Can U.S. Venture Capital Contracts Be Transplanted into Europe? Systematic Evidence from Germany and Italy

Law Working Paper N° 848/2025

June 2025

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ECGI Working Paper Series in Law

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Abstract

A vast literature has examined the contractual technology that venture capital (VC) funds and entrepreneurs deploy in the U.S. to define an agency cost-minimising structure of their relationship, leading many to conclude that U.S. VC contracts are the best real-world solution to the challenges bedeviling the financing of high-tech innovative startups and a model for VC transactional practice worldwide. Yet, whether VC funds and entrepreneurs can replicate the allocation of cash-flow and control rights resulting from U.S. VC contracts in non-U.S. jurisdictions has long been open to discussion. Research by financial economists and legal scholars have reached diverging conclusions. The existing literature exhibits three limitations, though. First, it has generally investigated at most only how a subset of the individual components of U.S. VC contracts fare under non-U.S. corporate laws. Second, it has typically considered the law on the books as opposed to the law in action. Third, it has relied on a loose definition of what qualifies as an effective substitute. This article examines how U.S. VC contracts fare under the corporate law regimes in force in two important European jurisdictions: Germany and Italy. It does so by taking a new approach to the matter. First, it considers the entire set of arrangements included in U.S. VC contracts rather than a sample. Second, it assesses the legality of those arrangements in the light of the applicable corporate law in action rather than the law on the books. Third, in assessing arrangements that deviate from U.S. private ordering solutions due to restrictive corporate law, it focuses on contract functionality rather than contract design. The results of the inquiry are straightforward: German and Italian corporate laws literally crash contracting parties' ambition to transplant U.S. VC contracts into their own jurisdictions and only allow for alternative arrangements that, if available at all, are costlier and/or less functional.

Keywords: Comparative Corporate Law, Comparative Corporate Governance, Entrepreneurship, Financial Contracting, Private ordering, Start-ups, Venture Capital
JEL Classifications: G38, K22, L26

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FOUNDATIONS OF LAW AND FINANCE

LawFin Working Paper No. 58

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Deutsche Forschungsgemeinschaft - DFG Project FOR 2774
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SAFE Working Paper No. 450 | June 2025

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This article examines how U.S. VC contracts fare under the corporate law regimes in force in two important European jurisdictions: Germany and Italy. It does so by taking a new approach to the matter. First, it considers the entire set of arrangements included in U.S. VC contracts rather than a sample. Second, it assesses the legality of those arrangements in the light of the applicable corporate law in action rather than the law on the books. Third, in assessing arrangements that deviate from U.S. private ordering solutions due to restrictive corporate law, it focuses on contract functionality rather than contract design. The results of the inquiry are straightforward: German and Italian corporate laws literally crash contracting parties' ambition to transplant U.S. VC contracts into their own jurisdictions and only allow for alternative arrangements that, if available at all, are costlier and/or less functional.

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SUMMARY

I. INTRODUCTION

Economic theory has long established that innovation, rather than other factors of production, leads to long-term growth.[1] Empirical evidence shows that venture capital ("VC") has built a solid track record for supporting high-tech firms and, thus, long-lasting economic growth.[2] Yet, to build a vibrant VC market, private players—namely, VC funds ("VCFs")[3] and entrepreneurs—and policymakers must address the various frictions that stand in the way of innovative startups' access to finance.[4] Consistent with this assessment, financial economists

[1] Robert Solow, *A Contribution to The Theory of Economic Growth*, 70 Q.J. ECON. 65 (1956).

[2] See, e.g., Samuel Kortum & Josh Lerner, *Assessing the Contribution of Venture Capital to Innovation* 31 RAND J. ECON. 674 (2000); and Sampsa Samila & Olav Sorenson, *Venture Capital, Entrepreneurship, and Economic Growth*, 93 REV. ECON. & STAT. 338 (2011).

[3] Our focus on such funds rather than on other forms of VC, such as corporate VC, is justified by VCFs' predominance in the market for entrepreneurial finance (see, e.g., Thomas J. Chemmanur & Paolo Fulghieri, *Entrepreneurial Finance and Innovation: An Introduction and Agenda for Future Research*, 27 REV. FIN. ST. 1, 4 (2014) (offering an overview of the players active in the market for early-stage entrepreneurial finance and stressing VCF's preponderance)).

[4] See generally, e.g., Josh Lerner, *The Governance of New Firms*, *in* FINANCING INNOVATION IN THE UNITED STATES - 1870 TO PRESENT 405, 406-409 (Naomi R. Lamoreaux & Kenneth L. Sokoloff eds., 2005).

and legal scholars have long theorised the pivotal role of private ordering and corporate law's flexibility in reducing the agency costs of the relationship between VCFs and entrepreneurs and allocating risks efficiently.[5]

Taking advantage of Delaware law's enabling nature,[6] VCFs and entrepreneurs have developed a complex contractual framework that, over time, has evolved as the best real-world solution to the problems bedeviling the financing of innovative firms.[7] It has thus emerged as the reference point for the transactional practice of VC financing worldwide.[8]

A sizeable scholarly debate has developed about whether VCFs and entrepreneurs can transplant U.S. VC contracts[9] into non-U.S. jurisdictions. Part of the literature has answered that question in the negative. An oft-cited law and finance study concluded that because of the rigidity of the local legal regimes and less effective enforcement, civil law jurisdictions may hinder the transplant of U.S. VC contracts into non-U.S. jurisdictions.[10] The authors observe that "[contracting p]arties cannot easily undo deficiencies of the law through private transactions if the legal system does not enforce certain types of contracts" and hint at the difficulty of devising contractual solutions that may supplant inadequate legal frameworks.[11] Similarly, some legal scholars have concluded that many non-U.S. corporate law regimes

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[5] Financial economists were the first to model the optimal private ordering solutions. See, e.g., Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts*, 29 RAND J. ECON. 57 (1998); Klaus M. Schmidt, *Convertible Securities and Venture Capital Finance* 58 J. FIN. 1139 (2003) (discussing the function and value of convertible securities in addressing information asymmetries and moral hazard problems). Legal scholars then followed on that path. See Michael Klausner & Kate Litvak, *What Economists Have Taught Us about Venture Capital Contracting in* BRIDGING THE ENTREPRENEURIAL FINANCING GAP: LINKING GOVERNANCE WITH REGULATORY POLICY, 54, 59 (Michael Whincop ed., 2001) (discussing the importance of private ordering in defining the governance of VCFs and VC-backed firms); Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1093 (2003) (same). The scholarly emphasis on the role of private ordering in the context of VC investing led several law and finance scholars to stress that devising and enforcing the private ordering solutions shaping VC-backed firms requires the applicable corporate law regime to exhibit one crucial property: flexibility. See, e.g., John Armour, *Law, Finance, and Innovation in* VENTURE CAPITAL CONTRACTING AND THE VALUATION OF HIGH-TECHNOLOGY FIRMS 133, 149–150 (Joseph A. McCahery & Luc Renneboog eds., 2005) (discussing how the flexibility of the legal regime for private companies may facilitate the adoption of U.S. VC contracts); Joseph A. McCahery & Erik P.M. Vermeulen, *Business Organization Law and Venture Capital*, *in* ID., 162, 167–169 (discussing the importance of a flexible business organization law for the purposes of drafting efficient VC contracts from a transaction-costs perspective). Most recently, see Paolo Giudici & Peter Agstner, *Startups and Company Law: The Competitive Pressure of Delaware on Italy (and Europe?)*, 20 EUR. BUS. ORG. L. REV. 597, 606–607 (2019) (generally stressing the importance of corporate law's flexibility for VC contracting).

[6] See *infra* Part II.B.

[7] See *infra* text corresponding to notes 96-97.

[8] See *infra* text corresponding to note 98.

[9] We use the term "VC contracts" to refer to the set of formally distinct but functionally and operationally intertwined contracts that govern the business relationship between shareholders, which in our context are VCFs and entrepreneurs. These contracts include not only the terms of the firm's charter but also ancillary contracts, such as shareholder agreements. This terminology is similar to the one deployed by financial economists, who use the same term to refer to the certificate of incorporation, the charter, the stock purchase agreement, and a number of shareholder agreements. See, e.g., Ola Bengtsson, *Financial Contracting in the US*, *in* THE OXFORD HANDBOOK OF VENTURE CAPITAL, 478, 486 (Douglas J. Cumming ed., 2014).

[10] Josh Lerner & Antoinette Schoar, *Does Legal Enforcement Affect Financial Transactions? The Contractual Channel in Private Equity*, 120 Q.J. ECON. 223, 224 (2005). See also Isin Guler & Mauro F. Guillén, *Institutions and the Internationalization of US Venture Capital Firms*, 41 J. INT'L BUS. STUD. 185, 189-190 (2010) (making a similar point).

[11] Lerner & Schoar, *supra* note 10, at 224.

hinder the adoption of critical components of the contractual framework governing VC deals in the U.S. or equally effective alternatives.[12]

Other scholars have expressed more benign views on the matter, though. An influential article concluded that legal regimes, including corporate laws, do not impede the transplant of U.S. VC contracts, because VCFs, particularly the most experienced ones, can replicate the optimal allocation of control and cash-flow rights under any legal regime.[13] Recently, some legal scholars independently focusing on the impact of two non-U.S. corporate laws—namely, German and Italian corporate laws—on the transplant of U.S. VC contracts have concluded that these regimes are no real obstacles to engineering contractual frameworks that may be as effective and thus valuable as U.S. VC contracts.[14]

Practitioners worldwide have taken an ambiguous stance on the matter: they have regularly attempted to minimise the adverse impact of applicable local corporate laws on VC contracts' functionality but also highlighted the legal risks associated with transplanting individual components of U.S. VC contracts.[15]

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[12] For E.U. jurisdictions, see, e.g., Theodor Baums & Matthias Möller, *Venture Capital: U.S.-amerikanisches Modell und deutsches Aktienrecht*, *in* CORPORATIONS, CAPITAL MARKETS, AND BUSINESS IN THE LAW : LIBER AMICORUM RICHARD M. BUXBAUM 33 (Theodor Baums et al. eds., 2000) (pointing out the rigidities of the German legal regime joint stock companies as standing in the way of the adoption of U.S. VC contracts); Giudici & Agstner, *supra* note 5, at 617-624 (laying bare the enforceability risk of some key U.S.-style provisions under Italian corporate law); Antonio Capizzi et al., Business Angels*,* Venture Capital *e la nuova s.r.l.*, 8 RIVISTA ORIZZONTI DEL DIRITTO COMMERCIALE 353 (2020) (acknowledging that, according to the current interpretation of Italian corporate law, conversion rights, liquidation preferences, anti-dilution provisions, and drag-along provisions could be null and void); Casimiro A. Nigro & Luca Enriques, Venture capital *e diritto societario: un rapporto difficile*, 20 ANALISI GIURIDICA DELL'ECONOMIA 149 (2021) (discussing how Italian corporate law in action stands in the way of adopting and using nearly all the components of U.S. VC contracts). As to China, see LIN LIN, VENTURE CAPITAL LAW IN CHINA, 143–175 (2020) (discussing convertible preferred shares and liquidation preferences under Chinese corporate law); *Id.*, *Contractual Innovation in China's Venture Capital Market*, 21 EUR. BUS. ORG. L. REV. 101, 115–120 (2020) (same). As to Korea, Narae Lee, *Accommodating Venture Capital Investors' Contractual Rights in the Korean Corporate Law*, 23 J. KOREAN L. 1 (2024) (spotlighting the uncertain legality of key contractual terms in VC deals under Korean corporate law). See also Alvaro Pereira, *The Law of Contingent Control in Venture Capital,* 2023 COL. BUS. L.R. 1, 16–20 (2023) (shedding light on the legal obstacles to adopting contingent control-related mechanisms, such as convertible preferred shares and shares with multiple voting rights, in various jurisdictions).

[13] See Steven N. Kaplan et al., *How Do Legal Differences and Experience Affect Financial Contracting*, 16 J. FIN INTERMEDIATION 273 (2007).

[14] As to German corporate law, see THILO KUNTZ, GESTALTUNG VON KAPITALGESELLSCHAFTEN ZWISCHEN FREIHEIT UND ZWANG. VENTURE CAPITAL IN DEUTSCHLAND UND DEN USA 758 (2016) (concluding, based on an extensive analysis of how German corporate law affects the adoption of the most important contractual solutions found in U.S. VC contracts (ibid. 524-757), that German corporate law does not necessarily prevent the transplant of U.S. VC contractual arrangemets, but relying on a genuine interpretation of the law that expands the room for private ordering). As to Italian corporate law, see Bruna Szego, *Finanziare l'innovazione: il* venture capital *dopo la riforma del diritto societario*, 103 RIVISTA DI DIRITTO COMMERCIALE 821 (2005) (discussing whether the 2003 reform of Italian corporate law expanded the room for importing a few contractual solutions typically found in VC deals and concluding that, relative to the corporate law regime previously in force, things significantly improved); ANDREA ZANONI, VENTURE CAPITAL E DIRITTO AZIONARIO 127209 (2010) (articulating a similar discussion with regard to the regime for joint-stock corporations); Paolo Giudici et al., *The Corporate Design of Investments in Startups: A European Experience*, 23 EUR. BUS. ORG. L. REV. 787 (2022) (arguing, on the basis of empirical data, that the constraints under Italian mandatory corporate law do not rule out contracting parties' ability to design agency cost-minimising governance structures at VC-backed firms).

[15] In describing the contents of the transactional documents relating to local VC deals, practitioners have sometimes elaborated, albeit merely occasionally and purely incidentally, on the obstacles that domestic corporate laws might create for mimicking U.S. VC private ordering solutions. In the German literature, see HANDBUCH VENTURE CAPITAL. VON DER INNOVATION ZUM BÖRSENGANG, *passim* (Wolfgang Weitnauer ed., 7th ed. 2022). See also VENTURE CAPITAL AGREEMENTS IN GERMANY. ENGLISHSPRACHIGE VC-VERTRÄGE NACH DEUTSCHEM

The existing literature exhibits several limitations. To begin with, it has considered chiefly whether VCFs and entrepreneurs in non-U.S. jurisdictions can transplant specific components of U.S. VC contracts. In addition, it has mainly focused on how statutory corporate law, as opposed to corporate law "in action"[16]—that is, the legal rules resulting from the interpretations of authoritative legal texts consistent with the applicable "metarules"[17]—affects the relevant transplants. Finally, in determining whether VCFs and entrepreneurs could achieve a given result through private ordering, it has built upon an incomplete understanding of what constitutes an equally effective substitute.

