeting keeps all of its competences in every insolvency proceedings where the board of directors and the controlling shareholders remain in control of the firm and maintain their powers.

However, it is unlikely that a shareholders' meeting will take place in a liquidation procedure following a formal declaration of insolvency when the corporate board of directors is committed to a receiver or liquidator.

One of the most important rights the shareholders' general meeting may have is to nominate and dismiss managers. As "owners" of a corporation, shareholders are never completely excluded from the decisions of an insolvent corporation and having the power to dismiss directors shareholders may indirectly influence the managerial behaviour through general meeting resolutions by giving instructions to the board on how to run the company business.

In the U.K., a qualified supermajority of shareholders is able to overrule the board on *any* matter within the management competence. However, a supermajority vote is difficult to obtain while a simple majority is usually able to remove the board. Even so,

> the latent power to make all business decisions, even in public companies, enhance the UK's position as the most shareholder-centric of our core jurisdiction[294].

In French and Italian jurisdictions, which are shareholder-centric systems as well, the majority of shareholders have a non-waivable right to dismiss directors at any time[295]. In Spain, the general power to remove managers at any time is also an essential competence of the shareholders' general meeting[296]. However, it is possible to restrict such a right by providing a supermajority requisite which can remove managers, but the majority can never be so high as to impede the exercising of such a right.

---

[294] L. Enriques, H. Hansamann and R. Kraakman, *The Basic Governance Structure: The Interestss of Shareholders as a Class*, in *The Anatomy of Corporate Law*, *supra* note 7. At page 73 which compares several legal systems: U.S.A., U.K., France, Germany, Italy and Japan.

[295] See Article L.225-18 *Code de Commerce* (France) and Article 2383 (2) *Codice Civile* (Italy).

[296] See Article 233 of the Spanish Corporate Enterprises Act.

When a corporation is undergoing insolvency proceedings, the new managers designated by the general meeting will then be subjected to the same rules of suspension or intervention as those who were dismissed but the insolvency receiver is also entitled to apply to the court for a modification in their role[297].

On the contrary, in *board-centric*[298] jurisdictions as the Delaware one (which is the dominant in the U.S.A.) shareholders do not usually have enough power to remove managers. Indeed, even if such power is the default rule, this is usually overruled by a statutory provision.

Moreover, Article 211 of the DGCL indirectly impedes the exercise of such a right because shareholders are not entitled to call a special general meeting unless the statute does not explicitly state they are able to do so.

Finally, Germany straddles such systems. German company law provides a default rule which allows a majority of not less than three-quarters of voting stocks to dismiss directors who have been previously elected by shareholders[299]. However, such a majority is not easy to achieve so the right of removing directors may not take place[300].

In conclusion, it is already noticeable how the right to vote remains one of the main powers that shareholders have and this is the one which is affected more at the beginning of insolvency proceedings. Anyway, it may be also noticed how some of the issues discussed above, such as shareholder involvement in the decision to file for insolvency, the right to be informed, the powers of a general assembly and the right to dismiss managers, do not fully complete the wider issue of how the right to vote is influenced during a financial crisis. This issue will be

[297] See Article 40 (4) of the Spanish Insolvency Act. From such rules for instance derives that when the shareholders' meeting decides to remove the directors who have been managing the company in a satisfactory way and replace them with directors that have been in the past responsible for the deterioration of the finances of the company, the insolvency representative could apply to the court to seek the suspension of the newly appointed directors and therefore the transfer of managing powers to the insolvency representative.

[298] See L. Enriques, H. Hansamann and R. Kraakman, *supra* note 294.

[299] See Article 103 *Aktiengesetz*.

[300] Pursuant to the absolute priority principle, holders of equity claims cannot ever participate in the creditor's meeting or vote on the liquidation or restructuring plan.

further analysed in detail separately for each insolvency proceeding[301].

3.1.3. Limited Liability Rule

In case of financial distress, shareholders do not risk much personally as they are protected by the limited-liability rule. They cannot ask for having their provision back before that every corporate creditor has been entirely paid and a receiver or an insolvency court might also ask shareholders and former owners of corporate stocks to pay the provisions still due[302].

Moreover, almost every legal order takes into consideration the eventuality that shareholders might be personally liable for insolvency in case of wrongful, personal behaviour[303].

In case of insolvency, there are three situations where shareholders may be held liable[304].

First of all, controlling shareholders may be judged liable as if they have acted as *de facto* or *shadow* directors, whenever one or some of them illegally convince managers to break their fiduciary duties or misappropriating corporate assets.

French law, for instance, condemns such conducts in case of insolvency with heavy sanctions and the controlling shareholder might have to compensate corporate creditors for their losses[305]. Similar provisions exist also in Germany and in Italy[306].

The level of liability depends on the way directors are treated according to legal orders in case of insolvency[307]. The U.S.A. is the country with the lowest intensity

---

[301] See below paragraph 3.2. and paragraph 3.3. in case of liquidation proceeding or reorganization, respectively.

[302] See for instance Article 150 of the Italian *Legge Fallimentare*.

[303] See for instance Paragraph 6.22 of the Model Business Corporation Act, entitled *Liability of Shareholders*.

[304] See J. Armour, G. Hertig and H. Kanda, *Transaction with Creditors*, in *supra* note 7. At page 138.

[305] See Articles L. 651-2 and L. 652-1 *Code de Commerce*.

[306] For Italy, see Corte di Cassazione, case law n.9795 of 14th September 1999.

[307] See a comparative analysis on the issue in L. Stanghellini, *supra* note 250, where the author highlights how continental European jurisdictions have introduced a different rule from the British one. For continental European laws to recognize directors' responsibility in case of insolvency << *its not enough that equity is thin, it is the fact that it is going to disappear that is important*>>.

of liabilities for directors[308]. This is similar to the U.K. where directors' duties are only linked to the corporation itself but the British legal system does recognise directors' liability in case of negligence for wrongful training[309].

In such a case, the court must then determine if directors have actually taken reasonable measures to reduce losses to corporate creditors and if they are aware that no rational possibility of avoiding insolvency existed.

A manager has indeed a legal obligation to take early steps to face a corporation in financial distress which may include appointing an administrator or filing for a voluntary winding up. It is highly risky for any director to continue to run up debts in such a business when the possibility of survival is remote. This in part explains the increased choice of out-of-court administrations and voluntary liquidations[310].

On the contrary, continental European managers can be held liable simply for failing to take action following serious loss of capital[311].

The second case is when shareholder involvement in the liability of an insolvent corporation may be associated with shareholders refunding the company so there are two main interests to be taken into consideration; avoiding shareholder opportunism on the one hand and safeguarding those shareholders who try to recover the company through new funds on the other.

Several jurisdictions have laws or doctrines, whereby loans given by stockholders to the company under certain conditions are subordinated to other debts in case of liquidation. The reason behind such loans is that the risk improvement, which derive from a continuous operation of the company, may prove to be damaging to third-party creditors. If the corporation continues to operate only because of such

[308] Under Delaware law, directors are generally protected by the *business judgment rule* already analysed in Chapter 2. Moreover, many States refer to the *duty of loyalty* which is not related to corporate individual creditors but to the insolvent corporation itself. See for instance Delaware Supreme Court, *North American Catholic Education Programming Foundation v. Gheewalla,* 2007.

[309] See Article 214 (2) U.K. Insolvency Act 1986.

[310] See P.L. Davies and S. Worthington, *Principles of Modern Company Law*, *supra* note 24.

[311] Such level of directors' liability may favour corporate creditors in case of insolvency but it is also potentially damaging whenever it discourages managers to start or accept restructuring plans for the (foreseeable but never certain) recovery of the company. For instance, in the U.K. where the board may be liable for wrongful trading (and so shareholders if they are so). See *ibidem*, at page 41-42.

loan the profits available in winding up may then be lower.
On the other hand, equityholders will gain most of the advantages of a continuous business, as a successful turnaround of the business will increase their wealth, even though the profits creditors can make are usually very small.
However, legal orders differ and some countries such as France and the U.K. do not recognise any subordination of shareholders debt claims as other systems do.
On the contrary, the so-called *Deep Rock* doctrine in the U.S.A. provides subordination whenever controlling shareholders have acted unfairly[312].
In Italy, subordination is possible according to the conditions stated in Article 2467 of the Civil Code[313]. The German system may indeed be defined as the best known example of the matter not only because it works automatically[314] but also because it covers loans given during the financial crisis and it may also include loans not withdrawn at the beginning of financial distress. Similar doctrines also exist in Slovenia[315], in Austria[316] and in other jurisdictions too[317].
The recent European Commission Recommendation on a new approach to business failure and insolvency has indeed highlighted the need for a protection of new financing whenever it is provided as part of a restructuring plan which is confirmed by a court; << exceptions to the rules on protection of new financing should be made where fraud is subsequently established in relation to the new financing >>[318].

[312] The name of such doctrine derives from the insolvent company, *Deep Rock Oil Corporation*, of a famous case law of 1939, *Taylor v. Standard Gas and Electronic Corporation*.
[313] Article 2476 Codice Civile establishes that shareholders loans granted to the company when it was in financial distress are generally refunded after all the other corporate creditors have been paid. But see also Article 2497-quinquies Codice Civile which regulated lending between a holding company and a corporation subject to management and coordination. Such loans are usually satisfied after corporate creditors claims.
[314] *See* Paragraph 39 *Insolvenzordnung*.
[315] Zakon o gospodarskih družbah, Paragraph 433 ans 434. See Markus Bruckmüller, *Eigenkapitalersatz in Slowenien*, in *Eigenkapitalersatz Im Österreichischen, Italienischen Und Slowenischen Recht* 69 (Susanne Kalss & Friedrich Rüffler) Eds. 2004.
[316] Bundesgesetz über Eigenkapital ersetzende Gesellschafterleistungen (EKEG), Art. I GesellschaftsGIRÄG 2003, BGB I 2003/92.
[317] See for example Pietro Abbadessa, *Il problema dei prestiti dei soci nelle società di capitali: una proposta di soluzione*, in Giurisprudenza Commerciale I/497-I/503, 1988.
[318] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014. See Paragraphs 27-28-29.

Finally, the third way of involving shareholders in corporate liability in case of insolvency is the so-called doctrine of *piercing the corporate veil*.
Such a procedure is against controlling shareholders in extreme circumstances and it exists in several jurisdictions although it is never allowed by any legal system in relation to minor or passive shareholders.
In the U.S.A., "veil piercing" is allowed when controlling stockholders ignore the integrity of their corporation by not observing formalities, when personal and corporate assets are mixed or when they fail to capitalize the corporation correctly. To be judged as liable shareholders must have acted fraudulently or unjustly or they must have clearly behaved wrongfully.
European legal orders also apply the veil piercing doctrine in the same way. In France, for instance, insolvency proceedings can involve shareholders who prejudice the integrity of their corporations, which is defined as *action en confusion de patrimoine*[319].
Therefore, *piercing the corporate veil* can be seen as just another of the situations where the limited liability may fail in relation to controlling shareholders. However some jurisdictions see a disintegration of a corporation's legal structure in applying such a procedure. Therefore, they believe that if it is applied only to one party it then implies disgregation for all.
All the above three ways of breaking the limited-liability rule are important even from an ex-ante perspective. All of the corporate creditors benefits are limited to the amount of principal plus interest stipulated ex ante, and they may also be aware of having most of the risk of failure. This is why contractual clauses are often required which limit the opportunism of debtors, managers and shareholders or they will otherwise be charged a risk-adjusted interest rate. For instance, a rational creditor may take the opportunity of veil piercing into account and adjust the interest rate accordingly. Some lenders may also make changes related to whether directors or shareholders have or do not have the possibility to remove assets from the company so increasing the possibility of insolvency and thus reducing the opportunity of rescue[320].

[319] See Articles L.621-2, 631-7, 641-1 *Code de Commerce*.
[320] See L. Enriques and M. Gelter, *supra* note 37, at page 35.

An influential institutional creditor in the European Union could theoretically even have the power of negotiation to induce a corporation to submit itself to a specific Member State's regime of creditor safeguard.
Finally, insolvency court are able to overthrow the limited liability rule almost everywhere but judges do not usually do so, especially in listed company or whenever shareholders do not take part to the management[321]. More important law cases involve the hypothesis of contractual malice or the opportunistic behaviour of shareholders.

3.1.4. Pre-Insolvency Solutions

As stressed in the previous Chapter[322], the main aim of any pre-insolvency solution is the early recovery of a corporation in financial distress to avoid the opening of insolvency proceedings.
In such a situation, a minimal or a total absence of shareholder involvement is more understandable than during insolvency proceedings.
The important decision to handle a financial crisis by initiating any kind of pre-insolvency procedure (when there are any) is not as crucial as liquidation may be and it does not determine the corporate nature of a business or shareholder participation like restructuring procedures may do.
On the contrary, the contents of an out of court agreement regarding some corporate creditors do not usually contain such *fundamental* decisions which only involve shareholders in management.
In the U.K., an out-of-court agreement is a widely adopted tradition, however the beginning of a Company Voluntary Arrangement does not have to be notified to shareholders. Indeed, only directors may propose the arrangement[323].
In Italy as well, the decision to begin an out-of-court agreement according to Article 182-bis of the *Legge Fallimentare* does not require the authorisation of shareholders in a general meeting nor ex-post approval. The plan must be negotiated between directors and corporate creditors. However nothing hinders a

[321] S.M. Bainbridge, *Abolishing Veil Piercing*, 26 Journal of Corporation Law 479, 2001.
[322] See Chapter 2, paragraph 2.4. *Pre-Insolvency Procedures*.
[323] See Article 1 of Insolvency Act 1986.

different provision in the constitutive act. Shareholders may be informed about the proposal when the application for the court validation is published in the public registry of business organisations, along the arrangement itself.
The same approach is adopted in France whenever the procedures of *alerte* and *prevention* or a proper *conciliation* are aimed at forestalling the need of insolvency proceeding and the collaboration of shareholders is not required.
What is important in such a context of applying a pre-insolvency procedure is to avoid creditors suffering unnecessary losses; and early interventions are surely an advantage for every stakeholder.
Therefore, when a pre-insolvency procedure is applied to a business in financial distress, the creditors more than the shareholders require safeguards to be put into place as they may not be completely informed about the conditions of the business and even if their consent is given they will have to face a change in their claims.

