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RENDERING (ONCE MORE) THE FINANCIAL ASSISTANCE REGIME MORE FLEXIBLE

ABSTRACT

Directive 2006/68/EC eliminated the ban on financial assistance imposed by Article 23 of Directive 77/91/EEC. The new formulation of article 23 allows Member States the possibility of authorising public limited liability companies to undertake financial assistance transactions provided they give adequate safeguards to the (minority) shareholders and to third parties. Various Member States have not exercised this possibility and prevalent doctrine has given a negative evaluation of the text of article 23 of the second Directive. The conditions set forth in article 23 aimed at protecting minority rights and rights of creditors have been considered to be excessively rigid and constituting an obstacle to the effective simplification of the regulations governing financial assistance. This article suggests possible modifications to article 23 of the second Directive which could render financial assistance regime more flexible without prejudicing the interests of shareholders and creditors. This compromise solution ensures an adequate balance between flexibility and certainty and appears preferable to the proposed elimination of financial assistance regulation.

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I. Introduction

Directive 2006/68 EC[1] eliminated the previous ban on provision of financial assistance, applicable in terms of article 23 of the second Directive. The current text of article 23 allows Member States to permit public limited liability companies "to advance funds, make loans or provide security, with a view to the acquisition of its shares by a third party" in such way that "increases flexibility with regard to changes in the ownership structure of the share capital of companies"[2]. The EU legislator did not however fully liberalize financial assistance as the UK legislator has done since 2006 for private companies[3]. Financial assistance is subject to substantial and procedural conditions aimed at safeguarding third party and minority shareholders interests

The majority of Member States has not exercised the option given in terms of article 23[4] and many scholars (some of whom were in favour of the abolition of an absolute ban on financial assistance[5]) have criticised the new text of article 23 of the second Directive. The substantive and proce-

[1] On Directive 2006/68/EC and developments that have led to its issue refer to Wymeersch, The Directive amending the Second Company Law Directive on Legal Capital, in P. Balzarini – G. Carcano – M. Ventoruzzo (Eds.), La società per azioni oggi, Milano, 2007, 333 et seq.; Lowry, The Prohibition Against Financial Assistance: Constructing a Rationale Response, Corporate Finance Law in the UK and EU (Eds. Prentice - Reisberg), Oxford, 2011, 21 et seq.

[2] Recital no. 5 of Directive 2006/68/EC.

[3] Vella-Prentice, Some aspects of capital maintenance law in UK, (Eds. Tison-De Wulf-Van der Elst-Steennot) Perspectives in Company Law and Financial Regulations, Cambridge, 2009, 295; Ferran, Regulation of Private Equity-Backed Leveraged Buyout Activity in Europe, ECGI Law Working Paper 84/2007, available at www.ecgi.org, 22.

[4] The English legislator, although in favour of relaxing financial assistance regulation (see. Roberts, Financial assistance for the acquisition of shares, Oxford, 2005, 37 et seq.), did not adopt the provisions of the "new" article 23 and preferred to wait for a more effective amendment to the second Directive. Ferran, Principles of Corporate Finance Law, Oxford, 2008, 309; Davies, Gower and Davies' principles of modern company law[8], London, 2008, 358: Vella-Prentice, Some aspects, 294 et seq.; Lowry, The Prohibition, 22.

[5] Wymeersch, Article 23 of the second company law Directive: the prohibition on financial assistance to acquire shares of company, in Festschrift für U. Drobnig, J. Basedow – K.J. Hopt – H. Kötz (Hrsg.), Tübingen, 1998, 741 et seq.; Wymeersch, The Directive, 351 et seq.; Ferran, Simplification of European Company Law on Financial Assistance, EBOR, 2005, 93 et seq.; Ferran Private, 20 et seq.; Ferran, Principles, 308 et seq.; Lowry, The Prohibition, 21 et seq.; Westermann, Kapitalschutz als Gestaltungsmöglichkeit, in ZHR, 2008, 165. For a positive analysis of article 23 of the second Directive Schmolke, Finanzielle Unterstützung des

dural conditions provided under article 23 were considered excessively onerous and time-consuming. The authorisation of the general meeting could, moreover, give rise to unfounded actions by the minority shareholders. Lastly, the directors are exposed to an excessive risk[6].

The main scope of the present article is not to evaluate the possibility of eliminating article 23 of the second Directive nor to introduce an alternative regime based exclusively on a solvency test[7], but to take into consideration possible amendments to article 23 which render the financial assistance regime more flexible without changing the structure of current legislation and without prejudicing the interest of minority shareholders and company creditors.

The article is set up as follows. Section II examines the risks arising from financial assistance and effecting creditors and minority shareholders and proves how the prohibition previously applicable under 23 was excessively restrictive. Section III illustrates the provisions of the present text of article 23 of the second Directive and the criticism levelled at it by authoritative doctrine. Section IV shows that the requirement of a quorum and a majority laid down in article 40 of the second Directive and the obligation of the shareholders to authorise the financial assistance on a transaction-by-transaction basis are excessively rigid conditions and are not necessary for the protection of minority shareholders and company creditors. Moreover, the possible remedies to limit the risks of unfounded actions by the minority shareholders aimed at blocking the transaction even if it is not detrimental to their interest, are also examined. Section V illustrates the *ratio* behind the limit of distributable net assets and the obligation to set up an undistributable reserve. It is shown that the financial assistance regime can be rendered more flexible (without prejudicing the interests of creditors) allowing the use of reserve laid down in article 23 (1) (4) to cover losses and, in such case, imposing that the reserve must be reconstituted using the profits recorded during subsequent financial years. Section VI shows that the conditions prescribed under article 23 are not fit to safeguard

derivativen Aktienerwerbs. Gläubiger- und Aktionärsschutz nach der geplanten Änderung der Kapitalrichtlinie, WM, 2005, 1837; Nodoushani, Financial Assistance und Konzerninnenfinanzierung, Der Konzern. 2008, 392.

[6] Department of Trade and Industry, Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company: A Consultative Document, available at www.bis.gov.uk/file14584.pdf, (London, March 2005), 36, according to which the conditions subject to which financial assistance may be given are complex and onerous and are therefore unlikely to be utilised by companies.

[7] In this respect, presenting different proposals, Boschma–Lennarts–Schutte Veenstra, Alternative Systems for Capital Protection, 2005, available at www.ez.nl., 73; Rickford (Ed), Reforming Capital. Report of the Interdisciplinary Group on Capital Maintenance, in EBLR, 2004, 986. See also Wymeersch, Article 23, 747; Enriques – Macey, Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules, 86 Cornell Law Rev., 2001, 1197 et seq.; Ferran, Principles, 275; Armour, Share Capital and Creditor Protection: Efficient Rules for a Modern Corporate Rules, 63 Modern Law Review, 2000, 374 et seq.; Lowry, The Prohibition, 25.

minority shareholders and company creditors in the merger leveraged buyout (MLBO). MLBO transactions must be excluded from the scope of application of article 23 and the necessity that, for such transactions, proper instruments are put in place to safeguard minority shareholders and company creditors. Section VII is the concluding section.

II. RISKS ARISING FROM FINANCIAL ASSISTANCE AND THE INTERESTS SAFEGUARDED IN TERMS OF ARTICLE 23 OF THE SECOND DIRECTIVE.

The previously applicable ban from providing financial assistance for the acquisition by a company of its own shares was based on various elements and had different scopes[8], since it was common understanding that providing financial assistance constituted a "dangerous" operation which could prove prejudicial to the interests of creditors and (minority) shareholders.

The ban under article 23 of the second Directive was first and foremost aimed at avoiding circumventing the rules on acquisition of own shares. The restriction was aimed at avoiding that companies bypassed the limits in terms of article 19 of the second Directive favouring the acquisition of own shares by third parties "close" to the company or controlling shareholders[9]. In general, the restriction on providing financial assistance was considered to form part of the system of capital maintenance[10]. Making loans or providing security for the acquisition of own shares could give rise to disguised distribution to shareholders or to the formation of "fictitious" capital[11].

[8] Schroeder, Finanzielle Unterstützung des Aktienerwerbs, Köln, Berlin, Bonn, München, 1995, 113et seq.; Ferran, Principles, 269 et seq.; Vicari, L'assistenza finanziaria per l'acquisto del controllo di società di capitali, Milano, 2006, 10 et seq.

[9] This argumentation has heavily influenced the German financial assistance regulations. § 71a AktG which included the ban on provision of financial assistance is in fact found amongst rules regulating acquisition of own shares under the heading "Umgehungsgeschäfte". See Lutter–Drygala, Kölner Kommentar zum Aktiengesetz[3], Band 1, Tl. 1, §§ 67-75, Köln – München, 2009, § 71a, Rdn. 7, 294; Hüffer, Aktiengesetz[9], München, 2010, § 71a, Rn. 1,; Bezzenberger, § 71a, Schmidt-Lutter (Hrsg.), Aktiengesetz Kommentar, Köln, 2010, Rn. 6-7; Wymeersch, Article 23, 731.

[10] In Germany an author has doubted whether the ban on financial assistance is necessary to safeguard company share capital. The ban on making distributions which could prejudice the company's net assets or bypass provisions regulating acquisition by a company of its own shares is deducible from the "general" provision of § 57, AktG, Abs. 1, Satz. 1, Abs. 3 (as before the MoMiG came into effect), in terms of which allotments cannot be repaid to shareholders and, prior to the liquidation of the company, only distributable profits can be distributed to shareholders. See Habersack, Die finanzielle Unterstützung des Aktienerwerbs – Überlegungen zu Zweck und Anwendungsbereich des § 71a Abs. 1 Satz 1 AktG, Festschrift für V. Röhricht, Köln, 2005, 158 et seq. It must be observed that, in terms of § 57 AktG (as modified by the MoMiG) financial assistance would be allowed if the credit standing of the third party has been duly investigated. In such case the right to restitution was not debatable and the transaction would not be tantamount to a distribution to shareholders. Article 71a, AktG therefore bans transactions which would otherwise have been possible in terms of § 57, AktG. Lutter – Drygala, § 71a, Rn. 18-20; Bezzenberger, § 71a, Rn. 7-8.; on the basis of the new text of § 57,

Moreover, the ban was justified by the fact that provision of financial assistance has the same effect as the acquisition of own shares on the company's assets therefore the company suffers a twofold damage (Doppelschade). On the one hand, the acquisition of own shares entails the immediate release of financial resources at the time of acquisition. On the other hand, in crisis situations, the company cannot recover the financial resources loaned to shareholders by selling own shares acquired. If the company is undergoing a crisis, the value of its shares is in fact reduced or completed annulled since the share value depends on the value of the company's assets.[12].

This twofold risk takes on a different form in the case of financial assistance. First of all, financial assistance does not imply the immediate use of financial resources if the company provides a security in favour of the third that acquires the company shares (a cash outflow is recorded only if the guarantee is enforced against the company after the default of the beneficiary of financial assistance)[13]. When the company grants a loan for the acquisition of its own shares the shares are not entered into the company's assets. In the company's balance sheet, the amounts loaned to the beneficiary of financial assistance will be replaced with the credit right under the loan.[14]. The risk level of financial assistance depends on the likelihood that the amounts loaned are duly repaid. As a result of financial assistance the company is exclusively exposed to the risk of the insolvency of a third party to whom the loan or guarantee was given[15]. Some authors therefore point out that financial assistance involves a change in the composition of the company assets and an increased risk similar to those resulting from any other loan[16].