As a result, the existing literature helps us gain a general idea of what VCFs and entrepreneurs bargaining under a specific non-U.S. corporate law regime can achieve through private ordering, but its findings are, at best, fragmentary and inconclusive. A comprehensive and reliable map of what VCFs and entrepreneurs seeking to design agency cost-minimising governance structures can achieve under non-U.S. corporate law regimes has not been drawn yet.

In a companion paper, we have refined the theory that corporate law's relative rigidity or flexibility affects VC contracting and investments.[18] We have identified the mechanisms originating from rigid corporate law that stand in the way of VCFs' and entrepreneurs' attempts to achieve the allocation of cash-flow and control rights that best suits their needs. In the process, we have highlighted the significance of corporate law in action as the actual source of the constraints on VC transactional practice. We have also shown that rigid corporate law can prevent efficient contracting by inhibiting both U.S.-style arrangements and any "functionally equivalent solution"—that is, a different but equally effective arrangement that allows contracting parties to achieve the *same practical result* as the U.S. template *at no higher cost*.[19]

RECHT (Stephan Bank & Peter Möllmann eds., 3rd ed., 2023). In the international literature, see, e.g., Wolfgang Weitnauer, *Standard Form of a Termsheet for International Use – Germany*, *in* INTERNATIONAL VENTURE CAPITAL TERMS, 375, 394 (Wolfgang Weitnauer ed., 2022) (pointing out that, due to the regime on capital maintenance, courts may invalidate (not the contractual provision stipulating the VCF's redemption right, but) the transaction whereby the VCF has its shares redeemed if the price paid to it exceeds fair value and thus suggesting the inclusion of a severability clause stipulating that, in that case, the VCF shall have the right to receive the lowest price possible). See also Marco Gardina & Giulia Pairona, *Standard Form of a Termsheet for International Use – Italy*, *in Id.*, 416, 427 (pointing out that general provisions of Italian corporate law may affect the enforceability of, *inter alia*, liquidation preferences, and drag-along rights provisions).

[16] For the classic distinction between "law on the books" and "law in action," see Roscoe Pound, *Law on the Books and Law in Action*, 44 AM. L. REV. 12 (1910).

[17] Pierre Legrand, *European Legal Systems Are Not Converging*, 45 INT'L & COMP. L.Q. 52, 57 (1996) (defining metarules as "the rules developed by a legal system (or, more accurately, by the actors within a legal system) in order to help it manage its body of rules").

[18] See Luca Enriques et al., *Venture Capital Contracting as Bargaining in the Shadow of Corporate Law Constraints (Manuscript dating 9 January 2025)* (2025), 12 (arguing that market participants who understand that existing constraints prevent them from fully realising their objectives through private ordering, will strike VC deals only at less favorable conditions, negatively affecting VC-backed firms' cost of capital and, at the margin, resulting in fewer startups obtaining VC, which ultimately hampers innovation and growth). Some legislative initiatives and contributions to the high-level policy debate in Europe align with our framework and recognise the importance of flexible corporate law for VC financing. See, e.g., E.U. Commission, *The Future of European Competitiveness - A Competitiveness Strategy for Europe* 29-30 (9 September 2024), https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en .

[19] We restrict the notion of functional equivalence to the case of equal (cost-)effectiveness from the contracting parties' perspective. For instance, specification costs ex ante and enforcement costs ex post can limit the value created by a contract. See Benjamin E. Hermalin et al., *Contract Law*, *in* THE HANDBOOK OF LAW AND ECONOMICS, 3, 7-12 (A. Mitchell Polinsky & Steven Shavell eds., 2007). Variations in unenforceability risk and/or enforcement costs then imply that two alternative contractual solutions do not have the same value. Cf., also for references, Kevin E. Davis, *Contracts as Technology*, 88 N.Y.U. L. REV. 83, 88-103 (2013) (discussing how a

That, in turn, implies that VCFs and entrepreneurs must content themselves with less effective alternative arrangements: that is, contractual solutions that—identical or similar as they may be to their U.S. counterparts—aspire but fail to achieve the same practical result or do so at a higher cost (hereinafter, "inferior alternative arrangements").[20]

In this article, we examine whether U.S. VC contracts work outside their home jurisdiction by examining whether they can be transplanted into Germany and Italy. We discuss how the corporate laws in action in these jurisdictions affect contracting parties' ambition to transplant U.S. VC contracts' functionality. Importantly, rather than examining whether German and Italian corporate laws allow for the transplant of the *provisions* included in U.S. VC contracts, we focus on whether they permit the allocation of cash-flow and control rights achievable through contracting under U.S. corporate law—irrespective of contract design. We provide systematic evidence that German and Italian corporate laws are inhospitable to such transplants. A few, partly immaterial exceptions aside, contracting parties regularly face insurmountable legal obstacles in allocating cash-flow and control rights based on the U.S. model. Casual observation of real-world Italian VC contracts, the standard contractual templates that leading German VC handbooks provide, discussions with VC lawyers, and other available empirical evidence confirm that transactional practice is consistent with the constraints we pinpoint.

Our findings cannot be dismissed as mere instances of (severe) regulatory uncertainty.[21] We document that in most instances the law in action unequivocally obstructs VCFs' and entrepreneurs' ambition to shape their relationship by contract. To be sure, we also find that regulatory uncertainty is itself a problem, further hampering contracting parties' reliance on contracts as a governance tool.

This study is the first to show how the entire set of private ordering solutions shaping U.S. VC contracts fares under the corporate law of specific non-U.S. jurisdictions. Its findings, together with those of our companion paper, have important lessons for policymakers aiming to enhance VC markets. We discuss and illustrate some of those lessons in a third paper.[22] Notably, while focusing on two individual non-U.S. jurisdictions, our overall discussion is relevant far beyond Germany and Italy. In fact, its value extends to all jurisdictions where rigid corporate law compels VCFs and entrepreneurs to bargain within a legal environment that is ultimately hostile to private ordering. In a fourth paper, two of us speculate about the factors that may explain the "*über*-mandatory structure of Italian corporate law"—as we term it—, articulating, again, reflections that may well have value across many other jurisdictions.[23]

The remainder of this paper unfolds as follows. In Part II, we set the stage for our discussion. We begin by recalling the fundamental building blocks of our theoretical framework. We then explain that Delaware corporate law matches the VC-hospitable corporate law we envision nearly perfectly, and has thus served as a fertile ground for developing the presumptively efficient U.S. VC contracts we know today. We finally explain that the German and Italian corporate laws, by contrast, depart in crucial respects from the VC-hospitable

variety of factors, including legal uncertainty and hence unenforceability risk, affect contract value). For details, see Enriques et al., *supra* note 18, at 14-15.

[20] See Enriques et al., *supra* note 18, at 15 (showing that alternative arrangements' inferiority is not due to the transaction costs incurred in devising them, but follows from higher agency costs ensuing under less functional contractual provisions).

[21] See *id.*, 17 (discussing the role of regulatory uncertainty on VC contracting).

[22] See Luca Enriques et al., *Mandatory Corporate Law as an Obstacle to Venture Capital Contracting in Europe: Implications for Markets and Policymaking*, *in* RESEARCH HANDBOOK ON THE STRUCTURE OF PRIVATE EQUITY AND VENTURE CAPITAL INVESTMENTS 23-29 (Brian J. Broughman & Elizabeth de Fontenay eds.) (*forthcoming*).

[23] Luca Enriques & Casimiro A. Nigro, *No Private Ordering Please, We're Italian* 10 ITALIAN L.J. (*forthcoming*) (2025).

corporate law essential for efficient private ordering. Having put our discussion in context, in Part III, we examine how German and Italian corporate laws respond to VCFs' and entrepreneurs' attempts to allocate cash-flow and control rights as they see fit. First, we account for how, in strict adherence to the interpretation practice of German and Italian corporate laws, we determine the legal parameter against which we assess the validity of the individual components of U.S. VC contracts. Second, we provide an overview of our results to help the reader access the bigger picture and better navigate the intricacies of VC contracting under German and Italian corporate laws. Third, we discuss how VCFs and entrepreneurs fare when attempting to transplant the material clauses of U.S. VC contracts in Germany and Italy. We show that, a few negligible exceptions aside, VCFs and entrepreneurs bargaining under German and Italian corporate laws may use neither the U.S. clauses nor functionally equivalent ones and, rather, have to resort to inferior alternative arrangements.[24] Part IV concludes.

II. SETTING THE STAGE

Before examining to what extent German and Italian corporate laws stand in the way of VCFs' and entrepreneurs' attempts to transplant U.S. VC contracts, we put our discussion in context. First, we outline the defining characteristics of an ideal pro-VC corporate law (Section A). Next, we show that Delaware corporate law matches nearly perfectly our pro-VC corporate law vision, thus proving a fertile ground for the development of the best real-world VC contracts (Section B). Finally, we show that, despite the reforms that statutory German and Italian corporate laws have undergone, both regimes remain significantly averse to private ordering and, thus, depart in crucial respects from that ideal pro-VC corporate law we envision (Section C).

A. *The Framework*

In one of our companion papers, we show how corporate law, depending on its relative rigidity or flexibility, affects the private ordering exercise that VCFs and entrepreneurs undertake to mould their business relationships as they see fit.[25] Our focus is on corporate law "in action"[26] as the actual determinant of transactional practice.[27] For our purposes, "corporate law" comprises all legal rules that affect the relationship between VCFs and entrepreneurs.[28]

Our companion paper argues that corporate law is optimally flexible for VC contracting if it:

a) adopts a hands-off approach regarding the validity and/or enforceability of the private ordering solutions shaping VC deals;

[24] See *supra* text preceding note 20.
[25] See Enriques et al., *supra* note 18, at 12.
[26] See *supra* text accompanying note 16.
[27] See Enriques et al., *supra* note 18, at 12-13.
[28] In particular, our analysis extends to rules and standards that are formally part of contract law, because corporations have a contractual basis in both our jurisdictions (like in many others: see, e.g., REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 17 (3rd ed., 2017)).

b) refrains from deploying ex post gap-filling mechanisms that restrict the exercise of contractual rights in ways inconsistent with the economic rationale of VC agreements; and
c) tackles the abusive exercise of such rights effectively, defining abuse as opportunistic behaviour that is inconsistent with the economic rationale of the VC deal.[29]

In other words, corporate law should ideally allow contracting parties to define through private ordering any aspect of the VCF-entrepreneur relationship, including the prescriptive contents of the relevant ex post gap-filling tools.[30] As the sole exception, private ordering cannot authorise the abusive exercise of the rights it bestows.[31]

When it features such traits, VC-hospitable corporate law enhances parties' ability to minimize uncertainty as to the rights and obligations arising from their contracts and the likelihood that courts or arbitration tribunals meddle with the regime governing future contingencies.[32]

Any country's corporate law may depart to varying degrees from this flexible model of VC-hospitable corporate law. It does so by prohibiting one or more private ordering solutions.[33] We distinguish between *absolute* and *relative* prohibitions. Absolute prohibitions prevent contracting parties from incorporating a given private ordering solution and—possibly with the support of a general anti-evasion rule or other doctrines and metarules—any functionally equivalent or inferior (but still useful) alternative arrangement.[34] Relative prohibitions rule out the viability of a specific private ordering solution and functionally equivalent arrangements but allow contracting parties to resort to inferior alternative arrangements.[35] In our companion paper we discuss the various channels through which corporate law's mandatory rules and standards can coerce contracting parties to resort to inferior alternative arrangements in our conceptual analysis.[36] For instance, relative prohibitions may allow for an arrangement that contracting parties would ideally include in the firm's charter[37] to be part only of shareholder agreements and thus hinder the arrangement's ability to bind all shareholders, present and future, which may reduce its functionality.[38] Corporate law can also impose restrictions on how contracting parties exercise contractual rights and/or fail to police their abusive exercise.[39] In either case, parties cannot fully rely on the tailor-made corporate contract they draft as the sole source for the allocation of cash-flow and control rights. Courts' inability to police the abusive exercise of contractual rights effectively has the same effect.[40]

[29] Enriques et al., *supra* note 18, at 13. The point is to tackle abuse that contradicts the economic rationale of the agreement. When abuse is understood as conduct violating extra-contractual, heteronomous legal principles, the legal system may inhibit actions that neither of the parties to a contract has ever thought of as contrary to the expectations and reciprocal understandings underlying their contractual relationship.

[30] *Id.*, at 13.

[31] *Id.*, at 13-14.

[32] *Id.*, at 13.

[33] *Id.*, at 13-14.

[34] *Id.*, at 14. For the definition of "functional equivalent solutions" and "inferior alternative arrangements," see *supra* text preceding notes 19-20.

[35] *Id.*, at 14-15.

[36] Enriques et al., *supra* note 18, at 15-17.

[37] We use the term "charter" throughout this article to include all the firm's constitutional documents: articles of incorporations, bylaws, and the charter itself, to the extent that it has a different meaning than articles of incorporations.

[38] *Id.*, at 14.

[39] *Id.*

[40] *Id.*, at 14-15.

We have also shown that, possibly because of the applicable metarules, rigid corporate laws, with their web of explicit and implicit rules and standards, can create heightened uncertainty as to the regime applicable to a given private ordering solution.[41] This in turn renders virtually any contractual arrangement litigable, thus decreasing its functionality significantly.[42]

Corporate law constraints enter real-world transactional practice via two channels: (1) ex ante, via the intervention of legal gatekeepers—such as notaries and corporate counselors—providing transactional services, and/or (2) ex post, via the intervention of courts and arbitrators adjudicating the validity and/or enforceability of a private ordering solution or the exercise of the ensuing rights.[43]

More prescriptive corporate law regimes restrict parties' ability to adopt optimal private ordering solutions or functional equivalents. They also limit their freedom to customize ex post gap-filling mechanisms according to their transaction's economic rationale,[44] or at least subjecting such customizations to greater legal uncertainty.[45]

B. *Delaware Corporate Law*

Delaware corporate law, which has emerged as the corporate law regime governing virtually every VC-backed firm in the U.S.,[46] emanates from a statute—the Delaware General Corporation Law[47]—that is enabling by design.[48]

Consistent with legislators' stance,[49] all players involved in interpreting and applying corporate law share a pro-market mindset and a firm faith in decentralised rule-making and, therefore, obey metarules that are largely favorable to private ordering. Scholars mostly endorse a pro-private ordering approach.[50] Practitioners are similarly minded. Lawyers exploit the room for private ordering to the fullest extent possible to engineer the most effective transactional solutions.[51] U.S. public notaries, in contrast to their peers in continental Europe,[52]

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[41] *Id.*, at 17-18.