3.2. Irremediable Insolvency: When Alternatives to Liquidation Do Not Exist

Liquidation proceedings have to be applied to a company in financial distress whenever the possibility of recovery is not existent because it no longer possesses any assets to run the business or because there is no longer any going-concern value left in the company itself.
The conditions why such proceedings have to take place and how the winding up of an insolvent company is able to satisfy corporate creditors with the profits of an auction sale have already been previously discussed. What I intend to go on to discuss is how the shareholders' position changes completely during the process of liquidation.
Firstly, there is no general right for shareholders to be involved in the decision to initiate liquidation procedures and in countries such as the U.S.A. shareholders cannot even spontaneously intervene without the involvement of the directors themselves[324].
Moreover, no legal orders leave the responsibility of initiating the winding up of a

[324] See *supra* Paragraph 3.1.2. *The right to an Informed Vote*.

company in the hand of shareholders as the board of directors is responsible for such a task, even if British law allows voluntary debt liquidation whenever a shareholder vote is required.

Unlike reorganizational procedures, the balance between shareholders and creditors interests is simpler in case of liquidation. In serious cases of insolvency, liquidation is indeed the only option available and its main aim the creditor protection. Creditors claims must be met as much as the insolvent assets allow them to be and distribution must be ensured in respect of the *par codicio creditorum*.

3.2.1. Debtor Dispossession and the Appointment of a Receiver

The main consequence of the beginning of a liquidation procedure may be dispossession of a company over its assets. A receiver is then appointed to take care of the winding up process, while management and shareholders are no longer allowed to run the corporation.

Dispossession is the core of the beginning of a liquidation procedure in Italy[325] as well as in Germany[326] and in the U.K..

The British Insolvency Act states for example that a corporation cannot dispose of its assets in any case, after filing the application, without the consent of the court[327]. Similarly, the German *Insolvenzordnung* allows dispossession which also involves properties that may later on become part of the corporate assets[328]; on the contrary every corporate act which has been put in place after the opening of the proceeding is no longer considered legally applicable[329].

In the U.S.A. the application of the procedure according to Chapter 7 of the Federal Bankruptcy Code also involves the stay of all the corporate operations and the company generally goes entirely out of business. The control of a bankrupt company is then transferred to a trustee, who is usually appointed by the creditors, and who will sell off the corporation's assets.

[325] See for instance Article 43 *Legge Fallimentare*.
[326] See Paragraph 80 *Insolvenzordnung*.
[327] See Section 129 and 122 of the Insolvency Act 1986.
[328] See Paragraph 35 *Insolvenzordnung.*
[329] See Paragraph 81 *Insolvenzordnung.*

Dispossession entails the inability to trade or to use the assets of a company. The nominated receiver is then involved in every right the debtors are entitled to. However, a liquidation procedure does not require the immediate interruption of the business everywhere.

The opening of a liquidation procedure creates a reduction and loss of the debtors' operative capacity which is not permanent but it will last until the end of the proceedings and which may last from a few days to several years, depending on the complexity of corporate asset estimates and the result of an auction sale[330].

The status of dispossession of a company in case of liquidation is also related to the system of administration, and several jurisdictions require an authorized court intervention to apply the correct procedure.

In case of liquidation, it may be difficult to imagine the shareholders' residual control over a corporation because the assets are all in the hands of a liquidator and because the ending of liquidation *in bonis* is rare.

However, in countries as Germany and Italy, courts may decide the *Eigenverwaltung* or the *continuazione* respectively if it is documented that continuation may be advantageous for creditors. In such cases the receiver may find himself in a situation similar to that of managers during the solvent life of a corporation.

A different issue which emerges in relation to the role of shareholders of a corporation undergoing liquidation proceeding is whether they might be entitled to nominate a receiver or not.

In the U.S.A., this entitlement is set out according to those conditions only in the States which have adopted the Model Business Corporation Act which provides shareholder action to appoint a custodian or receiver as a ratio of Paragraph 7.48. When a corporation is insolvent, such a provision entitles each shareholder to file for the appointment of a receiver, whenever:

> (1) The directors are deadlocked in the management of corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered;

[330] See Vincenzo Sparano and Biancamaria Sparano, *La Modifica delle Situazioni Giuridiche nelle Procedure Concorsuali*, Cedam, 2002, at page 106-107.

(2) *or* the directors or those in control of the corporation are acting fraudulently and irreparable injury to the corporation is threatened or being suffered.

Such a power with the related costs of voting are justified if one considers that the receiver can exercise all the powers of a company through or in place of its directors and it can dispose of all corporate assets under court authorization. The court will also define the powers and duties of the receiver in an order which may be amended from time to time. This power is also included in the Delaware rules in Article 279.

As already mentioned, shareholders are treated in the same way as stockholders during an insolvency proceeding according to the U.S. Federal Bankruptcy Code.

Within the European Union member States, the decision to nominate a receiver is generally taken at a shareholders' general meeting, which may sometimes also dismiss him or her.

In the U.K., for example, in case of debtor voluntary liquidation, shareholders must be advised about the board's choice of receiver and they also have to approve such an appointment.

This is essential when one considers that any decision taken at a shareholders' general meeting during an insolvency proceeding may have an economic reasons and any implication regarding the insolvency process has to be authorized or confirmed by the insolvency representative to be effective.

However, in other countries like Spain, shareholders cannot dismiss the receiver appointed by the Court.

In Italy the liquidator is never dismissed by the shareholders' general meeting irrespective of who have appointed him of her but he can only be dismissed by the Court and the resolution must be preceded by a consultation with the creditors' committee[331].

There are naturally risks involved in fair liquidation, as major creditors may follow their own interests during the procedure to the detriment of minor creditors, but there are several solutions available to reduce or avoid such a risk. The most common one is the usual practice of dividing creditors into different

[331] See Article 37 *Legge Fallimentare*.

classes with common shared features and asking for the consent of the majority of each class to approve any resolution[332].

3.2.2. The Admission of Creditors' Claims

Creditors are always involved in liquidation procedures in almost every country.
Such an involvement of a creditors' committee during a liquidation proceeding may be legitimated when considering the assumption that liquidation makes corporate creditors the *residual claimants* of an insolvent corporation.
Whenever an insolvent company is no longer able to regularly satisfy its due debts[333], its creditors become the beneficiaries of the company's management and of business profits. In the case of inefficient administration, creditors will suffer directly because they may receive less or no satisfaction for their claims which are now connected to the general trend of the proceedings.
During liquidation proceedings, one of the receiver's main duties is to verify the claims from every creditor[334].
In countries as Germany, the finding credit has the same effects as a final judgement within the insolvency proceeding itself. That is why each credit claim can be contested during an ad hoc creditors assembly by the debtor or by other creditors. Naturally, when paragraph 177 of *Insolvenzordnung* mentions the *debtor*, it refers to the directors of the company and because the decision taken has such definitive effects, eventual intervention by shareholders is allowed by law whenever directors remain inactive[335].
In Italy, shareholders do not have the right to challenge the court decisions on the admission of claims even though it might affect the amount of value which may remain at the end of the winding up. What is essential in such circumstances is the

[332] For an analysis of the issue in Italy, see L. Stanghellini, *supra* note 229.
[333] In case of proper insolvency where winding up only is the remedy it may be difficult to imagine an ending of liquidation *in bonis*. However such a situation is not impossible.
[334] Such profile is the same in case of reorganization proceeding, where a verification of any corporate creditors is central to prepare the restructuring plan or to imagine a merger or a proper corporate reorganization as well.
[335] See Article 201 and the following InsO.

right to be informed and to eventually make claims whenever any irregularity occurs[336].

While the right to protest against any unfair behaviour of a receiver in a court of insolvency is generally accepted, not every jurisdiction entitles shareholders to initiate liability action against those directors who are considered responsible to have voluntarily driven the company into a financial crisis and this is expressly forbidden by law in Spain[337] as well as in Italy[338].

Finally, even if the ending *in bonis* of a liquidation proceeding is quite rare it is not impossible. In case of a fruitful closure of the winding up shareholders may receive some dividends. This hypothesis is provided by the U.S. Bankruptcy Code which, by considering shareholders as every other stakeholder of the corporation, establishes that shareholders will be notified of Chapter 7 only if they may receive anything from the winding up as only if all secured and unsecured creditors have been paid in full.

3.3. Reorganization Proceedings

An insolvent company which is unable to pay all its due debts may still be able to keep some intrinsic financial value and the chance of being rescued. It may still have a positive going-concern value and the financial crisis may be related only to a temporary crisis of the market sector the company works in. Moreover, insolvency may have been caused by improper or misguided managerial decisions but a company may still be able to adopt prompt intervention which could create a positive turnaround[339]. In such cases, the best alternative to avoid winding up a company, which is still worth saving and investing in, might be to apply for

[336] However, when undergoing a liquidation proceeding, the management is committed to the receiver, shareholders are able to challenge single resolutions operations made by the receiver. The challenge is made through the procedure provided by Article 36 *Legge Fallimentare*.

[337] See Article 48-quater of the Spanish Insolvency Act.

[338] In Italy, discussed lawsuit may be only initiated by the insolvency representative, ex Article 2394-*bis* of the Civil Code. In a similar way, only the current receiver is able to initiate lawsuits against the former insolvency representative even if under authorization from the creditors' committee or from the court, as what is established by Article 38 *Legge Fallimentare*.

[339] See L. Guatri, *Turnaround. Declino, crisi e ritorno al valore*, Milano, EGEA, 1995.

restructuring proceedings which would enable a company to survive and to be able to satisfy its corporate creditors in a better way that they could have been in the case of liquidation.

A company undergoing reorganization may be even kept afloat with the intent of entirely or partially liquidating it, so creditors can avoid the loss of value during the time it takes to wind up the company.

There are various types of reorganizational plans. A reorganization plan may for instance be aimed at the elimination of the existing stocks and the parallel issuing of new ones which will be distributed solely to corporate creditors unless shareholders provide new equity to rescue the corporation. A further option may be a plan which organizes to issue new shares to be distributed among corporate creditors but without eliminating the existing ones. The issued stocks will have prevailing voting and governance rights over the existing ones. At the same time, this plan may also entail the transferral of a large part of the business to a third subject.

Shareholders may of course oppose all such plans as their role within a company would be considerably modified. They might also decide to exercise their pre-emption rights in case of an increase of capital.

Besides, whenever shareholders rights are affected by a reorganizational plan, a minority of shareholders may ask to held a shareholders' general meeting to seek the acceptance of several motions, which may even include the eventual dismissal of manager if they are still in charge during the insolvency proceedings.

In such circumstances, several uncertain issues relating to shareholders involvement in insolvency proceedings may also arise spontaneously.

First of all, can the stocks be assigned to a third party without the consent of their owner when the company is undergoing insolvency proceedings? Secondly, does such damaged shareholders should be compensated with at least the amount they would have received in case of liquidation proceeding? Moreover, are old shareholders entitled to maintain some equity even if corporate creditors have not been completely paid for their claims? Besides, do shareholders have the right to challenge those solutions which dispossess them but which are in the best interest of the creditors? Furthermore, would the solutions be affected if there were reasons to foresee that shareholders did not receive any proceeds in parallel case of liquidation?

In this paragraph I am attempting to answer these questions by being aware that in all such circumstances, when restructuring proceedings begin, the amount of shareholder involvement should be considered more than in the case of liquidation where there are no more alternatives to rescue a company. On the contrary, during reorganization proceedings, the debtor may negotiate several rescue plans with creditors which may be either totally indifferent for shareholders as well as extremely damaging for them by depriving them of their participation in a company which is maintained alive.

3.3.1. Dispossession v. Continuation of the Business

As during a liquidation proceeding, shareholders may be dispossessed in case of reorganization as well. Dispossession may happen immediately at the opening of proceedings, whenever a restructuring plan transfers a business to a third party or when a restructuring plan requires for the continuation of a business only to be able to wind it up. In such situations the debtor is finally dispossessed in the same way as during liquidation proceedings.

On the contrary, a restructuring plan may be aimed at the continuation of a business in order to rescue it. In such a case the opening of the proceeding creates a restriction upon corporate assets by hereafter addressing them to creditor satisfaction. According to a reorganizational plan, corporate creditors must be satisfied with both the existent assets and the future ones which will be predictably produced through the business.

The choice of maintaining a business afloat rather than closing it is also influenced by whether jurisdictions are considered “debtor-friendly” or “creditor-friendly” depending on the amount they limit or simplify creditor enforcement against insolvent company[340], even though such schemes do not always correspond to the traditional classification of common law-civil law traditions.

