FUNDAMENTAL CHANGES

- In presence of fundamental changes among corporate participants new agency problems arise

In fact fundamental changes are characterized not only by their economic magnitude but also by their capacity to reallocate power among firm participants. This exposure to midstream opportunism is the primary reason why corporate law intervenes.

- The corporate statutes provide for a reallocation of the decision power in order to protect the firm's stakeholders

- Across jurisdictions, limits on board discretion intensify when decisions:

(i) significantly affect participants' stakes,

(ii) create conflicts of interest even if not formally related-party transactions, or

(iii) involve non-firm-specific, investor-type judgments.

- regulations of fundamental changes vary in jurisdictions upon differences in ownership structure and connected agency problems

- the relevant size of the corporate action: there is ground to have a shareholders meeting approval, but size alone is not enough to explain the shift of decision powers to shareholders

- Large-scale decisions increase both the stakes and the informational burdens on shareholders, but empirical evidence shows that size alone does not justify reassigning decision-making authority away from the board.

- self interested decision making: low powered conflicts of interest can harm shareholders (the case of directors selling their company)

- Fundamental changes often trigger a “final period” incentive problem, where directors may prioritize private benefits (future employment, side deals) over maximizing firm value.

Fundamental changes may harm not only shareholders but also creditors and employees.

Actually transformative operations such as mergers, delistings, or restructurings may shift risks onto creditors and lead to employment reorganization, prompting some jurisdictions to adopt specific stakeholder protections.

Approaches of the jurisdictions can vary according to 2 matters: (i) selected fundamental changes which justified a legal intervention, (ii) kind of legal strategy to deploy

Commonly the legal strategies used to tackle fundamental changes side effects are: judicial review, super majority, disclosure, exit rights

WHAT ARE FUNDAMENTAL CHANGES AMONG PARTICIPANTS?

Which are the implied limits of the delegated management allocated to the board?

- F.C.: charter amendments, mergers, corporate divisions, asset sales, share issue, distributions or conversion reincorporations, delisting, deregistration, voluntary liquidation