[42] *Id.*, at 18.

[43] *Id.*, at 15.

[44] Id., at 17-18.

[45] *Id.*, at 18.

[46] Robert P. Bartlett III, *Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters* (Rock Center for Corporate Governance at Stanford University Working Paper No. 253) (2023), https://ssrn.com/abstract=4568695.

[47] See Delaware General Corporation Law, https://delcode.delaware.gov/title8/c001/ (hereinafter, "DGCL").

[48] See, generally, Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 848-855 (2008) (recalling in detail the law-making process that led to the adoption of the DGCL as well as the provisions that serve as the foundations of its flexibility). The judiciary is aware of this essential property of the DGCL. Cf., e.g., *Jones Apparel Group v. Maxwell Shoe Co.*, 883 A.2d 837 (Del. Ch. 2004), 845 ("Delaware's corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations").

[49] Welch & Saunders, *supra* note 48, at 848-855 (pointing out that the foundational provisions of the DGCL call for deference to private ordering).

[50] For an example, see Johathan R. Macey, *Corporate Law and Corporate Governance: A Contractual Perspective*, 18 J. CORP. LAW 185, 193-211 (1992) (strongly advocating a free-market approach to framing and applying corporate law).

[51] See R.J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, (1984) 94 YALE L.J. 239 (1984).

[52] See *infra* note 83 and accompanying text.

are not subject to the obligation of verifying the legality of the transactions brought before them.[53] Therefore, they have no concern about potential liability and ultimately no reason to offer conservative interpretations of corporate law that would constrain private ordering. Courts famously defer to private ordering,[54] by both upholding explicit arrangements and interpreting them in a way that reflects their economic rationale.[55] Moreover, if corporate law exceptionally includes mandatory rules that constrain contracting parties' choice to include a specific private ordering solution in the firm's charter, parties can escape such constraints by inserting a clause with the same effect in a shareholder agreement.[56]

As a result, Delaware's corporate law matches almost perfectly the ideal pro-VC corporate law we have described in Part II.A. It allows contracting parties to shape any aspect of their business relationship, including the prescriptive contents of the fiduciary duty of loyalty, as they see fit.[57] And by policing abuse strictly, it simultaneously ensures that parties stick to contractual promises.[58] Delaware's long-standing deference to private ordering implies that corporate law plays either a default or a minimal role in defining the structure of the business relationship.[59] Contracting parties can thus rely on private ordering to predetermine their expected behaviour, which in turn confines uncertainty about the legal regime governing

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[53] For details, see, e.g., CNI Notary Institute, 2023 NEW YORK NOTARY PUBLIC HANDBOOK, New York: Notary Public Publishing, 2023.

[54] See most recently, also for references, Megan Wischmeier Shaner, *Privately Ordered Fiduciaries*, 28 GEO. MASON L. REV. 345, 352 (2020).

[55] Cf. J.C. Coffee, *The Mandatory / Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COL. L.R. 1618, 1620 (1989) ("… to the extent that American courts have permitted greater contractual freedom in corporate law, their relative tolerance has been coupled with greater judicial activism *in reading implied terms into the corporate contract* … ") (emphasis added).

[56] See, e.g., *Manti Holdings, LLC v. Authentix Acquisition Co., Inc.*, 2021 WL 4165159 (Del. Sept. 13, 2021) (holding that sophisticated parties assisted by counsel and having real bargaining power can agree on the contractual solution they want and confirming the enforceability of shareholder agreements provisions waiving appraisal rights). In the literature, see generally Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U.L. REV. 913 (2021).

[57] For examples of private ordering solutions typical of VC deals that Delaware courts have upheld, in addition to *Manti Holdings*, *supra*, note 55, see *In re Appraisal of Ford Holdings, Inc. Preferred Stock*, 698 A.2d 973 (Del. Ch. 1997) (confirming the validity of an arrangement in the firm's charter imposing a cap on the price that preferred shareholders would receive by exercising their appraisal rights). See also *infra* note 366. Delaware courts have generally interpreted VC contracts in a manner that aligns closely with the underlying contractual logic. Consequently, they have refrained from imposing fiduciary standards that might undermine the exercise of contractual rights arising from the VC agreement. The best example in this respect comes from the judicial endorsement of the "control-contingent approach," as it can be gauged from the joint reading of two notable cases, *Orban v. Field*, No. 12820, 1997 Del. Ch. LEXIS 48 (Apr. 1, 1997), and *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040 (Del. Ch. 1997). For details see Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, (2005) 81 N.Y.U. L. REV. 967 (2005). More recently, the Delaware judiciary has tried to mitigate the distorting effects of the notoriously rigid *Trados* doctrine (see *In re Trados, Inc.*, 73 A.3d 17, 40-41 (Del. Ch. 2013)) and validated private ordering delineating the transaction-specific prescriptive content of the duty of loyalty. See *New Enterprises Associates 14, L.P., et al. v. George S. Rich, Sr., et al.*, A.3d, 2023 WL 3195927 (Del. Ch. May 2, 2023), 129.

[58] See, e.g., Coffee, *supra* note 55, at 1620 (noting that courts' deferential approach to private ordering comes along with a strong inclination to police opportunism). For an example in the VC context, see, e.g., *Basho Technologies Holdco B LLC v. Georgetown Basho Investors LLC*, C.A. No. 11802-VCL (Del. Ch. July 6, 2018) (ordering the VCF, which failed to meet its burden under the entire fairness test, to pay damages to the entrepreneur for, amongst other things, repeatedly using its veto rights to block a critical recapitalization, ultimately forcing the company into liquidation in order to purchase its assets at a depressed price).

[59] Cf. Robert B. Thompson, *Why New Corporate Law Arises - Implications for the Twenty-first Century*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES. IS THE LAW KEEPING UP?, 3, 3 (Steven D. Solomon & Randall S. Thomas eds., 2019) (emphasising that, as the twenty-first century approached, "[s]tate law abandoned its prior regulatory approach and its continual change in favor of a director-centric structure with expansive room for private ordering that has remained remarkably stable.").

a specific future contingency to exceptional instances.[60] Although legal uncertainty is largely confined to isolated instances, legal disruptions are not unprecedented.[61] Such disruptions, though, are not only infrequent but also transient, thanks to subsequent judicial or legislative interventions.[62]

C. *German and Italian Corporate Laws*

Unlike Delaware's, the German and Italian regimes depart significantly from the pro-VC corporate law ideal we outlined in Part II.A. As background, both Germany and Italy, like most jurisdictions, offer two main corporate forms: the "*Aktiengesellschaft*" ("AG") and the "*Gesellschaft mit beschränkter Haftung*" ("GmbH")[63] and the "*Società per azioni*" ("SPA") and the "*Società a responsabilità limitata*" ("SRL").[64] The AG and the SPA should serve primarily for capital raising from the public at large and thus exhibit a more rigid regulatory

[60] Cf., e.g., *Ascension Ins. Hldgs., LLC v. Underwood*, 2015 WL 356002 (Del. Ch. Jan.. 28, 2015), 4 ("[Delaware corporate law] respects the right of parties to freely contract and to be able to rely on the enforceability of their agreements; where Delaware's law applies, with very limited exceptions, our courts will enforce the contractual scheme that the parties have arrived at through their own self-ordering, both in recognition of a right to self-order and to *promote certainty of obligations and benefits*.") (emphasis added).

[61] The *Trados* doctrine (see *supra* note 57) is one such instance. Another such rare instances was when the Delaware courts ruled on "extreme" private ordering solutions that in the aggregate would have had the practical effect of depriving the board of its core function. See *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, No. 2023-0309-JTL (Del. Ch. Feb. 23, 2024) (invalidating various provisions in an unusual shareholder agreement assigning extremely broad veto rights to a shareholder). Senate Bill 313, which passed in June 2024, essentially overturned the ruling by amending the DGCL to give corporations the authority to enter into stockholder agreements like those invalidated in *Moelis*. Regardless of the merits of this exceptional legislative initiative (see, e.g., Mark Lebovitch, *Soap Opera Summer: Five Predictions about Delaware Law's Response to New DGCL 122(18)*, 15 HARV. BUS. L. REV. ONLINE 1 (2024)), the main takeaway is that Delaware seeks to uphold its private ordering hospitality rain or shine.

[62] With regard to *Trados*, see the *de facto* reversal in *New Enterprises*, *supra* note 57. In the literature, cf. Lawrence A. Hammermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1752 (2006) (noting that "policymakers act on conventional notions of (1) enhancing flexibility to engage in private ordering; (2) deferring to case-by-case development of the law, and avoiding legislation that is prescriptive and proscriptive; (3) avoiding impairment of preexisting contractual relationships and expectations; and (4) most importantly, avoiding legislative change in the absence of clear and specific practical benefits.").

[63] See Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BUNDESGESETZBLATT I [BGBI I] at 1089, last amended by Gesetz [G], Feb. 22, 2023, BGBI I no. 51 and Gesetz betreffend die Gesellschaften mit beschränkter Haftung [GmbHG] [Act on Limited Liability Companies Act], April 20, 1892, REICHSGESETZBLATT [RGBI] at 477, last amended by G, Feb. 22, 2023, BGBl I no. 51 (outlining the regimes for AG and GmbH, respectively).

[64] See artt. 2325-2451 and 2462-2483, codice civile (It.) (outlining the regimes for SPAs and SRLs, respectively). A special regime exists for small and medium enterprises organized as SRLs (hereinafter, ("SME SRLs"), which grants shareholders slightly more contractual freedom. See artt 25-27 of the Decreto Legge 18 October 2012, No. 179, later converted into Legge 17 December 2012, No. 221 (hereinafter "Decreto Sviluppo" and art 57, Decreto Legge 24 April 2017, No. 50, later converted into Legge 21 June 2017, No. 96. For details, see Peter Agstner, *New Legal Forms and Rules for Italian Innovative Enterprises*, 35 EUR. BUS. L. REV. 1065 (2024).

structure;[65] the GmbH and the SRL are meant for businesses that do not tap public capital markets and are thus subject to a more flexible regime.[66]

While most German and Italian VC-backed firms incorporate as GmbHs and SRLs,[67] some incorporate as AGs and SPAs. That is because the latter corporate forms alone allow for some solutions that are particularly valuable at more mature stages when preparing for scale-up rounds.[68] In addition, these forms are considered, especially in Germany, more reputable vis-à-vis customers, creditors, and in the business community at large.[69]

As a result of several reforms that followed a broader continental European trend,[70] both German and Italian statutory corporate laws feature a more enabling structure today than in the past.[71] In particular, the regimes governing GmbHs and, to an even greater extent, SRLs have undergone changes intended to permit customised arrangements.[72]

Yet, even after these reforms, corporate law in action facilitates private ordering only to a limited extent, because national legal culture and metarules have remained the same. In fact, most scholars, following a long-standing methodological tradition that rejects the concept of corporate law as merely enabling, instead view it as a set of explicit and implicit rules and standards aimed to achieve overarching policy goals, such as the protection of minority shareholders, creditors, or other constituencies.[73] Such rules and standards often derive from

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[65] See Holger Fleischer, *A Guide to German Company Law for International Lawyers - Distinctive Features, Particularities, Idiosyncrasies in* GERMAN AND NORDIC PERSPECTIVES ON COMPANY LAW AND CAPITAL MARKETS LAW, 3, 5 (Holger Fleischer et al. eds., 2015); Paolo Spada, *Classi e tipi di società dopo la riforma organica in* LE GRANDI OPZIONI DELLA RIFORMA DEL DIRITTO E DEL PROCESSO SOCIETARIO, 29, 32-33 (Giorgio Cian ed., 2005).

[66] See, respectively, Fleischer, *supra* note 65, at 21 (stressing that prospective business partners looking for a flexible legal product prefer the GmbH over the AG), and Paolo Spada, *supra* note 65, at 29-30 (pointing out that "authority" dominates the regime for SPAs, while "[contractual] freedom" dominates the regime for SRLs).

[67] See, respectively, Michael Denga, *Handelsbräuche bei Wagniskapitalfinanzierung*, 50 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECH 725, 734 (2021), and Giudici et al., *supra* note 14, at 796-797.

[68] In Germany, only shares of an AG can be listed on public markets. See Börsengesetz [BörsG] [Stock Exchange Act], Jul. 7, 2007, BGBL. I at 1330, § 32 para. 3 No. 1 of the Börsengesetz. This becomes important for ventures approaching the exit stage. In Italy, firms organized as SPAs, unlike SRLs, can, for instance, buy back shares, albeit within limits: compare artt. 2357-2359-*quater* with art. 2474, codice civile (It.). A narrow exemption is provided for SMEs organized as SRLs, which can buy their own shares but only to serve stock-based compensation schemes. See art. 26, § 6, Decreto Sviluppo, *supra* note 64.

[69] Holger Fleischer, *Einleitung in* MÜNCHENER KOMMENTAR ZUM GMBH-GESETZ, para. 321 (Holger Fleischer & Wulf Goette eds., 2022, 4th ed.) (pointing to the lower creditworthiness and reputation of the GmbH compared to the AG).

[70] In Germany, the main reform was the "*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen*" of 23 October 2008. In Italy, corporate law was reformed in 2003 with a view to making it friendlier to private ordering. See Legge 3 October 2001, No. 366. For details, see Guido Ferrarini et al., *Company Law Reform in Italy: Real Progress*, 69 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 658 (2006). The regime for SRLs was further amended between 2012 and 2017. See *supra* note 64.

[71] German scholars portray the GmbH as a largely flexible business organization form. See, e.g., Holger Fleischer, *Contractual Freedom and Corporate Law in Germany*, *in* REGOLE DEL MERCATO E MERCATO DELLE REGOLE, 111, 111-112 (Giuseppe Carcano et al. eds., 2016). Italian scholars generally reach similar conclusions as regards SPAs and above all SRLs. See, e.g., Floriano D'Alessandro, *La provincia del diritto societario inderogabile (ri)determinata. Ovvero: esiste ancora il diritto societario?*, 48 RIVISTA DELLE SOCIETÀ 34, 39 (2003); GIORGIO ZANARONE, LA S.R.L. A VENT'ANNI DALLA RIFORMA DEL DIRITTO SOCIETARIO 710 (2023).

[72] See, respectively, Fleischer, *supra* note 65, at 13-14 (explaining that "the modernization of GmbH … was primarily aimed at facilitating the incorporation process and streamlining several complex and highly technical aspects of legal capital."), and Ferrarini et al., *supra*, note 70, at 661-663 (highlighting the pro-private ordering driver of the 2003 corporate law reform in Italy). See also *supra* note 64.