Abs. 1, AktG as after MoMiG, Habersack, Finanzielle Unterstützung des Aktienerwerbs nach MoMiG, Festschrift für K. J. Hopt, Berlin – New York, 2010, 732 et seq.; Habersack – Verse, Europäisches Gesellschaftsrecht, München, 2011, 173.

[11] Wymeersch, Article 23, 733. The risk of formation of « fictitious » capital is particularly evident in the case of financial assistance aimed at subscription of issued shares. In such case the increase in share capital does not constitute an actual increase of company assets. See Cacchi Pessani, L'assistenza finanziaria per l'acquisto e la sottoscrizione di azioni proprie dopo l'attuazione della direttiva 68/CE/2006, 2011, unpublished manuscript, on file with author, 22 et seq.; Speranzin, L'aumento di capitale "garantito", Banca borsa, 2007, I, 454 et seq.

[12] Lutter – Drygala, Kölner Kommentar zum Aktiengesetz[3], Band 1, Tl. 1,, §§ 67-75, Köln – München, 2009, §71, Rdn. 21, 172; Oechsler, Münchener Kommentar zum Aktiengesetz[3], Band 1, Tl. 1,, §§ 1-75, München, 2008, Rn. 19; Schroeder, Finanzielle, 107 et seq.; Seibt, Gläubigerschutz bei Änderung der Kapitalstruktur durch Erhohung des Fremdkapitalanteils (Leveraged Recapitalization/Leveraged Buy Out), ZHR, 2007, 300.

[13] Ferran, Principles, 273; Davies, Gower and Davies' principles, 342; Cacchi Pessani, L'assistenza, 69.

[14] Ferran, Regulation, 26 et seq.; Lowry, The Prohibition, 5; Miola, Legal Capital and Limited Liability Companies: The European Perspective, ECFR, 2004, 453.

[15] Hartung, Financial assistance, Jena, 2010, 83. Schroeder, Finanzielle, 108; Freitag, Financial Assistance, 160.

[16] Davies, Gower and Davies' principles, 342; Wymeersch, Article 23, 742; Armour, Share, 369.

Loans granted to the beneficiary of financial assistance are different to other loans of the company, since they present a particular risk factor. If the third party is not able to repay the amounts received from the company and its assets are made up (wholly or in part) of shares acquired from the financial assistance, then the company could be assigned the same shares by way of compensation. In such case the financial assistance brings about the inclusion of own shares in the company assets, exposing the company to the doppelrisiko identical to that resulting from the direct acquisition of its own shares[17]. This is because when the company is in financial difficulties, the value of its own received shares could be notably reduced or nil[18].

In any event, an important difference exists between the acquisition of own shares and financial assistance. In the case of financial assistance the doppelrisiko is only potential, since the inclusion of own shares in net assets depends on the solvency of the beneficiary of the financial assistance[19].

The preceding arguments were not sufficient to justify the ban on provision of financial assistance. Comparing articles 19-22 and article 23 of the second Directive, the ban appeared excessively restrictive. In the light of protection of share capital, there were no reasons that banned provision of financial assistance within the limit of distributable net assets imposed for the acquisition of own shares[20].

The ban on financial assistance was aimed at safeguarding the interests, not only of company creditors, but also of the minority shareholders[21]. By providing financial assistance, the directors can influence the ownership structure, by favouring the introduction of new shareholders (of their

[17] Lutter – Drygala, § 71a, Rn. 7. It must be noted that in terms of article 20 (1) (g) of the second Directive the company can receive its own shares by way of settlement only on condition that these are fully paid up shares. Lutter – Drygala, Kölner Kommentar zum Aktiengesetz[3], Band 1, Tl. 1,, §§ 67-75, Köln – München, 2009, §71e, Rdn. 19, 409; Oechsler, Die Änderung der Kapitalrichtilinie und der Rückerwerb eigener Aktien, in ZHR, 2006, 87; Cacchi Pessani, L'assistenza, 29 et seq.

[18] Habersack, Die finanzielle, 159, 165 et seq.; Habersack, Finanzielle, 732 et seq.; Bezzenberger, § 71a, Rn. 6; Brosius, Die finanzielle Unterstützung des Erwerbs eigener Aktien, Köln – Bonn – Berlin – München, 2010, 24 et seq.

[19] Wymeersch, The Directive, 351; Ferran, Simplification, 96; Ferran, Regulation, 26.; Bezzenberger, § 71a, Rn. 6.

[20] Bezzenberger, § 71a, Rn. 6; d'Alessandro, Rapporti di scambio tra la società ed i suoi soci e divieto di assistenza finanziaria per l'acquisto delle proprie azioni, in Contr. impr., 1993, 1019; Cacchi Pessani, L'assistenza, 7 et seq.; Habersack, Die finanzielle, 157 et seq., confirmed the legitimacy of financial assistance within the limits of distributable net assets already in force of the preceding content of article 23 of the second Directive, proposing an analogous application of the established limit for acquisition of own shares.

[21] Ferran, Principles, 271; Wymeersch, Article 23, 734, 744 et seq.; Habersack, Finanzielle, 733; Lutter – Drygala, § 71a, Rn. 14; Oechsler, § 71a, Rn 4, 1887; Freitag, "Financial Assistance" durch die Aktiengesellschaft nach der Reform der Kapitalrichtilinie – (k)ein Freifahrtschein für LBOs?, AG, 2007, 163; Brosius, Die finanzielle, 20 et seq.; Hartung, Financial, 83; in Italy, d'Alessandro, Rapporti, 1020.

choice) or strengthening the position of the controlling shareholder. The directors can use the company resources (which should be used during the company's financial year in the interest of all shareholders and third parties) to the advantage of selected shareholders which intend to acquire or increase their participation in the company[22].

Some authors have, however observed that the absolute ban was, even in this case, not justified. An absolute ban constituted an excessive and unnecessary restriction with the purpose of protecting minority shareholders. The interest of minority shareholders is adequately protected by conflict of interest legislation and the directors' fiduciary duties[23]. In order to avoid that the directors and majority shareholders strengthen their position within the company by using the company resources, extending the solution envisaged under article 22 (1) (*a*) of the second Directive would have sufficed – that is suspending the vote of the shares acquired through loans of guarantees given by the company[24].

According to a theory, mainly supported by part of German authors, the ban on financial assistance would have had the further scope of banning leveraged buyout transactions (LBO)[25]. More specifically, the ban contemplated in the old formulation of article 23 would have served to avoid that the company assets and its cash flow were used to repay debts entered into to acquire control of the target company itself.

This theory appears to have been disproven by the increasing number of LBO being registered in Europe [26]. The ban on financial assistance only prevented loans or guarantees being granted by the target company in favour of the acquirer[27]. According to prevalent opinion[28], article 23 of the

[22] Schroeder, Finanzielle, 101 et seq.; Seibt, Gläubigerschutz,300.

[23] Wymeersch, Article 23, 742; Wymeersch, The Directive, 2007, 349.

[24] Fortunato, Anticipazioni, prestiti o garanzie per l'acquisto di azioni proprie, in La seconda direttiva CEE in materia societaria a cura di Buttaro - Patroni Griffi, Milano, 1984, 437.

[25] Oechsler, § 71a, Rn 4, 1887; Oechsler, Das Verbot des § 71a Abs. 1 Satz 2 AktG – Schutzzweck und praktische Anwendung, ZIP, 2006, 1664; Schroeder, Finanzielle, 105 et seq. Of a contrary opinion Habersack, Die finanzielle, 157; Nuyken, Finanzielle Unterstützung bei Private Equity Transaktionen - Fallstudien zu 71a AktG, ZIP, 2004, 1895 et seq.; Seibt, Gläubigerschutz,300. See also,Schmolke, Finanzielle, 1829.

[26] Ferran, Regulation, 3 et seq.; Davies, Gower and Davies' principles, 342; Enriques, EC Company Law Directives and Regulations: How Trivial Are They?, in (2006) 7 University of Pennsylvania Journal of International Economic Law, 39; Lutter – Drygala, § 71a, Rn. 16.

[27] The opposing view whereby the ban on financial assistance would serve to test the seriousness of the acquiring party does not appear decisive. Since loans for acquisition by the target company are not allowed, the acquiring party is forced to resort to third parties for financing. These latter would evaluate the seriousness of the transaction (Oechsler, § 71a, Rn 4, 1887; Oechsler, Das Verbot, 1664 et seq.). Habersack, Finanzielle, 736, points out that such seriousness test does not fully justify the ban. When the target company provide security to the acquiring party, the seriousness of the latter's project is necessarily evaluated by a third party financier.

second Directive did not forbid LBO transactions differently structured but (implicitly) requested that these were not deliberated by the directors autonomously but with the participation of the shareholders and ensuring adequate protection of the company creditors. In Germany (where § 71a, AktG bans financial assistance), LBO transactions are considered legal if undertaken pursuant to a domination agreement (Beherrschungsvertrag) or through a merger between the acquiring company and target company[29].

Under Italian law, articles 2358 and 2501-bis of the civil code specify that financial assistance regulation does not serve to ban LBO transaction. Until 2008, article 2358 of the civil code banned financial assistance and the legitimacy of LBO's was doubtful. In 2003, the Italian legislator introduced article 2501-bis of the Civil Code which allowed merger leveraged buyout (MLBO) imposing compliance with some safeguards of minority shareholders and company creditors[30]. Directive 2006/68/EC was implemented in 2008 and article 2358 of the Civil Code was amended to the effect that it subjected financial assistance to the conditions under article 23 of the second Directive. Article 2358 provides that article 2501-bis[31] continues to apply, thus excluding the existence of a ban on MLBO transactions.

III. AMENDMENT OF ARTICLE 23 OF THE SECOND DIRECTIVE. THE LIMITED SIMPLIFICATION OF FINANCIAL ASSISTANCE LEGISLATION

The ban on financial assistance for acquisition of own shares in terms of article 23 of the second Directive constituted an unjustified obstacle to the conclusion of transactions which were financially beneficial to the company and not "dangerous" to the company's assets. More specifically, the ban in terms of article 23 impeded leveraged buyout transactions which could be poten-

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[28] Lutter – Drygala, § 71a, Rn. 16.

[29] Lutter – Drygala, § 71a, Rn. 16; Habersack, Finanzielle, 736 et seq.; Eidenmüller, Private Equity, Leverage, und die Effizienz des Gläubigerschutzrechts, ZHR, 2007, 662; Cahn, § 71a, in AktG[2], Spindler-Stilz (Hrsg), München, 2010, Rn. 17-22, 744-46; Seibt, Gläubigerschutz,304; Riegger, Kapitalgesellschaftsrechtliche Grenzen der Finanzierung von Unternehmensübernahmen durch Finanzinvestoren, ZGR, 2008, 243 et seq.; See also Nodoushani, Financial , 388 et seq.; Kerber, Die aktienrechtlichen Grenzen der finanziellen Unterstützung des Aktienerwerbs im Buy-out-Verfahren, DB 2004, 1027 et seq.; Fleischer, Finanzielle Unterstützung des Aktienerwerbs und Leveraged Buyout. § 71 a Abs. 1 AktG im Lichte italienischer Erfahrungen, AG, 1996, 505et seq.; Schroeder, Finanzielle, 284 et seq.; Vicari, L'assistenza, 126 et seq.