[340] See Sefa Franken, *Creditor-and Debtor-Oriented Corporate Bankruptcy Regimes Revisited*, in European Business Organization Law Review n.5 of 2004, at page 645.

The U.S.A., as well as Japan, may be defined as debtor-friendly countries. In the U.S.A., debtor-friendliness is usually set within a typical debtor financial system which can be shared among several creditors where the majority are bondholders rather than banks. This corresponds to a framework where banks have traditionally been fragmented[341] and they do not usually really take up a strong position against the current management if it remains in control of the business.

On the contrary, countries such as the U.K. or Germany to a lesser extent, are considered to be more creditor-friendly. The U.K. has traditionally encouraged the enforcement of individual creditor security with little court involvement, so much so that, until not long ago, banks which keep security interests that cover the whole of an insolvent company's assets have been allowed to personally rule the realisation of corporate assets[342]. This coincides with a powerful, polarised banking sector which concentrates on finance and deals with relatively low bonds.

A similar framework may be found in Germany and in Italy as well.

In France, instead, the State plays a far more prominent role in liquidation procedures as it has a greater ownership of French banks. This reduces the capacity to oppose the liquidation regime which was introduced in 1985 and which supported employees' interests to the detriment of other corporate creditors. However, State ownership has started to decrease in recent years even though it is still linked with increasing creditor influence in rescue and recovery plans.

Generally, maintaining a business alive may be considered advantageous for the financial system as a whole as it might save progressively realised investments, by wasting less time and rescuing those companies which are still able to produce wealth.

Relating to this issue, it is debatable what the main aim of maintaining a business alive is. Whether it is in the creditors' best interest or whether the continuations of the business itself should be considered such a value, in the interests of the social

[341] See John Armour, Gerard Hertig and Hideki Kanda, *Transactions with Creditors*, in *The Anatomy of Corporate Law*, supra note 7, at page 149.

[342] See John Armour and Sandra Frisby, *Rethinking Receivership*, 21 Oxford Journal of Legal Studies, 73, 2001.

community as a whole and to the advantage of every stakeholders, such as employees.
This doubt was voiced by the European Parliament resolution of 15th November 2011 by recommendations to the Commission on insolvency proceedings in the context of EU company law, where the Parliament underlined as << *insolvency has an adverse impact not only on the businesses concerned but also on the economies of the Member States, and whereas the aim should therefore be to safeguard all economic stakeholders, taxpayers and employers against the repercussions of insolvency* >> as well as << *the approach in relation to insolvency proceedings is now centred more on corporate rescue as an alternative to liquidation* >>[343].
However, corporate recovery is only one of several possible endings of a business undergoing reorganization. As mentioned above a company may indeed be legitimately kept in business to be eventually wound up according to the plan. Therefore, the continuation of the business cannot be considered the purpose itself as this is only one of the more alternative endings of such a procedure.
On the other hand, a business can never be maintained alive during reorganization procedures when it goes to the detriment of the best interest of corporate creditors. On the contrary, the business is carried on to both preserve the assets and produce new profits as well as for creditors' better satisfaction, in comparison to those which could have been obtained in case of liquidation proceedings.

3.3.2. The Debtor in Possession

In case of reorganization proceeding, a business may still be kept running while dispossess debtors. In such a case a receiver is nominated who possesses the corporate assets and controls the business. The decision to leave the debtor in possession of assets rather than replacing it with a nominated trustee may indeed raise some legitimate doubts. How can management be trusted to be able to recover the company if it has brought it into a financial crisis? Can debtors be

[343] European Parliament Resolution, OJ C 153, 15.11.2011. Available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:153E:FULL:EN:PDF. See letters H-I respectively.

trusted to behave fairly with creditors?

However, a well-supervised attempt of recovery by the debtors can be important and useful for corporate creditors as it would allow them to avoid losing corporate know-how as well as those costs related to time-wasting and business braking which are typical of every transitions of management. Besides, a debtor-in-possession during reorganization may produce the same result as an out-of-court procedure with the advantage of having fewer costs and additional safeguards.

In the U.S.A., leaving the debtor in control of the business during reorganization procedures was an essential innovation in the 1978 Act.

According to the procedure in Chapter 11, however, a creditor trustee must be appointed by the court to manage a company whenever a debtor is considered incompetent, it has acted unfairly or if the nomination may prove to be the detrimental to corporate creditors interests[344].

However, the debtor usually retains possession of their corporate assets during reorganizational proceedings and business is carried out in the best interests of its creditors:

> on filing, the old "debtor" becomes the new "Debtor in Possession" (DIP), acquires nearly all the avoiding and other powers that a trustee would have, if appointed, and is charged with operating the business in the best interests of the creditors[345].

Here, the debtor remains in control of all assets and it manages the company by acting as a sort of corporate creditor trustee.

The debtor has an active role even though his influence is less than it would usually be in normal trading circumstances. In case of reorganization, the debtor powers should indeed be integrated for every measures diverging from such an aim, which is what the Bankruptcy Reform Act defines as the *ordinary course of*

---

[344] See Chapter 11 of the U.S. Bankruptcy Code at Section 1104 (a) which refers to << *fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor* >>. An appointment of a receiver may be provided even if << *if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor* >>. See also Section 1107.

[345] William J. Woodward jr, *supra* note 3.

business[346].

The new debtor in possession is then able to adopt *ordinary course* transactions[347] without any Court's supervision, while judicial authorization is required in other situations out of the ordinary course, where corporate creditors may have the right to be informed and also to be heard by the Court[348].

A similar rule applies not only in the U.S.A. but also in France[349], in Italy[350], in Spain[351] and in Germany too.

In German jurisdiction, there is a single insolvency proceeding where the debtor-in-possession is admissible only after a Court decision which must be based on an *ad hoc* claim of the debtor[352] and the judge may even limit the powers of debtors upon the request of corporate creditors[353].

However, the choice of maintaining the debtor in possession always depends on the corporate creditors or at least on those whose claims can ensure the approval of a reorganization proceeding rather than filing for liquidation.

Creditors of an insolvent company may indeed be seen as "forced shareholders" because they are now risking their claims, which may or may not be satisfied, depending on the result of the reorganization procedure. Therefore, the power of control is then transferred from the debtors to its creditors.

To begin restructuring proceedings, the plan must indeed be approved by corporate creditors who consequently have a residual power of control over the company in financial distress.

The consent of at least a simple majority of corporate creditors is necessary to approve a restructuring plan[354], but the suitable amount of shareholder involvement differs in various countries.

---

[346] See Article 363 (c) (1) Bankruptcy Reform Act 1978.
[347] See Chapter 11 of the U.S. Bankruptcy Code at Section 1107.
[348] Article 363 (b) (1) Bankruptcy Reform Act 1978.
[349] See Article L.622-1 and L.622-3 *Code de Commerce*.
[350] See Article 167 *Legge Fallimentare*.
[351] See Article 40 *Ley Concursal*, where the appointment of a trustee is voluntarily.
[352] See Paragraph 270 *Insolvenzordung*.
[353] See Paragraph 277 Insolvenzordung.
[354] The only exception is the hypothesis of cram down when it is admitted by law. See Chapter 2 at paragraph 2.4.2, *Reorganization Proceedings*. And see also below at paragraph 3.3.6.2. *Corporate Reorganization without Debtor Consent in the U.S.A.*.

Whenever the current management is empowered to maintain control during reorganizational procedures, the shareholders' general meeting remains in charge and keeps its normal competence if compatible with applied proceeding.

However, the decision of a general assembly may require the previous authorisation of the receiver, especially regarding those issues where shareholders' resolutions might *de facto* invalidate a restructuring plan.

In Germany, for instance, an insolvency administrator has considerable powers. He or she is generally appointed during pre-insolvency proceedings and is then replaced by a final administrator who may or may not be the same person appointed by the Court at the opening of the final insolvency proceeding.

An insolvency administrator possesses large powers in restructuring a company. He or she is able to decide whether to interrupt or to accept executory contracts entered into before the beginning of an insolvency proceeding. He or she must also submit certain major decisions to a general vote in the creditors' meeting[355]. However, both the preliminary and final administrator are under the court supervision.

In the U.K., the administrator has considerable powers as well. The Insolvency Act of 1986 establishes that an administrator may << *do anything necessary or expedient for the management of the affairs, business and property of the company* >>[356]; he or she may even remove a director and appoint a new one to fill a vacancy[357].

However, the shareholders' general assembly is still in charge and it maintains its normal competences, one of which is the right to dismiss managers. Voting in a general assembly is generally required beyond the ordinary decisions of management, especially in case of related-party transactions carried out during the solvent life of a corporation[358].

---

[355] A creditors' meeting has even the authority to either confirm or replace a final administrator. Moreover, if the general meeting of creditors decides that a company is to be provisionally restructured it can instruct the administrator to prepare an insolvency plan.

[356] Insolvency Act 1986, Schedule B1, Paragraph 59 (1).

[357] Insolvency Act 1986, Schedule B1, Paragraph 61.

[358] However, no legal order requires a widespread and generalized shareholders' consent for related-party transactions. France and the UK seem to be most suitable to give stockholders a voice in related-parties transactions. In France, company law requires

In the U.K. for instance *ex ante* shareholder approval for extraordinary transactions with managers and major stockholders is required in each listed firm. Such solutions, however, still leave some room for discretion in defining what "non-routine transaction" means and what it includes. For other corporations, the Companies Act requires shareholders' consent for some transactions with managers, such as substantial property transactions and credit transactions[359].

On the contrary, French company law requires an *ex post* ratification in case of non-routine self-dealing transactions began during the prior financial year.

However, shareholders approval seems to have the same legal results whether it comes before or it follows a conflicted operation. Nevertheless *ex ante* consent may seem to be more efficient when checking self-dealing transactions[360].

In other countries, new obligations and arrangements may be agreed to by corporation management according to the plan applied during reorganization procedures[361].

3.3.3. Presentation and Discussion of the Plan

Generally shareholders have a minimal role during reorganizational proceedings in the U.S.A. compared to their role in European jurisdictions; even though it is considered to be a debtor-friendly country.

American insolvency and company law are more focused on managers who may be able to negotiate a restructuring plan while shareholders are usually treated like any other stakeholders as they are simply considered to be a holder of interest.

This can occur both at the beginning of an insolvency procedure, in the case of the allowance of claims or interests, and at the moment of the acceptance of the

---

shareholders ratification of any unusual self-dealing transactions began during the prior financial year

[359] See Companies Act 2006, Articles188-226.

[360] L. Enriques, G. Hertig and H. Kanda, *Related-Party Transactions*, in *The Anatomy of Corporate Law*, *supra* note 7, at page 169.

[361] This is what happens, for instance, in Italy where Article 182-quater *Legge Fallimentare* qualified such obligations as administrative expenses. Consequently their holders have a priority right over all other previous obligations, but they have not any voting right over the restructuring plan.

reorganizational plan when shareholders vote, in the same way as any other class of claimants[362].

Section 1121 of Chapter 11 in the Federal Bankruptcy Code regulates the hypothesis of voluntarily cases where the petition is filed by the debtor itself[363]. Moreover, every party is entitled to file for a plan of reorganization if certain conditions are observed. It states that:

> Any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may file a plan if and only if:
>
> (1) a trustee has been appointed under this chapter;
>
> (2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or
>
> (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan[364].

No reference is made, by insolvency law, to a shareholder's right to file for reorganization proceedings. However, such a right should be properly conferred onto the company which expresses its will through the board of directors, in the same way it would have done in the solvent life of a company.

Restructuring plans can be organised by management bodies and are presented to courts by its legal agent also in Europe.

However, no European country requires an ex ante director authorization from shareholders to file for restructuring proceedings. However, managers can be consulted to call for a shareholders' general assembly and in such a context shareholders may adopt resolutions or may investigate specific circumstances.

In Italy, for instance, in the case of restructuring proceedings where the management remains in control of the business, any shareholder who holds at

---

[362] See Chapter 11 of the U.S. Bankruptcy Code, Sections 502 (*Allowance of claims or interests*) and 1126 (*Acceptance of plan*).

[363] The debtor is even the only one which may file a plan until after 120 days after the date of the order for relief under this chapter. See Section 1121 (b), U.S. Bankruptcy Code.

[364] Section 1121 (c), Chapter 11 U.S. Bankruptcy Code.

least 5 per cent of the corporate capital, or 2 per cent in the case of a listed company, is able to request an investigation into specific circumstances[365]. Moreover, the main shareholders, who represent the previously mentioned percentage, can also challenge the resolution of the board of directors if they consider their rights to have been damaged[366].

Similarly, in Spain, entitled shareholders still have the power to challenge decisions taken by a shareholders' general assembly or those taken by the board of directors, despite the fact that the company is insolvent[367].

In some European jurisdictions, such as in Italy, an insolvent company has the edge over its creditors because it is the only one to be entitled to propose a plan of reorganization, while creditors are only able to accept debtor's proposal or claim for a liquidation procedures.

This does not happen in other countries, such as the U.S.A., where insolvency law encourages arrangements between debtors and creditors.

The American insolvency system is indeed strongly based on the idea that the debtor and its creditors have the best knowledge of the enterprises, of the trends of its production area and of its future prospects[368].

Moreover, in the U.S.A., where shareholders are simply considered as one of the several categories of claimants, a reorganization plan can eventually be filed by

---

365 However, the constitutive act may provide a less percentage; see Article 2408 of the Italian Civil Code. But see also Article 2409 which enable shareholders representing 10% of corporate capital (or 5%, for listed companies) or a less percentage provided by the constitutive act, to claim for a special investigation which will be made by a court appointed officer. On the other hand, shareholders do not have special right to claim for investigation undergoing a liquidation proceeding.