[73] As to Germany, see Peter Kindler, *Grundzüge des neuen Kapitalgesellschaftsrechts - Das Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG)*, 61 NEUE JURISTISCHE

supposedly "foundational" statutory provisions of corporate law that apply to any firm, irrespective of its organizational form.[74] In some instances, they have their roots in highly underdetermined concepts, such as "fairness" or "property."[75] In addition, they usually have a broad scope, also thanks to anti-avoidance rules[76] that make those constructs applicable to the relevant arrangements irrespective of: (i) their legal form;[77] and (ii) whether they are located in the firm's charter or in shareholder agreements, which, therefore, are not always a viable tool to bypass mandatory corporate law.[78]

WOCHENSCHRIFT (NJW) 3249 (2008) (emphasising that the reforms aimed not only at making German corporate law more attractive for investors but also at enhancing creditor and stakeholder protection). As to Italy, see Luca Enriques, *Società per azioni in* ENCICLOPEDIA DEL DIRITTO - ANNALI X 958, 966-977 (2017) (highlighting that, despite the changes of the statutes, rules and standards that often rest upon generic rationales regarding the protection of various corporate constituencies still shape corporate law).

[74] Under German corporate law, for instance, fiduciary duties are ultimately traced back to the fundamental provision in BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 705 para. 1, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/ that defines the predominant understanding of shareholders as members ("Mitglieder") of an organization that pursues a common goal ("gemeinsamer Zweck"), leading to specific obligations largely independent of the organizational form. For the foundational contribution, see Marcus Lutter, *Theorie der Mitgliedschaft*, 180 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS (ACP) 85 (1980). Similarly, Italian corporate law regards the concept of the "corporate contract," as laid out in art. 2247, codice civile (It.), as a foundational concept that also defines the boundaries of private ordering in the corporate context. For details on how these concepts work under German and Italian corporate law, as well as examples from VC-related transactional practice, see, *infra* text accompanying notes 144-147 and 315-318.

[75] The specific application of the constitutional protection of private property to the benefit of shareholders illustrates how German and Italian scholars and courts conceptualise share ownership. In brief, the reasoning is that shareholders are the owners of a fraction of the firm's cash-flow rights and any *economic* curtailment of these rights affects the *legal* guarantee of ownership rights under the relevant constitutional provisions. See GRUNDGESETZ [GG] [BASIC LAW], Article 14(1), *translation at* https://www.gesetze-im-internet.de/englisch_gg/ and Article 42 of the Italian Constitution. In the literature, see, respectively, LARS KLÖHN, DAS SYSTEM DER AKTIEN- UND UMWANDLUNGSRECHTLICHEN ABFINDUNGSANSPRÜCHE 79-84 (2009) (providing an account of the jurisprudence of the German constitutional court), and, and Giuseppe B. Portale, *Tra diritto dell'impresa e metamorfosi della s.p.a. in* SOCIETÀ, BANCHE E CRISI D'IMPRESA. *LIBER AMICORUM* PIETRO ABBADESSA, 107, 113 (Mario Campobasso et al. eds., 2014) (briefly stressing the importance of using the concept of property and the remedial apparatus that assists it under Italian (constitutional) law to address opportunism in the corporate context) and Vincenzo Salafia, Squeeze out *statutario*, 26 SOCIETÀ 1450, 1450 and 1451 (2007). In the case law, see e.g., respectively, Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], April 27, 1999, 100 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVerfGE] 289 (asserting that the constitutional guarantee of private property encompasses the substance and the value of share ownership) and Tribunale di Milano, 1 April 2008 (invalidating drag-along rights provisions for violating the constitutional law protecting private property because the lack of any reference to a minimum sale price enabled the expropriation of the dragged-along shareholder). For further examples, see *infra* text accompanying notes 259-263 and text preceding note 291.

[76] German law relies on an uncodified evasion doctrine that leads to the immediate application of the circumvented provision and thereby effectively voids any bypassing arrangement that contracting parties may have envisioned. See, e.g., SUSANNE SIEKER, UMGEHUNGSGESCHÄFTE 8-45 (2001). Under Italian law, any contract or clause that constitutes the means for evading a mandatory provision is void. See art 1344, codice civile (It.).

[77] For an example, see *infra* text accompanying notes 432-443 and 454-456 (discussing how Italian corporate law treats bad leaver provisions and extends that treatment to other similar arrangements).

[78] Under German law, scholars and courts explicitly acknowledge that in several instances resorting to shareholder agreements does not increase the leeway for private ordering. For examples, see *infra* text following note 244 and 362-364. In Italy, the widely held view is that shareholder agreements cannot serve as a tool to bypass mandatory corporate law provisions. See Corte di Cassazione, 18 July 2008, No. 15963 (concluding that private ordering in shareholder agreements can operate "within the limits set by mandatory corporate law provisions.") (our own translation). In the literature, see, e.g., Carlo F. Giampaolino, *Clausole di trascinamento (c.d.* drag along*): "equa" determinazione del valore vs. valorizzazione*, 12 RIVISTA ORIZZONTI DEL DIRITTO COMMERCIALE 230, 233 (2024) (same). In SPAs, shareholder agreements are subject to a regime that makes them

The hostility to private ordering we have described is particularly pronounced if those arrangements (1) shape the position of an investor in the firm as a hybrid between debt and equity and hence escape the bright-line conceptual distinctions that are held to inform corporate law in both jurisdictions;[79] (2) may directly or indirectly harm creditors' interests;[80] (3) are supported by self-enforcing mechanisms that bypass judicial intervention and are thus often seen as inherently prone to abuse.[81]

German and Italian legal gatekeepers—namely corporate counsel and notaries—and courts and arbitrators tend to share scholars' methodological canons and legal culture and, therefore, often endorse academics' prevailing views and interpretations, considering doctrinal scholarship as particularly authoritative.[82] Consequently, corporate attorneys and notaries[83] and especially courts and arbitrators tend to align with scholars' constructs when advising on deals or reviewing the validity of the relevant arrangements and the exercise of the ensuing rights.[84]

As a result of these dynamics, German and Italian corporate laws in action depart in three crucial respects from the VC-hospitable corporate law model we outlined in Part II.A. First, German and Italian corporate laws take a heavily interventionist approach to private ordering solutions.[85] Second, they marshal fiduciary standards that are mostly mandatory and hardly

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an ineffective alternative anyway: the Italian Civil Codestipulates that shareholder agreements relating to firms organized as SPAs are subject to a five-year time limit; and if the shareholder agreement stipulates no duration, then each of its parties may withdraw from it with a 180-day notice. See art. 2341-*bis*, codice civile (It.).

[79] For an example, see *infra* text accompanying notes 134 and 144-147 (accounting for the implicit standards that, under German and Italian corporate laws, require contracting parties to design financial claims as either equity or debt).

[80] For an example, see *infra* text accompanying note 376.

[81] The judicial saga regarding so-called Russian roulette provisions that unfolded before both German and Italian courts over the last decade illustrates the particular scrutiny that courts apply to innovative arrangements if they feature self-enforcing mechanisms. See, e.g., Martin Schaper, *Russian-Roulette: Möglichkeiten und Grenzen von Beendigungsklauseln in Gesellschaftsverträgen*, 67 DER BETRIEB 821 (2014); Nicola de Luca, *Una rivoltella puntata alla tempia. (A proposito di clausole della* roulette russa*)* 68 RIVISTA DI DIRITTO CIVILE 862 (2022).

[82] See Fleischer, *supra* note 65, 7 (stressing the central role that German scholars have historically played and, to a large extent, still currently play in interpreting corporate law); Enriques & Nigro, *supra* note 23, at 11-13 (describing the Italian practice).

[83] Both in Germany and Italy, the firm's charter has to be notarized. German notaries are under the legal obligation not to provide their services to support evidently illegal ends. Despite some variations, professional ethics, the precautionary principle, and incentives to limit professional liability will generally prompt notaries to adopt a conservative approach that curtails private ordering. Italian notaries also have a duty to refuse assistance for charters containing provisions that are against the law, which has traditionally led them to take a similarly cautious approach. The ultimate result is that German and Italian notaries—unlike their U.S. peers (see *supra* text preceding and following note 53)—have incentives to veto contractual arrangements in the firm's charter that may be seen as violating corporate law. Enriques et al., *supra* note 22, at 13.

[84] See Peter O. Mülbert, *Einheit der Methodenlehre? Allgemeines Zivilrecht und Gesellschaftsrecht im Vergleich*, 214 ACP 188, 291-292 (2014) (showing the authority and influence of German doctrinal scholarship on corporate law courts' adjudication). For a recent illustration from a leading German VC advisor, see Martin Schaper, *Venture Capital in der Vertragsgestaltung*, 53 ZGR 509 (2024) (discussing some limits of venture capital contracting in Germany by scrutinising doctrinal corporate law scholarship). As to Italy, see Enriques & Nigro, *supra* note 23, at 11-13.

[85] In Germany, statutory law drastically limits the leeway for private ordering in AGs. See AktG, § 23 para. 5 (stipulating that deviations from the statutory regime are allowed only "where this has been explicitly permitted."). In the literature, see, e.g., Heribert Hirte, *Die aktienrechtliche Satzungsstrenge: Kapitalmarkt und sonstige Legitimationen versus Gestaltungsfreiheit*, *in* GESTALTUNGSFREIHEIT IM GESELLSCHAFTSRECHT. DEUTSCHLAND, EUROPA UND USA. 11. ZGR-SYMPOSION – 25 JAHRE ZGR, 61 (Marcus Lutter & Herbert Wiedemann eds., 1998). The law of the GmbH knows a host of doctrines that express an inherent proclivity to police private ordering and safeguard the interests of (minority) shareholders and stakeholders. See CHRISTIAN HEISTER, GESTALTUNGSFREIHEIT IM INNENVERHÄLTNIS DER GMBH 49-96 (2019) (surveying the doctrines that limit private ordering in the GmbH). As to Italy, see Enriques & Nigro, *supra* note 23, at 11-13.

adapted to the specific contingencies of individual cases; therefore, they fail to provide for ex post gap-filling tailored to VC contracts' transactional objectives.[86] Finally, because metarules grant courts broad discretion in interpreting the law, it is very difficult to predict (i) what exact constraints mandatory corporate law imposes on private parties,[87] and (ii) how constraints that have been established may change even in the absence of any formal legal reform.[88] Corporate law hence assumes an unpredictably expansive role in defining the governance of business relationships, thwarting contractual arrangements in an unanticipated manner.

[86] The directors' fiduciary duty of loyalty illustrates this aspect. As we explain later (see *infra* text accompanying note 328), German corporate law requires corporate directors to pursue the interest of the firm as fiduciaries and specifies the ensuing obligations on a uniform doctrinal basis for the AG and the GmbH, with no explicit attention to the specific companies' purposes and financing structures. Holger Fleischer, *Zur organschaftlichen Treuepflicht der Geschäftsleiter im Aktien- und GmbH-Recht*, 57 WERTPAPIER-MITTEILUNGEN 1045, 1050 (2003) (showing the common doctrinal anchor of the directors' duty of loyalty in the AG and the GmbH and surveying its content jointly for both legal forms). This regime is largely mandatory and thus also rules out customised arrangements. See *infra* text accompanying note 330. In Italy, with the support of scholars, such a duty is construed as the duty to advance the interest of the firm. This conceptualization of the duty of loyalty is monolithic: that is, it applies irrespective of any company's individual characteristics. Thus, not only is the content of the duty of loyalty of widely held companies' directors the same as that for directors of close corporations, but, within the universe of close corporations, no variations exist between the duty of loyalty of directors of a corporation running a family business and that of directors of a VC-backed firm. Crucially, private ordering cannot alter this. See., e.g., Alberto Mazzoni, *Patti di co-vendita e doveri fiduciary*, *in* TRASFERIMENTI DI PARTECIPAZIONI AZIONARIE, 211, 245-249 (Alberto Crivellaro ed., 2017) (arguing that a director must always pursue the interest of the shareholders as a class, irrespective of a specific firm's financial structure and governance and, ultimately, of what (implicit) contractual arrangements may suggest); *id*. at 253 (stressing that, unlike in common law jurisdictions, private ordering cannot ex ante exempt a fiduciary from their duties). Intuitively, the lack of nuance, coupled with the limits for private ordering, may lead to outcomes inconsistent with the arrangement that the VCF and the entrepreneur devised to serve their mutual interests. Gian Domenico Mosco & Casimiro A. Nigro, *I doveri fiduciari alla prova del capitalismo finanziario*, 20 ANALISI GIURIDICA DELL'ECONOMIA 257, 261 (2021).

[87] In Germany, for instance, courts invoked highly specific provisions in the law of corporate groups, directly applicable only to the AG, to establish a general corporate law doctrine under which dominant shareholders in a GmbH can be held personally liable for the losses of the company if their interventions caused the firm's bankruptcy; later, amidst massive criticism, courts switched to general tort law to sustain these sweeping veil-piercing actions that they felt warranted due to gaps in statutory creditor protection. See Mülbert, *supra* note 84 at 213-215, 259-262 (surveying the case law and highlighting its surprising characteristics). In Italy, several examples help understand how unpredictably corporate law can evolve. Take the regime governing the recharacterization as equity contributions of any loans that a shareholder may extend to the firm when it is under financial distress. Italian blackletter corporate law lays down this regime only for SRLs. See Art 2467, codice civile (It.). With the support of scholars (see Umberto Tombari, *La partecipazione di società di capitali in società di persone come nuovo "modello di organizzazione dell'impresa*, 51 RIVISTA DELLE SOCIETÀ 201 (2006)), courts have concluded that this provision is the expression of a wide-ranging precept applying also to SPAs. See, e.g., Corte di Cassazione, 7 July 2015, No. 14056. Suddenly, SPAs found themselves to be subject to a new precept.

[88] In Germany, for instance, courts significantly changed their jurisprudence on capital maintenance and required, without explicit statutory link, that liquid assets be held against minimum legal capital, prompting the legislator to step in and correct the judicial overreach. See Wolfgang Servatius, *§ 30*, *in* GMBHG, para. 36 (Ulrich Haas et al. eds., 24th ed. 2022). In Italy, examples abound. The most instructive one is perhaps the emergence of the so-called "principle of fair value." See *infra* note 293 and accompanying text.