[30] Spolidoro, Fusioni pericolose (Merger Leveraged Buyout), Riv. soc., 2004, 229 et seq.

[31] See para. VI.1.

tially economically worthwhile [32]. Generally, there seemed to be no valid reason to regulate financial assistance more rigidly than the acquisition of own shares, a transaction which could pose a higher danger to the company's net assets[33].

Accepting the opinion of the High Level Group of Company Law Experts and of the SLIM group[34], the EU legislator, in terms of Directive 2006/68/EC, removed the ban on financial assistance, thus rending more flexible the ownership structure of the company[35]. The present text of article 23 of the second Directive allows Member States the possibility of allowing a joint stock company "to advance funds, give loans or provide guarantees for the purchase of it shares by a third party". Providing financial assistance is subject to substantial limitation and procedural obligations, aimed at protecting the interest of parties (creditors and minority shareholders) put at risk by the transaction[36].

In order to avoid that directors (and majority shareholders) influence the governance of the company to the prejudice of the interest of minority shareholders, article 23 (1) (1) provides that the financial assistance must be authorised by the general meeting by resolution taken with the special majority requirements in terms of article 40 of the second Directive[37]. The approval of the general meeting does not exempt the directors from liability, since in terms of article 23 (1) (2) transactions are undertaken "under the responsibility of the administrative or management body". The directors are bound to certify that the transaction was carried out at fair market conditions with respect to in-

[32] Cfr. Armour, Share Capital, 368 et seq.; Ferran, Corporate transactions and financial assistance: shifting policy reception but static law, Cambridge law journal, 2005, 225 et seq.; Ferran Private, 20 et seq.; Davies, Gower and Davies' principles of modern company law[8], London, 2008, 341; Rickford (Ed), Reforming, 945; Enriques – Macey, Creditors, 1165; Wymeersch, Article 23, 741 et seq.; Cacchi Pessani, L'assistenza, 16 et seq.

[33] Supra note 20.

[34] Recommendations by the company law SLIM working group in the simplification of the first and second company law Directives, available at http://ec.europa.eu/internal_market/company/docs/official/6037en.pdf.; High Level Group of Company Law Experts, Report on a "Modern Regulatory Framework for Company Law in Europe, available at ec.europa.eu/internal.../company/modern/index_en.htm.

[35] Recital n. 5 of the Directive 2006/68/CE.

[36] According to recital 5 of Directive 2006/68/EC "Member States should be able to permit public limited liability companies to grant financial assistance with a view to the acquisition of their shares by a third party up to the limit of the company's distributable reserves so as to increase flexibility with regard to changes in the ownership structure of the share capital of companies. This possibility should be subject to safeguards, having regard to this Directive's objective of protecting both shareholders and third parties".

[37] Pursuant to article 40 of the second Directive the laws of the Member States shall provide that the decisions referred to in Articles 29 (4) and (5), 30, 31, 35 and 38 must be taken at least by a majority of not less than two-thirds of the votes attaching to the securities or the subscribed capital represented. The laws of the Member States may, however, lay down that a simple majority of the votes specified in paragraph 1 is sufficient when at least half the subscribed capital is represented.

terest and guarantees given to the company. Moreover, the credit standing of the counterparty must be duly investigated [38].

The directors present a report to the general meeting describing the transaction from a financial and legal point of view, detailing *i*) the reasons justifying it; *ii*) the interest of the transaction to the company; *iii*) the transaction terms and the risks which it could place on the liquidity and solvency situation of the company *iv*) the price at which the third party acquires the shares. When financial assistance is given to the directors of the company or those of the holding company (in terms of article 1 of Directive 83/349/EEC) or to a holding company (or to third parties acting in the name of such parties), Member States ensure by adequate safeguards that the transaction does not conflict with the company's best interests (see article 23a of the second Directive)[39].

A special provision applies even if the beneficiary of the financial assistance acquires from the same company own shares in terms of article 19 (1) or subscribes for shares issued in the course of an increase in the subscribed capital. In order to avoid that such transactions lead to a dilution of existing shareholders, article 23 (1) (6) provides that the acquisition and subscription shall be made at a fair price [40].

Lastly, article 23 (1) (4) provides a quantitative limit. As per Directive 2006/68/EC, the legislator holds that financial assistance constitutes a transaction having similar financial effects as acquisition of own shares. Consequently article 23 also provides protection of share capital (or distributable reserves). To avoid that provision of financial assistance effects maintenance of share capital, article 23 (1) (4) provides that the financial assistance "shall at no time result in the reduction of the net assets below the amount specified in points (a) and (b) of Article 15(1), taking into account also any reduction of the net assets that may have occurred through the acquisition, by the company or on behalf of the company, of its own shares in accordance with Article 19(1) »[41]. Article 23 (1)

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[38] Schmolke, Finanzielle, 1833, observes that such provision also precludes possible disguised distributions in violation of norms regulating maintenance of share capital.

[39] Schmolke, Finanzielle, 1836; Santella-Turrini, Capital Maintenance in the EU: Is the Second Company Law Directive Really that Restrictive?, EBOR, 2008, 448.

[40] See Commission working document: Detailed explanation (by article) of Proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC, available at http://ec.europa.eu/internal_market/company/docs/capital/2004-proposal/explanation_en.pdf; Wymeersch, The Directive, 351; Ferran, Simplification, 98. When financial assistance is used by third parties for the purchase of own shares held by the company, article 23 (1) (6) also protects the preservation of share capital (and therefore creditors) avoiding that share are transferred at a price with is lower than that which would have been obtained from transferring the same on the market.

[41] Report on a "Modern Regulatory Framework for Company Law in Europe arranged by the High Level Group of Company Law Experts, 85, «we would favour a solution whereby financial assistance is allowed to the extent of the distributable reserves. Such a solution would be consistent with the approach to the acquisi-

(4) also requires that a reserve, unavailable for distribution, of the amount of the aggregate financial assistance, is included among the liabilities in the balance sheet.

A number of authors have criticized the new regime regulating financial assistance, observing that the flexibility cited by the legislator was purely theoretical[42]. The conditions prescribed by article 23 of the second Directive are excessively restrictive with respect to those applicable to other transactions considered "dangerous" to the (minority) shareholders and the creditors.

General meeting approval on a transaction-by-transaction is deemed to constitute a substantial restriction on financial assistance, especially for listed companies with dispersed ownership[43]. There is also the risk that the minority shareholders may challenge the decision of the general meeting even if the conditions in terms of article 23 are respected. Even the obligation of creating a reserve, unavailable for distribution, of an amount equal to the financial assistance is considered excessively restrictive and can obstacle the implementation of the transaction.

These considerations have induced some scholars to suggest the elimination of the rules governing financial assistance or the passage to an alternative regime based exclusively on a solvency test to be carried out on the directors[44]. A similar legislative development presently seems unlikely[45]. In spite of this, the importance of the criticism levelled by most authoritative commentators, prescribes checks on whether it is possible to render more flexible the financial assistance regime laid down in article 23.

IV. APPROVAL BY THE SHAREHOLDERS

Article 23 (1) (3) requires that provision of financial assistance is approved by the general meeting, in order to limit the risk that the directors influence the composition of company ownership by using company resources[46]. Approval of the transaction by the general meeting safeguards

tion of own shares by the company. The distributable reserves should provide for full cover of the risk associated with the financial assistance».

[42] Above note 5.

[43] Ferran, Simplification, 96; Lowry, The Prohibition, 22.

[44] Above note 7.

[45] European Commission. DG XV – Internal Market and, Results of the external study on the feasibility of an alternative to the Capital Maintenance Regime of the Second Company Law Directive and the impact of the adoption of IFRS on profit distribution, 2008, available at http://ec.europa.eu., "the current capital maintenance regime under the Second Company Law Directive does not seem to cause significant operational problems for companies. Therefore no follow-up measures or changes to the Second Company law Directive are foreseen in the immediate future".

[46] de Luca, sub art. 2358, Commentario al codice civile, diretto da Gabrielli, Torino, 2012, 139.

the (minority) shareholders who can challenge the validity of the approval resolution. In the case that the resolution is challenged it is then the Court that decides on whether the transaction is in line with the terms prescribed by law.

Approval by the general meeting constitutes an important tool for the protection of minority shareholders and cannot be eliminated. It is however necessary to check whether the provisions of article 23 (1) (3) could be applied with more flexibility and whether adjustments could be made to prevent transaction-disrupting actions by the minority shareholders.

1. No requirement for a quorum and a majority laid down in Article 40 of the second Directive

Two differences exist between financial assistance regulation and the regulation of acquisition of own shares. On the one hand, article 23 (1) (3) provides that financial assistance must be authorised by a resolution taken with the necessary quorum and approved by the special majority pursuant to article 40 of the second Directive concerning the exclusion of the pre-emption rights and the reduction of share capital. On the other hand, approval must be granted by the general meeting on a transaction-by-transaction basis. Article 23 does not allow the general meeting to authorize the board of directors to engage the company in the provision of financial assistance for a maximum period and for a maximum amount not exceeding the profits and distributable reserves.

The European Commission justified reference to article 40 of the second Directive on the basis of the extraordinary sensitivity of the transaction, which necessitates a more extensive involvement of the shareholders [47]. This reasoning does not appear to be exhaustive[48], since the Commission did explained neither the reasons behind the "extraordinariness" of the transaction nor the interests protected by imposing a higher quorum.

In Germany, some authors have stated that the special majority is justified since financial assistance impacts the company structure in the same way as transactions referred to in article 40 of the second Directive. Moreover, financial assistance involves an exception to the principle of equal treatment in the same way as a capital increase with the exclusion of the pre-emptive right. All the shareholders would, in fact, have equal rights to receive financial assistance from the company to preserve their percentage of ownership (the so called Bezugsfinanzierungsrecht), on condition that

[47] Commission working document: Detailed explanation (by article) of Proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC

[48] Ferran, Simplification, 96; Lowry, The Prohibition, 21. See also Habersack, Finanzielle, 746.

their credit standing is not under discussion[49]. If the company favours the acquisition of shares by a shareholder or a third party (i.e. a future shareholder), the equal treatment principle imposes on the other shareholders that they maintain their percentage of ownership unaltered[50].

This theory does not appear to be convincing and the similar application of the norms regulating increase in capital seems unfounded.

The general meeting resolution in terms of article 23 (1) (3) is not a “structural” resolution such as those that exclude pre-emption rights or reduction of capital[51]. It is possible that provision of financial assistance by the company does not affect the legal standing of some of the shareholders[52]. Financial assistance does not necessarily “dilute” the percentage of ownership of the minority shareholders. If the (minority) shareholders decide to not transfer their shares to the beneficiary of the financial assistance, their percentage of ownership remains unchanged[53]. Provision of financial assistance to a shareholder or to a third party cannot result in the dilution of shareholding of the other shareholders against their will.