366 See Article 2377, 2378 and 2388 of the Italian Civil Code. Moreover, shareholders may not only challenge some single decision of the board, but a shareholder representing at least the 20% of the legal capital can sue the current and the former directors on behalf of the company and claim for damages; see Article 2393-*bis* of the Italian Civil Code.

367 See Article 206 of the Corporate Enterprises Act. At the moment, none law provision states that shareholders lose their rights to challenge the decisions of the general assembly or of the board of directors and there are even several law cases where it is admitted that shareholders are empowered to challenge decisions even in case of insolvency. Such an example, see SAP Madrid (Section 28) Judgment no. 34/2009 of the 16th February 2009 (AC\2009\858) or SAP Vizcaya (Section 4) Judgment no. 292/2011, of the 15th April 2011 (JUR\2011\302243).

368 For a comparative analysis of American Bankruptcy Law, see G. Marcus Cole, I*l diritto concorsuale statunitense in un contesto globale, in Soluzioni negoziali e istituti "preconcorsuali" nella gestione delle crisi*, Quaderni di Giurisprudenza Commerciale, 366, Giuffrè Editore, 2013.

managers or creditors without any approval whatsoever of the shareholders, even if the plan may involve a loss of shareholders control over a corporation.

3.3.4. Debt Recovery

The sooner a financial crisis is faced in its early stages, the sooner it can be resolved through financial operations and procedures without having to change the corporate, legal identity of a company or the structure of ownership.

A reorganizational agreement for the debt recovery of corporate credits can be renegotiated and such a procedure may concern the reduction of credit interest as well the reduction of the amount of corporate credits or an extension of the credit due date.

For instance, a reorganizational plan may provide for a moratorium of its credits while still maintaining a business alive so producing new profits to fully pay corporate creditors. Otherwise creditors might be partially paid off at the opening of the proceedings while another percentage may be satisfied as a result of the business trade, and so on.

Supervisors have several options available to them to collect unpaid debts, apart from reducing the legal capital to release some corporate assets and allowing shareholders to provide new finance for a company in distress[369], which both may require for a shareholders involvement.

In all such circumstances, the continuation of a business may be an advantage for creditors because it may permit to generate new profits to satisfied them.

However, whenever an insolvent company is kept in business, new credit, funds and raw materials will have to be found to keep the company afloat. Clearly, it is extremely difficult to find new investors or suppliers who would be willing to trade or invest in a feasibility insolvent company so a restructuring plan may be the right solution in this case. In such circumstances, the continuations of previous supply contracts as well as new contracts or loans may be satisfied in advance to existent corporate creditors.

Such new loans are defined, in Chapter 11 of the U.S. Bankruptcy Code, as

[369] See above Paragraph 3.1. *The Eve of Financial Distress*.

administrative expenses[370] but this procedure is also available in Italy, in Germany and in France as well[371].

The priority of new corporate credits over existent ones can only be determined through proper insolvency proceedings under court control. It should also confirm if the corporate assets are sufficient enough to pay any administrative expenses as well. All such cautions are provided because such operation may be extremely damaging for existing corporate creditors who might then see their claims placed behind new ones. However, one should never forget that every restructuring plan must be approved by the majority of every class of existing corporate creditors to be considered legally binding[372], so creditors can express their will.

Maintaining the going-concern value of a business in financial distress may also be achieved by transferring corporate assets, or part of them, to a third party.

Such a choice may have both benefits and drawbacks. On the one hand, it is a positive procedure as the risk of new losses is then taken over by someone else but on the other hand, this operation could also be risky as creditors may be then committed to a third party who will acquire all the know-how of the business but who may not be able to face or resolve the financial crisis in hand.

This is why the concession of any business to a third party should be included in a strict restructuring plan under a court control, to ensure enough safeguards are put in place to cover all corporate creditors.

All the above-mentioned solutions may be contained in a restructuring agreement approved by the majority of the creditors (or by the majority of each class of creditors) and by the board of directors, while shareholder may or may not be

---

370 See Section 503 U.S. Bankruptcy Code.

371 In Italy the *prededuzione* is regulated in Article 111 *Legge Fallimentare*; in Germany, *Massegläubiger* is provided by Paragraphs 53-55 *Insolvenzordnung*; in France *frais et dépens de la liquidation judiciaire* id regulated by Article L.643-8 *Code de Commerce*.

372 However, sometimes a creditors approval may be overtaken by a judge decision, but in such a case the court must be very careful and must always take in mind that every insolvency proceeding should purse the aim of the best interest of the creditors. An example of extremely bad court decision of overtaking the absence of a creditors' approval over the plan is the American law case of Eastern Airlines in 1989. See L.A. Weiss and K.H. Wruck, *Information Problems, Conflicts of Interests, and Asset Stripping: Chapter 11's Failure in the Case of Eastern Airlines*, in Journal of Financial Economics, 48, 1998, at page 55 and the following. The consequences of cram-down will be analysed in the details below at Paragraph 3.3.6.2. *Corporate Reorganization without the Debtor Consent in the U.S.A.*.

involved in the decision.

The issue essentially remains the same; shareholders must be involved in *fundamental* decisions which may modify their rights or their ownership. Such shareholder rights should be balanced with the interests of corporate creditors who are now *de facto* residual claimants.

As already mentioned, even board-centred jurisdictions like the American Delaware one has to struggle with the difficulty of defending settled expectations against attacks by the board to take over the power given to stockholders or by those majority of shareholders who wish to benefit at the cost of corporate creditors[373].

In Europe, Article 19 of the Second Directive requires managers to call a shareholders' general meeting in case of any serious loss of the subscribed capital to take into consideration the issue of whether the company in question should be liquidated or whether other measures should be adopted. In this way shareholders are involved in the financial crisis.

As mentioned above, in Europe every modification of the legal capital must be approved by the majority of shareholders as well as every substantial modification of the constitutive act. Therefore, whenever a reduction of capital is seen as a positive solution to face a financial crisis, a shareholders' general meeting should be called to adopt such a resolution.

On the contrary, restructuring of debts by moratorium or by interest reduction as well as the arrangement of new credits which have priority over all other obligations do not require any shareholders involvement because none of such decisions are able to modify their participation into the company. Therefore, the board has the discretion to negotiate these solutions, which can be legitimated by considering their lack of influence on shareholder ownership.

[373] See Edward Rock, Paul Davies, Hideki Kanda and Reinier Kraakman, *Fundamental Changes*, in *The Anatomy of Corporate Law*, 2009. At page 183.

3.3.5. Extraordinary Corporate Transaction when Facing a Financial Crisis

Shareholders consent over a reorganization plan is required every time it includes extraordinary corporate transactions such as merger, corporate divisions or reincorporation.

In Europe, the Third Council Directive in company law has established that a decision concerning a merger must be approved by a majority of not less than two thirds of the votes attaching either to the shares or to the subscribed capital represented. National laws of European countries might also provide that a simple majority of the votes is sufficient to approve a motion << *when at least half of the subscribed capital is represented* >>. Moreover, when << *there is more than one class of shares, the decision (...) shall be subject to a separate vote by at least each class of shareholders whose rights are affected by the transaction* >>[374].

Shareholders are also involved at a national level. German and U.K. company law both require the approval of 75 per cent of shareholders with voting rights to approve any future merger[375].

In Italy (as well as in Spain) mergers, but also divisions and reincorporation, are subordinated to the decision of an extraordinary general assembly as well[376]. Moreover, such a resolution does not need to be approved by the court and this may even help to partially save the shareholders' old corporate participation. In such a case however creditors will express their agreement through their vote, which is always required to approve every reorganization plan[377].

In Spain, however, an insolvency representative is unable to take decisions which belong to the general assembly but he or she can come to agreements with stockholders if certain proceedings are essential in reorganizing the corporation, such as in the case of a merger.

---

[374] See Article 7, III Council Directive 78/855/CEE.

[375] See paragraph 65 *Unwandlungsgesetz* (Germany); and Section 895 of U.K. Companies Act 2006, which has transposed the Third Council Directive.

[376] Ordinary and extraordinary general assemblies are not two different meetings but they only differ for constitutive and deliberative quorum and for the procedures to write the report, and of course for the subjects they may deliberate on.

[377] See L. Stanghellini, *Fusioni e scissioni senza autorizzazioni*, Il Sole 24 ORE, 19/08/2013.

The American procedure also requires a specific majority of shares for any corporation involved in a merger. However, some States do not usually require a shareholder vote when an incorporated corporation already possesses a large amount of stock of the another corporation and when the merger does not entail a modification of the constitutive act.

Shareholder involvement in case of a restructuring plan providing a merger is seen as reasonable. One should indeed considers how shareholders will not be dispossessed but the stake in their ownership might be considerably reduced, modified or cashed in by a merger. The latter fundamentally reorganizes the rapports among corporate members and this is the reason why every national legal order is particularly sensitive about the issue and grant special treatments to mergers.

On the contrary, several countries do not require a specific shareholder decision in case of corporate divisions. In Europe, as well, the Sixty Corporate Law Directive leaves Member States free to decide whether corporate divisions should be regulated or not[378].

Shareholder approval is finally required by Italian company law in every procedure resulting in a substantial change of the corporate business[379].

In the U.S.A., instead, no shareholder involvement is required at all[380] because American corporate divisions can be arranged as stock trade or as a share of dividends by stocks, which are both included with issues regarding management

---

[378] Directive 82/891/EEC on concerning the divisions of public limited liability companies, of 17th December 1982. Besides, such a regulation may be avoided by maintaining the company alive after the transferral because such a Directive is applied only in the case where the transferring corporation have conferred all its assets to other existing or newly formed corporations. See Articles 1, 2, 21 of the Directive.

However, several national laws fill the gap of the European directive, such as in France or in Germany, and nearly all the main jurisdictions usually require shareholders approval in the transferring corporation after full disclosure of the plan of division.

Nevertheless, German regulations on the issue may be avoided as the same result of a division may be achieved by adopting alternative transactional forms, such as a sale of a specific asset even for shares, which is not regulated by the division's law.

Differently, in France the law does not admit any other convenient processes to split the debt of an insolvent company.

[379] See Article 2479 Italian Civil Code.

[380] The U.S.A. only regulates divisions on an ad hoc basis when opportunism appears unless the corporation sells all or substantially all of its assets and Japan regulates divisions only perfunctorily.

decisions.

Finally, shareholder involvement in reincorporation may be related to the fact that such an operation may often transform the relationship among participants by aggravating the management-shareholder or controlling-non controlling shareholders agency issues[381].

Generally, it can be seen that European jurisdictions pay much more attention to shareholders needs than in the U.S.A.. This view is expressed even in their different approach towards charter amendments. In the U.S.A. they have to be proposed by a board of directors and this excludes charter amendments which will benefit shareholders but could be damaging to management.

On the contrary, under the default regime created by the ECJ case law, shareholders may unilaterally decide to change a company charter or to reincorporate it into another jurisdiction without creditor approval[382].

In conclusion, while debts restructuring does not usually require shareholder involvement and managers have the discretion to negotiate an agreement with corporate creditors, shareholders should usually be involved and their consent should be obtained, whenever a recovery plan includes extraordinary corporate transactions such as mergers or divisions. Stockholder involvement in this procedure may be coherent with the position they have in a company in financial crisis but which may be still recoverable.

The reason for this kind of measure is clear. Shareholders may not be expropriated by a merger plan but they may have their participation totally modified at the end of the process; for instance they might pass from being majority shareholders to being minority ones. Bankruptcy proceedings may indeed expropriate shareholders in case of insolvency but they cannot impose them to be part of a new corporation against their will.

---

381 See Edward Rock, Paul Davies, Hideki Kanda and Reiner Kreekman, *Fundamental Changes*, in *The Anatomy of Corporate Law*, *supra* note 7, at pages 214-215.

382 See Frank Woolridge, *Überseering: Freedom of Establishment of Companies Affirmed*, in European Business Law Review, 14, 2003. See also the ECJ's Daily Mail opinion. *The Queen v Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust*, Case 81/87, 1988, ECR 5483, which allows Member States to impose an "export ban" on the firms incorporated under their respective law.

3.3.6. Corporate Reorganization

As already mentioned in the previous chapter, another option available to recover an insolvent company may be the so-called *corporate reorganization.*

This plan of reorganization does not simply imply renegotiating debts or extraordinary corporate transactions to face a financial crisis but creditors are converted into the equity of a solvent company and their claims are satisfied by stocks.

Whenever a company is properly insolvent, corporate creditors *de facto* have no longer the certain right to be paid for their claims hence they have become *de facto* residual claimants of the insolvent corporation and they now participate in the risk of a business undergoing reorganization.

In such an (extreme) situation it is the corporate creditors and no longer the shareholders who are the ones whose claims stand last in line, and their payment strictly depends on the good or bad performance of the proceedings.

Consequently, one may reasonably doubt whether the subordination of a corporate reorganization should be up to shareholder consent even when they may never obtain any profits in case of liquidation.

This may even be perceived unfairly because it impedes corporate creditors to obtain better satisfaction, if not a full repayment, for their claims. One might argue that approving such a provision is the idea of creditors who are residual claimants.

A corporate reorganization may be realized by two main different techniques, plus a peculiar mechanism adopted by Argentinian insolvency law which may be considered an *unicum* of such jurisdiction[383].

