

THE EXIT RIGHT GRANTED TO MINORITY SHAREHOLDERS IN ENGLISH, ITALIAN AND CHINESE LAW: PATH-DEPENDENCE RESISTANCE TO GLOBAL-CONVERGENCE

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Abstract

Looking at the evolution of the exit right granted to minority shareholders by different company law systems through the lens of economic history may reveal the extent to which path-dependence is resisting to global convergence. The role played by the privatisation of large corporations in the development of Italian company law has been of the utmost importance: in an effort to shift, in a few years, from the state-ownership structure of the industrial system to a partial private-ownership one, company law has been significantly amended with the hope to artificially reproduce the conditions of an efficient and liquid market. Minority shareholders in Italy have been granted the right to withdraw from the company in a wide range of circumstances, all based on the mere disagreement of the minority with respect to resolutions passed by the majority shareholders. The right to withdraw has been structured in such a way that the duty to re-purchase the shares of the withdrawing shareholder ultimately rests on the company, as a result of the scarce liquidity of the equity market. Additionally, a sell-out right has been introduced for listed companies only, with a clear concern for the restoration of a minimum level of liquidity of the relevant shares. The Chinese case is, in this respect, surprisingly similar to the Italian one. The massive privatisation of state-owned enterprises in China, which is being carried out in these years, is triggering changes to its company law system that mirror the Italian one in terms of enlargement of the withdrawal right and development of the sell-out right for listed companies as a tool to preserve the listed shares' liquidity. Additionally, the conversion of the Chinese and Italian industrial systems into a private-ownership one is far to be completed in both countries, as few or no public companies emerged as a result of the privatisation process and the State still exercises a significant influence on the privatised companies through "golden shares" mechanisms. Minority shareholders' protection under UK company law has not evolved with a concern for market liquidity. This is probably due to two factors: first, the English equity market has been traditionally stronger than that of many other countries; second, the British industrial system has undergone a more genuine shift from public to full private ownership during the privatisation wave of the eighties. "Golden shares" mechanisms adopted under UK law have been shaped with a weaker interventionist stance and for some reasons (probably based on path-dependence) have not prevented the emergence of public companies. As a consequence, exit rights are granted very sparingly by UK company law and only in cases where an "unfair prejudice" has been suffered by the minority shareholders, as opposed to the mere disagreement which is enough to ground the withdrawal right in Italy and China. Additionally, the sell-out right was first introduced in UK law as a balancing act against the squeeze-out right, thus being based on concerns different from that of the liquidity of the equity market: indeed, the squeeze-out and the sell-out rights are applicable to both listed and non-listed companies in the UK.

Keywords: Exit right – withdrawal right – appraisal right – Italy – UK – China – path dependence – global convergence – equity exchanges – minority shareholders – liquidity – sell out – squeeze out.

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1. Introduction

The relationship between minority and majority shareholders lies at the heart of any company law system. Under a principal-agent perspective, it may be argued that majority shareholders act as agents of the minority ones to the extent that their behaviour positively or negatively affects the minority shareholders' position.

Minority shareholders are usually granted protection in terms of *appointment rights* (e.g.: by making it mandatory to insert a provision governing

cumulative voting systems or setting voting caps in the company's by-laws), as well as *decision rights* on certain matters of major importance and, in some cases, specific rights relating to *profits sharing*. Additionally, several company law systems have developed strategies to protect minority shareholders through constraints on controllers and directors²⁰.

²⁰ This often implies the hard task to find a consistent conceptual basis for imposing fiduciary duties on directors *vis-à-vis* individual shareholders. In *Percival vs Wright* [1902] Ch 421, the principle was established whereby

This article focuses on the protection of minority shareholders in terms of *affiliation rights* (i.e.: exit rights and appraisal rights). More precisely, the aim of this article is to provide a preliminary and non-conclusive evidence that the following proposition is true: the extent to which different legal systems grant exit rights to minority shareholders varies according to the extent to which *path-dependence* dynamics are resisting to *global convergence* in the development of the legal systems at stake.

Three company law systems will be compared: the British, Italian and Chinese ones.

United Kingdom, Italy and China represent three completely different economies which are increasingly intertwining in recent years. The European Union integration is resulting in a partial convergence of the Italian and British company law rules, while the Chinese legal system is evolving at an increasing pace to reach international standards in an effort to meet the expectations of foreign investors.

Yet, the Chinese economic history has some similarities with the Italian one, at least under a perspective which has significantly influenced the evolution of the corporate law systems of the two countries: the role played by the massive privatisation of state-owned enterprises, which occurred in Italy in the nineties and is currently taking place in China. Additionally, the three mentioned legal systems have undergone recent major reforms: a company law reform in Italy came in to force in 2004; a new company law has been enacted in China in 2005 and the last version of the British Companies Act received Royal Assent on November 8th, 2006.

For all these reasons, it becomes apparent that comparing these three legal systems may provide interesting insights as to the clash between global convergence and path dependence in the evolution of company law.

Paragraph 1 will provide a general overview of the relevant provisions of British statute and common law with respect to appraisal and exit rights granted to minority shareholders, while the Italian and Chinese

legal framework will be briefly described, respectively, in the second and third paragraphs.

Paragraph 4 addresses the issue of identifying the path-dependence determinants in the evolution of Chinese and Italian company law and mainly focuses on the privatisation of state-owned enterprises.

My conclusions will be summarised in Paragraph 5.

2. Exit Rights under U.K. Law

In an effort to summarize the legal framework governing minority shareholders' protection under U.K. law in terms of affiliation rights, it appears convenient to focus on three fundamental areas, namely: Section 122 of the Insolvency Act 1986; the "unfair prejudice" remedy under Section 994 of the Companies Act 2006 (formerly Section 459 of the Companies Act 1985) and the "sell-out right" within the context of a takeover.