Moreover, financial assistance does not weaken the value of the shares of the existent shareholders. Such risk does not exist if the beneficiary of the financial assistance acquires the shares on the market. In the event that a third party, using the financial assistance of the company, purchases the company’s own shares within the meaning of Article 19(1) or subscribes to shares issued by an

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[49] Oechsler, § 71a, Rn 9, 1892 et seq. The same author supports the requirement of a qualified majority stating that the effects of financial assistance on the situation of the shareholder are similar to those arising from a resale of own shares. With respect to this latter case § 71, Abs. 1, Nr. 8, AktG, provides that the resale of own shares must be approved by the general meeting with a qualified majority in terms of § 186, Abs. 3, Satz 2, AktG if it takes place in breach of the equal treatment principle. By analogy to provisions regulating increase in capital, the legislator, therefore attributes to the pre-existing shareholders pre-emption rights on the purchase of own shares which could only be excluded with a qualified majority of shareholders (Cahn, § 71, in AktG[2], Spindler-Stilz (Hrsg), München, 2010, Rn. 134-135, 727). It must, in any event, be observed that unlike financial assistance, the exclusion of pre-emption rights on purchase of own shares could affect the position of the shareholder. In the event that this latter has transferred his shares to the company and has then not been able to repurchase them, the transaction would bring about the reduction of the percentage of ownership held by the shareholder, It must also be observed that a qualified majority is not requested by the second Directive. In Italy, article 2357-ter, co. 1, of the Civil Code provides that resale of the shares must be approved by an ordinary general meeting. (Carbonetti, L’acquisto di azioni proprie, Milano, 1988, 127; Nobili, Osservazioni in tema di azioni proprie, in Riv. soc., 1987, 788).

[50] Oechsler, § 71a, Rn 9, 1892 et seq.; critical Drygala, Finanzielle Unterstützung des Aktienerwerbs nach der Reform der Kapitalrichtilinie, in Der Konzern, 2007, 403.

[51] See Schmolke, Finanzielle, 1834; Drygala, Finanzielle, 403, according to whom the qualified majority would be necessary in the event that the financial assistance is used to achieve the control of the company.

[52] Schmolke, Finanzielle, 1834.

[53] Brosius, Die finanzielle, 280.

increase of share capital, the existing shareholders are protected under article 23 (1) (5), in terms of which the acquisition or subscription must be made at a fair price.

Once must also consider that the presumed Bezugsfinanzierungsrecht would present a relevant difference from the pre-emption rights pertaining to the shareholders in the event of an increase in capital. Pre-emption rights pertain to all shareholders. On the other hand, the right to receive financial assistance from the company would apply in favour of the shareholder whose credit standing is not in doubt[54]. The right to receive financial assistance does not apply to the shareholders simply on the basis of their shareholding but depends on their personal financial condition (credit standing) which falls outside the scope of the corporate relationship. On the contrary, the principle of equal treatment applies within the corporate relationship[55]. The "identical conditions" to which reference is made in article 42 of the second Directive are the terms applicable to the shareholder in his capacity as shareholder. The "personal" situation of the shareholder is of no concern in the application of article 42[56].

On more general lines, it is doubtful that provision of financial assistance to a shareholder or to a third party gives rise to a breach of equal treatment in the same way as the exclusion of pre-emption right. The equal treatment principle applies only in relation to rights pertaining to shareholders in their capacity as shareholders. The said equal treatment principle does not involve transactions which the company can implement irrespective whether it involves a shareholder or a third party[57]. In other words, the principle of equal treatment does not apply if the shareholder appears before the company in the same way as a third party. If the terms of article 23 are fulfilled and, more specifically, the transaction takes place at fair market conditions, the equal treatment does not apply. In such case the qualification of shareholder is of no consequence for financial assistance[58].

[54] Drygala, Finanzielle, 405, according to whom a credit standing estimate of all the shareholders would be impracticable with respect to companies with dispersed ownership.

[55] Drygala, § 53a, Zöllner-Noack (Hrsg.), Kölner Kommentar zum Aktiengesetz, 3 Auflage, Köln, 2011, Rn. 5 et seq.; Fleischer, § 53a, Schmidt-Lutter (Hrsg.), Aktiengesetz Kommentar, Köln, 2008, Rn. 18; Henze-Notz, § 53a, Hopt-Wiedemann (Hrsg.), AktG Großkommmentar, Berlin, 2004, Rn. 21; Lutter- Zöllner, § 53a, Kölner Kommentar zum Aktiengesetz, 2 Auflage, Köln, Berlin, Bonn, München, 1984, Rn. 17 et seq.; Schön, Allgemeine Rechtsgrundsätze im Europäischen Gesellschaftsrecht, Festschrift für K. J. Hopt, Berlin – New York, 2010, 1343 et seq.

[56] Fleischer, § 53a, Rn. 24 et seq.; Drygala, § 53a, Rn. 18 et seq.; Henze-Notz, § 53a, Rn. 39.

[57] Drygala, § 53a, Rn. 19 et seq.; Fleischer, § 53a, Rn. 18; Henze-Notz, § 53a, Rn. 41 et seq.; Brosius, Die finanzielle, 282; d'Attorre, Il principio d'eguaglianza tra soci nelle società per azioni, Milano, 2007, 354 et seq.; of a contrary opinion Hartung, Financial, 72 et seq.

[58] Brosius, Die finanzielle, 282.

Moreover application of the equal treatment principle would bring about paradoxical results. If the company gives financial assistance to the shareholder on conditions which are more favourable then prevailing market conditions, the equal treatment principle would impose provision of financial assistance at the same favourable conditions to all shareholders with good credit standing. The obligation of providing financial assistance also to other shareholders would aggravate the damage to the assets and the consequent prejudice to the creditors.

This conclusion is confirmed by the fact that the second Directive does not extend the principle of equal treatment to the sale of own shares[59]. The effects of this operation on the corporate governance are the same as those of financial assistance. The sale of own shares could allow the entry of new shareholders or strengthen the position of existent shareholders.

The conclusion should be the same even if one supported the theory in terms of which the equal treatment principle would apply even if the beneficiary of the financial assistance is not a shareholder, since such third party is considered to be a future shareholder[60]. Placing financial assistance and the exclusion of pre-emption rights would therefore not be acceptable. If the transaction takes place at market conditions, financial assistance will not result in the dilution of the percentage of ownership of the minority shareholder (that does not intend to transfer his shares)[61], but it would only affect the ownership structure (favouring the introduction of new shareholders or strengthening some of the existing shareholders).

The fact remains that the authorizing resolution could be illegal even if the financial assistance is provided at fair market conditions. If the transaction does not benefit the company or is aimed exclusively at promoting the interests of the beneficiary, then the authorising resolution could be impugned – depending on the laws in force in the Member State – on the basis of conflict of interest or abuse of majority powers and breach of the fiduciary duty of the majority shareholder[62]. If the financial assistance does not give any advantage to the company, the shareholders and the creditors can also take action against the directors who could be held responsible for breach of their duty of fairness and care[63].

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[59] See above note 49.

[60] Hartung, Financial, 72 et seq.; Fleischer, § 53a, Rn. 19; Henze-Notz, § 53a, Rn. 40.

[61] Brosius, Die finanzielle, 283; from a different perspective Schroeder, Finanzielle, 117.

[62] Fleischer, § 53a, Rn 49 et seq.; Drygala, § 53a, Rn. 81 et seq.; Henze-Notz, § 53a, Rn. 42; Mucciarelli, Equal treatment of shareholders and European Union law. Case note on the Decision “Audiolux” of the European Court of Justice, ECFR 2010, 163. See also Roberts, Financial, 149 et seq.

[63] Abbadessa, I prestiti ai soci: appunti sul tema, in La struttura finanziaria e i bilanci delle società di capitali. Studi in onore di Giovanni E. Colombo, Torino, 2011, 82 et seq.

2. Case by case approval of financial assistance

The second difference between regulations governing financial assistance and those governing the acquisition of own shares involves the mode in which the shareholders must give their approval. Article 19 (1) (*a*) provides that the general meeting can give a standing authorization for the acquisition of own shares for a maximum of five years. The High Level Group of Company Law Experts had suggested extending this procedure to financial assistance[64]. This suggestion was not adopted and the new text of article 23 of the second Directive requires authorization of financial assistance on a transaction-by-transaction basis[65].

In the explanation of the proposal for the amending Directive, the European Commission explained that, in view of the "extraordinary sensitivity" of the transaction, the General Meeting authorization must be given on the basis of a report drawn up by the directors which illustrates the terms of the transaction and indicates the beneficiary of the financial assistance and his credit standing[66]. In this way, the shareholder can properly evaluate the benefit that it presents to the company and the pertinence of the terms thereof.

Authoritative commentators have expressed conflicting opinions. Some authors have observed that the authorization to provide financial assistance on a transaction-by-transaction basis is in line with the provisions of article 23. Compliance with the conditions contemplated in article 23 (1) (2) and the obligation to supply information in terms of article 23 (1) (3) impose reference to a specific and definite transaction[67]. At the time of approval, the general meeting must be aware of the credit standing of the beneficiary and evaluate whether the transaction terms correspond to the market parameters. The general meeting cannot evaluate the conditions of the transaction and the credit standing of the beneficiary in advance. Market conditions and the credit standing of the beneficiary could change between the date of approval and that of the actual issue of the loan or guarantee.[68].

On the contrary, other authors observed that the approval of financial assistance on a transaction-by-transaction basis is an excessively rigid condition and notably reduces the practical useful-

[64] Report on a Modern Regulatory Framework for Company Law in Europe, 85.

[65] Oechsler, § 71a, Rn 8, 1891.

[66] Commission working document: Detailed explanation (by article) of Proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC.

[67] Oechsler, § 71a, Rn 8, 1891; Schmolke, Finanzielle, 1834; Brosius, Die finanzielle, 277.

[68] Schmolke, Finanzielle, 1834.

ness of the relaxation of the ban on financial assistance. For companies with dispersed ownership it could be impossible to obtain the approval of the shareholders for each single transaction [69].

Notwithstanding the wording of article 23, a certain flexibility seems possible. Since the approval of the general meeting is granted before signature of the financing agreement or the guarantee and the transfer of the shares, some of the information requested in terms of article 23 could be unavailable at the time of general meeting approval. For example the amount of the financial assistance (which could vary closer to the date of signature of the loan or guarantee agreement due to external factors) and the price of sale of the shares to third parties could be finalized after the general meeting approval[70].

It is therefore possible for the directors to indicate the maximum amount of financial assistance (which may not exceed the limit pursuant to article 23 (1) (4))[71] in the report to be drawn up in terms of article 23 (1) (3). The solvency test prescribed under article 23 (1) (3) must, in such case, be carried out bearing in mind the maximum amount of the financial assistance. If the amount financed or the guarantee given to the company is lower, the interests of the minority shareholders and the creditors are evidently not prejudiced.

