

Modification of participation rights: in which cases the withdrawal of the shareholder is justified

In judgement no. 13845/2019 the Supreme Court has ruled that the change of a by-laws clause which indirectly reduces the eligible percentage of dividend distribution by increasing the percentage to be allocated to reserves, negatively affects the shareholders' patrimonial rights, thus justifying the withdrawal right of those shareholders that did not take part to the relevant shareholders resolution pursuant to Article, paragraph 1, lett. g) of the Italian Civil Code.

Amongst the range of instruments that the Italian Civil Code provides for to protect minority shareholders, the right of withdrawal (*diritto di recesso*) is one of those that were most shaped by the 2003 reform of Italian corporate law. If, on the one hand, the reform has reinforced the powers of majorities, for instance by reducing the chances of minorities to cast vetoes (pursuant to article 4, paragraph 9, lett. d) and article 3, paragraph 1, lett. f) Law no. 366/2001), on the other hand, it has tried to rebalance the interests of minority shareholders, *inter alia*, by adding to Article 2437 more grounds for withdrawal (both mandatory or non-mandatory).

Article 2437 of the **Italian Civil Code** grants shareholders of a joint stock company with the **right to divest** - by exercising their **right of withdrawal** and triggering a procedure aimed at having their participation liquidated - in case they have been absent, have dissented to or have abstained from voting a number of resolutions that have the ultimate effect of significantly changing the **company's risk profile**. Such decisions include: "*an amendment to the provision of the company's by-laws regarding the corporate purpose, when it triggers a significant change to the company's business* (lett. a)); the "*transformation of the company*" (lett. b)), the "*transfer of the company's registered office abroad*" (lett. c)), the "*revocation of*

the liquidation procedure" (lett. d)), and "*changes to the by-laws relating to voting or participation rights*" (lett. g)).

Changes to the by-laws relating to voting or participation rights

Amongst the decisions triggering the right of withdrawal, **letter g)** of the **first paragraph** of **Article 2437** includes such resolutions that amend the company's by-laws with respect to "voting rights" or "participation rights". "**Voting rights**" refers to the innate right of each shareholder to determine the company's future in the shareholders meeting. Resolutions that trigger letter g) would be, for instance, those converting non-voting shares into voting shares; or changing the conditions to which the exercise of voting rights is subject to, etc. The expression "**participation rights**", on the other hand, has given rise since the 2003 reform to many discussions due its vagueness.

The (rather scarce) case law and the academics have focused on identifying (i) what can qualify as "participation right" and (ii) what kind of amendments to such right may, in fact, trigger the right to withdraw by the dissenting shareholder.

According to a minority opinion, somewhat extensive, participation rights would encompass **economic rights** (fore and foremost, the right to dividends and the right to the quota of liquidation upon winding-up of the company) and all **administrative rights** other than the right to vote (including the right to request the call of the shareholders meeting pursuant to Article 2367 of the Italian Civil Code; the right to challenge the shareholders resolutions pursuant to Article 2377 of the Italian Civil Code; the right to complain to the Board of Statutory Auditors pursuant to Article 2408 of the Italian Civil Code).

The **prevailing position** – also confirmed by the same Supreme Court in a previous judgment (Supreme Court, judgement n. 13875/2017) – is more restrictive and includes only rights with an economic/patrimonial nature in the participation rights.

Different opinions have been maintained over the years with respect to the nature of the by-

laws amendments apt to trigger the withdrawal right. Recent case law seems to suggest that only “**direct**” **changes**, meaning changes regarding specifically the rights stemming from each share and therefore the prerogatives of each shareholder in the abstract, are considered relevant for the purpose of the right of withdrawal. For example, the introduction of a by-laws clause that, in the event of future increases in corporate capital to be paid in cash, requires shareholders to immediately pay the entire amount subscribed, instead of 25% pursuant to Article 2439 of the Italian Civil Code, has been considered as a direct change to a patrimonial right (Court of Rome, 21 January 2013). “**Indirect**” or “**de facto**” **changes**, on the contrary, would not amount to a cause for withdrawal.

For instance, no right of withdrawal has been granted by Italian tribunals in the event of amendments (i) to the *quorum* of the shareholders’ meeting (Supreme Court, judgement no. 13875/2017) or (ii) to the procedures for the appointment of the company’s directors (for example, by introducing or eliminating the so-called “list voting” practice, such as in Court of Rome, 30 April 2014), maintaining that such changes do not affect the voting right incorporated in each share. In such events the extension or the content of the right to vote remain themselves unchanged, and only the *de facto* position of the shareholder who, as a consequence of the amendment, might lose the power to veto certain resolution, or to appoint one director, is affected.

Supreme Court’s decision

The judgement rendered on 22 May 2019 by the First Section of the **Italian Supreme Court** is one of the few cases where the Supreme Court has had the chance to give its opinion on letter g) of Article 2437.

The dispute originates from a **merger by absorption** of two companies. While the by-laws of the merged company provided that the shareholders meeting could resolve on the dividend distribution only after 5% of the profits were allocated to the legal reserve (in compliance with Article 2430 of the Italian Civil Code) and a further 5% was allocated to an

extraordinary reserve, the by-laws of the absorbing company allowed the distribution only subject to a significant portion of the yearly net profits being allocated to equity. More specifically, the dividend distribution was subject to the allocation of at least 12% of profits to the legal reserve (up until such legal reserve was equal to 40% of the corporate capital) and a further 5% to the extraordinary reserve (up to 40% of the corporate capital).

The **shareholders** who did not participate in the approval of the merger plan were **denied** their **right of withdrawal** by the absorbing company, and brought an action to court to have the company been ordered to liquidate their shares. Both the Appellate Court and the Supreme Court considered the withdrawal to be lawful, endorsing the position of the plaintiffs according to which the change in the by-laws made during the merger had caused a direct modification of the shareholders' participation rights pursuant to art. 2437, paragraph 1, letter g), of the Italian Civil Code.

More specifically, the Supreme Court maintained that the **new by-laws clause directly** – and negatively – **influenced the shareholders' patrimonial rights** because, due to the increase in the percentage to be allocated to reserves, in practice it reduced the eligible percentage of dividend distribution, and thus ended up *“limiting the freedom itself of the ordinary shareholders' meeting to resolve on this matter”*. In the Supreme Court's view, it is immaterial to the case at stake that the right to dividend generally arises only following a specific resolution by the shareholders meeting (thus potentially qualifying as a simple “expectation” rather than a right). In the case at hand, the by-laws provision would be considered as directly limiting the right of the shareholders meeting, therefore **compressing the individual shareholders' dividend rights**, even before such rights arise.

Although indirectly adhering to the opinion maintaining that only direct changes should amount to a cause for withdrawal, the Supreme Court has failed to take a clear position on the definition of “participation rights”. It only stated that *“there is no doubt that the expression refers in any case to patrimonial rights, because such are, in the joint stock*

company, those implicated by the right of participation, including the percentage of the dividend distributable on the basis of the by-laws”.