Looking at the evolution of UK company law from an historical perspective, the oldest remedy for minority shareholders protection can be identified in Section 122 (1) (g) of the Insolvency Act 1986, which was introduced in the earliest days of modern company law (e.g.: see Section 110 of the Insolvency Act 1948) and entitles the Court to wind up the company when it deems it "just and equitable".

The broad freedom left in the hands of the Court to decide what it is meant by "just and equitable" could have easily resulted in the instability of the entire system but, notwithstanding this risk, as a matter of fact this remedy has always been perceived as an "*extrema ratio*" to solve serious conflicts which are likely to undermine the relationship of mutual trust on which the company's incorporation is based.

In 1948, Section 210 of the Insolvency Act was introduced²¹ with the purpose to improve the flexibility of this remedy. Pursuant to this provision, if the circumstances were such that a just and equitable winding-up was available but it was inappropriate to grant this remedy, the court could instead grant such other remedy as it thought fit²². As a consequence, court's intervention was allowed not only to dissolve the company, but also to take such other actions as organizing the exit of one of the litigants under fair conditions.

Here again, the concern for the instability of the entire system has most likely triggered the courts' reluctance to adopt an interventionist approach²³,

directors do not owe duties to individual shareholders: a proposition which, coupled with the fact that common law does not perceive the controlling shareholders to be in a fiduciary position towards the minority, would result in the minority shareholders being poorly protected. That's why the Common Law system has increasingly developed the "special facts" doctrine, in an effort to recognise that in some exceptional cases the directors can be regarded as under a fiduciary duty *vis-à-vis* the shareholders: see *Peskin v Anderson* [2001] 1 BCLC 372. Section 994 of the Companies Act 2006 contains a provision (that was already provided by Section 459 of the Companies Act 1985) which allows a member of a company to apply to the court by petition in case of unfairly prejudicial misconducts carried out – *inter alia* – by other members. The court may ultimately order the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly.

²¹ See the report of the Cohen Committee, "Report of the Committee on Company Law Amendment" (Cmd 6659, HMSO, London, 1945).

²² P.DAVIES (2002) "Introduction To Company Law", Oxford, 237. For a general assessment of the current state of English company law on minority shareholders' remedies from historical and theoretical perspective, see A.J. BOYLE (2002) "Minority Shareholders' Remedies", Cambridge.

²³ The nature and scope of the just and equitable winding up has been reviewed in two leading cases that shaped the use of this remedy to cover situations where a fraud on minority

which lead to the introduction of new statutory law in 1980 (see Sections 459-461 of the Companies Act 1980 and 1985) governing the judicial reaction in cases of “unfair prejudice” suffered by minority shareholders due to the majority’s “oppression”²⁴.

The current formulation of the “unfair prejudice” remedy is set forth under Part 30 (Section 994) of the Companies Act 2006 (formerly Section 459 of the Companies Act 1985) and allows the minority shareholder to make a petition to the competent Court in order to demonstrate that: (a) the company’s affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members, or (b) an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial. If the court is satisfied that the petition is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of, including, *inter alia*, to “provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company’s capital accordingly”.

This remedy seems to have quite a large spectrum of possible applications and it is being increasingly used as a substitute for derivative action²⁵.

As a matter of fact, however, a reasonable offer to buy out the petitioner’s shares at a fair price may suffice to avoid the compulsory winding-up of the company under Section 122 of the Insolvency Act²⁶ and, at least in some cases²⁷, a petitioning minority has been barred from complaining about unfair prejudices in cases where he was not in a position to demonstrate that he had tried to use the provisions of the articles of association to determine the fair value of his shares. This trend of common law clearly reveals the courts’ effort not only to allow for the exit of the minority shareholders in order to avoid further

worsening of the litigation which may hamper the company’s operations, but also to organize such exit at fair conditions. That’s why the price at which the shares are bought by the majority shareholder is a critical issue, which is usually dealt with in the articles of associations²⁸.

Given this general overview, it becomes apparent that UK company law uses appraisal rights very sparingly and is quite reluctant to enable the minority shareholders’ exit unless it has been ascertained that the conduct of the majority is in some sense improper²⁹. In the unparalleled words of Professor Paul Davies, “*The unfair prejudice remedy, like the law of divorce, is much better at bringing relationships to an end on a fair basis than at restoring partnerships which have broken down*”³⁰.

To complete this picture, Section 983 of the Companies Act 2006 (formerly, Section 430A of the Companies Act 1985) provides that the holder of any voting shares to which a takeover offer relates (where “takeover offer” means a takeover on all the company’s shares) who has not accepted the offer may require the offeror to acquire those shares if, at any time before the end of the period within which the offer can be accepted, the offeror has acquired or contracted to acquire not less than 90% of the shares carrying voting rights³¹.

This provision, referred to as the “sell-out” right granted to minority shareholders, represents an additional case where minority shareholders can exit the company and it applies both to listed and non-listed companies. Quite differently from what we have seen in so far, here the circumstance which entitles the minority shareholder to leave the association is not a conflict with the majority, or a misconduct of the latter: it’s the mere fact that the majority shareholder has gained control of more than 90% of the voting rights. So what’s the rationale of this provision and how can it be consistent with the conceptual

shareholders occurred. See *Ebrahimi v. Westbourne Galleries* [1973] AC 360 and *O’Neill v Phillips* [1999] 2 BCLC 1 (HL).

²⁴ This shift towards the conceptual foundation of the minority’s exit on the notion of “unfair prejudice” was designed by the Jenkins Committee in 1962. Replacing the concept of “oppressive conduct” (in the old Section 210) with that of “unfair prejudice” reveals how the moral assessment of the misconduct *per se* is not enough to ground a petition under the unfair prejudice statute: what you need is to demonstrate objectively that a given misbehaviour triggers unfair consequences to the detriment of the complaining shareholder.