A certain degree of flexibility appears to be allowed in relation to the obligation to indicate the price at which the beneficiary acquires the shares. The indication of the price makes more easily recognizable any sale of shares at an unfair price, which favour a disguised distribution to the detriment of the other shareholders or company creditors[72]. To avoid this risk, it is possible for the report of the directors to indicate a price range or the criteria for establishing the price at which the beneficiary will acquire the shares[73].

As we have already stated, article 23 prevents the general meeting from authorizing the directors to engage the company in financial assistance for a maximum period and a maximum amount not exceeding the profits or the distributable reserves. It is therefore not possible to allow the board

[69] Ferran, Simplification, 96; Ferran, Regulation, 25; Lowry, The Prohibition, 21; Wymeersch, The Directive, 350; Brosius, Die finanzielle, 288; Department of Trade and Industry, Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company: A Consultative Document (London, March 2005), para. 3.4.2.

[70] Cacchi Pessani, L'assistenza, 60.

[71] Distributable net assets existing at the time of the authorisation could be eaten up by losses. The directors must ascertain that the limits in terms of article 23 (1) (4) are respected at the moment in which the loan or security are given to the beneficiary. V. Hartung, Financial, 57 et seq., 359.

[72] de Luca, sub art. 2358, 143 et seq.; Cacchi Pessani, L'assistenza, 76 et seq., 144.

[73] The price could be established in line with the profits for the period or in line with other profit and asset ratios. Cacchi Pessani, L'assistenza, 77.

of directors to identify the beneficiary. According to the legislator the evaluation of the conditions of the transaction by the shareholders presumes that the beneficiary has already been identified at the time of general meeting approval. This can be deduced from article 23 (1) (2) which provides that the credit standing of the third party "shall have been duly investigated", therefore requesting that an evaluation on the credit standing must have already been made by the directors. The general meeting cannot authorize the board of directors to give financial assistance for a determined period of time even if the potential purchaser is already identified by the shareholders. The credit standing of the third party could vary at the time of providing the financial assistance[74].

Approval on a transaction-by-transaction basis is an excessively rigid requirement and not necessary for the protection of the interest of minority shareholders and creditors. The risk that the financial conditions existing at the time of the approval change during the period for which the approval has been given, exist even with respect to acquisition of own shares. Article 19 (1) (*a*) remedies such risks by prescribing limits on the acquisition of own shares by directors[75].

The obligation of carrying out the transaction at fair market conditions and of evaluating the credit standing of the third party and the solvency test of the company required in terms of article 23 (1) (3) are aimed at preventing the risk that the financial assistance gives rise to a disguised distribution in breach of law and to the detriment of the net assets (and possibly the company share capital)[76].

A resolution of the shareholders which authorises the directors for a maximum period of time to give financial assistance does not necessarily prejudice the interests of the minority shareholders and the creditors. The resolution to give "prior" approval could indicate the criteria to define market conditions under which the directors must finalise the transaction. For example, instead of indicating a predefined rate of interest, the resolution could set the criteria to establish the rate of interest of the financial assistance[77]. Not even the evaluation on the merit of the credit standing in terms of article 23 (1) (2) requires the prior identification of the beneficiary. The resolution of approval could predefine the requisites that the beneficiary of the financial assistance must meet. For example, the resolution could request that of the third party has a certain rating or, in the absence of such rating, assets, earnings and cash flows levels that prove an acceptable credit standing.

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[74] Schmolke, Finanzielle, 1834.

[75] Schmolke, Finanzielle, 1834.

[76] Schmolke, Finanzielle, 1833; Hartung, Financial, 48.

[77] For example the interest rate could coincide with a reference rate (e.g.: LIBOR) plus or minus a fixed percentage.

Prior setting of the criteria to establish applicable market conditions and credit standing of the future beneficiary avoids (in line with the scope of the European legislator) the risk that the directors grant financial assistance at conditions which are not fair or to a third party clearly incapable of repaying the amounts loaned by the company.

Identifying the beneficiary before the shareholders authorize the financial assistance is not essential also for the purposes of the evaluation of the interest which the transaction has for the company. The indication of the interest to the company could be unrelated to the identity of the beneficiary[78].

Article 23 does not appear to request that the directors indicate the interest of the company in giving financial assistance to a specific beneficiary known at the moment of the general meeting approval[79]. The benefit which the transaction could have for the company could be merely financial (e.g. Enabling the introduction into the company ownership of a party which is willing to finance the company's development plans)[80]. The interest of the company in entering into such a transaction therefore consists in the advantage that the company gains by giving the financial assistance and identifying such benefit could be independent of the identity of the beneficiary.

Giving financial assistance cannot be considered equivalent to the exclusion of pre-emption rights. In this latter case it is necessary – according to prevalent doctrine – that the directors indicate the interest which necessitates or at least renders preferable excluding pre-emption rights and sacrificing the interest of the existing shareholders. Indicating the interest of the company in giving the financial assistance to a specific beneficiary is necessary only for the purpose of the hypothesis under article 23a of the second Directive. This rule requires evidence that "the transaction does not run counter to the best interests of the company" since the risk of a conflict of interest is higher when the financial assistance is given to directors of the company or its holding company, to the holding company or third parties acting on behalf of the same[81].

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[78] As an example the companies' interest could be that for easing the entry of a shareholder operating in a certain sector with the scope of developing operating cooperation.

[79] Brosius, Die finanzielle, 280; from a different perspective, Drygala, Finanzielle, 405; Oechsler, § 71a, Rn 9, 1893; Hartung, Financial,75; Abbadessa, I prestiti, 87.

[80] Hartung, Financial, 75; Cacchi Pessani, L'assistenza, 65 et seq.

[81] Commission working document: Detailed explanation (by article) of Proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC; Grundmann, Europäisches Gesellschaftsrecht, 2. Ed., Heidelberg, 2011 183; Brosius, Die finanzielle, 285; de Luca, sub art. 2358, 145 et seq.; Santella-Turrini, Capital, 448, "if the beneficiary of the loan is a director of the company, there will be more reason to apply the rules on conflict of interests".

Consideration must also be given to the fact that article 29 (5) of the second Directive allows the shareholders to give the board of directors the power of excluding or limiting the pre-emption rights for a maximum period of 5 years[82]. The general meeting can delegate the exclusion of pre-emption rights to the board of directors before the subscriber of the new shares is identified and before the conditions of the transaction have been defined[83]. The general meeting must only define the possible terms of the transactions and the conditions for excluding pre-emption rights and indicating the criteria to identify the beneficiary. If the directors do not respect the criteria established by the general meeting, the shareholders can impugn the resolution of the board of directors[84].

An inconsistency exists between article 23 (1) (3) and article 29 (5). There is a contradiction in that the general meeting may delegate the exclusion of pre-emption rights for a maximum period of 5 years but cannot authorize provision of financial assistance for a specific period of time. This appears even more incongruous when one considers that the exclusion of pre-emption rights necessarily impacts the position of the minority shareholder while financial assistance could well leave unaltered the percentage of ownership of the minority shareholder affecting only the distribution of power amongst shareholders.

The fact remains that in the case of "prior" approval to financial assistance the information on the risk which the transaction presents to the liquidity and the solvency of the company could become obsolete. Between the date of the general meeting and that of granting financial assistance the situation of the company could deteriorate. In this case the directors cannot give the financial assistance if this jeopardizes the solvency of the company[85]. Any action by the directors which jeopardises the company's solvency would constitute a breach of their fiduciary duties. Moreover, one must take into consideration that the risk that solvency forecasts presented to the general meeting become obsolete exists (even if to a lesser extent) in all cases since it is normal that the date of approval of the general meeting and that of the actual grant of the loan or guarantee do not usually coincide.

[82] Hirte, Isssuing new shares and pre-emptive rights. Recent issues in European corporate statutes, P. Balzarini – G. Carcano – M. Ventoruzzo (Eds.), La società per azioni oggi, Milano, 2007, 740 et seq.

[83] Cahn, Pflichten des Vorstandes beim genhmigten Kapital mit Bezugsrechtsausschluß, ZHR, 1999, 557 et seq.; Stamatopoulos, Die Pflichtenstellung des Vorstands der Aktiengesellschaft und der Schutz der Aktionäre beim bezugsrechtsfreien genehmigten Kapital, München, 2007,134 et seq.; in Italy, Giannelli, L'aumento di capitale a pagamento, Abbadessa-Portale (Eds.), Il nuovo diritto delle società, vol. 3, Torino, 2006, 271 et seq.

[84] With reference to the board of directors resolutions excluding preemption rights Stamatopoulos, Die Pflichtenstellung, 263 et seq.

[85] Strampelli, Distribuzioni ai soci e tutela dei creditori, Torino, 2009, 150 et seq.; Viëtor - van der Zanden, Repeal of the Dutch Financial Assistance Prohibition for BVs: Are We Just Dressing Old Worlds New?, International Corporate Rescue, 2010, 99.

Finally, article 23 could be amended to allow the shareholders to authorise the board of directors to give financial assistance for a maximum period of time, on condition that the resolution of the shareholders indicates the criteria to establish the transactions conditions and to estimate the credit standing of the third party. This solution renders the financial assistance regime more flexible without prejudicing the interests of the minority shareholders and the company creditors.

Given the potential change in market conditions and the financial situation of the company, it is in any case opportune that the prior authorization is given for a shorter period than that under article 19 (2) of the second Directive for the acquisition of own shares. The general meeting could authorize the board of directors to give financial assistance for a maximum period of 12-24 months. Moreover, the directors cannot autonomously decide to provide financial assistance to the persons indicated under article 23a. This latter rule requires the directors to provide the shareholders with the reasons why the transaction does not conflict with the company's best interests. Provision of financial assistance to the parties under article 23-bis must be authorised case by case by the general meeting.

3. The risk of transaction-disrupting actions by the minority shareholders: possible remedies

The proposal for the amending Directive (article 23a) provided that the shareholders have the right to contest the general meeting's approval of a financial assistance transaction by applying to the appropriate administrative or judicial authority to decide on the legality of that transaction.

This provision does not appear in the definitive text of Directive 2006/68/EC. Article 23a was eliminated since there exists no harmonized regulation on the invalidity of general meeting resolutions[86], the elimination of this regulation does not prevent the shareholders from contest the approval resolution. The shareholders can contest the approval in terms of the relative regulations applicable in the Member States[87]. The minority shareholders therefore have the right to apply to the appropriate administrative or judicial authority to decide on the transaction. The shareholders could object to the approval of the general meeting when they find that the terms of the transaction are not in line with those prevailing on the market and that the credit standing of the third party has not been duly investigated [88]. The shareholders could also contest the resolution in the event that there

[86] See Siems, Convergence in Shareholder Law, Cambridge, 2007, 218 et seq.

[87] Drygala, Finanzielle, 403; Brosius, Die finanzielle, 277 et seq.; Hartung, Financial, 47.

[88] Drygala, Finanzielle, 403.

are procedural defects and, more specifically, if the directors' report is incomplete or provides incorrect information.