III. VC CONTRACTING IN GERMANY AND ITALY

Leveraging the attributes of Delaware corporate law,[89] U.S. VCFs and entrepreneurs, supported by the *National Venture Capital Association* (NVCA) and specialised legal counsel,[90] have devised a sophisticated and standardised contractual framework.[91] This framework is specified in the charter of VC-backed firms and various shareholder agreements.[92] It chiefly aims to mitigate market frictions amongst VCFs and entrepreneurs and "braids" the contract the VCF enters with the entrepreneur, on the one hand, with the one it enters with its investors, on the other.[93] This braiding enables VCFs, *inter alia*, to better diversify their portfolios.[94]

Empirical evidence suggests that U.S. VC contracts are the best real-world solution to the governance challenges in the VCF-entrepreneur relationship.[95] Financial economists thus predicted that U.S. VC contracts would gain popularity across jurisdictions over time and serve as a model for value-enhancing private ordering worldwide.[96] Transactional practice across jurisdictions seems to confirm these predictions.[97] Yet does this practice actually replicate the economic functions of U.S. VC contracts and not only their form, once the restrictions that the local corporate law in action imposes on private ordering are taken into account?

In this Part, we systematically document how VCFs and entrepreneurs fare when they attemp to adopt U.S. VC contracts under German and Italian corporate law. We cover the comprehensive array of arrangements that feature in U.S. VC deals,[98] except for so-called

[89] See *supra* Part II.B.

[90] The NVCA drafts standard contracts—also known as the "Model Legal Documents"—that serve as the starting point for negotiations between VCFs and entrepreneurs. See NVCA, *Model Legal Documents* (2020), https://nvca.org/model-legal-documents. Lawyers have also played an important role in this process. See John F. Coyle & Joseph M. Green, *Startup Lawyering* (2017) 95 N.C. L. REV. 1403, 1412-1415.

[91] For extensive accounts see THERESE H. MAYNARD & DANA M. WARREN, BUSINESS PLANNING: FINANCING THE START-UP BUSINESS AND VENTURE CAPITAL FINANCING (2nd ed., 2014); RUPERT PEARCE & SIMON BARNES, RAISING VENTURE CAPITAL, (2006); BRAD FELD & JASON MENDELSON, VENTURE DEALS. BE SMARTER THAN YOUR LAWYER AND VENTURE CAPITALIST (3rd ed., 2016). See also Bartlett III, *supra* note 46, 18-30 (providing empirical evidence on standardization).

[92] See MAYNARD & WARREN, *supra* note 91, at 112.

[93] See Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1091 (2003)

[94] Enriques et al., *supra* note 22, at 14.

[95] Lerner & Schoar, *supra* note 10, at 224. VC contracts are effective in mitigating market frictions along multiple dimensions. Steven N. Kaplan, & Per Strömberg, *Characteristics, Contracts, and Actions: Evidence from Venture Capitalist Analyses*, 59 J. FIN. 2177 (2005). They are the closest to the predictions of financial contracting theory that real-world transactional practice has ever engineered. Steven Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281 (2003). Besides, they have remained largely stable over time and across industries. *Id.*, 286-295. Finally, they have emerged more recently as the contractual underpinning of startup-financing relationships also outside the VC industry. Sergey Chernenko et al., *Mutual Funds as Venture Capitalists? Evidence from Unicorns*, 34 REV. FIN. STUD. 2362 (2021).

[96] See Steven N. Kaplan et al., *How Do Legal Differences and Experience Affect Financial Contracting*, 16 J. FIN. INTERMEDIATION 273, 275 (2007) (noting that "[t]he intuitions and predictions of financial contracting theories appear to be valid across different institutional and legal regimes" and that, "[b]ased on this, we would expect more convergence toward [U.S.-]style contracts in the future.").

[97] *Id.*, at 291-292 (documenting the adoption of U.S. VC contracts outside the U.S., possibly by engineering alternative arrangements mimicking the same functions as the private ordering solutions included in U.S. VC contracts).

[98] As we have found them extensively described in the sources referenced *supra* note 91.

registration rights, granting VCFs specific powers in the context of IPOs.[99] Contractual arrangements that can be transplanted into Germany and Italy without adaptations are an exception. They comprise tag-along rights provisions[100] and, limited to German GmbHs only, corporate opportunity waivers. These exceptions aside, German and Italian corporate laws reject the transplant, whether verbatim or via functionally equivalent solutions, of contractual arrangements shaping VC deals in the U.S.[101] Contracting parties must content themselves with inferior alternative arrangements.[102]

We proceed by, first, explaining how we distil German and Italian corporate laws in action (Section III.A). Then, we provide an overview of our results that should help the reader access the bigger picture and more easily navigate the intricacies of VC contracting under German and Italian corporate laws (Section III.B). Finally, we discuss whether and, as the case may be, to what extent German and Italian corporate laws allow for the transplant of U.S. VC contracts clauses (Section III.C).

A. *How We Identify the Law in Action*

We are fully aware that corporate law is relevant for VC contracting only if VCFs and entrepreneurs cannot avoid its strictures by choosing a more flexible-law jurisdiction to incorporate the VC-backed firm. As we explain in a companion paper, however, it is not cost-effective for German and Italian VCFs and entrepreneurs to use foreign legal vehicles, especially at an early stage, if they plan to run their VC-backed firms locally.[103] Therefore, our inquiry has economic relevance that goes beyond showing the drawbacks of using German and Italian corporate laws as the regimes governing VC deals and highlighting the competitive disadvantage of those offering corporate law-related services in those two jurisdictions.

As anticipated, we focus on those jurisdictions' corporate law in action.[104] Because in both jurisdictions corporations have a contractual basis,[105] German and Italian corporate laws

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[99] Registration rights are "initiation rights" and "piggy-back rights," which grant VCFs the power to initiate an IPO or to have their shares included on a *pro rata* basis in an IPO initiated by the company, respectively. See MAYNARD & WARREN, *supra* note 91, at 651-667. The rationale for omitting such arrangements in our analysis is two-fold. First, IPOs are in general not as common as trade sales. See Michael Klausner & Stephen Venuto, *Liquidation Rights and Incentive Misalignment in Start-up Financing*, 98 CORNELL L. REV. 1399, 1403 (2013); and Salma Ben Amor & Maher Kooli, *Do M&A Exits Have the Same Effect on Venture Capital Reputation as IPO Exits?*, 111 JOURNAL OF BANKING & FINANCE 1, 1-2 (2020) (providing recent data about the exit channels used at U.S. VC-backed firms. This is particularly the case in Europe. See Andrea Bellucci et al., *Venture Capital in Europe. Evidence-based Insights about Venture Capitalists and Venture Capital-backed Firms* (2021), https://publications.jrc.ec.europa.eu/repository/handle/JRC122885. Second, and more importantly, VC-backed firms make it to the IPO stage if they are particularly valuable, implying that the going-public process will typically be value maximizing for VCFs and entrepreneurs. Incentives are therefore fully aligned and disagreement between contracting parties seems unlikely. Therefore, private ordering to resolve impending frictions seems less urgent than in downside scenarios, because the VCF hardly needs to rely on contractually assigned exit rights if an IPO is a viable exit option.

[100] See *infra* text accompanying notes 472-473.

[101] See *infra* text following note 371.

[102] See *supra* text preceding notes 19-20.

[103] See, also for references, Enriques et al., *supra* note 22, at 16 (accounting for the obstacles that VCFs and entrpreneurs in Germany and Italy encounter when attempting to bypass local corporate laws).

[104] See *supra* text preceding notes 16 and 26-27.

[105] As to German corporate law, see Jens Koch, *§ 23 in* AKTIENGESETZ, para. 6-7 (Jens Koch ed., 19th ed., 2025) (explaining that the AG originates from the charter as a contract sui generis); Wolfgang Servatius, *§ 2*, *in* GMBHG, para. 3 (Ulrich Haas et al. eds., 24th ed., 2022) (same for the GmbH). In the case law, see

in action comprise elements of the respective contract law (including, for instance, the general duty of good faith[106]), albeit with the adaptations required by the organizational nature of the corporate contract.[107]

We distil the relevant German and Italian corporate law in action as follows: if pertinent well-established case law exists, we look exclusively at it. If there is no case law, or if the exact meaning and/or authoritative character of the relevant judgments is unclear, we extend our analysis to legal scholarship and other relevant sources, such as the guidelines on corporate law issued by the regional association of notaries in Italy.[108] In these instances, corporate law in action includes the interpretation of existing legal texts that is predominant amongst legal scholars and/or legal gatekeepers at the time of our writing. Our approach reflects the best possible approximation of how German and Italian lawyers, notaries, courts, and arbitrators would determine the meaning of existing statutes if contracting parties requested their advice or ruling on the validity of a given private ordering solution or the limits to the exercise of the ensuing rights.[109]

To complicate our task, there is a dearth of legal scholarship and case law addressing the specific legal questions that one must answer to determine whether specific components of U.S. VC contracts can be transplanted into our two jurisdictions.[110] When no specific answer exists, we address them by turning—again in strict adherence to Italian and German interpretation practices—to doctrinal legal scholarship and case law on more general (or similar) corporate law issues that legal scholars, legal gatekeepers, and courts and arbitrators would consider in determining the corporate law regime applicable to a specific arrangement

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Bundesgerichtshof [BGH] [Federal Supreme Court], Oct. 4, 1956, 21 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN [BGHZ], 370, 373 (outlining the contractual basis of legal persons). As to Italian corporate law, see art. 2247, codice civile (It.) (laying down the definition of "società," a broad category that comprises both partnerships and corporations, and identifying it as a contract). In the case law, see, e.g., Corte di Cassazione, 26 October 1995, No. 11151 (stressing explicitly that corporations have a contractual basis).

[106] The good faith obligation is enshrined in general contract law both in Germany and Italy. See § 242 of the BGB; art. 1375, codice civile (It.).

[107] See, e.g., Christoph H. Seibt, *§ 23*, *in* AKTG, para. 3 (Karsten Schmidt & Marcus Lutter eds., 5th, ed. 2024) and Floriano D'Alessandro, *Il fenomeno societario tra contratto e organizzazione* 44 GIURISPRUDENZA COMMERCIALE 487 (2017), respecitvely.

[108] Notaries in Italy are organized in regional associations that issue guidelines on how to interpret corporate law. For an example, see *infra* note 137. These guidelines are generally based on the predominant view on a specific legal issue amongst legal scholars. The associations have specialized commissions preparing these guidelines, which often comprise mainly if not exclusively, legal academics. Affiliated notaries duly consider such guidelines when performing their functions. In particular, they must check the legality (broadly construed) of the transaction brought before them. Failure to do so may lead to professional liability. Notaries thus generally adhere strictly to those guidelines to limit liability risk (see *supra note* 83). The most influential guidelines are those published by the notarial association of Milan, which we primarily take into account to distil the law in action. When the association of Milan has issued none, we look at the guidelines issued by other notarial associations. In one instance (see *infra* note 322) we observe divergence between the stance taken on a specific legal issue by the notarial association of Milan and the one taken by another notarial associations and characterise this circumstance, in the absence of legal precedents or authoritative scholarly opinions, as giving rise to unresolvable uncertainty (see *infra* text preceding note 322).

[109] We are ready to acknowledge that both legal gatekeepers and enforcers may occasionally deviate from scholars' (majority) views.

[110] The lack of case law is easy to explain: VCFs and entrepreneurs tend to solve their disagreements without resorting to litigation. When they do, they use arbitration. See Denga, *supra* note 67, at 725, 728, 755 (2021) (highlighting that disputes are almost exclusively solved via arbitration in the VC context); Carlo F. Giampaolino, *Clausola di co-vendita (*drag-along*) ed "equa" valorizzazione dell'azione*, 62 BANCA BORSA E TITOLI DI CREDITO 523, 525 (2009) (making the same point). As to the lack of literature, see, e.g., KUNTZ, *supra* note 14, at 4-6 (highlighting the lack of comprehensive studies on the impact of German corporate law on transplanted U.S. VC contracts as of 2016); Giudici & Agstner, *supra* note 5, at 616 (stressing that, as of 2019, corporate law scholarship "substantially ignored the VC model of startup financing.").

or the exercise of the ensuing rights. However, it is fair to admit that in some cases it is impossible to tell what the law in action is on a given issue. In such cases, we indicate that there is unresolvable uncertainty as to the applicable law, which is of course problematic for VC contracting.[111]

B. *Overview of Our Results*

We find that German and Italian corporate laws prevent VCFs and entrepreneurs from transplanting nearly any of the U.S. arrangements. They do so by enlisting various legal constraints, which:

a) only occasionally originate from harmonised E.U. corporate law;[112]

b) are rarely explicitly stated in national statutory law. Instead, they almost always stem from scholarly constructs;

c) rarely take the form of absolute prohibitions that prevent contracting parties from incorporating in VC deals either a given U.S. clause or any functionally equivalent solution or inferior alternative arrangement.[113] In most instances, we detect instead relative prohibitions that rule out the viability of the specific private ordering solution included in U.S. VC deals and functionally equivalent solutions but allow contracting parties to avail themselves of inferior alternative arrangements.[114]

C. *How Contractual Transplants Are Rejected*

We now account for how German and Italian corporate laws treat U.S. VC contractual arrangements. To do so, we first describe the structure of a given individual component of U.S. VC contracts and sketch out its economic function. Next, we identify the corporate law constraints that prevent their transplant into German and Italian VC-deals. Finally, we assess whether contracting parties can adopt functionally equivalent solutions or just inferior alternative arrangements and, where appropriate, we briefly spotlight the diminished functionality of such alternative arrangements compared to the corresponding U.S. arrangement.

We group the contractual clauses typical of U.S. VC deals according to their impact on the VC-backed firm's financial structure (Section III.C.1), its governance arrangements (Section III.C.2), and contracting parties' position in exit transactions (Section III.C.3).

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[111] See *supra* text accompanying notes 41-42.

[112] The most notable example is the regime regarding capital maintenance, which also limits firms' discretion to make distributions to shareholders. See *infra* text accompanying note 221. In other instances, E.U. company law introduces provisions that are *de facto* non-mandatory. The most notable example is the regime regarding mergers. The relevant E.U corporate law regime stipulates that cash payments in mergers cannot exceed 10% of the shares' nominal value, but it also allows member states to introduce functionally equivalent transactions to which the 10% cap on cash payments does not apply. For details, see *infra* text accompanying note 490.

[113] See *supra* text preceding note 19.

[114] See *supra* text preceding note 20.

1. Financial Structure

U.S. VC contracts design an elaborate financial structure for the VC-backed firm to allocate risk between the parties. If the firm does not perform within the stipulated timeframe, the VCF can force the liquidation of its assets or of the VCF's own shares and, very much like a creditor, seize all the firm's residual value (or most of it) ahead of the entrepreneur.