²⁵ *Re A Company* (No. 005278 of 1985) [1986] 1 WLR 281; *Re A Company* [1986] BCLC 382; *Re A Company* [1986] BCLC 376. Further to the recent introduction of new statutory provisions in the Companies Act 2006, chances are that the relationships between these two remedies will be partially reviewed.

²⁶ *Re A Company* (No. 002567 of 1982).

²⁷ *Re A Company* (No. 004377 of 1986) [1987] BCLC 94 at 102.

²⁸ Whether the valuation of the shares should be performed on a pro-rata basis or a discounted minority holding basis is quite a controversial and far to be solved issue. See *Virdi v. Abbey Leisure* [1990] BCLC 342. A comprehensive analysis of this case is discussed in A. GREGORY and A. HICKS (1995), “*Valuation of Shares: a Legal and Accounting Conundrum*”, in *Journal of Business Law*, pp. 56 ff.

²⁹ See, for instance, *Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2)* [1982] Ch 204; *Pavlidis v Jensen* [1956], Ch 565, *Birch v Sullivan* [1958] 1 All ER 56, [1957] 1 WLR 1247. Additional references may be found in K.W. WEDDERBURN (1957), *Shareholders’ Rights and the Rule in Foss v Harbottle*, in “*Company Law Journal*”, pp. 93 ff.

³⁰ P. DAVIES (2002) 242. This is not to say that UK company law is poor on minority shareholders’ protection, which is obtained through other mechanisms. See LA PORTA, LOPEZ-DE- SILANES, SHLEIFER and VISHNY (1997) “*Legal Determinants of External Finance*”, in *Journal of Finance*, 52, 1131-1150.

³¹ This description of the relevant provision is merely explanatory and voluntarily simplified.

framework envisaged in the “unfair prejudice” remedy and the “just and equitable” winding-up?

It may be argued that this provision should be read as an effort to comply with the Thirteenth Directive on takeovers, which makes it compulsory for Member States to grant a sell-out right to minority shareholders³². However, the sell-out right has been introduced in UK well before the Directive came into force. Another explanation might be that the minority shareholders must be protected against the risk that their shares are not liquid enough to let the market properly set their price. But also this latter hypotheses seems to be falsified by an historical analysis of how and when the sell-out right has been introduced in the UK. Such analysis seems to ground the conclusion that the sell-out right has been introduced as a balancing act against the *squeeze-out* right granted to the majority shareholder. Such right, currently set forth under Section 979-982 of the Companies Act 2006 (formerly Sections 428-430F of the Companies Act 1985³³) allows the majority shareholder who has acquired or unconditionally contracted to acquire not less than 90% of the voting rights to force the minority shareholders to sell their shares³⁴.

The fundamental purpose of the squeeze-out right is to “enable takeover bids to be fully implemented”³⁵ and protect the majority shareholders against the risk of greenmailing by the minority ones. On the other side, the purpose of the sell-out right in English company law is to strike a balance between the strong protection granted to the majority shareholder through

the squeeze out right and the need to prevent majority shareholders from abusing of such right³⁶.

Besides their historical evolution, what makes the British sell-out and squeeze-out rights quite unique is that they are provided with respect to listed as well as non-listed companies. As explained in the following paragraph, this is not the case under Italian and Chinese law.

3. Exit Rights under Italian Law

The exit strategies available for minority shareholders of Italian joint-stock companies can be found in two fundamental areas company law: the right to withdraw from the company and the sell-out right.

Interestingly, the sell-out right is granted only to minority shareholders of listed companies.

As far as the right to withdraw is concerned, it has been significantly widened further to the recent company law reform (so-called “Vietti Reform”)³⁷.

The new Section 2437 of the Italian Civil Code, which applies to listed and non-listed companies, now provides as follows:

“shareholders who have not taken part to resolutions relating to:

- a) a change of the clause regarding the corporate purpose, when it permits a significant change of the company’s business;
 - b) a conversion of the company;
 - c) a transfer of the company’s registered office abroad;
 - d) a revocation of the winding-up status;
 - e) a suppression of one or more of the reasons for withdrawal provided by the following paragraph or by the by-laws;
 - f) a change of criteria for determining the share value in case of withdrawal;
 - g) amendments of the by-laws relating to voting or participation rights
- have the right to withdraw, with respect to whole or part of their shares”.

³² The concerns which lie behind this provision of the Thirteenth Directive are widely explained in the report of the High Level Group of Company Law Experts (so-called “Winter Report”) and can be approximately summarised as follows: (i) risk of abuse of its own rights by the majority shareholder; (ii) the risk that the reduction of the shares’ liquidity resulting from the collection of shares in excess of a 90-95% threshold may hamper the minority shareholders.

³³ But the first statute containing this provision was Section 155 of the Companies Act 1929, followed by Section 209 of the Companies Act 1948.

³⁴ This description of the relevant provision is merely explanatory and voluntarily simplified.

³⁵ See Company Law Review Steering Group’s consultation document “*Modern Company Law For a Competitive Economy – Completing the Structure*”, p. 209. See also *Re Britoil* [1990] BCC 70 and *E. BOROS* [1998], *Altering the Articles of Association to Acquire Minority Shareholdings*, in B. RIDER, “*The Realm of Company Law*”, London – The Hague – Boston. According to this latter Author, the origins of the squeeze-out right can be found in the “*Report of Company Law Amendment*” (1926) drafted by the Greene Committee. Further to the suggestions contained in such document, the squeeze-out right was first introduced in Australia where, after an initial cautious attitude of the Courts (see *Re Hoare and Co. Ltd* [1933] 150 LT 374 and *Blue Metal Industries Ltd. And Anor v R W Dilley* [1970] AC 827), it has increasingly been accepted from the mid-eighties on (see *TNT Ltd v NCSC* [1986] 11 ACLR 59).