The risk of actions of minority shareholders is considered to be very high given the subjective nature of the verification of the terms and conditions of the transaction, the evaluation of the third party credit standing and the forecast of the effects of the transaction on the solvency and cash flow situation of the company[89]. Moreover, one must take into consideration that the minority shareholders can contest the approval resolution even if this is taken in line with article 23, if they can demonstrate and abuse of power or a conflict of interest of the majority shareholder[90].

The interruption of the transaction in view of the action taken by the minority shareholder could have serious consequences given the time factor. For example, in the event of action by minority shareholders, it is likely that the buyer-beneficiary would be obliged to request bridge loan from the bank until it receives the financial assistance of the company with the consequent increase in costs of the transaction[91].

In Germany and the United Kingdom the risk of action by the minority shareholder is considered to constitute a relevant obstacle to financial assistance. The same problem arises also in relation to other decisions of the shareholders such as that on an increase in capital or a merger[92]. Doctrine has therefore presented some proposals to limit such risk.

According to the first proposal, only shareholders who own a minimum percentage of share capital should be allowed to take action against a resolution authorising financial assistance[93]. Shareholders who do not possess the percentage prescribed only have the right to claim compensation for damages suffered as a result of the transaction. The introduction of a quorum only for the resolution on financial assistance is not considered possible[94]. A "general" rule would have to be put in place such as that under article 2377 of the Italian civil code which requests the 5% quorum (or 1%$_o$ for listed companies) for challenging voidable resolutions. The necessity of a minimum percentage of share capital to contest general meeting resolutions does not seem possible in jurisdic-

[89] Drygala, Finanzielle, 403; Brosius, Die finanzielle, 277 et seq.; Ferran, Simplification, 97.

[90] Brosius, Die finanzielle, 279 et seq.

[91] Drygala, Finanzielle, 403; Hartung, Financial, 243 et seq.

[92] Hartung, Financial, 244.

[93] Hartung, Financial, 250 et seq. This solution was already suggested in the English law reform project of 1961 by the Jenkins Committee that indicated a quorum of 10%. See Roberts, Financial, 13 et seq.

[94] Hartung, Financial, 251.

tion where the right of the single shareholder to object to a resolution is impervious (such as in Germany)[95].

In terms of different solution, to limit unfounded objections it may be possible to set up an independent judicial or administrative authority that controls the existence of the conditions under article 23 (1) (2) and the congruency of the forecast of the directors on the effects of the transaction on the solvency of the company[96]. If the judgment of the independent body is positive, the objection to the resolution approving financial assistance is not allowed or is subjected to the possession of a minimum percentage of share capital[97].

This solution has certain limits. The prior control of the independent authority could merely verify that the transaction complies with market conditions and that the information on the credit standing of the third party and on the effects on the solvency and cash flow situation of the company are true. The prior control by the authority could not limit the right of the shareholder of contesting the approval given under article 23 (1) (3) any time that the majority shareholders abuse of their voting rights to gain advantage at the expense of the other shareholders. It must be noted that a similar measure cannot be introduced only with respect to the resolution taken pursuant to article 23 (1) (2) but should have a wider application[98].

In the light of the preceding considerations it is not possible to introduce into the second Directive a provision that allows the shareholders to object to an approval of the general meeting only if these possess a predetermined percentage of share capital. It is doubtful whether such provision could be implemented in Member States where the right to object to a resolution is considered to be a subjective right of the shareholder.

To limit the risk of unfounded actions it is necessary to amend article 23 by including a provision similar to that under article 10 of Directive 2011/35/EU which in the case of merger prescribes the appointment of an independent expert, by the judicial or administrative authorities, who will

[95] Hartung, Financial, 251.

[96] Hartung, Financial, 251, who (recalling the general proposal made by Vetter, Modifikation der aktienrechtlichen Anfechtungsklage, AG 2008, 185 et seq.) proposes to assign the prior check of the financial assistance transaction to the BaFin; Ding, Missbräuchliche Anfechtungsklage im Aktienrecht, München, Frankfurt am Main, 2011, 157 et seq.

[97] A similar solution was adopted under article 2434-bis of the Italian civil code in terms of which, in the event that the auditor has given a positive opinion on all the matters contained in the audit report, then the resolution approving the financial statements can be impugned only by shareholders representing at least 5% of the share capital.

[98] Hartung, Financial, 250; Vetter, Modifikation, 183.

examine the terms of the transaction[99]. The second Directive should also require Member States to enact regulations governing the third party responsibility of the expert in the event that the latter does not properly execute his duties.

A similar solution is found in article 2501-bis of the Italian civil code regulating merger leveraged buyout. This rule requires that the independent expert appointed in terms of article 2501-sexies of the civil code (corresponding to article 10 of Directive 2011/35/EU) ratifies the information supplied by the directors on the funds usable for the reimbursement of the debt burdening the company and resulting from the merger between the target company and the acquiring company[100]. The expert is responsible in terms of article 64 of the Code of Civil Procedure for damages suffered by the company as a result of its breach of obligations.

The independent expert appointed by the court or by the administrative authorities would need to examine the terms and conditions applicable to the financial assistance and, more specifically, the compliance of the same with those of the market. The expert would also need to evaluate whether the investigations on the credit standing of the third party and the reliability of the forecasts on the effect of the transaction on the solvency and liquidity of the company were adequately carried out. The intervention of the independent expert reduces any asymmetry that could exist between the information available to the majority shareholders (and the directors) and that available to the minority shareholders. The positive judgment of the independent expert could dissuade the shareholders from taking unfounded action[101]. The examination of the conditions of the transaction by an independent expert could also enable a speedier decision by the judicial authorities in case of an appeal and also allow the application of judicial procedures analogous to those under § 246a AktG that avoid that the transaction is stalled for a long period in the event that the action is not adequately founded[102]. In Member States where this is compatible with laws in force, it would be possible also to provide that only shareholders who own a minimum percentage of shares can object to general meeting approval when the expert has positively evaluated the transaction terms and has verified the veracity of the information provided by the directors.

[99] Drygala, Finanzielle, 403; Hartung, Financial, 47.

[100] Silvestri, The New Italian Law on Merger Leveraged Buy-Outs: A Law and Economics Perspective, EBOR, 2005, 120 et seq., who doubts the usefulness of the intervention of an independent expert to limit the agency problems between the directors and the shareholders and between the majority and minority shareholders.

[101] It is in any case unlikely that the intervention of the independent expert could prevent disruptive action by predator shareholders (räuberisch).

[102] Hartung, Financial, 249.

Any negative judgment by the expert will not prevent implementation of the transaction. The indications supplied by the expert aid the self defence mechanism of the minority shareholders and the company creditors. In the event that the judgment is negative, these may contest the approval resolution of the general meeting or bring suit against directors [103].

V. CREATION OF AN UNDISTRIBUTABLE RESERVE IN TERMS OF ARTICLE 23 (1) (4)

In line with the report of the High Level Group of Company Law Experts, the Directive 2006/68/EC has subjected financial assistance to the same quantitative limit imposed on acquisition of own shares in terms of article 19 (1) (a) of the second Directive[104]. Article 23 (1) (4) provides that the aggregate financial assistance cannot exceed the distributable net assets. Article 23 (1) (4) also prescribes the creation of an undistributable reserve of an amount equal to the financial assistance, in the same way as article 22 (1) (b) applicable to purchase of own shares.

The distributable net assets limit is directed at curtailing any attempt to circumvent the limit on acquisition of own shares by giving financial assistance and preventing that this eats up the share capital of the company or other net undistributable entries [105].

Doctrine partly criticised conditioning financial assistance to the same quantitative limit applicable to acquisition of own shares. This solution was deemed unjustified since the inherent risks to the share capital are different with respect to acquisition of own shares and financial assistance. The creation of an undistributable reserve appears to constitute an excessively rigid condition which could hinder financial assistance transactions[106].

1. *The reasoning behind the distributable net assets limit in terms of article 23 (1) (4) of the second Directive*

Article 23 (1) (4) of the second Directive proves that the legislator considers the effects of financial assistance to be equivalent to those of purchase of own shares.

The two transactions cannot be considered on the same level from an accounting perspective. The acquisition of own shares, in the same way as distribution of dividends, also involves the restitution of part of the assets to the shareholders and the reduction of the company's net assets. On the

[103] In this respect, with reference to Italian regulation of MLBO, Spolidoro, Fusioni, 255 et seq.; Vicari, L'assistenza, 128.

[104] Above note 41.

[105] Ferran, Regulation, 23 et seq.

[106] Ferran, Regulation, 26 et seq.; Wymeersch, The Directive, 351.

other hand, provision of financial assistance does not involve any reduction of the company's net assets. If the transaction takes place at market conditions, the assets amount remains unchanged and could only suffer an alteration of its composition[107].

When the company gives a loan to a third party for the acquisition of its own shares, the financial resources loaned to the third party are replaced with the credit right under the loan. The total assets amount does not change. The provision of guarantees for the acquisition of own shares does effects neither the amount of the assets nor their composition, since it does not involve an immediate outflow of cash[108]. The company's assets are only reduced when the beneficiary is not capable of paying off the loan received or (in the case of giving guarantees) to reimburse the payment made by the company[109].

Consequently, the function of the limit on distributable profits and distributable reserves is different depending on whether we are dealing with acquisition of own shares or financial assistance [110]. Article 19 (1) (*b*) of the second Directive contemplates the risk that the buyback could reduce the net assets below the subscribed capital and undistributable reserves.

In the case of financial assistance, the limit of distributable net assets faces a risk of a different nature. Article 23 (1) (4) covers the risk that the share capital and the undistributable reserves are "covered" by an asset (the loan granted to the third party) considered "dangerous" by the legislator. As already recalled, the legislator considers loans from financial assistance to be different to other loans of the company, since they present a doppelrisiko. Besides the "normal" risk related to the solvency of the debtor, there is also the risk that the company receives its own shares as reimbursement when the debtor does not succeed in repaying the amounts received and its net assets are wholly or to a greater extent, made up of the shares acquired thanks to the financial assistance. Only in this case does the provision of financial assistance involve the entry of own shares in the company's assets, exposing the company to the same risks inherent in acquisition of own shares[111].

Article 23 (1) (4) provides for the risk that the company capital and the distributable reserves are eaten up by losses (potential) which will result if the third party is insolvent and not able to repay the amounts owed or (in the case that the guarantee is enforced against the company) to return

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[107] See above notes 13, 14,

[108] Above note 13.

[109] Above note 15.

[110] Wymeersch, The Directive, 351.

[111] Supra para. 2.

the amounts paid by the company[112]. In other words, article 23 (1) (4) prevents that financial assistance reduces the net assets of the company below the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes.

Some commentators judge the limit imposed by article 23 (1) (4) excessively restrictive. The discovery of loss of the subscribed capital and the entry of own shares in the company assets are only hypothesis. The risk of financial assistance depends exclusively on the solvency of the beneficiary[113]. Notwithstanding these objections, the limit of the reserves and the distributable profits does not appear to have been eliminated. Article 23 (1) (4) is part of the system of capital maintenance and avoids circumvention of the limit on purchase of won shares prescribed under article 19[114].