U.S. VC deals allocate risk this way to allow the VCF to inject funds into portfolio companies only as they meet predetermined milestones. To make funding dependent on the companies' sustained positive option value, parties rely on a unique security design facilitating morphable financial claims. Additional protections significantly expand VCFs' fixed claims over time and reallocate value to them in case they had overvalued the firm at the stage of their initial investment. The resulting downside protection is crucial to generate portfolio returns proportionate to the high risks VCFs take.

The arrangements leading to this result are, more specifically, those governing staged financing, conversion rights, liquidation preferences, automatic and cumulative dividends, and anti-dilution provisions. This section describes these arrangements and takes stock of the regulatory constraints that VCFs and entrepreneurs face under German and Italian corporate laws when they attempt to transplant them.

i. Staged Financing

Under the contractual framework governing U.S. VC deals, VCFs commit capital in stages, disbursing funds as the portfolio company achieves predetermined milestones that serve as proxies for successful business development.[115] Staged financing enables VCFs to screen out poorly developing investment opportunities[116] and, after investing, save on monitoring costs.[117] In addition, it reduces VCFs' exposure to the individual portfolio company's risk and mitigates agency costs.[118]

German and Italian corporate laws allow for staged financing arrangements,[119] as transactional practice confirms.[120] This observation should be taken with a pinch of salt, though. Staged financing embeds an abandonment option,[121] which serves as the VCF's first line of defence against the risk that the project may fail.[122] This abandonment option as such only allows VCFs to avoid injecting additional funds. The ultimate price for exercising the option hinges on whether VCFs can also recover some of the value left in the firm that, without

[115] PEARCE & BARNES, *supra* note 91, at 129-138 (discussing staged financing and particularly milestones from a transactional perspective in detail).

[116] See Klausner & Litvak, *supra* note 5, at 59.

[117] Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital* (1995) 50 J. FIN. 1461.

[118] See Gilson, *supra* note 5, at 1078-1081.

[119] See, respectively, Eckart Gottschalk & Konrad Ulmer, *Garantien der Aktiengesellschaft bei einer Kapitalerhöhung*, 59 DEUTSCHES STEUERRECHT 1173, 1178 (2021) (indicating that authorized capital increases can be used to implement staged financing arrangements) and Szego, *supra* note 14, 824-825 (acknowledging that these arrangements are viable under Italian corporate law).

[120] See, as to Germany, Wolfgang Weitnauer, *Teil E - Die VC-Beteiligung*, *in* HANDBUCH, *supra* note 15, at para. 120-123 (providing examples for staged financing structures applied in German VC deals). As to Italy, Gardina & Pairona, *supra* note 15, at 424-425 (confirming that staged finance arrangements are ubiquitous in Italian VC deals).

[121] See Gilson, *supra* note 5, at 1078.

[122] Gompers, *supra* note 117, at 1461.

additional capital, is bound to be liquidated.[123] The arrangements intertwined with staged financing that in U.S. VC deals allow VCFs to recover such value are less effective under German and Italian corporate laws.[124] A VCF exercising the abandonment option may thus lose more than it would in a similar U.S. deal. Consistent with this, at least in Italy, practitioners warn their clients about the higher costs of termination.[125]

ii. Conversion Rights

U.S. VC contracts typically stipulate that the entrepreneur holds common shares, while the VCF holds convertible preferred shares, which it can convert into common shares at any time.[126] The crux of convertible preferred shares lies in their conversion rights,[127] which allow VCFs to transform their financial claims against the VC-backed firm from fixed to residual.[128] By allowing VCFs' cash-flow and control rights to change, which will *de facto* depend on firm performance, conversion rights play a major role in addressing the adverse selection and moral hazard problems that plague the financing of high-tech innovative firms: conditioning entrepreneurs' payouts heavily on success of the VC-backed firm induces optimal effort while screening out bad ventures.[129]

German and Italian corporate laws do not allow for conversion rights as we have just described them.

In principle, German corporate law grants contracting parties a large degree of freedom in shaping the attributes of shares[130] and also allows convertible bond issuances in the AG.[131] However, two implicit legal requirements rule out U.S.-style conversion rights. One obstacle is the informative function of the firm's charter. German legal scholars see the firm's charter as instrumental to conveying information about the firm's essential organizational and financial features to shareholders and other stakeholders.[132] Therefore, the charter cannot include provisions stipulating that an external event not fully specified in the charter itself, and thus publicly available from the corporate register, for instance one shareholder's decision, may change one of the company's essential features—namely, the type of shares held by its shareholders. Such provisions, as the doctrine goes, would require stakeholders to engage with a firm whose fundamental organizational and financial features are "unstable," resulting in a

[123] See William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock* (2013) 161 U. PA. L. REV., 1814, at 1878 (showing that U.S. VC contracts lower the strike price for the abandonment option because they "provide for the event of failure by allocating such value as has been created to the venture capitalist.").

[124] These arrangements are liquidation preferences and automatic and cumulative dividends. For a description of U.S. arrangements and their regulatory treatment under German and Italian corporate laws, see *infra* Parts III.C.1.iii and III.C.1.iv.

[125] Gardino & Pairona, *supra* note 15, at 427 (hinting at the importance of appreciating the viability of staged financing also in light of how regulatory constraints affect the functionality of other private ordering solutions).

[126] For details, see MAYNARD & WARREN, *supra* note 91, at 479-482.

[127] *Id.*, at 528-529.

[128] Fried & Ganor, *supra* note 57, at 982.

[129] See generally Klausner & Litvak, *supra* note 5, at 65-66 (discussing conversion rights as a component of convertible preferred shares in combination with liquidation preferences and explaining their economic function).

[130] The corporate law regime for AG stipulates that a share "may confer different rights, namely as concerns the distribution of profits and the company's assets", with "[s]hares having the same rights … form[ing] a class of shares." § 11 of the AktG. The corporate law regime for GmbH allows contracting parties to achieve the same result and explicitly acknowledges their freedom to customize profit participation rights. GmbHG, § 29 para. 3 sentence 2. See also *infra* note 135.

[131] AktG, § 221 para. 1.

[132] Hans-Joachim Priester, *Satzungsänderung und Satzungsdurchbrechung*, 161 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT 40, 53 (1987).

lack of legal certainty that would ultimately prevent the firm from operating effectively on factor markets.[133] Based on this general construct, German corporate law bans conversion right clauses. In fact, these clauses imply radical changes in shareholders' cash-flow and governance rights in the firm.

Another such obstacle derives from the fundamental legal concept of "shares." German corporate (and insolvency) law includes an implicit guiding principle that shares must represent residual claims.[134] To be sure, shares can be designed to include bond-like features in dividend distribution,[135] but this implies *a contrario* that they cannot exhibit such a structure in liquidation.

The consequence of the two constructs above is that, under German corporate law, arrangements seeking to create U.S.-style conversion rights are unviable, as transactional practice confirms.[136]

Similarly, Italian corporate law in principle grants contracting parties broad discretion in defining shares' attributes for both legal forms, permitting, *inter alia*, rights *ad personam* in SRLs.[137] It also allows conversion rights in the SPA,[138] but essentially prohibits them in the SRL.[139] Yet, even where corporate law allows for conversion rights, it precludes the types that

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[133] This construct emerged from the regime governing AGs. For details see, e.g., Jens Koch, *§ 179 AktG, in* AKTIENGESEGTZ, *supra* note 105, at para. 26. It then migrated into the regime governing GmbHs as a general corporate law principle. See Joachim Tebben, *§ 53 in* SCHOLZ GMBHG - VOL. III, para. 185 (13th ed., 2025).

[134] AktG, § 271 para. 1 and GmbHG, § 73. See, e.g., Gregor Bachmann, *§ 271 in* BECK'SCHER ONLINE GROßKOMMENTAR ZUM AKTG, para. 2 (Gerald Spindler & Eberhard Stilz eds., 5th ed.2022); Hans-Friedrich Müller, *§ 73, in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 3 para. 1 (Holger Fleischer & Wulf Goette eds., 4th ed., 2022).

[135] See AktG, § 139. See, e.g., Gerald Bezzenberger & Tillman Bezzenberger, *§ 139 in* GROßKOMMENTAR ZUM AKTG, paras. 7-9 (Heribert Hirte et al. eds., 5th ed., 2021). The regime governing the GmbH also allows charters to establish profit preferences. GmbHG, § 29 para. 3. In the literature, see Jens Ekkenga, § 29 *in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 1 para. 189 (Holger Fleischer & Wulf Goette eds. 4th ed. 2022).

[136] Even the template for an investment agreement with a German firm organized as a GmbH provided in the leading handbook does not foresee convertible shares and instead resorts to inferior alternative arrangements with convertible loan agreements (on these see *infra* text accompanying notes 149-150). See Wolfgang Weitnauer, *Anhang VI. 1 – Beteiligungsvertrag (GmbH)*, *in* HANDBUCH, *supra* note 15, at 3B.

[137] The corporate law regime for SPAs stipulates that the firm's charter can define the attributes of special classes of shares (that is, shares other than common shares), albeit "within the limits established by the law." See art. 2348, comma 2, codice civile (It.). In SRLs, contracting parties can achieve partly similar results by granting governance and profit participation rights *ad personam*, i.e., rights assigned to specific shareholders, not incorporated in the equity participation they hold and, ultimately, non-transferable. See art. 2468, comma 3, codice civile (It.). Scholars, however, conclude that such rights *ad personam* can also pertain to matters other than those that blackletter corporate law mentions explicitly. See, e.g., Mario Notari, *Diritti "particolari" dei soci e categorie "speciali" di partecipazioni*, 3 ANALISI GIURIDICA DELL'ECONOMIA 325, 330-332 (2003). Practitioners concur. See, e.g., Consiglio Notarile di Milano, *Massima No. 39 of 19 November 2004 "Diritti particolari dei soci nella s.r.l.,"* https://www.consiglionotarilemilano.it/massime-commissione-societa/39/. Furthermore, blackletter corporate law stipulates that (1) SME SRLs can issue "classes of shares," meaning shares incorporating different sets of rights; and (2) contracting parties can determine the shares' attributes in a way similar to what corporate law allows as regards firms organized as SPAs. See Decreto Sviluppo, art. 26, commas 2, 3, *supra* note 64. Commentators have concluded that the general implicit regulatory constraints that limit contracting parties' discretion in shaping the attributes of SPAs' shares apply also to SME SRLs. See, e.g., Niccolò Abriani, *La struttura finanziaria della società a responsabilità limitata*, 12 RIVISTA DI DIRITTO SOCIETARIO 501 (2019).

[138] Amal A. Awwad, *Profili di tutela delle azioni convertibili* in SOCIETÀ, *supra* note 75, at 459-461 (explaining that the permission to convert tracking shares into ordinary shares, art. 2350, comma 4, codice civile (It.), has given legitimacy to "a general principle of convertibility of shares of one class into shares of another class"). For a broader discussion, see GIUSTINO DI CECCO, CONVERTIBILITÀ E CONVERSIONE DEI TITOLI AZIONARI 245-269 (2012) (showing that shareholder conversion rights are, in principle, accepted by most scholars).

[139] Conversion rights are unviable in SRL because there is no possibility to create different classes of shares (other than in SME SRLs: see *supra* note 137). While the Civil Code does not stipulate such a restriction (*cf.* art.

are commonplace in U.S. VC deals. That is because, according to legal scholars, arrangements spelling out the attributes of shares must be in line with the implicit corporate law requirements defining shares' key features. Amongst such features is the assignment of a residual claim enabling the shareholder to participate in the firm's upside. Any security that does not incorporate such a claim is simply not a share.[140]

This implicit construct serves as the main analytical framework to define what private ordering—whether by using the firm's charter or a shareholder agreement—can achieve when shaping shareholders' cash-flow rights and, more broadly speaking, their position within the firm.[141] An implication of this construct is that private ordering cannot design shares in such a way that a VCF shall permanently *or temporarily* have a fixed claim against the firm from unconverted preferred shares.[142] U.S.-style conversion rights are, therefore, simply a non-starter in Italian VC deals, as available evidence confirms.[143]

To give a sense of the reasoning underlying this conclusion, it is worth noting that scholars ultimately draw on three statutory provisions. The first one is the Civil Code's article jointly defining the contract establishing partnerships and companies as the contract that binds two or more persons to contribute goods or services with a view to jointly running an economic activity for the ultimate purpose of sharing in its profits.[144] The second one stipulates that SPA shareholders must participate, *inter alia*, in the company's net profits and the proceeds from winding it up.[145] The third provision treats arrangements that exclude a shareholder from participating in any of the firm's profits or bearing any of its losses as null and void.[146] This requirement, known as the "prohibition against *societas leonina*" and, on its face, only applying

2468, codice civile (It.)), scholars argue that a differentiation of the contents of SRLs' shares is impermissible other than in the form of rights *ad personam* (see *supra* note 137). In the literature, see, e.g., Alessandra Daccò, *Le partecipazioni dei soci in* DIRITTO COMMERCIALE - VOL. III. DIRITTO DELLE SOCIETÀ 669, 674 (Marco Cian ed., 2017). In the absence of scholarly views (to the best of our knowledge), practitioners appear to admit (automatic) conversion rights in SME SRLs. Cf. Consiglio Notarile di Milano, *Massima No. 171 of 27 November 2018 "Nozione di categorie di quote di s.r.l. PMI",*" https://www.consiglionotarilemilaNo.it/massime-commissione-societa/171/ (discussing the viability of mechanisms leading to the automatic conversion of such shares). However, even insofar as conversion rights may, in principle, be viable in such companies, they remain subject to the general corporate law limits we discuss next. See *infra*, text accompanying notes 144-147.

[140] See, e.g., Nicola de Luca, *Il socio "leone". Il* revirement *della Cassazione su opzioni put a prezzo definito e divieto del patto leonino*, 72 BANCA BORSA E TITOLI DI CREDITO 70, 91 (2019) (affirming that a security is a share if and only if it exposes its holder to the firm's risk). This "*summa divisio*" between equity and debt is an unchallenged concept taught also in law schools. See, e.g., NICOLA DE LUCA & ALBERTO STAGNO D'ALCONTRES, MANUALE DELLE SOCIETÀ, 188-195 and 237-250 (2nd ed., 2023) (discussing the fundamental features of shares and bonds). Case law confirms the significant role of this *summa divisio* in today's corporate law. See, e.g., Corte di Cassazione, 4 July 2018, No. 17498 (affirming that, although Italian corporate law now gives more room to private ordering than in the past, the *summa divisio* between equity and debt persists).