³⁶ It’s noteworthy to highlight that the squeeze-out right has been introduced only recently in several European countries. In Italy, it has been introduced in 1998 (Section 111 of the Legislative Decree No.58/98); in Germany, in 2001 (*Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen*); in France, in 1993 (L. 93/1444 of December 31st, 1993, as amended by the *arrête* of December 18th, 2000).

³⁷ More precisely, before the enactment of the new law, the right to withdraw was granted according to the following provisions only:

(i) Section 2437 of the Italian Civil Code provided that “shareholders disagreeing upon resolutions regarding changes of the company’s business purpose, a conversion of the company and a transfer of the company’s registered office abroad, are entitled to withdraw and to claim for the reimbursement of their shares [...]”;

(ii) Section 131 of the Legislative Decree 58/98 (which governs listed companies only) provided that: “shareholders disagreeing upon resolutions regarding mergers or demergers of the company are entitled to withdraw under Section 2437 of the Italian Civil Code”.

Additionally, the same provision states that “*unless otherwise provided for by the by-laws, shareholders who have not taken part to the approval of a resolution concerning a) an extension of the company’s term; or b) establishment or removal of encumbrances on the circulation of share certificates have the right to withdraw*”.

Again, a withdrawal right is also granted *ex lege* in those cases where the company’s term is not determined: “*If the company is formed for an indefinite time and shares are not listed on a regulated market, a shareholder may withdraw by giving at least one hundred and eighty days’ prior notice*”. Finally, pursuant to Section 2497-quarter of the Italian Civil Code, a minority shareholder of a company subject to direction and coordination of an other company is entitled to withdraw from the company, *inter alia*, “*when the entity exercising direction and coordination has either resolved its own conversion, insofar as it entails change of its purposes, or a change of scope, to the extent that it involves activities significantly and directly altering the economic and financial position of the directed company*”.

As a result of the company law reform, minority shareholders of Italian joint-stock companies – no matter if the relevant company is listed or not – are entitled to the withdrawal right in a far wider range of circumstances, all based on the dissent of the minority shareholder upon certain resolutions passed by the shareholders’ meeting.

The Italian sell-out right is set forth under Section 108 of Legislative Decree 58/98 (i.e.: the regulatory framework for listed companies) sets forth a sell-out provision stating that “*any person who comes to own a shareholding exceeding ninety per cent of the ordinary shares shall file a takeover bid to buy all the shares with voting rights at the price set by Consob unless, within one hundred and twenty days, he restores a free float sufficient to ensure regular trading [...]*”.

The structural difference between the withdrawal right and the sell-out right is that the withdrawal right may ultimately result in the *company* being forced to purchase the dissenting minority’s shares (thus triggering the need to reduce the corporate capital accordingly, to the detriment of creditors), while the sell-out right imposes the duty to purchase said shares on the *majority* shareholder only.

Another important difference lies in the circumstances which give rise to the sell-out right vis-à-vis those triggering the right to withdraw. It may be argued that, as far as the *sell-out right* is concerned, the event which entitles the minority shareholder to sell-out his shares to the majority consists of a *de facto change* of the company’s ownership structure: that is, the concentration of ninety percent of the shares in the hands of one shareholder. Quite differently, the *withdrawal right* results from the *conflicting opinions* of majority and minority shareholders as to some fundamental changes in the basis of the shareholders association.

Some authors have argued that, in light of the above, both the withdrawal right and the sell-out right

are grounded on the need to allow an exit strategy for the minority shareholders in those cases where the basis of the association (as inherently laid down in the articles of association or in the ownership structure of the company) is going to be changed against the will of the minority³⁸.

Building on this thesis, it can be argued that the rules governing the exit right for minority shareholders in Italian companies are to be interpreted in the light of the following scenario: on the one side, when the dialectics between majority and minority shareholders turns out to be unbalanced, the remedies available under applicable law are the “ordinary ones”³⁹ and are aimed at restoring the original equilibrium between majority and minority; on the other side, beyond a certain threshold of tolerance, the minority shareholder is allowed to exit the company at fair conditions. Such threshold of tolerance seems to be a twofold nature: it can consist of major changes in the basis of the association due to decisions passed by the majority (thus giving rise to the withdrawal right), or of *de facto* changes in the ownership structure (thus triggering the sell-out right). In the first case, as the changes are caused by the company through a shareholders’ meeting resolution, the company should ultimately bear the costs of the minority’s exit (withdrawal right); in the latter, the event triggering the exit right (collection of shares in excess of the ninety percent threshold) is caused by the objective conduct of the majority and that’s why the same shall be forced to file a bid in order to allow the minority shareholder exit the company (sell-out right). In this latter connection, it is in uncontroversial that the sell-out right has been introduced in Italy with a concern for the liquidity of the shares purchased by the minority shareholder⁴⁰, as opposed to the different concern grounding the British sell-out right.

A squeeze-out right is also provided by Section 111 of Legislative Decree no. 58/98 with respect to listed companies only, stating that “*any person who, further to a takeover bid filed on all the shares of a listed company carrying voting rights, comes to own a shareholding exceeding ninety eight per cent of such shares, is entitled to purchase the remaining shares*”.

³⁸ F. ANNUNZIATA (2001) “*La disciplina del mercato mobiliare*” 332.

³⁹ For instance, the provisions whereby the minority shareholder is allowed to challenge resolutions of the shareholders’ meeting; those forbidding the abuse of the rights granted to the majority; the petition to the Court.