One option requires the creation of a new solvent corporation (NewCo) where assets of an insolvent corporation are conferred and creditors will then acquire

[383] See Chapter 2 at paragraph 2.4.2., *Reorganization Proceedings*. Such a reorganization procedure consists in a coercive auction sale of stocks of an insolvent company where the valued of shares is directly paid to corporate creditors. It is like if stocks of an insolvent company are coercively transferred by the corporation itself to corporate creditor which may accept the price of the auction or decide to retain the shares and cede their credit, so becoming shareholders of a solvent company. The original shareholders will then only receive compensation when an expert has evaluated that its shares have a value higher than zero, otherwise no compensation is needed.

shares through compensation of their claims against the insolvent corporation.

The other one obtains the same result without the creation of a NewCo but by increasing corporate capital so cancelling existing shares. Creditors will then be satisfied with new shares proportionally conferred in compensation for their claims[384].

These solutions may present problems in different jurisdiction especially whenever corporate shareholders have denied their approval on a possible corporate reorganization plan.

Furthermore, both such solutions do not require all creditors of an insolvent company to become equityholders of a solvent one therefore some creditors may remain debtholders of the NewCo or of the rescued company[385]. Creditors may be paid with shares of the recovered corporation or whit profits the business will produce as well as through profits of the sale of part of those corporate assets that are unnecessary for the continuation of the business.

Finally, it is debatable wheter such a plan may retain some shares of the new or existent corporation for shareholders of the insolvent company[386].

3.3.6.1. Corporate Reorganization without Debtor Consent Among Europe

A measure to reorganize a company without the debtor consent which is the only one available in almost every European jurisdiction, is the creation of a NewCo where the assets of an insolvent company can be conferred and the shares may be transferred to corporate creditors through compensations by their claims.

---

[384] A common problematic issue occurs in both the hypothesis of reorganizations procedures, with or without the debtor's consent. Such an issue relates to the respect of the *par condicio creditorum* whenever shares are conferred to corporate creditors. As has been mentioned in the first Chapter indeed, the value of shares cannot simply be determined by dividing the corporate assets for the number of shares, but it is related to economic and administrative rights connected to the stock. Common difficulties of evaluation occur whenever credits have to be converted into equity. Such an issue has been analysed by Lorenzo Stanghellini, *supra* note 231; and by Giacomo D'Attorre, *L'attribuzione ai creditori di partecipazioni sociali tra par condicio creditorum e principio di eguaglianza tra soci*, in Riv. Delle Società, 56, 2011, at page 853 and the following.

[385] As stressed in Chapter 2, insolvency does not necessarily presume a lack of corporate assets value. See Paragraph 2.1., *The Notion of Insolvency*.

[386] See Paragraph 3.3.6.3. *Shareholders Rights to Maintain Shares v. the Absolute Priority Rule.*

European jurisdictions, as already mentioned, provide statutory default regulations requiring shareholder approval of issues of stocks. This therefore excludes the alternative technique of corporate reorganization without shareholders consent as expressed in a general meeting.

The issuing of new shares for those companies regulated by the European Second Council Directive[387] must always be decided in a shareholders' general assembly, as required by Article 29.

Such a provision was examined in detail by the European Court of Justice in several of its judgement in the 1990s, regarding some Greek laws which legitimated the issuing of shares without any shareholder consent. Such laws were deemed to be unlawful according to the former Article 25 (1) (now Article 29) of the Directive[388].

In such judgments, the Court highlighted how such a provision cannot be waived in any cases nor in case of insolvency.

In such circumstances, the Court referred to Article 17 (now Article 19) of the Directive which states << *in case of a serious loss of the subscribed capital, a general meeting of shareholders must be called* >> and it underlined how *serious loss* should be interpreted as including the hypothesis of a serious financial crisis or even insolvency.

Consequently, if the current Article 19 requires shareholders involvement every time the company is in *serious loss* and it confers the power to adopt needed measures to the general assembly, then shareholders cannot loose such power according to Article 29. The only possible compatible interpretation is to read the norm in a restrictive way. Therefore the Court concludes that a shareholders' general assembly must always adopt the resolution of the increase of capital even in time of insolvency[389].

Such an interpretation of Article 29 clearly excludes the issue of new shares regardless of a resolution of the shareholders' general meeting.

However, the same aim, in term of financial results, may be achieved through the

---

387 See Annex 1 of the Second Council Directive, 77/91/EEC as modified in 2012.

388 See C-441/93 *Panagis Pafitis and others v Trapeza Kentrikis Ellados A.E. and others*, 12th March 1996. But see also *Syndesmos Melon* case, C-381/89 of 24th May 1992 and *Karella*, C-19/90 of 30th May 1991.

389 The only exception has been provided by the Court in the Karella case law, *Ibidem*.

creation of a NewCo. This is what happened for instance in Italy with the Parmalat corporate reorganization.

In such a case insolvency was mainly provoked by the unreliable and wrongful behaviour of corporate management but the company itself maintained all its going-concern value. Hence, the need to maintain the business up and running was essential and, for the first time in Italy, a company was reorganized. Corporate creditors were so reduced to an amount equal to the value of the corporate assets, than the assets were conferred to a NewCo which shares were distributed to existing creditors proportionally to their restructured claims. Such a procedure was possible thanks to specific law provision of 2004[390], which was then adopted as an example in point for a general reform of the Italian law about restructuring proceedings[391].

The company was then listed on the market and some creditors could therefore sell their shares so converting their stock into cash.

Parmalat NewCo did not loose any value during the proceeding and neither the production or sale were reduced. The company actually benefited from the new honest management. Consequently, one may then doubt what advantage creditors may obtain from corporate reorganization without the creation of a NewCo, wheter there are there any differences between these two solutions in term of efficiency and if any company value is lost. All such questions remain unanswered at the moment.

Finally, it is important to point out how even if corporate reorganization seems to be such a suitable remedy to resolve a financial crisis, without loosing any corporate value as it enables creditors to obtain more than what they would receive in case of liquidation, at the same time it is not often admissible in real.

Firstly, not every company might be listed on the market and this is a central step to be able to offer an attractive plan to creditors. Indeed, not every debtholder might be interested in being transformed into an equityholder and even if this is not required for every creditor, at least a substantial amount of debts must be converted into equity, to be able to recovery an insolvent company. Therefore, the

[390] Article 4-bis of Law n. 39/2004 which refers to the Italian proceeding so-called *amministrazione straodinaria*.

[391] See Article 160 *Legge Fallimentare* as modified in 2005 by Law n. 35.

possibility to sell shares on the market might be a positive incentive for creditors to accept the plan.

Secondly, corporate reorganization may be efficient in case of large corporation, such as was the Italian Parmalat case, when the business is well known on the market independently from its management.

On the contrary, when the business trend is strictly related to the personality of its shareholders or its directors, a corporate reorganization may even produce a loss of value unless, for instance, part of the equity remain in the hands of the previous shareholders[392].

Finally, not every insolvent company has corporate assets lower than its liabilities hence shares may have no financial value.

As has been stressed in the previous chapter, insolvency is simply related to the corporate inability to entirely satisfy all its due debts but only the absence of any share value may legitimate the expropriation of shareholders participations whether the company is maintained alive, as they are not liable for corporate debts or obligations.

Such an issue has been debated in a recent judgment of the European Court of Human Rights in 2012.

The European Convention on Human Rights, indeed, does not impede shareholder expropriation, hence shareholders might be deprived of their participations against their will if it is contained in a legitimate restructuring plan. The Court of Strasburg, in *Dennis Grainger and others v. the United Kingdom*, stated how property might be only expropriated in the general interest[393] and by respecting the procedure in every national law. Every expropriation must be then compensated.

This was one of the first cases where the Court of Strasburg encountered a reorganization proceeding without any debtor consent. The case refers to the

---

[392] See below Paragraph 3.3.6.3. *Shareholder Right to Maintain Shares v. the Absolute Priority Rule.*

[393] What a *general interest* is should be evaluated, in the Court opinion, by national authorities because of their direct knowledge of their society and its needs. The Court will generally respect the legislature's policy choice unless it is << *manifestly without reasonable foundation* >>. See *Dennis Grainger and others against the United Kingdom*, no. 34940/10, ECHR, 2012-IV, at paragraph 36.

nationalisation of a British bank, Northern Rock, which was under the specific regulation of the U.K. Banking Act of 2009. In this case, shareholders' rights for compensation were denied. This was based on the argument that the public interest for expropriation existed and the shares were in possession of shareholders so they *should* be compensated. However, the value of such shares were zero so shareholders were not entitled to any form of compensation.

However, as already mentioned, the E.U. Second Council Directive does not apply to every Member-States enterprise but only to those mentioned in the first Annex where no reference is expressly made to banks or other financial institutions. Nevertheless, the national companies the Directive refers to may be the only legal form that banks are able to adopt, hence the Directive applies to banks as well.

This is what happen in Italy where banks may only adopt the legal form of a *società per azioni* which is included in the Second Council Directive so they are binding from Article 29 as well[394].

Even if a common tendency to make the proceedings of corporate reorganization more flexible then in the past can be seen nowadays in every European jurisdiction, no country allows an insolvency Court to approve corporate reorganization, which does not provide a NewCo, without debtor consent.

The only exception is that of Germany, which is now the European jurisdiction more respectful of the freedom of negotiation among all stakeholders. Thanks to the reform of 2012[395], indeed, German insolvency law has resembles the American one by implementing corporate restructuring solutions which transform debtholders into equityholders.

Since 2012, corporate reorganization always required the shareholder consent so

[394] However, banks institutions have a different regulation, even at the European stage. On the 27th of June 2013, the Regulation EU no. 575/2013 and the Directive 2013/36/UE of the European Parliament and the Council have been published the in the Official Journal of the European Union. They both refer to requirements for the access to the activity of credit institutions, the prudential supervision of credit institutions and investment firms and they both want to affect the rules defines by the Basle Committee from December 2010. From the 1st January 2014 such a new framework has replaced the Directives 2006/48/CE and 2006/49/CE.

[395] The German recent reform was introduced by the *Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* (ESUG; the Act for the Further Facilitation of the Restructuring Companies) and became effective in March 2012.

de facto reducing the chance of restructuring. Trough the reform, the proceeding was put into effect and today it even provides a *cram down* opportunity.
Shareholders are now simply considered as a group of stakeholders. Their consent may so be overruled every time they are unable to prove that the plan stops them from receiving any proceeds or when creditors may receive what they are titled to in the plan.
Since 2012, a preliminary creditor committee has been able to impose the approval of the proposal of self-administration on an Insolvency Court[396], even if such a plan provides a swap of creditors into equityholders against the will of existing shareholders.
To sum up, the fact that several European jurisdictions apart from Germany do not allow a corporate reorganization without the shareholders consent and without the creation of NewCo, may be considered a situation open to criticisms.
Every time an insolvent company still has a going-concern value and it cannot find a purchaser on the market, corporate reorganization should at least be an available option to corporate creditors. As *de facto* residual claimants of an insolvent corporation, it is the creditors who are the ones who risk more and who should be entitled to approve the plan that they believe is in their best interests. Furthermore, they are the most encouraged to pursue efficient business management in order to achieve maximum profits. In case of insolvency, they, and no longer the shareholders, have the greater financial interest in controlling management and the profitability of the business. This might be advantageous even in the public interest[397].
However, the shareholders limited liability, which follows from the fact that a company is a separate person, makes a company only liable for its debts and obligations. On the contrary, shareholders are the owners of shares, not the company itself. Consequently, coercively transferring shares from shareholders of an insolvent company to corporate creditors may subvert the property right regime

[396] Self-administration proceeding (*Eigenverwaltung*) is comparable to Chapter 11 of the U.S. Bankruptcy Code. See Chapter 2, at paragraph 2.4.2. *Reorganization Proceedings*.
[397] See the Northern Rock Case mentioned above, *Dennis Grainger and others against the United Kingdom*, no. 34940/10, ECHR, 2012-IV.

and property rights are usually protected at a national Constitutional level as well as at the European one[398].

Therefore, court intervention may seem to be the only solution to ignore shareholders disapproval similarly to the cram-down mechanism recently adopted in Germany.

Nevertheless, it may be finally highlighted how either technique of corporate reorganization may achieve the same result in terms of financial efficiency.

Therefore, even if most European jurisdictions – with the only exception of Germany – do not permit both corporate reorganization techniques available in the U.S.A., they may still achieve the same final result: recovered corporate creditors claims can be satisfied through equity of a solvent company. Even if the same result must be achieved by creating a NewCo this may not affect the final result.

3.3.6.2. Corporate Reorganization without Debtor Consent in the U.S.A.

In the U.S.A., both the above-mentioned techniques of corporate reorganization are theoretically admissible.

As mentioned in the previous chapter, a plan of reorganization needs to be approved by every class of creditors with the right to vote to be then confirmed by the court. The plan is considered to be accepted by a class whenever it has been accepted by creditors or other holders of claim or interest

> that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class[399].

Nevertheless, if an agreement is not reached, a court decision may make the plan binding for all the class of creditors, even for those who have voted against the plan, if the plan << *does not discriminate unfairly* >> but it is << *fair and equitable* >>[400] and it respects every class of claims or interests which has not been impaired under the plan and which has not accepted it[401]. It is the so-called *cram down* mechanism. What *fair and equitable* means is defined by Section 1129 (b) (2).