[141] PAOLO SFAMENI, AZIONI DI CATEGORIA E DIRITTI PATRIMONIALI 88-102 (2008) (stressing that contracting parties must act within this framework in defining the attributes of shares in SPAs). The foundational nature of those corporate law provisions and the general nature of the derived doctrinal standards imply that they determine the boundaries of private ordering in shaping the attributes of SRLs' shares and the rights (for instance, *ad personam*) that SRL shareholders can be granted. See, e.g., Consiglio Notarile di Milano, *supra* note 137 (explaining that the regime allowing SRL charters to assign a shareholder rights *ad personam* must comply with the prohibition against *societas leonina* and the framework described above, as well as, more broadly, with "other mandatory corporate law provisions.").

[142] Under U.S. VC contracts, the VCF is *de facto* a fixed claimant as long as its shares are unconverted. See *supra* note 128 and corresponding text.

[143] See Giudici et al., *supra* note 14, at 801 (reporting that, based on the empirical evidence, conversion rights are absent from Italian transactional practice).

[144] Art. 2247, codice civile (It.).

[145] Art. 2350, codice civile (It.) On its face, this provision applies only to firms organized as SPAs. Yet scholars consider it as the source of a foundational precept defining the core features of the equity interest irrespective of the firm's organizational form.

[146] Art. 2265, codice civile (It.).

to partnerships, has been held to express a general principle also applying to companies,[147] and implies that a shareholder, to be considered as such, *must* have a claim to a fraction of the firm's profits.

VCFs and entrepreneurs bargaining under German and Italian corporate law may devise alternative arrangements replicating the contingent payoff of convertible preferred shares through other securities—namely, convertible bonds or similar. In German VC deals involving GmbHs, contracting parties indeed resort to a combination of convertible loans[148] and shareholder agreements.[149] These shareholder agreements typically stipulate that at predetermined events and/or at the discretion of the VCF, the contracting parties will take the steps required to convert loans into equity—that is, to execute a capital increase and make the necessary amendments to the firm's charter.[150] These solutions are inferior alternative arrangements, though, because they suffer from one fundamental limitation. As they are included in shareholder agreements and hinge critically on the entrepreneur's cooperation, they are not self-enforcing. They are thus not functionally equivalent to their U.S. counterparts. Convertible bonds, available in VC-backed firms incorporated as AG,[151] might work more effectively, as the conversion as such is self-enforcing.[152] However, such bonds cannot provide for governance rights similar to those shareholders enjoy, typically attached to U.S.-style convertible shares.[153]

[147] The main rationale for this widely held view is that arrangements departing from it would make a shareholder insensitive to the firm's fate and thus create incentives to make irresponsible decisions. See, e.g., NICCOLÒ ABRIANI, IL DIVIETO DEL PATTO LEONINO VICENDE STORICHE E PROSPETTIVE APPLICATIVE , 41-51 (1994). Scholars and courts have hardly questioned this interpretation. See Nicola De Luca, *Dal socio leone all'agnello sacrificale? Considerazioni sulla clausola di recesso a prezzo definito*, 74 BANCA BORSA E TITOLI DI CREDITO 369, 375 (2021); Tribunale di Milano, 30 December 2011. A recent exception is Antonio Capizzi, *Contro il divieto di patto leonino applicato alle società di capitali: per un giudizio in concreto sulle ipotesi di abuso da parte del socio esentato dalle perdite*, 13 RIVISTA ORIZZONTI DEL DIRITTO COMMERCIALE 487 (2024).

[148] See Wolfgang Weitnauer, *Anhang VI. 1 – Beteiligungsvertrag (GmbH) Anlage 3B.1*, *in* HANDBUCH, *supra* note 15 (providing a standard form for the convertible loan agreement). In an AG, convertible bonds are available. § 221(1) of the AktG. No such securities can instead be issued in a GmbH, requiring transactional practice to replicate the conversion mechanism in loan agreements and rely on shareholder agreements. For details, see Johannes Maidl, *Die Wandelschuldverschreibung bei der GmbH*, 9 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT [NZG] 778 (2006).

[149] This is the solution suggested by the templates provided in the leading practioners handbooks. See e.g., Stefan-Ulrich Müller, *O. Gesellschaftervereinbarung - Shareholders' Agreement § 13*, *in* BECK'SCHES FORMULARBUCH ZIVIL-, WIRTSCHAFTS- UND UNTERNEHMENSRECHT (Robert Walz ed., 5th ed., 2022); WEITNAUER, *supra* note 136 (providing a standard contractual form for the investment agreement ("Beteiligungsvertrag")).

[150] In a first step, the VCF and the entrepreneur have to create pre-determined and pre-authorized capital. See § 55a of the GmbHG. In a second step, the authorized capital has to be issued as specified events materialize. Voting agreements oblige the entrepreneur to vote for the underlying capital increase that permits the conversion of the VCFs' bonds as specified events materialize. See Laura Frühauf and Christoph H. Seibt, *F.V.2 Gesellschaftervereinbarung (Beitritt eines Finanzinvestors, Venture Capital-typische Klauseln*, *in* BECK'SCHES FORMULARBUCH MERGERS & ACQUISITIONS, para. 1, 12 (Christoph H. Seibt ed., 4th ed., 2025). See also Wolfgang Weitnauer, *Teil E – Die VC Beteiligung*, *in* WEITNAUER, *supra* note 15, at paras. 8, 12.

[151] See *supra* text accompanying note 131.

[152] Tim Florstedt, *§ 221*, *in* KÖLNER KOMMENTAR ZUM AKTG, para 274 (Wolfgang Zöllner & Ulrich Noack eds., 3rd ed., 2017) (summarising the predominant doctrine of *facultas alternativa* that sees bondholders substituting their debt claim for a residual one as shareholders).

[153] Holders of convertible bonds only become shareholders upon conversion and enjoy shareholder rights only thereafter. See Mathias Habersack, *§ 221 in* MÜNCHENER KOMMENTAR ZUM AKTG – VOL 4, para. 24a and 27 (Mathias Habersack & Wulf Goette eds., 5th ed., 2021) (explaining that the conversion creates an original shareholder position for the first time, whereas prior to conversion bondholders are only creditors of the company).

In Italian VC deals, VCFs and entrepreneurs may use, as suggested by some scholars,[154] convertible bonds or, depending on the firm's organizational form, debt notes.[155] Yet, under Italian corporate law, neither of such securities could grant VCFs governance rights similar to those attaching to shares, including voting rights, which VCFs typically demand.[156]

To be sure, conversion rights are nothing but a technical instrument used in U.S. VC contracting to enable VCFs to shift risk in response to firm performance.[157] Even though U.S.-style conversion rights are unavailable in Germany and Italy, VC contracting in these jurisdictions might not be significantly impaired if VCFs and entrepreneurs could resort to functionally equivalent arrangements that permitted the critical risk-shifting through other techniques. In theory, one such technique would be liquidation preferences in favour of the VCF.[158] However, as we see in the next section, this technique also fails because U.S.-style liquidation preferences cannot be transplanted—whether verbatim or via functionally equivalent solutions—and are thus substituted by inferior alternative arrangements.

iii. Liquidation Preferences

Unconverted convertible preferred shares incorporate, *inter alia*, special cash-flow rights. They provide liquidation preferences and automatic and cumulative dividends,[159] which benefit from anti-dilution protections.[160] We discuss liquidation preferences first.[161]

In U.S. VC contracts, liquidation preferences, which are typically included in the firm's charter, determine the allocation of proceeds amongst the VCF and the entrepreneur in so-called liquidity events, such as redemptions, trade sales, or the company's winding up.[162] More precisely, "non-participating" liquidation preferences enable the VCF to receive a specified amount per share before any payment is made to the entrepreneur. The residual surplus, if any, is assigned entirely to the entrepreneur.[163] "Participating" liquidation preferences instead imply that, in addition to the specified amount per share, the VCF also receives a *pro rata* share of any residual surplus.[164] Participating liquidation preferences can be either "capped" or "uncapped," depending on whether there is a ceiling on the VCF's preferential cash-flow rights.[165] For uncapped participating liquidation preferences, conversion rights are practically unimportant, as VCFs' payoff will always be greater without converting.[166] Both types of liquidation preferences are often disproportionate to the amount originally invested[167] and

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[154] Szego, *supra* note 14, at 841 (advancing this suggestion as to firms organized as SPAs).

[155] Under Italian corporate law, firms organized as SPAs can issue convertible bonds, and firms organized as SRL can issue similar "debt notes." See artt. 2420, 2483, codice civile (It.), respectively.

[156] For details, see Nigro & Enriques, *supra* note 12, at 173-174 (showing that, under Italian corporate law, convertible bonds or, depending on the firm's organizational form, convertible debt notes, as long as they are unconverted, may not grant voting rights in the shareholder meeting).

[157] See *supra* text preceding note 129.

[158] For details on this arrangement, see *infra* text accompanying notes 161-171.

[159] On automatic and cumulative dividends, see *infra* Part III.C.1.iv.

[160] See *infra* Part III.C.1.v.

[161] See generally, MAYNARD & WARREN, *supra* note 91, at 492-528.

[162] Klausner & Venuto, *supra* note 99, at 1403. For a basic definition of trade sales and redemptions, see *infra* text accompanying notes 477 and 538, respectively.

[163] Klausner & Venuto, *supra* note 99, at 1404.

[164] *Id*., at 1405.

[165] *Id*., at 1405-06.

[166] Conversion rights are economically useless when VCFs receive participating uncapped liquidation preferences. In this case, the VCF's payoff is always greater if it does not convert, regardless of the amount for which the company is sold, because the liquidation preferences top up the pro rata participation in the realized firm value. See Klausner & Venuto, *supra* note 99, at 1407.

[167] Fried & Ganor, *supra* note 128, at 982 ("Depending on the circumstances, these multiples can be quite high, as much as six times the original purchase price or higher.").

bound to increase over time because of automatic and cumulative dividends.[168] The VCF may receive the bulk, if not all, of the proceeds of a liquidity event because of these arrangements.[169] Liquidation preferences have a strong efficiency rationale.[170] They are crucial for efficient risk allocation and have a significant impact on VCFs' portfolio returns.[171]

German and Italian corporate laws preclude the transplant of U.S.-style liquidation preferences.

German corporate law bans liquidation preferences for three reasons. First, as we have seen, U.S.-style conversion rights are prohibited,[172] which, in turn, rules out the mechanism required for non-participating or capped participating liquidation preferences to perform their function. In addition, the legal obstacles we document erect impediments to uncapped participating liquidation preferences.

Second, such arrangements would clash with the implicit guiding principle in German corporate (and insolvency) law that shares must represent residual claims.[173] Third, although German corporate law allows for arrangements curtailing or even suppressing shareholders' rights to participate in the company's profits,[174] including in the event of liquidation,[175] such arrangements are available only when the company is formally dissolved and its assets are sold off. They are not available for the allocation of the proceeds of other liquidity events, including trade sales in the form of share transfers.[176] Therefore, the only way for German VCFs and entrepreneurs to replicate U.S.-style liquidation preferences in trade sales would be to structure

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[168] See *infra* text accompanying notes 216-218.

[169] See, also for references, *infra* note 481and accompanying text.

[170] See, e.g., Fried & Ganor, *supra* note 128, at 983 (discussing how these arrangements address market frictions).

[171] See William W. Bratton, *Venture Capital on the Downside: Preferred Stock and Corporate Control*, 100 MICH. L. REV. 891 (2002) (discussing the significance of VCFs' protections to allocate risk efficiently); and Sven Riethmueller, "*Rise of the Zombies:" The Significance of Venture Capital Investments That Are Not Profitable"*, 22 HOUS. BUS. & TAX L.J. 98 (2021) (using simulations of VCFs' portfolio returns to demonstrate how results that are in line with market benchmarks depend on this type of protections).

[172] See *supra* Part III.C.1.ii.

[173] See *supra* notes 134-136 and accompanying text.

[174] Commentators predominantly build on blackletter AG law to consider this kind of arrangements valid even when they are included in the firm's charter. See § 11 of the AktG; and, in the literature, e.g., Hildegard Ziemons, *§ 11 in* KOMMENTAR ZUM AKTG, para 22 (Karsten Schmidt & Markus Lutter eds. 5th ed., 2024). Some commentators have expressed concerns about their validity, though. See, e.g., Sebastian Mock, *§ 11 in* GROßKOMMENTAR, *supra* note 135, at para. 49. These arrangements are certainly valid for GmbHs. Case law explicitly acknowledges this. See BGH, Jul. 14, 1954, BGHZ 14, 264.

[175] This issue is controversial under the regime governing the AG. Some very old judicial opinions validated a provision in the firm's charter that created a class of shares that would receive a larger than pro-rata share in liquidation. See Reichsgericht [RG] [Supreme Imperial Court], Apr. 8, 1908, 68 ENTSCHEIDUNGEN DES REICHSGERICHTS IN ZIVILSACHEN [RGZ] 235. Building on it, some commentators have taken a more liberal approach to the matter. See, e.g. Karsten Schmidt, *§ 271* in GROßKOMMENTAR, *supra* note 135, at para 5. Most commentators take a more restrictive stance, though. See, e.g., Jens Koch, *§ 271*, in MÜNCHENER KOMMENTAR, *supra* note 153, at para. 6 (Wulf Goette & Mathias Habersack eds., 5th ed., 2021). As to the GmbH, blackletter law explicitly validates such arrangements even when they are included in the firm's charter. See GmbHG, § 72. Therefore, commentators do not question arrangements excluding the shareholders' right to receive a fraction of the liquidation proceeds. See, e.g., Hans-Friedrich Müller, *§ 72*, *in* MÜNCHENER KOMMENTAR ZUM GMBH-GESETZ – VOL. III, para 18 (Holger Fleischer & Wulf Goette eds., 4th ed., 2022).