⁴⁰ See, *ex multis*, F. ANNUNZIATA (2001) 330; R. D’AMBROSIO (1998) “*Offerte pubbliche d’acquisto e scambio*”, in C. RABITTI BEDOGNI “*Il Testo Unico della intermediazione finanziaria*” 609; E. DESANA (1999) “*Offerta pubblica d’acquisto residuale*”, in AA.VV. “*La legge Draghi e le società quotate in borsa*” (directed by COTTINO) 63; M. VENTORUZZO (1999) “*Offerta pubblica d’acquisto residuale*” in P. MARCHETTI and L.A. BIANCHI, “*La disciplina delle società quotate nel Testo Unico della Finanza*” 427; G. ROMAGNOLI (1996) “*Le offerte pubbliche d’acquisto obbligatorie*” 71 and 294.

within four months from the completion of the takeover, if he declared his will to make use of this right in the takeover offer”.

It may be appreciated that the relationship between the *squeeze-out* and the *sell-out* rights in Italian law is quite the opposite of that envisaged in British law: in Italy, the *squeeze-out* right is mainly regarded as a tool to maintain a minimum level of liquidity in the stock-market⁴¹, while in UK it has been conceived as a way to protect the majority shareholder against the risk of greenmailing by the minority one. The analysis carried out so far brings us to a twofold preliminary conclusion.

First, it seems quite apparent that, under English law, a mere disagreement between majority and minority shareholders is not enough for court intervention and for the exit of the minority shareholder: if that is all there is, the majority view must prevail⁴². A significant misbehaviour of the majority shareholder is required to ground court intervention and exit by the minority.

This is not the case under Italian law, where the withdrawal right is granted in a wide range of circumstances, all based on the assumption that a mere dissenting opinion of the minority is enough to trigger the application of the rule. Even beyond this, if the company has been incorporated for an indefinite term, the minority shareholder can withdraw by simply sending an advanced notice to the company (as explained above), being it unnecessary to prove that he disagrees upon a given resolution.

Second, the development of the *sell-out* right in England and its relationship with the *squeeze-out* right shows that these provisions, which apply to listed and non-listed companies in the UK, have been introduced with a concern for the internal organization of the company rather than for the liquidity of the market. On the contrary, the structure of the Italian⁴³ *sell-out* and *squeeze-out* rights (which apply to listed companies only) suggests a concern about the absence of liquidity in a traditionally thin equity market.

4. The Chinese Case

The new PRC Company Law Reform came effective on January 1st, 2006. It represents a further signal of the strong commitment of Chinese authorities on developing a legal environment able to meet the expectations of foreign investors.

The reform has introduced major changes in the corporate governance of Chinese companies and –

despite several uncertainties still contained in the new law – it seems that most of the new provisions will also apply to the so-called “foreign invested enterprises” (i.e.: sino-foreign equity and contractual joint ventures; wholly foreign owned enterprises; holding companies; foreign invested commercial enterprises)⁴⁴. For instance, new rules governing fiduciary duties have been enacted, committing directors, supervisors and senior officers to uphold “duties of loyalty and diligence” to their companies and allowing minority shareholders to commence a derivative action against the directors⁴⁵.

Turning to the exit right granted to minority shareholders, it is noteworthy that some of the remedies briefly discussed with respect to UK and Italian law have been in some way reproduced (with significant amendments) under the new Chinese company law system.

An echo of the old remedy of the “*just and equitable*” winding-up provided by English law is to be found in Section 183 of the new Chinese company law, which provides that “*if serious difficulties arise in the operation and management of a company and its continued existence would cause a material loss to the interests of the shareholders and the difficulties cannot be solved through other means, shareholders holding at least 10% of all shareholder voting rights may petition a people’s court to dissolve the company*”⁴⁶.

This provision is coupled with the withdrawal right set forth under Section 75, whereby “*A shareholder who votes against a relevant resolution at a meeting of the shareholders may request that the*

⁴⁴ Although laws regulating foreign invested enterprises prevail over conflicting provisions of the new company law, the latter applies for matters that are not addressed in foreign invested enterprise laws (see Section 218 of the new company law). As a consequence, considering that foreign invested enterprise laws are currently silent on the imposition of fiduciary duties on directors and the restriction of abuses by controlling shareholders, the new company law will most likely govern on these matters. See C. ANDERSON and B. GUO (2006), “*Corporate Governance under the New Company Law (Part I): Fiduciary Duties and Minority Shareholder Protection*”, in “*China Law & Practice*”, Vol. 20, No. 3, 17.

⁴⁵ Under Section 152, shareholders may “*directly initiate legal proceedings in the people’s court in their own name for the benefit of the company*”. Additionally, shareholders holding three per cent or more of a company’s shares may put forward proposals to the board of directors and shareholders holding one per cent of the company’s shares for at least 180 days in succession may apply to the supervisory board for the commencement of a legal proceeding against the directors. What sounds quite unusual is that, should the supervisory board take no action, the derivative action may be started by the same minority shareholders holding only a one per cent stake of the company’s corporate capital.

⁴⁶ See J.M. DESCHANDOL and C. DESMEULES (2006), “*One Hesitant Step Forward: New Company Law Brings Mixed Feelings*”, in “*China Law & Practice*”, Vol. 19, No. 10, 13.

⁴¹ See M. DRAGHI, (1998) “*Audizione del direttore generale del Tesoro presso il Senato della Repubblica, 22 gennaio 1998*”, in “*Rivista delle Società*”, 1, 1998, 23.

⁴² In such cases, protection is granted to minority shareholders through alternative means, such as supermajority requirements and, of course, self-help.