The major obstacle for providing financial assistance is however made up of the inclusion of undistributable reserves in the balance sheet[115], since this renders the company's equity situation rigid and could in fact prevent the completion of the transaction even when there are adequate available reserves and profits. It is therefore necessary to verify whether the regime regulating reserves in terms of article 23 (1) (4) could be rendered more flexible without negatively effecting the rights of creditors.

2. *Regulation of reserve in terms of Article 23 (1) (4)*

On the one hand, the creation of a reserve, unavailable for distribution, of the amount of the aggregate financial assistance prevents profits and distributable reserves from being used various times for financial assistance transactions and purchase of own shares in breach of the limit imposed by articles 19 and 23 of the second Directive[116]. On the other hand, the creation of an undistributable reserve complements the limitation on distributable net assets. This latter provides protection of share capital only at the time of provision of the financial assistance. The creation of an undistributable reserve offers protection to the share capital throughout the transaction[117].

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[112] High Level Group of Company Law Experts, Report, 85; Velasco San Pedro, La reforma de la asistencia financieira en Europa, available on internet site http://www.ucm.es/BUCM/der/10437.php, 2006, 33; Schmolke, Finanzielle, 1835.

[113] Above note 19.

[114] High Level Group of Company Law Experts, Report 85.

[115] Ferran, Simplification, 96.

[116] Ferran, Private, 778; Vaquerizo Alonso, Asistencia financiera para la adquisición de acciones proprias, Madrid, 2003, 466.

[117] High Level Group of Company Law Experts, Report, 85

The reserve in terms of article 23 (1) (4) is undistributable and unavailable for the increase in subscribed capital. If the reserve were distributed or imputed as subscribed capital, future losses arising from the financial assistance would directly affect the company's share capital and the undistributable reserves. It is doubtful whether the reserve in terms of art, 23 (1) (4) can be used to cover losses.

If the reserve were consumed by financial year losses, the losses reported when the beneficiary of the financial assistance is insolvent could eat away the share capital and the undistributable reserves. This conclusion was confirmed by article 23 (1) (4) of the second Directive, according to which the financial assistance "shall at no time result" in a reduction of net assets below the aggregate of subscribed capital and the undistributable reserves. The net assets, less the financial assistance, must, for the duration of the transaction, exceed liabilities by an amount at least equal to the subscribed capital and the undistributable reserves.

The reserve laid down in article 23 (1) (4) can only be reduced in line with the negative variance of the value of the loan granted to the beneficiary and not in relation to the financial year losses. This use could reduce net assets, net of the aggregate financial assistance granted to the third party, below than the aggregate of the share capital and unavailable reserves.

A confirmation is also found in the works preceding Directive 2006/68/EC. The Directive proposal presented by the European Commission in September 2004 set the limit of profits and distributable reserves but did not request the inclusion of an undistributable reserve in the balance sheet. It also provided for a solvency test based on the forecast cash flows of the subsequent five years. As a result of the perplexity shown on the feasibility and the effectiveness of the five yearly solvency test,[118] the legislator eliminated the solvency test and in Directive 2006/68/EC, introduced the obligation to include an undistributable reserve in the balance sheet[119] in order to avoid that the aggregate financial assistance exceeds the limits of distributable net assets. In order to protect the share capital the legislator considers it necessary to impose a limitation on net assets which coincides with that imposed for the acquisition of own shares. The obligation of the directors to certify the credit standing of the beneficiary and to evaluate the risks which the liquidity and solvency of the company run, as a result of the financial assistance granted, is not considered to constitute sufficient protection for this purpose.

[118] Ferran, Simplificación, 98; Drygala, Finanzielle, 402; López Mateo, Asistencia financiera: Análisis y crítica del derecho vigente. Ley 3/2009. (I), in Rev. der. Merc., 2009, 595; Velasco San Pedro, La reforma, 34.

[119] Drygala, Finanzielle, 402; Westermann, Kapitalschutz, 162.

3. *Proposal for more flexibility: the availability of the "financial assistance reserve" to cover losses*

As already explained, the ban on distribution to the shareholders or to imputing the reserve to share capital, in terms of article 23 (1) (4), is essential for the preservation of share capital. If the shareholders were able to distribute the reserve the limitation on profits and distributable reserve could have been circumvented.

The ban from using the reserve for losses appears excessively rigid.

Amounts receivable from third parties are considered as assets of no value and are neutralised for accounting purposes (in the same was as own shares) by inclusion of an undistributable reserve in the balance sheet. This solution is not acceptable since a loan granted to the beneficiary of financial assistance is an asset with an intrinsic value which depends on the solvency of the beneficiary[120]. Article 23 of the second Directive is contradictory because, on the one hand, imposes the "neutralisation" of the loan by the creation of an undistributable reserve, and on the other requires the directors to evaluate the credit standing of the counterparty, implicitly admitting that the value of the credit depends on the solvency of the beneficiary[121].

Loans granted are neutralised by creation of an undistributable reserve even if there is no concern on the insolvency of the beneficiary of the financial assistance. The unavailability of the reserve in terms of article 23 (1) (4) to cover losses introduces a relevant rigidity element on the equity structure of the company and could hinder the implementation of such transactions[122]. As a result of the creation of the undistributable reserve, financial assistance could no longer be "feasible" for the company even if the company has sufficient profits and available reserves and the beneficiary does not have any solvency problems.

If the company balance is negative (because of a downturn of the company's affairs or the impairment of assets), since the reserve in terms of article 23 (1) (4) is unavailable to cover losses there could be a serious loss of the subscribed capital and the directors are bound to call a general meeting in terms of article 17 of the second Directive in order to consider adoption of possible measures. The problem is particularly relevant in Member States (such as Italy) where the "recapitalize or liquidate" rule applies (see article 2447 of the Italian Civil Code). The ban from using the

[120] Freitag, Financial Assistance, 162.

[121] Wymeersch, The Directive, 352; Freitag, Financial Assistance, 162; Eidenmüller, Private, 663 (note 96).

[122] On the same lines Ferran, Private, 23 et seq.; Wymeersch, The Directive, 351 et seq.

financial assistance reserve as cover could oblige the company to recapitalize the company, even if the solvency of the beneficiary of the financial assistance is not under discussion[123].

In order to add flexibility to article 23 (1) (4) without prejudicing the interests of the minority shareholders and the creditors it is possible to allow the use of the reserve for covering losses by taking the necessary precautionary measures. When the reserve is eaten up by the losses, article 23 should impose its reconstruction by crediting therein profits from subsequent financial years up to the amount of the financial assistance.

A similar solution is contemplated in article 34 (1) (*a*) of the fourth Directive. Even this norm is aimed at protecting share capital in case of booking assets considered "dangerous" by the legislator, such as formation expenses included between company assets. Article 34 (1) (*a*) bans any distribution to shareholders until such time that the amount of available reserve is at least equal to that of the unamortized formation expenses.

In conclusion, the use of the reserve in terms of article 23 (1) (4) to cover financial year losses does not prejudice the interests of the company's creditors. If there are no doubts on the solvency of the beneficiary use of the reserve for losses does not involve any risk to the company's share capital. On the other hand, when the solvency of the beneficiary is in doubt, it is necessary to write down the carrying amount of the loan and consequently reduce the reserve laid down in article 23 (1) (4). In such case, the reserve is already reduced and cannot be used to cover financial year losses.

VI. EXCLUSION OF MERGER LEVERAGED BUYOUT FROM THE SCOPE OF ARTICLE 23 OF THE SECOND DIRECTIVE: THE MODEL OF ARTICLE 2501-BIS OF THE ITALIAN CIVIL CODE

The merger leveraged buyout (MLBO) is a transaction that produces similar effects to those resulting from provision of financial assistance, since the debt contracted for the acquisition of the target company's shares burdens the assets of the same target. In the MLBO this effect is a consequence of the merger between the target company and the acquiring company (the so called newco)[124]. The target does not give financial assistance to the newco before the merger. Article 23 of the second Directive does not clarify whether the limits and the conditions applicable to financial assistance apply to MLBO transactions. Even if from a legal perspective the MLBO and financial

[123] Cacchi Pessani, L'assistenza, 106.

[124] Eidenmüller, Private, 649; Sabiwalsky, Finanzielle Risiken durch Leveraged Buyouts und die Glaubigerschutzwirkung alternativer Kapitalerhaltungskonzepte, DBW 2008, 546 et seq.; Hartung, Financial, 65 et seq.

assistance are different transactions, it is a moot point whether article 23 of the second Directive applies to the MLBO[125].

The preferred theory is that which holds that article 23 does not apply when the acquirer takes a loan from third parties to acquire the shares of the target company and the debt is transferred on the target itself as a result of the merger between the target company and the newco[126]. The provisions of article 23 do not adequately protect minority shareholders' rights and those of the company's creditors in MLBO transactions.

A MLBO increases the target company's indebtedness but does not expose the company to the potential doppelrisiko arising from provision of financial assistance[127]. As opposed to financial assistance, the MLBO does not give rise to a credit payable by the newco to the target company and therefore there is no risk of entry into the assets of the target of own shares in the event of the insolvency of the newco. As a result of the merger the creditors of newco become creditors of the target and the debt contracted for the purchase of the target is transferred to the same target[128]. Article 23 (1) (2) which imposes an evaluation of the credit standing of the third party and requests that the transactions take place at fair market conditions, especially with regard to interest received by the company and with regard to security provided to the company, does not apply.

Even the quantitative limit in terms of article 23 (1) (4) does not apply to MLBO transactions. Following the merger, the share capital of the company could be eaten up by future losses which must be calculated bearing in mind the obligations arising in terms of the repayment of the acquisition financing. The MLBO does not have any effect on the share capital until the post-merger net assets are sufficient to absorb future losses [129]. The feasibility limit of the MLBO depends on the amount of available reserves for losses and is not equivalent to the limit under article 23 (1) (4).

[125] See Ferran, Private, 23; Salès, French financial assistance rules hinder leveraged finance, IFLR, May 1996, 12; Spolidoro, Fusioni, 244 et seq.; Miola, Legal, 451; Silvestri, The new, 106 et seq.: Nuyken, Finanzielle, 1897 et seq.

[126] Habersack, Die finanzielle, 173 et seq.; Habersack, Finanzielle, 745; Fleischer, Finanzielle, 505; Lutter – Drygala, § 71a, Rn. 38; Riegger, Kapitalgesellschaftsrechtliche, 248 et seq.; Hartung, Financial, 294 et seq.. In Italy this is by far the prevalent doctrine following the introduction of article 2501-bis of the civil code (see Spolidoro, Fusioni, 244 et seq.; Silvestri, The New, 111 et seq.).

[127] Supra para. II.

[128] Cacchi Pessani, L'assistenza, 47 et seq.

[129] The accounting standards for drawing up the financial statements affect the feasibility of the MLBO. The IAS/IFRS standards could favour MLBO transactions. For example the provisions of IAS 36 which do not require the amortisation of goodwill could favour the transaction by reducing the level of losses which the company will suffer during the subsequent financial years. Cacchi Pessani, L'assistenza, 51.