---

[398] See Chapter 2 Paragraph 2.4.2. *Reorganization Proceedings.*
[399] Section 1126 (c), Chapter 11 of the U.S. Bankruptcy Code.
[400] *See* Chapter 11 of the U.S. Bankruptcy Code, Article 1129 (b).
[401] See D. J. Meyer, *supra* note 129, at page 418.

Therefore, as shareholders are considered as mere holders of interests, their approval is not necessary whenever their rights are satisfied by the plan at least as much as they would have been in the case of liquidation.
Such a provision is seen as innovative if one considers what the plan may contain. Indeed, Section 1123 of Chapter 11 states that a reorganizational plan may include not only satisfaction or modification of any lien, extension of a maturity date or a change in the interest rate or other term of outstanding sale of all or any part of the property of the company, but it also permits distributions of all or any part of the property of the company among those having an interest, the cancellation or modification of any indenture or similar instrument, mergers or consolidations of the debtor and amendment of the debtor's charter[402]. Furthermore, a reorganizational plan may modify the rights of holders of secured claims as well as of those holders of unsecured claims, and it may even entitle the debtor to keep part of the property of the company.
Moreover, managers of a company under the Delaware regime have the exclusive authority to issue new shares within the limit of amount established by the charter[403]. Besides, whenever original shareholders retain some shares during reorganization, no pre-emptive rights occur without a specific provision of the constitutive act.

---

[402] See Section 1123 Chapter 11 of the U.S. Bankruptcy Act which ends with an open clause which approves the plan which includes every kind of appropriate provision which is << *not inconsistent with the applicable provisions of this title* >>.
Moreover, Section 1127 admits that the plan may be modified, without failing to meet the requirements of sections 1122 and 1123, by the proponent at any time *before* confirmation, as well as at any time *after confirmation of the plan but before substantial consummation* of such plan (the latter modification may be required by the debtor reorganized as well). The plan as modified becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified. Then, any holder of a claim or interest that has accepted or rejected a plan is deemed to have accepted or rejected such plan as modified, within the time fixed by the court, such holder changes such holder's previous acceptance or rejection.
And see also Section 1126, which regulates the acceptance or the reject of the plan by any holder of a claim or interest.
[403] One exception exists under U.S.A. listing requirements for exchange-trade firms. Here a shareholders involvement is required whenever the issue of new shares is large enough to shift voting control over the management of a listed corporation. However this applies unless the new shares issued takes the form of a public offer to dispersed shareholders. See Paragraph 312.03 (c) NYSE Listed Company Manual and Paragraphs 712, 713 of the American Stock Exchange Company Guide.

3.3.6.3. Shareholder Right to Maintain Shares v. the Absolute Priority Rule

The above mentioned absolute priority rules requires respecting the creditors order of payment; no junior creditors should be satisfied before other superior creditors have been repaid in full for their claims.

There are two principles which regulate creditor satisfaction during an insolvency proceeding.

On the one hand, respecting the order of priorities: prior creditors must be satisfied before secured creditors and unsecured creditors will be only paid if there is enough credit left after the full satisfaction of any secured one.

On the other hand, creditors who are part of the same category should be paid proportionally. Such a rule may however be pacifically derogated among jurisdictions whenever corporate holders of creditors or interests are divided into classes for homogeneous interests, during a reorganization plan[404].

In this case, the proportionality principle must be respected within every single class of interests while the plan can give different creditor satisfaction in different classes.

What differs among jurisdictions is whether the absolute priority rule may be derogated during a reorganizational procedure by leaving current equityholders in total or partial possession of their stocks even if corporate creditors are not all fully satisfied.

Such an option is allowed in the U.S.A. where Section 1129 of U.S. Bankruptcy Code authorizes the Court to confirm a plan which allows shareholders to maintain some shares of the rescued company without paying all the current creditors only the following conditions are satisfied:

a. the plan is approved by every class of holder of interest or credits;

b. or, if there is not approval of each class of creditors, shareholders may provide new value to the company, they may "purchase" such shares[405].

---

404 Dividing holders of credits or interest in different classes is mandatory in the U.S.A., while may be optional in European jurisdictions.

405 In this case, an issue is how establishing the amount of payment. Several are the mechanisms proposed by scholars. The more widespread is the so-called *market test* which provides a competitive auction sale to determine the share value. However, some

This may make sense by when one considers that creditors are the new residual claimants in case of insolvency. Therefore they should be entitled to controlling power over the insolvency proceedings and the absolute priority rule might be waived if every class of creditors agree to it. On the contrary, whenever shareholders are favoured without the consent of some creditors, the latter must at least gain some advantages. In this way, creditors will be not fully satisfied for their claims but they will be part of a corporation with some more value.

Moreover, not displacing shareholders may be always an advantage for all corporate creditors because the first will be incentivized to discover insolvency earlier.

Nevertheless, in European countries the absolute priority rule is rigidly applied. Consequently, shareholders may only retain shares of the company if every corporate creditor is fully satisfied. However such a situation is quite rare while it is common that corporate creditors may not be fully satisfied by insolvency proceedings.

Authorising shareholders to reserve part of the corporate equity when not all creditors have been fully paid is criticised in European jurisdictions because insolvency law is seen as the regulation of a specific case of debt non-fulfilment which takes its basic principles from the law of obligations, even if its main aim is the protection of creditor rights.

Such disapproval is usually based on two main arguments.

On the one hand, one may underline how enabling stakeholders to freely negotiate the content of a reorganizational plan, which may even keep some shares for current shareholders may cause and create *perverse incentives* and the entire bankruptcy system may hence be exposed to abuses and to the dishonest behaviours of stakeholders[406].

On the contrary, insolvency law should not overthrow either the order of creditor satisfaction or that of debtor liability. Inadequate efficiency in the fulfilment of credit rights may reduce trade by making transactions unsafe for all stakeholders.

District Courts have not applied such a rule. See for instance *In re Zenith Electronics Corp*, United States Court of Appeals, Third Circuit. - 329 F.3d 338; Argued 7th April 2003 Filed 21st May 2003.

[406] See T.H. Jackson, *The Logic and Limits of Bankruptcy Law*, Cambridge, 1986. At page 20 and the following.

Furthermore, it has been proven that this may even provoke a financial boost.

National laws only allow derogations to debtor responsibility for its credits – which should be satisfied through every present and future debtor assets – when this is required by specific law provisions. When such a legal provision is missing, the absolute priority rule must be respected and shareholders cannot retain part of the rescued company shares unless every corporate creditor is fully satisfied, as they are residual claimants.

On the contrary, there are some authors who believe that enabling shareholders to retain participation in reorganization proceeding may be seen positively as it involves shareholders more in the efficient working of a business and it is more likely that a financial crisis is discovered and avoided.

There are two main arguments to support such a view.

Firstly, it may be argued that the debtor responsibility rule might be interpreted in a functional way. This could be seen as the consuquence of safeguarding creditors by preventing debtor to exclude part of its assets from creditor claims. Shareholder conservation of part of their shares might indeed be seen by creditors themselves as the best solution available in reality; especially if corporate creditors would received less in liquidation proceedings than in case of reorganization.

Then, another argument looks at the rule which requires a specific provision of law, to be able to legitimately provide an exception to the absolute priority rule, and it affirms that reorganization proceedings themselves might be interpreted as legal exceptions, so allowing shareholders to maintain corporate shares whenever a reorganizational plan has been approved by every class of stakeholders[407].

Besides, another complex (already overtaken) issue, may arise which is related to the role of dissenting creditors. Differently from shareholders indeed, corporate creditors have not accepted the majority rule.

However, such an argument does not make any sense anymore for the majority of scholars. What is important today is that insolvency creates a group of holders of

---

[407] See Giacomo D'Attorre, *Concordato preventivo e responsabilità patrimoniale del debitore*, V Convegno annuale dell'associazione italiana dei professori universitari di diritto commerciale "Orizzonti del diritto commerciale", L'Impresa e il diritto commerciale: innovazione, creazione di valore, salvaguardia del valore nella crisi. Rome, 21-22 febbraio 2014. See at page 9.

similar interests while the involuntary nature of such an event is irrelevant. What is crucial in case of insolvency is to be able to identify who is the most suitable to take the best decisions in case of insolvency to be able to increase corporate value[408].

Another problem however, is related to the future profits that the recovered company may generate. In such a situation another violation of the debtor liability rule may be seen which requires debtors to respond even whit its future assets.

However, it has been properly highlighted[409] how the opening of an insolvency proceeding always provides a separation between existing creditors and creditor claims, which may arise during the procedure as well as out of it.

Moreover, whenever shareholders maintain part of a rescued-company's equity they will benefit from the foreseeable profits of the business together with the creditors who have been transformed into equityholders but this would only happen after creditor approval when the best creditors interests test is satisfied.

In these limited cases shareholders might be indeed rewarded for their collaboration but at the same time corporate creditors will be satisfied more than in the alternative case of liquidation.

Even if currently a strict interpretation of the absolute priority rule prevails among European countries, it is also possible to argue in favour of overthrowing such a perspective, based on the example of the American system.

In such circumstances, the European Commission has recently intervened with a recommendation to the European Parliament which also aims at encouraging

> Member States to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance, thereby promoting entrepreneurship, investment and employment and contributing to reducing the obstacles to the smooth functioning of the internal

[408] L. Stanghellini, *supra* note 229, at page 377. The majority rule works properly in the presence of three conditions: A) commonality of interests between the members of the group; B) when some limits are established to the majority rule (*individual rights*); C) when the voting right is fairly exercised.

[409] See D'Attorre, *supra* note 407, at pages 19-20.

market[410],

by more flexible techniques of reorganization whenever insolvency impedes rescuing a company with the full satisfaction of all creditor claims.

Finally, some authors in Italy have argued that whenever shareholders want to maintain possess over shares of a rescued company they should pay for their value so providing new value to the corporation.

Such a position recalls the old American *new value doctrine* or *exception.*

This doctrine was elaborated in the 1930s by *Case v. Los Angeles Lumber Products Co*.[411] and then partially modified with *LeSalle*[412], both law cases of the U.S. Supreme Court. This doctrine required shareholders to acquired their participation whenever the company was unable to pay all its creditors during the restructuring procedure. Such a rule then evolved and it does not apply anymore apart from the case of *cram down*. Whenever a class of creditors does not approve the plan, shareholders need to provide new equity if they want to obtain some shares of the recovered company.

In Italy, some authors have look at such procedure and have proposed to apply such a rule (with some differences) in *every kind* of Italian corporate reorganization where shareholders maintain some value[413].

None hypothesis has already had a confirmation by Italian insolvency law.

3.4. Conclusions

This Chapter has examined how shareholder rights change in case of financial distress or insolvency.

Alterations of such rights are more or less significant in relation to the seriousness of a financial crisis. But some common factors may be identified.

Firstly, whenever a company is in financial distress shareholders may no longer be entitled to perceive dividends. In Europe, dividends may indeed be only

---

[410] Commission Recommendation on a New Approach to Business Failure and Insolvency, C (2014) 1500 final, of 12th March 2014.

[411] U.S. Supreme Court, *Case v. Los Angeles Lumber Products Co*., Ltd, 308 U.S. 106, 1939.

[412] U.S. Supreme Court, *Bank of American National Trust and Saving Association v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 1999.

[413] See D. Vattermoli *Concordato con continuità aziendale, absolute priority rule e new value exception*, (forthcoming essay 2014)

conferred if a surplus of assets exists which corresponds to the difference between the corporate assets and its legal capital. However, such a rule may sometimes not reflect the real financial situation of the company which may have a surplus but it may be even unable to pay its due debts. In such a circumstances a distribution of dividends may worsen the situation of financial distress and that is why European jurisdictions are starting to look at the American rule of the *solvency test*, and vice versa even the American jurisdiction has introduced stricter rules which are closer to the European ones.

A second shareholder right which is immediately influenced by a financial crisis is the right to vote. Here the difference of approach between Europe and the U.S.A. is clear. Shareholders of an American firm are treated as any other stakeholders so they will vote as well as they will be only informed if they receive some proceeds from the proceeding.

On the contrary, in Europe the general attitude is to involve shareholders, as residual claimants, in any main decision which is able to change or radically influence their participation in a company, even though voting is still a cost which should be taken into consideration.

Such a different approach between the U.S.A. and Europe corresponds to the traditional attitude of corporate governance.

However, what all the analysed countries agree upon is that the intensity of shareholder involvement depends on the type of insolvency proceeding that has been agreed upon.

In case of bankruptcy, the minimal involvement of shareholders might be understandable as nothing more can be done to resolve the financial crisis, therefore winding up is the only solution left to them. On the contrary, a company undergoing reorganization proceeding might be merged and the whole property structure may have to be restructured. In such cases it is hard to imagine a total indifference of shareholders, especially in Europe where shareholder "ownership" is more safeguarded than in the U.S.A..

The right to vote refers even to the right to be informed. In case of financial distress, the rights of governance generally are not affected and shareholders still have the power to request information and to intervene in a shareholders' general meeting like they were able to do during the solvent life of the company.

However, *de facto*, they may not be able to take advantage of such opportunities when a company is wound up because it is unlikely that a general assembly will be held during liquidation proceedings. This differs in case of reorganization where a company is usually maintained in possess of its assets and the current management remains in charge.

Finally, insolvency may interfere with one of the main features of company law which is the limited-liability rule. Shareholders may indeed be judged personally liable for corporate creditors in the following three situations.

Firstly, this may happen whether they have acted as *de facto* or *shadow* shareholders.

Secondly, shareholders can be made responsible in relation to their opportunistic refunding to the company.