Risk of freeze-out of minority shareholder

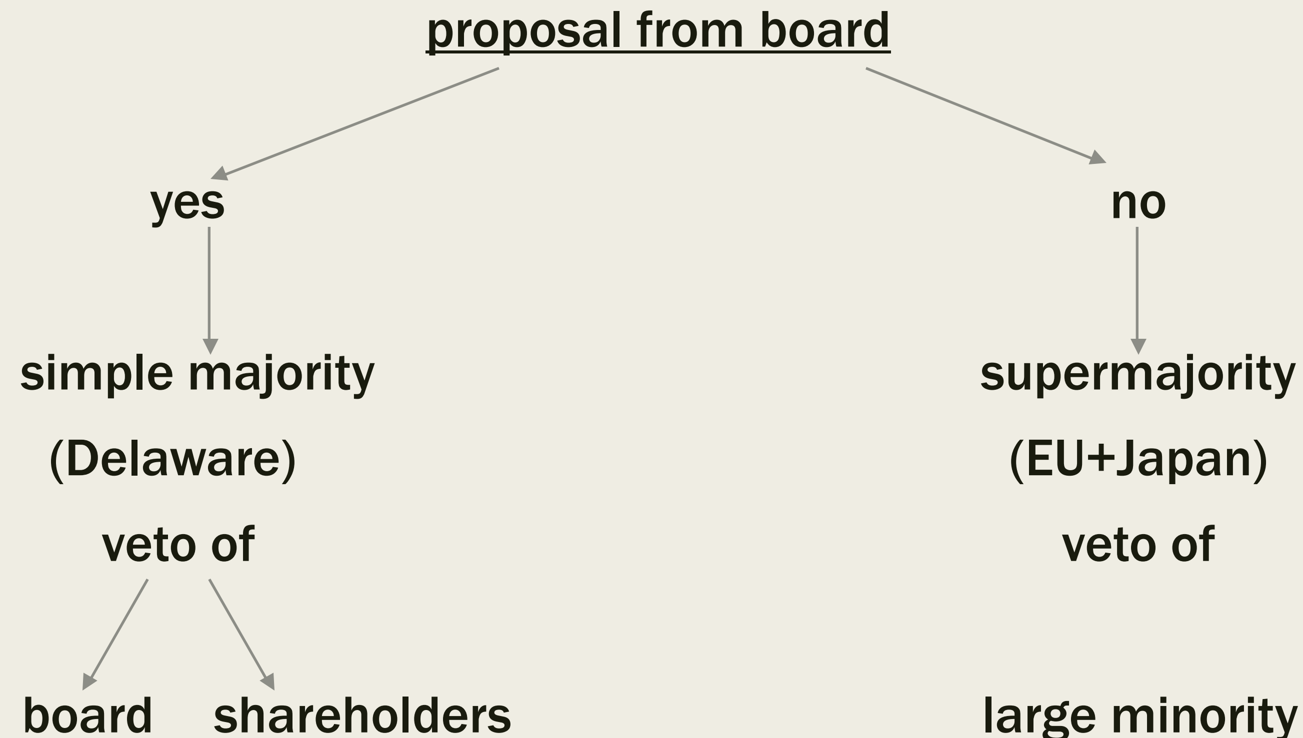
→ acceptable because

1) eliminate conflict of interest
2) allow cash out
3) encourage new investments of controllers
4) eliminate costs of being a public corporation

CHARTER AMENDMENTS

- general introduction on the structure and functions of the charter

- Because charter rules allocate core governance powers, any amendment is universally treated as a fundamental change requiring shareholder ratification.



- vetoes entrench governance provisions of the charter!

- the introduction of a classified or staggered board can work to block a hostile takeover

Brazil allows charter amendments without board approval and with simple majority of shareholders, but dissenting shareholders have an appraisal right + standard strategy on controlling shareholders

In fact Brazilian law requires controlling shareholders to act in the "interest of the company," a fiduciary standard intended to constrain abusive amendments.

- the role of shareholders' agreements (commonly require unanimous consent)

- Unlike charter provisions, shareholder agreements do not automatically bind new shareholders. Yet they can still entrench governance rules effectively when structured to require majority approval for amendments.

- charter binds new shareholders

- charters required to have certain mandatory provisions

share capital

- Delaware: board has the right to issue share below the number fixed by the charter
- Japan: one-fourth rule (in public corporations board cannot issue more than four times the issued shares)
- EU: shareholders authorisation + pre-emption rights

• Jurisdictions vary widely in how prescriptive the mandatory content of the charter must be: some require only minimal governance provisions, while others mandate detailed shareholder rights and limits on liability.

Differences in the mandatory content of charter:

1) Structure of board

- in the charter (EU+Japan)
- in the bylaws (US+UK)

2) Statement of subscribed legal capital

- in the charter (EU)
- nowhere (US+Japan)

MANAGERS/SHAREHOLDERS CONFLICTS

- charter provisions can entrench management vis-à-vis shareholders (e.g. providing for a classified board)

• A staggered board limits shareholders' ability to remove directors quickly during a contest for control, operating as a powerful anti-takeover device.

- decision rights of shareholders to address agency problems versus directors

MAJORITY/MINORITY CONFLICTS

- supermajority + class of shareholders approval, e.g. preferred stockholders (but see Delaware and UK)

- judicial review (bona fide, majority abuse, etc) = unsuccessful!

- More effective protections derive from class approval requirements and appraisal rights when amendments materially affect dissenting shareholders' rights.

Appraisal right (exit), to protect dissenting minority = common protections. Indeed the charter amendments must materially affect the rights of the dissenting shareholders

Charter provisions used to solidify control

dual class capital structure

- voting shares
- non voting shares

SEC and US stock exchanges ban midstream dual class recapitalization: i.e. exchange of non voting share for voting shares (Japan same)

allowed in EU but the law requires that any exercise of the power to issue differential-share classes respect mandatory principles ive rights of shareholders