⁴³ Similar conclusions may be applicable to French law, but this falls beyond the purposes of this paper.

company purchase his or her equity at a reasonable price if: (i) the company has not distributed profits for five consecutive years where the company has been profitable during those five years and the shareholder satisfies the conditions for the distribution of profits specified in this law; (ii) the company merges, demerges or transfers its main property; or (iii) the term of operation specified in the company's articles of association expires or other grounds for dissolution as specified in the articles of association arise and the shareholders' meeting resolves to amend the articles of association to extend the life of the company".

It becomes now apparent that the new Chinese company law envisages quite a strong protection of the minority. Additionally, it shares with the Italian legal system the view that exit rights should be granted to minority shareholders not only when an *unfair prejudice* is suffered by the same, but also when they *merely disagree* upon major resolutions.

Withdrawal rights are granted to minority shareholders in China in a narrower range of circumstances as compared to Italy, but the Chinese system shows a stronger interventionist stance as the court may ultimately dissolve the company under a remedy similar to the "*just and equitable*" winding up, which is almost unknown to the Italian Civil Code⁴⁷.

Chinese law also provides for a sell-out right in circumstances quite similar to those referred to under Italian law. Section 97 of the "*Securities Law of the People's Republic of China*"⁴⁸ applies only to listed companies and provides that "*if, after the expiration of the takeover period, the spread of the equity of the acquired company ceases to satisfy listing conditions, the listing and trading of such listed company's shares shall be terminated by the stock exchange in accordance with the law. The other shareholders who still hold shares of the acquired company shall have the right to sell their shares to the acquirer on terms equivalent to that of the takeover, and the acquirer shall acquire the same*".

This language is a clear indication of the concern for the absence of liquidity in the equity market which lies behind the Chinese sell-out right. Indeed, the Securities Law previously in force, which also set forth a similar provision under Section 87, was

⁴⁷ Section 2484 of the Italian Civil Code provides that "*Companies limited by shares [...] shall be wound up [...] due to the impossibility to operate or the continued inactivity of the shareholders' meeting [...]*". However, it is questionable whether the court, in deciding if the company shall be wound up or not, must assess the circumstances which caused the impossibility to operate, or shall simply acknowledge such impossibility and decide accordingly. See *Cass, May 8th, 1992, no. 5498* and the verdict of the *Naples Tribunal on July 28th, 1992*.

⁴⁸ As recently amended on October 27th, 2005, effective from January 1st, 2006. See, for preliminary comments, Y. TIECHENG, A. XU and A. ZHONG (2006), "*Steady as she goes – China's new Securities Law*", in "*China Law & Practice*", Vol. 19, No. 10, 16.

structured in such a way as to grant the sell-out right to minority shareholders only upon reaching the usual 90% threshold by the majority one⁴⁹. That is, the quantitative threshold has been turned into a qualitative one ("*the spread of the equity of the acquired company ceases to satisfy listing conditions*"), thus making it apparent that the purpose of the Chinese sell-out right (similarly to the Italian one) is to ensure a minimum level of liquidity of the listed shares.

5. Path-dependence determinants in the evolution of Chinese and Italian company law: the privatization of state-owned enterprises

The evolution of Italian corporate law in the twentieth century has been heavily influenced by the role played by the state. As widely explained by Prof. Ferrarini⁵⁰, such role was initially limited to supporting industrial growth but, during the "mixed economy" period (from Fascism to the new Republican Constitution in 1948), it turned into a significant interventionist stance in terms of public ownership of large banks and industrial companies. This resulted in the state replacing the private sector in the accumulation of capital⁵¹ and gave raise to a legal framework, envisaged in the Italian Civil Code of 1942, which almost ignored issues like minority shareholders' protection and the efficiency of capital markets.

The exceptional growth of the Italian economy in the sixties did not trigger major structural changes in the industrial state-based system. Rather, the public enterprise system was the backbone of the newly established welfare state: unquestionably, one of the most relevant political determinants of corporate governance in Italy⁵².

⁴⁹ A comprehensive analysis of the "*PRC, Securities Law*" of December 29, 1998, is contained in I. A. TOKLEY and T. RAVN (1998) "*Company and Securities Law in China*", Hong Kong – Singapore.

⁵⁰ G. FERRARINI (2005) "*Corporate Governance Changes in the 20th Century: A View from Italy*", ECGI Working Paper No. 29/2005.

⁵¹ A. AGANIN and P. VOLPIN (2003) "*History of Corporate Ownership in Italy*", ECGI Working Paper No. 17/2003.

⁵² M. ROE (2003) "*Political Determinants of Corporate Governance*", Oxford, 162 ff. The growth of the welfare state, combined with the pivotal role played by the State in the industrial system, resulted in the highly concentrated ownership structure of Italian companies. This is probably due to two factors: on the one side, "*social democratic pressures increased managerial agency costs for shareholders and thus decreased the firm's value to diffuse shareholders. Owners presumably sought alternatives that reduced agency costs, such as close ownership*" (M. ROE, *Ibidem*, 27); on the other, "*the increased role of public ownership reduced the number of enterprises that could assume a diffuse ownership structure as well as the interest for a modern listed companies' regulation*" (G. FERRARINI, *Ibidem*, 14).

Italian company law was partially reformed in 1974, in an effort to organize a securities regulation system and to introduce rules aimed at protecting the so-called “shareholders-investors”⁵³ and create incentive to attract financial resources to the stock market.

Yet, “controlling minorities” enjoyed much more benefits from the reform as compared to investors, and no significant change was introduced to strengthen the monitoring over directors by minority shareholders.

From the early nineties, the European Union integration has increasingly intensified the cross-border interaction of the Italian financial and industrial system with that of other (especially European) economies. At the same time, the massive public debt accumulated as a result of the uncontrolled development of the welfare state in the eighties forced the Italian governments – from the early nineties on – to reduce the role of the state in the economy by starting one of the most impressive privatisation plans ever implemented, in an effort to meet the Maastricht criteria to enter the Euro area⁵⁴.