This amount includes reserves (e.g.: the statutory reserve) that are unavailable to cover financial year losses in terms of article 23 (1) (4) [130].

In the MLBO, minority shareholders and creditors are safeguarded by the merger regime[131]. Minority shareholders of the target could challenge the resolution approving the merger which is detrimental to their interests and which results in a dilution of their percentage of ownership. Company creditors are protected in terms of article 13 of Directive 2011/35/EU which prescribes the implementation of an adequate system of protection of the interests of creditors of the merging companies. Creditors are also authorised to apply to the appropriate administrative or judicial authority for adequate safeguards provided that they can credibly demonstrate that due to the merger the satisfaction of their claims is at stake and that no adequate safeguards have been obtained from the company

One cannot, in any event, forget that the MLBO produces similar effects to financial assistance. In both cases the acquisition of shares is financed with the resources of the company itself. Both the transactions could affect the liquidity and the solvency of the company even if in different manners. In the case of financial assistance the company bears the risk of the insolvency of the beneficiary. In the MLBO, following the merger, the same company is exposed to the risk of insolvency because it may not possess sufficient funds to repay its debt contracted (by newco) for the purchase of its own shares. In both cases it is therefore necessary that the shareholders and the third parties are properly informed on the risks which he transaction could have on the solvency and the liquidity of the company.

Article 2501-bis of the Italian Civil Code, which regulates the MLBO, is aimed at meeting this requirement. This norm prescribes that shareholders and third parties must be informed of the effected of the MLBO on the solvency of the target company. More specifically, article 2501-bis provides that in the merger plans, the directors of the companies involved must show the financial resources which will be used to repay the debt contracted by the newco and to include in their reports a strategic and financial plan which indicates the source of these financial resources [132]. Article 2501-bis also provides that an independent expert ratifies the reasonableness of the additional information provided in the merger plan. Information supplied by the directors and the certification of the expert limit any asymmetry in information and aid the self defence mechanism of the minority

[130] Sabiwalsky, Finanzielle, 563.

[131] Habersack, Die finanzielle, 169 et seq.; Brosius, Die finanzielle, 146 et seq.

[132] Silvestri, The New, 110 et seq..

shareholders and the company creditors. The disclosure and the advice of the independent expert could render the application of remedies by the Court less cumbersome and more effective[133].

In conclusion, the limits in terms of article 23 are not aimed at protecting the minority shareholders and the company creditors when the debt contracted for the acquisition of the shares in the target is entered in the debts of the target company as a result of the merger. Therefore it is opportune to exclude the application of article 23 to the MLBO (by means of proper provision in article 23). Since the MLBO could expose the solvency of the target company to risk, it is opportune that even in the MLBO the directors are bond (as per article 23) to evidence the possible consequences of the MLBO on the solvency of the company. It is also opportune to request an independent expert opinion on the reasonableness of the information supplied to the directors, in terms of 2501-bis of the Italian civil code.

By way of protection of minority rights and the rights of creditors of the target, a norm similar to article 2501-bis of the Italian Civil Code should be introduced in Directive 2011/35/EU, regulating mergers, which will apply when by reason of the merger the debt contracted for the acquisition of the shares of the target is transferred to the same target company. The merger plan and the report prescribed under article 9 of Directive 2011/35/EU should provide information of the effects of the merger on the solvency of the target company. Moreover, the expert appointed in terms of article 10 of Directive 2011/35/EU should certify that the information supplied by the directors is reasonable. Since the certification of the expert is relevant even to the company creditors, in the case of the MLBO the shareholders should not have the possibility given under article 10, par. 4 of Directive 2011/35/EU to renounce to the appointment of the expert. It is understood that norms regulating the MLBO similar to those under article 2501-bis of the Italian Civil Code could be introduced by the local legislator even if the Directive will not give this option. But in such a case the level of harmonization would probably be hindered.

1. *Provision of financial assistance by the target to the newco before the merger: application of article 23 of the second Directive*

The regulation of the MLBO as detailed in the preceding paragraph is not suitable to protect the minority shareholders and the creditors of the target when this (to favour a nonhostile takeover) gives financial assistance to the newco before the merger. Any action taken by the minority shareholders against the resolution approving the merger does not eliminate the harm caused to the same

[133] Spolidoro, Fusioni, 252; Vicari, L’assistenza, 123 et seq.; Silvestri, The New, 144.

shareholders which have arisen prior to the merger as a result of the financial assistance. For the same reason, protection in terms of Directive 2011/35/EU also does not adequately protect the company's creditors[134]. When the target gives financial assistance to the newco article 23 of the second Directive must apply. The minority shareholders and the creditors must be given protection from the moment that the financial assistance is provided.

The application of article 23 of the second Directive constitutes a significant obstacle to MLBO transaction in that application of the limitation under article 23 (1) (4) could mean that the target would not be able to grant a bridge loan to the newco, which will be forced to take a third party loan (usually from a bank) at more onerous terms. The need to protect the creditors of the target company, in any case, imposes compliance with the conditions pursuant to article 23 of the second Directive [135]. It is possible to allow the debts exceeding distributable net assets to be transferred to the target company only as a result of the merger, whose regulation prescribes that an adequate guarantee must be given to the company's creditors.

When the target company gives financial assistance to the newco prior to the merger and as a result of the merger no further debts contracted for the purchase of shares are transferred to the target, the application of the rules governing the MLBO suggested in the above paragraph is superfluous[136].

Article 23 requests the directors to explain the effects of the concession of the loan or the guarantee on the net asset situation of the target. The risks of the transaction are already known at the time of the merger. If the target has given a loan to the newco, further disclosure is useless since the loan to the newco is extinguished as a result of the merger. When the target gives a guarantee to the newco, the risks on the solvency and the liquidity of the target which could arise from calling in the guarantee must be detailed in terms article 23 (1) (3). The capacity of the target to repay the debt contracted by newco will also appear in the report in terms of article 23 (1) (3).

Article 23 of the second Directive adequately protects minority shareholders' interests and the interest of the creditors. Minority shareholders can challenge the approving resolution taken by the general meeting if they hold that the financial assistance is prejudicial to their interests. The inter-

[134] For a different perspective with reference to German laws, Habersack, Die finanzielle, 176 et seq.; Brosius, Die finanzielle, 160 et seq.

[135] In such case financial assistance regulation prescribes a "seriousness test" (Above note 27). If the acquirer is not capable of acquiring a bridge loan from a third party or to undertake the burdens deriving from the acquisition financing, the purchaser's standing could be doubtful.

[136] de Luca, sub art. 2358, 150; from a different perspective Cacchi Pessani, L'assistenza, 57 et seq.

ests of the creditors are protected by the conditions under article 23 and, more specifically by the limit on the distributable net assets.

VII. Conclusion

The above analysis shows the necessity of measures to protect (minority) shareholders and corporate creditors from risks arising from financial assistance. The conditions laid down in article 23 of the second Directive are, in some aspects, excessively rigid and not necessary for safeguarding minority shareholders and creditors. It is possible to alter article 23 to add some flexibility to the financial assistance regime without prejudicing the interests protected under the second Directive. It would, moreover, be opportune to exclude the application of MLBO transactions from the scope of article 23 and to include in the Directive 2011/35/EU safeguards for the minority shareholders and the creditors of the target similar to those prescribed by article 2501-bis of the Italian Civil Code.

The suggested amendments to article 23 could appear to lack force. Some authors advocate the need to eliminate article 23 from the second Directive to make the legislation more flexible and to facilitate financial assistance transaction, thus encouraging development of the private equity sector. The risks arising from financial assistance should be faced by the directors who are obliged to verify whether the transaction is in the interest of the company and that whether it negatively affects the net asset situation of the company or prejudice the solvency and liquidity of the company[137]. The risk that financial assistance gives rise to market abuse or discrimination amongst shareholders should be limited by the remedied already applicable in the legislation of the various Member States. For example, the regulation of financial services or, more in general, the fiduciary duties of the directors and their duty to act in good faith or conflict of interest regulations[138].

"Liberalising" financial assistance calls for proper evaluation. On the one hand, article 23 of the second Directive constitutes a clear parameter of what is allowed and what is not[139]. On the

[137] Boschma–Lennarts–Schutte Veenstra, Alternative, 73.

[138] Rickford (Ed), Reforming, 945; Davies, Gower and Davies' principles, 357;Ferran, Corporate Transactions, 240; Ferran, Principles, 274; Wymeersch, Article 23, 744 et seq.; Lowry, The Prohibition, 24 et seq.

[139] Hooft, The Financial Assisitance Prohibition: Orginis, Evolutions, and Future, European Company law, 2011, 160. KPMG Deutsche Treunhand Gesellschaft AG, Feasibility study on an alternative to the capital maintenance regime established by the Second Company Law Directive 77/91/EEC of 13 December 1976 and an examination of the impact on profit distribution of the new EU accounting regime, 2008, available on internet site http://ec.europa.eu, 308, "Shareholder and creditor may be worsen if a further liberalisation of financial assistance takes place in favour of fiduciary duties of directors. The addition of a balance sheet/solvency test may benefit shareholders and creditors in helping them to assess the viability of a company after financial assistance, if the testing procedure is effective".

other hand, it is doubtful whether eliminating article 23 would increase the flexibility of financial assistance regulation[140]. Eliminating article 23 of the second Directive could bring about the substitution of ex ante remedies (e.g.: shareholders approval; disclosure obligations; balance sheet test) with ex post remedies (directors responsibility; invalidity of the resolution of the board of directors; bankruptcy laws).

If financial assistance regulations were eliminated from the second Directive, financial assistance transactions would need to be evaluated in terms of wider legal concepts such as, for example, capital maintenance, distributions to shareholders, directors' duties, fraudulent transfers, abuse of majority rule, protection of minority[141].

For example provision of financial assistance at conditions which are not in line with fair market conditions, could still be considered illegal even if regulation of financial assistance were eliminated. In Germany such transactions would breach the general principle of Vermögensbindung laid down in § 57, Abs. 1, AktG[142]. Even in absence of such general principle, the transaction would give rise to directors' responsibility towards the company and eventually towards the corporate creditors. Moreover the general terms of conflict of interest and protection of minorities are also applicable[143].

In conclusion, elimination of financial assistance regulation is not the best solution, since it could render financial assistance more uncertain without any actual benefit of added flexibility. On the other hand, the suggested amendments to article 23 add flexibility to financial assistance regulation without prejudicing the interests of shareholders and creditors.

[140] Hooft, The Financial, 160; Viëtor - van der Zanden, Repeal, 100.

[141] Miola, Legal, 452; Santella-Turrini, Capital, 448; Company Law Review Steering Group, Modern Company Law for a Competitive Economy. Developing the Framework. The Second Document, para. 7.23–7.24; Lutter-Wahlers, Der Buyout: Amerikanische Fälle und die Regeln des deutschen Rechts, AG, 1989, 3 et seq.; Baird, Legal Approaches to Restricting Distributions to Shareholders: The Role of Fraudulent Transfer Law, EBOR, 2006, 205 et seq.

[142] Above note 10. See also Schmolke, Finanzielle, 1833.

[143] See above para 2.