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Corporate capital increases: share premium and minority interests

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Purposes and functioning of share premiums

In most corporate capital increases, where new shares are issued the company usually determines the selling price, adding an additional sum to the nominal value of the shares. The difference between the nominal value and the selling price of the shares is known as the share premium.

The reason that a company issues its shares at a premium is that their market value is usually higher than their par value, since the latter is typically set at a minimum value. However, the real function of the share premium is to ensure that the selling price of the shares is consistent with their real market value. This prevents new shareholders from reaping undue benefits from the higher value of the shares, which is derived mainly from the activities of existing shareholders in developing the business. Thus, one of the purposes of the share premium is to balance the position between new and old shareholders.

If new shareholders were allowed to acquire new shares at par value, they would be able to take advantage of the net assets or equity of the company, which includes available reserves accrued by the old shareholders (eg, through total or partial dividend waivers, allowing profits to be reinvested the company, rather than distributed).

In addition, share premiums received by the company in connection with the earlier transactions in respect of its equities converge in the net assets of the company as a special reserve, which can be used once the legal reserve has reached one-fifth of the company's corporate capital under Article 2431 of the Civil Code.

Share premium and option rights

In light of the above, Italian law provides that companies must issue their shares at a premium when the option right is excluded in respect of existing shareholders. In such cases – for instance, where capital increases are made through contributions in kind – Section 2441(6) of the code provides safeguards for existing shareholders. The company's directors must file a report at the company's registered office, at least 30 days before the shareholders' meeting, to explain the reasons for the exclusion of the option right and the criteria used to determine the selling price of the shares. This report must be submitted to the statutory auditors and the account auditors (if applicable). The statutory auditors must express their opinion in order for the price to be regarded as adequate. Furthermore, the statutory auditors' report must be filed at the company's registered office at least 15 days before the shareholders' meeting. For contributions in kind, the report must be accompanied by an attested report by a court-appointed expert (where necessary), or supplemented by the documentation required under Section 2343(3) of the code. The resolution on the increase in corporate capital may exclude the option right on condition that such a resolution is approved by shareholders representing over half of the capital stock (even if adopted in a meeting after the first call).

On the question of price, the abovementioned rule sets out a fundamental requirement to consider (an accurate estimate of) the company's net asset value. This ensures that the sale price of the shares is as near as possible to their real market value. In the case of listed shares, the price must be determined by taking into account the pricing trend of such shares during the previous semester.

Ordinary corporate capital increases and minority shareholders' interests

Italian corporate legislation does not stipulate a rule on the share premium for ordinary corporate capital increases when the option right is not excluded. As such, there is a real risk that gaps in legislation may jeopardise the interests of minority shareholders.

In such circumstances there are no mandatory limits on the directors' freedom to determine the price of the issued shares. It is common practice for the shareholders' meeting to delegate the directors to decide on a capital increase without fixing a price or the criteria that should determine it, although the shareholders' meeting normally sets a minimum and maximum share premium. In theory, therefore, the directors' discretion may be unlimited, allowing them to fix an arbitrary issue price.

Thus, if the share premium is too high, former shareholders may, in practice, be prevented from exercising an option right. In addition, they may be encouraged to sell such rights. However, such circumstances would ultimately have significant consequences for the corporate governance assets, enabling the majority shareholders to strengthen their powers. In the absence of a specific rule in corporate legislation, these may be mitigated by the provision of more detailed instructions to the directors from the shareholders' meeting, curbing the discretion of the former and preventing arbitrary decisions. In view of the connection between share premium and option rights, the only way to protect the old shareholders (and, primarily, the minority shareholders) is to set the price of new shares for issue, taking into particular consideration the company's net assets and equity, as well as other discretionary evaluations in view of the success of the stock operation.

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Even where option rights are not excluded, there is good reason to believe that the share premium maintains its fundamental function of preserving the actual value of the stockholding; therefore, it is necessary to adopt appropriate criteria for such a calculation in order to reduce the risks of minority dilution.

Different share premiums for different classes of share

A company may set different share premiums for different classes of share. The prices of different classes of share may vary according to the dividend and voting rights connected to each class. The provision of different prices also serves the purposes of a company with expanding operations, as it encourages investors to subscribe to new shares on the basis of different requirements. Most experts agree that the issuance of different share premiums, to be applied to different categories of share, does not violate the principle of equal treatment of shares. This principle allows for exceptions. For instance, in certain circumstances different share premiums may apply within the same category of share.

For example, some shareholders may have discounted subscription prices due to the fact that they have loaned money to the company in previous years. This factor may be considered sufficient to justify the application of a different share premium among shares belonging to the same class.

Another similar case may arise where shareholders that contributed earlier are given the right to subscribe to a part of the corporate capital increase with a discounted share premium. The contributions made before the expiry date indicated for the completion of the capital increase provide a benefit to the company (ie, the immediate availability of those funds), thus justifying the different treatment of the shareholders in respect of the same class of shares.

Despite the absence of specific rules or commentary on this issue, these cases suggest that different share premiums can be applied to shares belonging to the same category; however, this decision should be supported by specific reasons and implemented in a way that does not breach the option rights of the other shareholders.

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