In the late nineties, some of the largest Italian companies (formerly state-owned enterprises) had been listed in the Italian stock-exchange, which made it necessary to reform the regulation of financial markets through the “Draghi” law (i.e.: Legislative Decree No. 58/98) that was enacted in 1998.

The “Draghi” law is probably the first attempt to structure a legal framework able to strike a balance between the need to develop the market for corporate control and that to protect minority shareholders. Concepts like the derivative action were first introduced by the “Draghi” law and all the rules governing takeovers (including the sell-out right) were significantly modernised. The trend started with the “Draghi” law was then further developed by the company law reform of 2004 (the “Vietti Reform”), which set forth several provisions focused on minority shareholders’ protection.

It may be argued that the protection of minority shareholders, almost ignored by Italian corporate law before 1998, suddenly became a major concern for the law maker from the late nineties on. The privatisation of large state-owned companies and their listing on

the stock-exchange made it necessary to strongly promote investments in regulated markets and to preserve the liquidity of listed shares. At the same time, the task to accumulate capital was re-assigned to the private ownership in a relatively short time, after having been carried out by the state as entrepreneur for fifty years or so.

If looked at through the lens of this background, the structure of the Italian withdrawal and sell-out right mirrors a wider effort of the Italian law-maker to create an efficient-like equity market, where minority shareholders find in the law a protection which they can not find in the market, as the market is not liquid enough due to the persistence of the State through “golden shares” and to path-dependence on close ownership⁵⁵. Additionally, it seems quite apparent that path-dependence dynamics have negatively affected any attempt to convert the privatised corporations into genuine public companies. This explains the wide range of circumstances under which the minority shareholder is allowed to withdraw from the company (thus forcing the company to repurchase his shares, in the absence of a liquid market) and the concern for the liquidity of capital markets which lies behind the Italian version of the sell-out right. The evolution of Chinese law has, in this respect, some interesting similarities with that of Italian law. It is well-known that foreign direct investments which have massively being directed to China in the last two decades have fuelled an unprecedented economic expansion, which resulted in the growth of the gross national product at an increasing pace in recent years.

To support the astonishing development of Chinese economy, the Government authorities have been devolving significant efforts in the last ten years to restructure the financial system which has been traditionally based on the perverse relationship between state-owned banks and state-owned

⁵³ As opposed to the so-called “shareholders-entrepreneurs”: the “shareholders-investors” are referred to as those shareholders who are only interested in the investment *per se*, while the “shareholders-entrepreneurs” are regarded to as those shareholders who invest in order to manage the company.

⁵⁴ The privatisations carried out in Italy have resulted in a reduction of the interests paid on public debt in the area of ten billion Euros (Ministry of Treasury data). According to FRAQUELLI (2000), “*L’attesa della privatizzazione: una minaccia credibile per il manager?*”, Working Paper Ceris-CNR, no. 8, this triggered a significant increase of the efficiency of the internal organization of the privatised companies. The Italian privatisations are discussed in details in D. SINISCALCO, B.BORTOLOTTI, M.FANTINI, S. VITALINI (1999), “*Le Privatizzazioni Difficili*”, Bologna.

⁵⁵ The “golden share” is well-known to UK law too, but its effect on the efficiency of the financial market has been less detrimental, probably due to path-dependence reasons. Additionally, the UK golden share is based on the assumption that the State is a shareholder of the privatised company, while Section 2450 of the Italian Civil Code provided that “*The provisions of this Chapter apply also to limited by shares companies of national interest, consistently with the provisions of special laws which establish a specific discipline for such companies with respect to company management, transfer of shares, voting rights and appointment of directors, statutory auditors and officers*”, no matter whether the State is a shareholder or not. Said special law was the Law No. 474 of July 30th, 1994 as amended by Law No. 350 of December 24th, 2003. This provision has been recently cancelled on February 8th, 2007, due to the verdict of the European Court of Justice in the proceeding C-58/99, but it is still provided that the State may have significant extra-management and monitoring powers if it owns shares in the relevant company. The British and Spanish golden shares have also been challenged too by the Court of Justice in the proceedings C-463/00 and C-98/01.

enterprises. This is being done through an economic policy which may be summarised as follows: (i) state-owned enterprises in strategic industrial sectors are being restructured and often merged into larger corporations (through domestic mergers and acquisitions), in an effort to create “national champions” able to become global players; (ii) state-owned enterprises not operating in strategic industries are being restructured and subsequently privatised.

What sounds unique of the Chinese case is the system which has been created in order to carry out the massive privatisation of companies whose aggregate value exceeds the GDP of several developed countries. In order to avoid the value disruption which occurred in the former Soviet Union, where many of the most prominent and profitable corporations have been privatised through management-buy-out transactions for a consideration significantly lower than the market value, a number of “equity exchanges” have been set up by the Government with the hope of ensuring the transparent, regulated fair and open transfer of state-owned equity.

A body of regulations known as “One Decree and Eight Documents”⁵⁶ constitutes the regulatory underpinnings of China’s “equity exchanges”. Such regulatory framework basically provides that any sale of state-owned assets or equity must be conducted through one or more “equity exchanges”, which consist of a trading platforms to which potential purchasers (companies or financial institutions) have access. This enables the activation of a bidding contest whereby their relevant equity or asset is sold at the highest price or under contractual conditions which are comprehensively considered more convenient by the public seller.

The “equity exchanges” are subject to the supervision of the “State-Owned Assets Supervision Commission” (“SASAC”), which is a State Council-level body that oversees major state-owned enterprises.