Thirdly, there is the so-called *veil piercing* doctrine which refers to controlling shareholders who have ignored the integrity of their company by not observing formalities. This may occur even when personal and corporate assets are mixed or when shareholders fail to correctly capitalise the company. In such a situation, shareholders must have acted fraudulently or illegally or they must have clearly behaved wrongly to be judged as liable.

The period before actual financial distress is felt can still affect shareholders, even before insolvency proceedings take place. Indeed, they may be informed about the crisis to enable them to take suitable solutions and sensible courses of action ro rescue a company.

In Europe such a need is recognized through the duty of corporate managers to call a shareholders' general meeting << *in case of a serious loss of the subscribed capital* >>[414], when shareholders will be able to adopt corrective solutions to prevent insolvency.

Shareholders may freely decide to confer new funds, to reduce the legal capital and they may also open the company to new equity.

---

[414] Article 19 of the Second Council Directive, 77/91/EEC. In case of listed companies there are mandatory duties of inside information provided at the European stage as well as a national one.

In Europe, every modification of the legal capital must be approved of by a general assembly while in the U.S.A., managers may issue new shares within a limited amount fixed in the corporate constitutive act.
However, even Article 44 of the E.U. Second Council Directive reserves the right to decide on capital increases to shareholders but it does not state that every kind of provisions must take the form of a capital increase.
Therefore, if some shareholders indirectly invest funds in the company, for instance through renouncing their right to debt reimbursement by such a corporation, they may be allowed to do so without a decision taken in a general meeting as long as the operation does not entail the issue of new equity.
Shareholders involvement is minimal in case of pre-insolvency proceeding. Indeed, the decision to agree to such procedures is not as crucial as bankruptcy proceedings may be and it does not influence the corporate nature of a company or shareholder participations as much as restructuring procedures may do.
Similarly but for totally different reasons, shareholders are not very much involved in case of bankruptcy. Here there is not a general right of shareholders to be informed in the decision to initiate the liquidation proceeding. This may be seen as corresponding to the fact that liquidation is the default proceeding, which must begin whenever an insolvent company cannot be recovered.
The main consequence for shareholders in case of liquidation is dispossession. The debtor is usually replaced by a receiver which takes possession over the corporate assets. He or she is entitled to manage the business whenever it is maintained alive and to look after the winding up of the insolvent company. Shareholders may be more or less involved in the appointment of a receiver through ex-ante power of nomination or ex-post right of dismission depending on national laws.
The way shareholders' are involved becomes instead extremely debated in case of reorganization proceedings.
During such a proceeding, the debtor may maintain possess over the insolvent company and it may be able to independently adopt transactions of *ordinary course of business*. Maintaining the debtor in possession rediscovers the

traditional conflicts of governance between managers and shareholders, which depends on legal traditions.

However, no jurisdiction imposes the duty to initiate an insolvency proceeding to shareholders, while managers are only responsible for it and even eventually liable for inactivity.

In Europe, however, shareholders are entitled to require the board of directors to call for a shareholders' general meeting as during the solvent life of the corporation. Hence during such an extraordinary assembly, shareholders may potentially discuss about a reorganization plan and deliberate on the issue.

Shareholders may vote properly only if they are correctly informed and engaged in the business. In listed companies, for instance,

> there is a perceived lack of shareholder interest in holding management accountable for their decisions and actions, compounded by the fact that many shareholders appear to hold their shares for only a short period of time.[415]

Moreover, shareholders of an insolvent company may be required to express their consent on some extraordinary corporate operations provided in a plan of reorganization. Such involvement is as much pressing as the plan is able to influence or modify, even indirectly, shareholder participations in the company.

Generally, it is possible to distinguish three different context of a plan of reorganization.

Firstly, a proposal may contain a simple debt recovery through reduction of credit interests or through extending the credit due date as well as reducing the amount of the credit itself. In such a context the business may be maintained alive and it may probably need to contract new obligations or to make new credits, for instance with suppliers. Such operations may recover a corporation in financial distress but they may be extremely dangerous for creditors as well. On the contrary, shareholders may not be influenced from such operations hence the board of directors have a full discretion to negotiate such a plan.

[415] See the Action Plan on European Company Law and Corporate Governance, 12.12.2012, COM (2012) 740 final.

Secondly, extraordinary corporate transactions may be adopted to recover an insolvent corporation, such as mergers with solvent corporations, reincorporation in a country with a different legal regime of creditor protection or divisions. All these operations require somehow a shareholders' engagement and that is reasonable as their participation can be reduced, modified or cashed in.

In conclusion, it is clear that the opportunity exists for corporate shareholders to keep control of a company more in the case of reorganization than in case of bankruptcy. Shareholders might be more or less involved in relation to the type of restructuring or reorganizational proceeding adopted. Different procedures could be to try and keep a worthwhile business afloat to pay the creditors with the profits of the business or intervening and changing the corporate structure of a company through mergers or through new provisions and legal capital modifications.

The one which stronger requires for shareholders engagement is the case of proper corporate reorganizations. Here debtholders are converted into equityholders and their credits are "paid" through shares of a solvent company. Such a result may be obtained through the creation of a new solvent corporation where creditors will acquire shares through compensation of their credits; as well as without the creation of a NewCo but by issuing new shares which will be acquired through compensation by all or part of the corporate creditors. Simultaneously, a reduction of capital is provided by destroying the existing stocks. In Europe however the unique way available without shareholders' consent is the creation of a NewCo, because every modification of the legal capital must always be approved by the general assembly.

European jurisdictions differ from the U.S.A. federal insolvency law under other two central aspects. On one hand, with the only exception of Germany, none European country provides a mechanism similar to the American *cram-down* which entitles the judge to confirm a plan of reorganization which has not been approved by each class of stakeholders, unless stakeholders do not receive less satisfaction than it would be in case of liquidation. The non-existence of a similar instrument within Europe authorizes shareholders of an insolvent company to impose their will over corporate creditors. Consequently, to realize a corporate reorganization without shareholders' consent it is necessary to create a NewCo.

On another hand, only American insolvency law allows the reorganization of a company in derogation of the absolute priority rule so admitting shareholders to maintain part of the corporate equity of the restructured company even if creditors have not been all paid in full. Such a derogation is admissible whenever it has been approved by every class of claimants.

However, in case a class of creditors does not approve a plan with such content, the *cram-down* can apply only if shareholders confer new equity to the company, as a "payment" for the stock.

Such a solution is proposed by part of the doctrine even in European jurisdictions, such as in Italy. It is indeed perceived how giving shareholders the chance to maintain a participation in the rescued company might incentivised an early discover of the financial crisis. However, such a derogation to the absolute priority rule is not provided by law, at this moment in time.

Conclusions

After having analysed the role shareholders play during a solvent life of a corporation and how it changes in cases of insolvency, some comparative conclusions may be reached.

As residual claimants, shareholders have a controlling power over the corporation; they appoint members of the board of directors and thus may dismiss them. However, it is the managers who take the daily decisions of management while a shareholder involvement may be only required for *fundamental* transactions, such as modifing the ownership structure of the corporation; creating conflict of interests between managers and shareholders, and transactions which might be decided even without a specific and technical knowledge that shareholders might not be fully aware of.

Even if shareholders are not those who daily manage the corporation it is extremely important that they maintain at least indirectly control of the business (through the managers nomination and revoke) as they are the one which more than any other stakeholders are incentivised to manage the business in an efficient and lucrative way as their right to perceive dividends stand last in line between other corporate credits.

The role of shareholders during the solvent life of a corporation is regulated by company law. On this very matter it has been possible to highlight a generalized distinction between Europe and the U.S.A.. As the latter are characterised by a widespread ownership, the main conflict that corporate governance regulations must face in the U.S.A. is between shareholders as a whole and corporate managers. On the contrary, European corporations usually present a corporate structure characterised by a strong majority which control management, hence the more dangerous aspect is indeed the majority-minority conflict. On these assumptions there have developed a number of rights legally recognized to shareholders during the solvent life of a company.

Whenever a corporation becomes insolvent as it is no more able to regularly pay all its debts as they fall due, shareholders incentives to (indirectly) manage the corporation in an efficient way might be distorted.

Thanks to the limited liability rule they are not responsible for corporate debts and obligations – with only few exceptions, such as when shareholders act as *de facto* directors –. Moreover, while during the solvent life, as residual claimants, they should control the company, as they bear the the cost of failure, when insolvency takes place shareholders will not probably receive anything from a proceeding and they may be able to foresee that. Consequently, they might tend to adopt risky transactions hoping for more favourable circumstances which might actually never arrive.
A similar running of the company will be detrimental to corporate creditors which have become *de facto* residual claimants of the insolvent corporation as they have no longer a certain right to obtain a full repayment for their claims.
It has been argued indeed how in case of insolvency creditors, and no longer shareholders, are *de facto* residual claimants of the corporation. This is why, whenever insolvency comes, bankruptcy laws intervene and work for the best interest of corporate creditors.
As it has been seen, insolvency law provides two main procedures: a liquidation procedure which aims to wind up the company and thus to satisfy creditors with the profits of an auction sale; and a reorganization procedure which consist in an agreement between the debtor and its creditors and which may have several contents.
No shareholders involvement is required whenever they are dispossessed, either if this takes place at the opening of a liquidation proceeding, after the business has been meantime maintained alive or even in case of corporate reorganization whenever corporate assets are conferred to a new corporation whose shares will be then distributed to existing creditors in compensation of and proportionally to their recovered claims.
Shareholders are not even involved in case of reorganization plans which simply provide forms of debt restructuring. Therefore, such a proceeding is totally managed by directors.
These conditions shift whenever a plan includes forms of extraordinary transactions such as mergers. In these cases shareholders are not dispossessed as well, but, unlike debts restructuring, a plan which provide a merger may indeed

considerably influence their participation in the corporation by reducing, modifying or cashing in their stocks. For this reason, shareholders involvement is usually required in such a case.

This different approach between Europe and the U.S.A. on the role of shareholders should have undergoing an insolvency proceeding is maxim in case of corporate reorganization without the debtor consent.

Instead of creating a NewCo which shares will be acquired by existing creditors in compensation of their claim, the same result may be achieved by restructuring the solvent company through a contextual reduction of capital and the destruction of existing shares thus the issue of new shares. These will be acquired by existing creditors in compensation and proportionally to their claims. Such a procedure is however admitted only in the U.S.A. and, since 2012, in Germany.

Here shareholders are treated as one of the several classes of holders of interests or credits. The U.S. Bankruptcy Code – and on its example the German *Insolvenzordnung* – then enable the judge to confirm a plan of reorganization without the consent of a class. This is the so-called *cram down* which can be admitted by law unless the creditors *best interest test* is respected, hence whenever each holder of a claim or interest of the impaired class has accepted the plan or otherwise it will << *receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7* (…) >>[416].

European countries– with the only exception of Germany – have a different approach and every issue of new shares must be authorised by a shareholders' general meeting resolution. As has been examined, however, the same financial result may be achieved by creating a NewCo, as it has happened in the case of the Parmalat corporate reorganization.

Moreover, it may be even discussed how such two different remedies might be interchangeable in term of financial efficiency.

[416] Section 1129 (7) (A) U.S. Federal Bankruptcy Code.

What indeed considerably differs between Europe and the U.S.A. is the possibility to reserve some shares of the reorganized corporation to shareholders even if not all existing creditors have been paid in full.
It has been mentioned how leaving shareholders the possibility to maintain some shares in case of corporate reorganization can work as an important incentive for an early discovery of financial crisis. Furthermore, it may even occur to repair a typical effect of insolvency consisting in the not-efficient shareholder incentives to adopt risky decision of management which goes all to the detriment of corporate creditors.
However, only the U.S. Federal Bankruptcy Code gives shareholders such a possibility. Indeed, here the absolute priority rule may be derogated whether every class of holders of creditors have approved the plan but even through the cram down mechanism when a class dissents. In such a case however, shareholders must confer new equity to the company to maintain a stock.
Such an option is indeed never admitted among European countries where the absolute priority rule can be waived only by law and no law provisions already occur in such sense. However, it is a controversial issue.
The main argument against exception to the absolute priority rule refers to the risk of creating *perverse incentives* between stakeholders, consequently exposing the entire bankruptcy system to abuse and opportunistic behaviours of shareholders. Moreover, admitting the possibility to modify the order of creditor satisfaction may reduce trade by making transactions unsafe for all stakeholders, so provoking a boost under a financial perspective.
However, leaving such possibility to the decision of every stakeholder it may be extremely advantageous in term of efficiency, as it occurs in the U.S.A.. Here indeed, creditors are left free to evaluate the convenience of the plan, whichever the contents, until it is approved by every class of creditors. Indeed, whenever the consent of one class is denied, not only the best interest test must be satisfied – so every dissenting claimants of the dissenting class must be satisfied at least as much as they would obtain in case of liquidation – but also new equity will be provided to the rescued company and such a equity goes to the advantage of creditors as well, who are now equityholders of the reorganized corporation.

One should never forget how insolvency proceedings are indeed focused on the realization of the best interest of corporate creditors. The latter are becoming *de facto* residual claimants and if we assume as central the equation *more risk-more power* we should enforce corporate creditors control over the insolvency proceeding. Moreover, no one better than creditors themselves may know which is the most efficient solution.