As a matter of fact, this policy is triggering the creation of a dynamic private equity market, whose liquidity is comparable to (and prospectively higher than) that of the Shanghai stock-exchange. The exceptional increase of the “M&A” market in China in the last five years is a clear indication of this trend, as the largest “equity exchange” in China has performed more than 3,800 deals in 2006 for an aggregate value in excess of five billion Euros⁵⁷.

All the above, coupled with the increasing attention paid by foreign venture capital funds to China, might bring us to the conclusion that the Chinese economic environment is undergoing a

reorganisation which – notwithstanding self-evident differences – can be compared to the conversion of the Italian economy from a state-owned industrial structure to a system based on private ownership. The implementation of the “equity exchanges” system is being successful far beyond the expectations of those who have designed it⁵⁸ and is driving a significant increase of the Chinese equity market’s liquidity.

The corporate law system seems to have been restructured accordingly. In the new era of Chinese economy, whose *paradigm* is private ownership of corporations, minority shareholders’ protection becomes an essential tool to attract financial resources to the equity market. And the need to adopt a legal framework consistent with the raise of a new equity market, whose liquidity is being significantly increased by the recent reforms, is rapidly aligning Chinese law to that of other countries which have had a similar recent history. Paralleling the Italian case, many privatisations in China are *de facto* being conducted in such a way to ensure that the State still plays a fundamental role in the ownership structure of the privatised companies⁵⁹ and they will hardly result in the establishment of genuine public companies.

Concurrently, a fundamental concern for the preservation and increase of the equity market’s liquidity through new legal provisions comes about in this scenario, as it can be easily appreciated by looking the structure of the sell-out right in China and its changes in the last decade.

6. Tentative conclusions

The evolution of the Italian and the Chinese legal systems is significantly influenced by the economic history of the two countries. Within such history, the massive privatisation of state-owned enterprises has played a fundamental role both in Italy and China.

Looking at the development of an efficient equity market as a priority for the lawmaker is a relatively new experience for Italy and China, and structuring a legal framework instrumental to the project of creating a dynamic equity market implies shaping the rules in such a way as to artificially reproduce the features of an efficient market.

An example of this tendency is precisely the legislative policy to enable minority shareholders to exit the company at fair conditions by forcing the company to purchase the minority shareholders’ shares (withdrawal right) in cases where a mere dissent arises: in the lack of an efficient equity market, where selling the shares is a relatively easy

⁵⁶ Whose backbones are the “Provisional Measures of the Administration of the Transfer of State-Owned Property Rights of Enterprises” (known as “Decree No. 3”).

⁵⁷ Source: internal data of “China Beijing Equity Exchange”, delivered to the author during a presentation at its headquarters.

⁵⁸ The Chinese “State-Owned Assets Supervision Commission” is devolving resources to find scientific-based explanations of the reasons why the “equity exchange” system is being so successful in China, as compared to similar experiments in other countries.

⁵⁹ In most cases, the State maintains a stake in the corporate capital of the privatised companies and is granted significant powers to interfere in the company’s management.

exercise, mandatory provisions are introduced which allow for the exit, ultimately, at the company's expenses. Needless to say, the choice to grant the withdrawal right to minority shareholders in a wide range of circumstances based on mere dissent implies that other interests must be sacrificed, such as those of the company's creditors.

And this tentative conclusion seems to be confirmed by comparing the Italian and Chinese law with the UK one. One reason why under UK law the exit of the minority shareholder is not allowed unless an unfair prejudice occurs might be precisely that minority shareholders are simply regarded to as parts to an agreement (the articles of association), and their protection is confined to what is strictly necessary to ensure that the provisions set forth by the agreement are duly fulfilled. An argument may be built that UK company law has not evolved with a concern for market liquidity because the privatisation of the industrial system after a long-enduring state-intervention has been performed quite differently as compared to jurisdictions like Italy and China. The wide use of hard "golden shares" mechanisms and the path-dependence constraints which, both in Italy and China, have prevented the privatised companies to be converted into genuine public companies, made it necessary to develop rules which could address the concern for market liquidity.

The evolution of the sell-out right in UK, as compared to Italy and – even more remarkably – to China, seems to further strengthen this conclusion: after having been introduced as a balancing act against the squeeze-out right in the UK, where it applies to both listed and non-listed companies, it has been converted into a tool to preserve the liquidity of listed shares in Italy and China.

As a conclusive remark, it seems that an explanation of the different approaches to minority shareholders' protection in British law as compared to the Italian and Chinese ones may be found in different path-dependence dynamics.

At the same time, however, the introduction of provisions aimed at protecting minority shareholders in Italian and Chinese law should be considered as an evolution towards higher corporate governance standards: an evolution triggered by the global convergence of different legal systems, where "global convergence" means the acknowledgement, by different legal systems, that certain issues should be regarded to as priorities, being it understood that they are addressed differently in each jurisdiction due to path-dependence reasons⁶⁰.

The tension between path dependence on one side, and global convergence on the other, is shaping the legal framework of countries whose industrial system is entering the global arena after decades of state interventionism: granting minority shareholders

easy access to exit rights seems to be a powerful substitute for market liquidity although, in the long run, it might disturb the transition towards the establishment of an industrial system based on private ownership of the corporate equity⁶¹.

⁶¹ It has been widely demonstrated that the more minority shareholders are protected in a given company law system, the more dispersed is the corporate ownership structures of the companies governed by such provisions. See J. COFFEE (1999), "The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications", in *Northwestern University Law Review*, 1999, vol 93, p. 654 ff. It may therefore be argued that granting wide exit rights might result in the emergence of a larger number of public companies even in jurisdictions like Italy and China, but it's my personal view that replacing market liquidity with withdrawal rights may hardly lead to this outcome in a system with strong path-dependence constraints.

⁶⁰ As a consequence, for the purposes of this paper, the expression "global convergence" should not mean the mere harmonisation of rules of different jurisdictions.