Hence, it might be argued that the recent European Commission Recommendation to promote efficiency of national insolvency proceeding may relates to such profiles when it aims for the adoption of more flexible and efficient national insolvency remedies. In such a recent Recommendation[417], the Commission indeed requires new interventions in order to facilitate the process for adopting a restructuring plan, keeping in mind the interests of both companies and creditors, with a view to increasing the possibilities of recovering viable businesses.

Among European jurisdictions national regulations vary in relation to the range of the procedures available to debtors facing financial difficulties in order to restructure their business. In Europe, some member States have a limited selection of proceedings and this means that businesses can only be restructured at a relatively late stage, in the context of formal insolvency proceedings. In other European jurisdictions indeed restructuring is possible at an earlier stage but the procedures available are not as effective as they could be or involve varying degrees of formality, in particular in relation to the use of out-of-court procedures[418]. For all these reasons the European Commission has asked national jurisdictions to intervene to facilitate the restructuring of companies in financial distress at an early stage, without needing to formally open court proceedings and to generally facilitate the process for the adoption of a restructuring plan.

Regarding the rules safeguarding the shareholders interests, European law should balance different interests << *in order to establish an "optimum" of shareholder protection, not a maximum* >>[419] which might go to the advantages of corporate creditors which are *de facto* residual claimants of the insolvent company.

---

417 European Commission Recommendation on a new approach to business failure and insolvency, of 12.03.2014, C(2014) 1500 final.

418 *Supra* "Whereas" (2).

419 J. Armour, *supra* note 12 at page 630.

The best interest of corporate creditors should be the core of every insolvency proceeding. However, such best interest may not simply be evaluated by looking at the original claims but it must be appreciated in relation to what the single shareholder would obtain in the alternative solution of liquidation.

WORK CITED

P. Abbadessa, *Il problema dei prestiti dei soci nelle società di capitali: una proposta di soluzione*, in Giur. Comm., I, 1988

J. Armour, *The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the U.K.*, in Review of Law and Economics, 8, 2012

J. Armour, *How do legal rules evolve? Evidence from a Cross-Country comparison of shareholder, creditor, and employee protection*, in The American Journal of Comparative Law, 57, 2009

J. Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, 58 Current Legal Probs, 2005

J. Armour and S. Frisby, *Rethinking Receivership*, 21 Oxford Journal of Legal Studies, 73, 2001

S.B. Bainbridge, *Corporation Law and Economics*, New York, 2002

W. Baumol, *Business Behaviour, Value and Growth*, London, Macmillian, 1959

V.F.Barca and M. Becht, *The control of corporate Europe*, 2001

L. Bebchuk, *The Case for Increasing Shareholder Power*, in Harvard Law Review, 2004

A. Berle Jr. and G. Means, *The Modern Corporation and Private Property*, New York, Macmillan, 1932

M.M. Blair, *Ownership and control: rethinking corporate governance for the twenty-first century*, Washington D.C., The Brookings Institution, 2005

G. Bosi and S. Trento, *Il governo dell'impresa: economia e diritto della corporate governance*, Bologna, 2012

R.A. Brealey, S.C. Myers and F. Allen, *Corporate Finance*, McGraw Hill, 2006

M. Bruckmüller, *Eigenkapitalersatz in Slowenien*, in *Eigenkapitalersatz Im Österreichischen, Italienischen Und Slowenischen Recht* 69 (Susanne Kalss & Friedrich Rüffler), 2004

V. Buonocore, *Le situazioni soggettive dell'azionista*, Napoli, 1960

M. Celentani, F. M. García-Posada and F. Gómez, *The Spanish Business Bankruptcy Puzzle*, Working Papers, 2010-11, Departamento de Economía Universidad Carlos III de Madrid, available at http://edirc.repec.org/data/deuc3es.html

S. Claessens and L. F. Klapper, *Bankruptcy around the World: Explanations of Its Relative Use*, in American Law and Economics Review, vol. 7 no. 1, 2005

R. C. Clark, *Corporate Law*, Boston, 1986

G. Marcus Cole, *Delaware is Not a State: Are We Witnessing Jurisdictional Competition in Bankruptcy?* 55 VAND. L. REV. 1845, 2002

G. Marcus Cole, *Il diritto concorsuale statunitense in un contesto globale,* in Soluzioni negoziali e istituti "preconcorsuali" nella gestione delle crisi (trad. D. Serafini). Quaderni di Giurisprudenza Commerciale, 366, 2013

R. Costi, *L'interesse sociale nella riforma del diritto azionario*, in Diritto, mercato, etica. Omaggio a Piergaetano Marchetti, Milano, 2010

G. D'Attorre, *Concordato preventivo e responsabilità patrimoniale del debitore*, V Convegno annuale dell'Associazione italiana dei professori universitari di diritto commerciale "Orizzonti del diritto commerciale", L'Impresa e il diritto commerciale: innovazione, creazione di valore, salvaguardia del valore nella crisi. Rome, 21-22 febbraio 2014

Giacomo D'Attorre, *L'attribuzione ai creditori di partecipazioni sociali tra par condicio creditorum e principio di eguaglianza tra soci*, in Riv. Delle Società, 56, 2011.

P.L. Davies, *Gower and Davies' principles of modern company law*, 6th ed., 1997

P.L. Davies and S. Worthington, *Principles of Modern Company Law*, Sweet & Maxwell, 9th edition, 2012

N. De Luca, *Unequal treatment and shareholders' welfare growth: "Fairness" v. "Precise Equity"*, in Rivista delle Società, 629, 4/2009

P. Di Martino, *The historical Evolution of Bankruptcy Law in England, the US and Italy up to 1939: Determinants of Institutional Change and Structural*

Differences, in *History of Insolvency and Bankruptcy from an International Perspective*, Edited by Karl Gratzer and Dieter Stiefel, (Södertörn Academic Studies, 38) Södertörms högskola, Huddinge, 2008

S. Djankov, O. Hart and C. McLiesh, *Debt Enforcement Around the World*, ECGI Working Paper n.147/2007, in Journal of Political Economy, 116, 2008

F. H. Easterbrook and D. R. Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, 1991

V. Edwards, *EC Company Law*, 69, 1999

H. Eidenmüller*, Trading in Times of Crisis: Formal Insolvency Proceedings, workouts and the Incentives for Shareholders/Managers*, in European Business Organization Law Review, 2006

H. Eidenmüller, *A New Framework for Business Restructuring in Europe: The EU Commission's Proposals for a Reform of the European Insolvency Regulation and Beyond*, ECGI Working Paper Series in Law, n.199/2013

L. Enriques and M. Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, Harvard Law School, Discussion Paper No. 19, 7/2008

L. Enriques and J. R. Macey, *Creditor versus capital formation: the case against the European legal capital rule*s, Cornell L. Rev. 1165, 2001

G. Falcone, *La riforma concorsuale spagnola*, Milano, 2006

E. Felli*, I diritti delle categorie di soci*, in G. Berta (directed by) La tutela dei soci, Torino, 2008

G. Ferri jr, *La struttura finanziaria della società in crisi*, in Riv. Dir. Soc., 477, I, 3, 2012

V. Finch, *Pre-packaged administrations: bargains in the shadow of insolvency or shadowy bargains?*, in Journal of Business Law, 2006

D.R. Fischel, *Organized exchanges and the regulation of dual class common stock*, U. Chi. L. Rev., 1987

S. Franken, *Creditor-and Debtor-Oriented Corporate Bankruptcy Regimes Revisited*, in European Business Organization Law Review, n.5, 2004

L. Ghia, *Lo status del fallito negli altri paesi della Comunità Europea*, in *Diritto Fallimentare*, I, 2003

L. Guatri, *Turnaround. Declino, crisi e ritorno al valore*, Milano, 1995

F. Guerrera and M. Maltoni, *Concordati giudiziali e operazioni societarie di "riorganizzazione"*, in Riv. Soc., 2008

H. Hansmann and R. Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, in The Yale Law Journal, n.7, 1991

O. Hart, *Firms contracts and financial structure*, Oxford, 1995

J. Houghton, R. Agostinelli, H. Diogo Amengual, F. Grell and I. Pallarés, *Insolvency Reforms in Europe*, LMA News, July 2012

T.H. Jackson, *The Logic and Limits of Bankruptcy Law*, Cambridge, 1986

T.H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlement and the Creditors' Bargain*, 91 Yale Law Journal, 857, 1982

M. Jensen and W. Mackling, *Theory of the Firm: Managerial Behaviour, Agency Costs, and Capital Structure*, in Journal of Financial Economics, 1976, n. 3

M. Kahan, *Legal Capital Rules and the Structure of Corporate Law: Some Observations on the Differences Between European and U.S. Approaches*, in Capital Markets And Company Law (Klaus J. Hopt & Eddy Wymmeersch), 2003

K.N. Klee, *All You Ever Wanted To Know About Cram Down Under the Bankruptcy Code*, in 53 Am. Bankr. L.J., 133, 1979

R. Kraakman, J. Armour, P. Davies, L. Enriques, H. Hansmann, G. Herting, K. Hopt, H. Kanda, E. Rock, The Anatomy of Corporate Law: A Comparative and Functional Approach, Oxford University Press, 2nd Edition, 2009

R. La Porta, F. Lopez de Silanes, A. Shleifer, R. W. Vishny, *Agency Problems and Dividend Policies around the World*, in The Journal of Finance, 55, vol.1, 2000

R.C. Lease, J.J. McConnell and W.H. Mikkelson, *The market value of control in publicly-traded corporations*, 11 Journal Fin. Econ 439, 1983

S. Lombardo and P. Pasotti, in *Disintegrating the Regulation of the Business Corporation as a Nexus of Contracts: Regulatory Competition vs. Unification of Law*, ECGI Working Paper Series in Law, n.102/2008

L. M. LoPucki and S. D. Kalin, *The Failure of Public Company Bankruptcies* in Delaware and New York: Empirical Evidence of a "Race to the Bottom", 54 VAND. L. REV. 231, 2001

J.M. Lucheux and O. Puech, *France: Bankruptcy and Insolvency Law and Policy* in The Law of International Insolvencies and Debt Restructurings, ed. J.R. Silkenat, C. D. Schmerler, Dobbs Ferry, NY: Oceana, 2006

M. Maugeri , *Partecipazione sociale e attività di impresa*, Milano, 2010

D. J. Meyer, *Redefining the New Value Exception to the Absolute Priority Rule in Light of the Creditors' Bargain Model*, 24 Indiana Law Review, 417, 1990-1991

A. Nigro, *La disciplina delle crisi patrimoniali delle imprese,* XXV, Trattato di diritto privato by M. Bessone, Torino, 2012

F. Pasquariello, *Gestione e riorganizzazione dell'impresa nel fallimento*, in Quaderni di giurisprudenza commerciale, Milano, 2010

J. Rickford, *Reforming Capital. Report on the Inter- disciplinary Group on Capital Maintenance*, 2004 EUR. BUS. L. REV.

G.C.M. Rivolta, *La partecipazione sociale*, Milano, 1965

E. B. Rock, *The logic and (uncertain) significance of institutional shareholder activism*, 79 in George Town Law Journal, 445, 1991

M. J. Roe, *Corporate reorganization and Bankruptcy (legal and financial materials)*, New York, 2000

G. Rossi, *Proprietà, controllo e mercato: una triade scomposta*, in *Proprietà e controllo dell'impresa: il modello italiano stabilità o contendibilità?*, a conference on private and procedural civil law problems "Adolfo Beria di Argentine", National Centre on prevention and social defence, Milano, 2008

G. Rossi, *Il fallimento nel diritto nordamericano*, Padova, 1965

D. A. Skeel, jr., *What's So Bad About Delaware*, 54 VAND. L. REV. 309, 2001

D.A. Skeel, *Debt's Dominion: A History of Bankruptcy Law in America*, Princeton University Press, 2001

V. Sparano - B. Sparano, *La Modifica delle Situazioni Giuridiche nelle Procedure Concorsuali*, Padova, 2002

L. Stanghellini, *Fusioni e scissioni senza autorizzazioni*, Il Sole 24 ORE, 19/08/2013

L. Stanghellini, *Directors' duties and the optimal timing of insolvency. A reassessment of the "recapitalize or liquidate" rule,* in Il diritto delle Società Oggi. Scritti in Onore di G. Zanarone, Torino, 2011

L. Stanghellini, *La crisi di impresa fra diritto ed economia*, Bologna, 2007

L. Stanghellini, *Creditori "forti" e governo della crisi d'impresa nelle nuove procedure concorsuali*, in Fallimento, II, 4/2006

R. S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357 (2000)

U. Tombari, *Principi e problemi di diritto societario della crisi*, in Riv. Soc., 1138, 2013

D. Vattermoli, *Concordato con continuità aziendale, absolute priority rule e new value exception*, (forthcoming essay 2014)

M. Ventoruzzo, *I criteri di valutazione delle azioni in caso di recesso del socio*, in Riv. Soc., 309, 2005

L.A. Weiss and K.H. Wruck, *Information Problems, Conflicts of Interests, and Asset Stripping: Chapter 11's Failure in the Case of Eastern Airlines*, in Journal of Financial Economics, 48, 1998

O. Williamson, *Corporate Finance and Corporate Governance*, in *Journal of Finance*, 1988, n. 43

W. J. Woodward jr, *Insolvency Procedures in the U.S.A.*, in Profili Storici, Comunitari, Internazionali e di Diritto Comparato, V Volume of Trattato di diritto fallimentare e delle altre procedure concorsuali, Torino, 2014

Frank Woolridge, *Überseering: Freedom of Establishment of Companies Affirmed*, in European Business Law Review, 14, 2003