[176] See, e.g., Rainer Loges & Wolfram Distler, *Gestaltungsmöglichkeiten durch Aktiengattungen*, 36 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 467, 471 (2002). Redemption rights are not a viable instrument to take advantage of liquidation preferences. Under German law, these arrangements face peculiar restrictions. See *infra* text accompanying notes 547-559. Besides, the underlying share buybacks are constrained by minimum capital requirements. See AktG, § 57 and GmbHG, § 33. For details, see, in the literature, Jürgen Oechsler, *§ 71 in* MÜNCHENER KOMMENTAR ZUM AKTG – VOL. I, paras. 17 and 70 (Mathias Habersack & Wulf Goette eds., 6th ed., 2024); and Christian Kersting, *§ 33*, in GMBHG, para. 9 (Ulrich Noack et al. eds., 23rd ed., 2022). These requirements may prove particularly onerous in ailing firms.

these transactions as a piecemeal asset sale, which is, in theory, possible but, in practice, unworkable most of the times.[177]

Participating liquidation preferences present their own problems. Building on the idea that participating liquidation preferences enable the VCF to capture a disproportionate amount of firm value *qua* both fixed and residual claimant,[178] and that they can thereby lead to an unfair outcome for the entrepreneur in low-value liquidity events,[179] scholars advocate an ex post check on their size by deploying well-established doctrines.[180] These doctrines include the reasonableness test under the law of unfair terms and conditions and the doctrine of unconscionability,[181] but the most trenchant one is rooted in the broad concept of good faith.[182] In general, good faith commands a contracting party to consider the interests of the other party when performing their obligations and exercising their rights, the underlying rationale being that each of them should achieve their transactional objectives.[183] Because liquidation preferences can lead to VCFs receiving the bulk, if not all, of a liquidity event's proceeds, entrepreneurs may in some cases look like the victims of a full-blown expropriation strategy.[184] When liquidation preferences are subject to a good faith test, judges can review transaction terms.[185] This gives entrepreneurs an implicit option to renegotiate the VC deal. If they exercise it, such renegotiation disrupts the originally agreed-upon risk allocation and can undermine the financing conditions that depend on this arrangement. The implication is clear: the higher-of mechanism is an inferior alternative arrangement.

Under Italian corporate law, liquidation preferences *à la* Delaware face similar obstacles. Let us consider non-participating and capped participating liquidation preferences first. Three obstacles stand in their way. First, the unviability of U.S.-style conversion rights—which we flagged above[186]—entails that it is impossible to reproduce such arrangements. Second, Italian corporate law requires that shares incorporate the right to share in the firm's uncapped upside,[187] which renders non-participating liquidation preferences a non-starter, as empirical evidence confirms.[188] The same requirement can be inferred to rule out capped participating liquidation preferences as well, although there is no authority explicitly confirming this. Second, building once again on the prohibition against *societas leonina*,[189] scholars argue that the firm's equity structure must allow all shareholders to realise a (non-symbolic) portion of

[177] On the functional limitations of such transactional solution as a means to transfer firm control, see Joan C. Coates IV, *Mergers, Acquisitions, and Restructurings: Types, Regulation, and Patterns of Practice in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 1st ed., 2018), 570, 572.

[178] See *supra* text preceding note 164.

[179] See *supra* text preceding note 169. See also *infra* text preceding note 481.

[180] See, for references, KUNTZ, *supra* note 14, at 545 (pointing to the standard of good faith and the principles for the judicial review of the exercise of shareholder rights under it).

[181] For this claim, building on BGB, §§ 307 and 138, see CHRISTOPH WINKLER, RECHTSFRAGEN DER VENTURE CAPITAL-FINANZIERUNG, 91-95 and 237 (2004).

[182] See BGB, § 242 (stipulating that "an obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration.").

[183] See, also for references, e.g., Claudia Schubert, *§ 242 in* MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH, para. 10 (Franz Jürgen Säcker et al. eds., 8th ed., 2019).

[184] For details on the instances mentioned in the main text (chiefly trade sales irrespective of their transactional form), the applicable regime under German corporate law, and its drawbacks, see *infra* notes 492-496 and accompanying text and 515-519 and accompanying text.

[185] For a discussion, see KUNTZ, *supra* note 14, at 544-546.

[186] See *supra*, text accompanying notes 137-147.

[187] See *supra* text accompanying notes 144-147.

[188] See Giudici et al., *supra* note 14, at 807-808 (providing evidence that contracting parties include non-participating liquidation preferences in Italian VC deals in a negligible number of cases).

[189] See *supra* text accompanying notes 146-147.

firm value.[190] More specifically, they argue that Italian corporate law also bans so-called "giraffine pacts"—that is, arrangements that create an equity structure resembling a tall tree with foliage only at the top, accessible only to the long-necked giraffe.[191] Liquidation preferences emerge as the giraffine pact *par excellence*,[192] and the greater the preference, the more likely it is that the VCF will be the only shareholder realising firm value in downside scenarios. In theory, setting liquidation preferences at a magnitude that does not strictly prevent the entrepreneur from sharing in the firm value could avert this outcome. In practice, however, liquidation preferences cannot be drafted ex ante to preserve the entrepreneur's right to "get at least something" without impairing their core function.[193] An entrepreneur who receives little or nothing as a result of a trade sale can thus threaten the VCF with litigation, forcing a renegotiation of the agreements on the allocation of the firm's risk and the financing conditions overall.[194] Unlike the requirements that imply that shares must always incorporate the right to participate in the firm's uncapped upside, which affects the viability of specific types of liquidation preferences, the prohibition against *societas leonina* rules out all types of liquidation preferences. In fact, it makes them all litigable ex post due to an alleged unfairness of the allocation of firm value to which they may lead.

Contracting parties in both jurisdictions resort to alternative arrangements, aiming partly also to make up for the lack of U.S.-style conversion rights.[195] The most common alternative arrangement in German VC deals is the so-called "higher-of mechanism."[196] In its typical form, this arrangement features in shareholder agreements and governs the distribution of proceeds of trade sales executed as compelled share co-transfers. It stipulates that the VCF will receive a predetermined fraction of a liquidity event's proceeds when they are below a certain target amount and that it will participate on a pro rata basis if the proceeds are higher than that threshold amount.[197] Yet, these arrangements exhibit four significant limitations.

First, it is unclear whether liquidation preferences can be included in shareholder agreements. An isolated judicial opinion held that, for transparency reasons, liquidation preferences connected with trade sales must be included in the corporate charter.[198] Although

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[190] See ABRIANI, *supra* note 146, at 124-125 (making this general point in abstract terms); and ZANONI, *supra* note 14, 137-141 (reporting the relevant doctrinal framework when discussing what private ordering can achieve in VC deals involving SPAs).

[191] See ABRIANI, *supra* note 146, at 125.

[192] Commentators discussing liquidation preferences stress that such arrangements must comply with both the prohibition against *societas leonina* and the related ban on giraffine pacts. See, e.g., ZANONI, *supra* note 14, at 152 (ruling out that shares' cash-flow rights can be so designed as to have the effect of excluding other shareholders from participating in the firm's profits). They also rule out the viability of "shares that incorporate a right to receive a predetermined fraction of firm value because this would be tantamount to a creditor claim contingent [upon the firm's dissolution], which would neutralise the shareholder's exposure to equity risk and thus be tantamount to a provision excluding them from bearing the firm's losses". See SFAMENI, *supra* note 190, at 98 (our translation). Notaries also make the same point. See, e.g., Consiglio Notarile di Milano, *Massima No. 126 of 5 March 2013* "*Ripartizione non proporzionale del corrispettivo della vendita o del riscatto di partecipazioni sociali*," https://www.consiglionotarilemilano.it/massime-commissione-societa/126/.

[193] See Nigro & Enriques, *supra* note 12, at 180.

[194] For details on the strategy that the entrepreneur could deploy to litigate some transactions and achieve his goals, see *infra* note 482 and corresponding text.

[195] See *supra* text following note 129.

[196] See, e.g, WEITNAUER *supra* note 136, at B.7.2 (providing a sample form for the investment contract).

[197] See, e.g., Loges & Distler*, supra* note 176, at 471.

[198] Landgericht Frankfurt am Main, Dec. 23, 2014, 18 NZG 482 (2015). Note that the inclusion of such a provision in the charter would not change its legal nature as an agreement that is only binding for the contracting parties (i.e., the original shareholders). See KUNTZ, *supra* note 14, at 540-543.

this opinion is often characterised as an outlier,[199] available evidence suggests that it has some grip on transaction drafting: notaries encourage their clients to include liquidation preferences *both* in the firm's charter and in shareholder agreements.[200] Transactional practice, however, regularly opts for including them only in shareholder agreements.[201]

Second, if they are included only in shareholder agreements, as is standard in transactional practice, liquidation preferences lose their self-enforcing nature: the VCF has nothing but a contractual claim against a likely cash-strapped entrepreneur.[202]

Third, higher-of mechanism arrangements fail to fulfil the intended purpose of conversion rights.[203] Alternative arrangements that mimic conversion rights without enabling the VCF to capture the firm's upside with the same level of certainty are not equally valuable to contracting parties.

Fourth, the extent to which parties are free to define the type and size of liquidation preferences through alternative arrangements is unclear. Arrangements that enable VCFs to enjoy a double dip into firm value lead to an ex post check of the terms of the liquidity event.[204]

VCFs and entrepreneurs bargaining under Italian corporate law react to regulatory constraints regarding liquidation preferences (and conversion rights[205]) by adopting two types of alternative arrangements. First, they sidestep the requirement that shares must always incorporate a right to share in the upside through provisions in the firm's charter that grant VCFs uncapped participating liquidation preferences.[206] Second, they replace non-participating liquidation preferences with arrangements that rely on a higher-of mechanism[207] that is basically the same as the one deployed in German VC deals.[208] These arrangements fail, however, to neutralise the unenforceability risk stemming from the prohibition against *societas leonina*.[209] In fact, this prohibition admits no circumvention through private ordering, as scholars and practitioners unanimously acknowledge.[210] Transactional practice has reportedly sought to minimise this risk by including additional provisos to the effect that liquidation

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[199] See, e.g., Stephan Harbarth et al., *Gestaltung einer von der Satzung und dem gesetzlichen Regelfall abweichenden Gewinnauszahlungsabrede in der Aktiengesellschaft*, 61 DIE AKTIENGESELLSCHAFT 801, 803 (2016).

[200] See Martin Thelen, *Beteiligungsverträge in der notariellen Praxis*, 165 RHEINISCHE NOTARZEITSCHRIFT 121, 135 (2020). See also Wolfgang Herrler, *§ 9*, *in* GESELLSCHAFTSRECHT IN DER NOTAR- UND GESTALTUNGSPRAXIS, para. 140 (Wolfgang Herrler ed., 2017).

[201] See WEITNAUER, *supra* note 136, at B.7.

[202] Recall that the relocation of a private ordering solution that is optimally located in the firm's charter to shareholder agreements implies a loss in functionality and, thus, a decrease in the value of the relevant arrangement. See *supra* text preceding note 38. We discuss this point more in detail in Enriques et al., *supra* note 18, at 14-15. In this paper, we document this decrease in functionality chiefly when it comes to VCFs' and entrepreneurs' attempts to transplant U.S.-style redemption rights. See *infra* text accompanying notes 547-**Fehler! Textmarke nicht definiert.**.

[203] For details on these arrangements in German and Italian VC deals, see *supra* text following note 196 and text accompanying note 208, respectively.

[204] See supra text accompanying notes 178-185.

[205] See *supra* text preceding note 129.

[206] See Giudici et al., *supra* note 14, at 807-808.

[207] *Id.*, at 808.

[208] See *supra* text following note 196.

[209] See *supra* text preceding note 124 and corresponding text.

[210] Recall that the doctrinal construct defining what private ordering can achieve when shaping the attributes of shares, including the prohibition against *societas leonina*, is mandatory corporate law. See *supra* text following note 146. Thus, it does not allow for any circumvention, including through shareholder agreements. See *supra* note 78 and accompanying text. Consistent with this, scholars acknowledge that, based on the currently dominant interpretation of legal texts, liquidation preferences are exposed to the risk of being declared null and void. Cf. Agstner et al., *supra* note 12, at 429 (describing the restrictive majority interpretation). Similarly, notaries notice that these arrangements are only allowed within the limits resulting from the prohibition against *societas leonina*. See chiefly, Consiglio Notarile di Milano, *supra* note 192.

preferences shall not impair the entrepreneur's right to receive a symbolic fraction of value.[211] This solution, however, is unlikely to prove effective because it would not prevent courts from applying the prohibition against *societas leonina*[212] and giraffine pacts.[213]

To conclude, German and Italian VC corporate laws ban U.S.-style liquidation preferences. In response, VCFs and entrepreneurs adopt alternative arrangements that provide less stable and reliable downside protection compared to U.S. VC contracts.

iv. Automatic and Cumulative Dividends

U.S. VC deals grant VCFs the right to receive automatic dividends—that is, dividends that mature regardless of whether the firm has posted a profit and require no specific resolution by the company's bodies.[214] Such "guaranteed" dividends are typically between 2% and 11% per year.[215] If, as is usually the case, the firm does not pay out the due amount, the same amount accrues to the nominal value of liquidation preferences,[216] cumulating over time[217] and becoming payable in the case of a liquidity event.[218] Automatic and cumulative dividends thus add an interest-like time-value-of-money adjustment to VCFs' liquidation preferences.[219]

These arrangements are simply off-limits under both German and Italian corporate laws. This is due to several reasons that are nearly identical in the two jurisdictions.

Shares as equity interests incorporate a residual claim to future cash flows.[220] These cash flows, in turn, are inherently linked to the firm's fortunes. Consistent with E.U. corporate law,[221] shareholders may receive dividends only out of realized profits. Any arrangement that introduces certainty into shareholder returns is considered incompatible with the inherently uncertain nature of equity ownership.[222]

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[211] See Giudici et al., *supra* note 14, at 809.

[212] *Id.*, at 809-810 (noting that "in a hypothetical court case a judge following the mandatory constraints theory would check whether such a contractual provision is in fraud of the law and thus invalid.").

[213] See *supra* notes 189-192 and corresponding text.

[214] See MAYNARD & WARREN, *supra* note 91, at 490-491. To be sure, in addition to automatic dividends, U.S. VC deals also grant the VCF the right to receive "priority dividends," implying that, should the VC-backed firm declare and distribute any dividends, the VCF would have the right to receive a predetermined amount of such dividends for each of his convertible preferred shares before the entrepreneur may receive any dividend. *Id.* at 484-486. But because VC-backed firms almost never declare and distribute dividends, VCFs can be expected to factor in the basic insignificance of this provision for the economics of the deals. In light of this, and due to space constraints, we omit analyzing these arrangements here.

[215] *Id.*, at 491-492.

[216] *Id.*, at 490-491.

[217] *Id.*, at 490.

[218] To be sure, the obligation to pay accrued dividends may be triggered by the firm's decision to distribute dividends to common shareholders. But this possibility is for business reasons obviously rather remote. It is much more likely that a liquidity event will trigger that obligation instead. *Id.*, at 491.

[219] *Id*. On liquidation preferences, see *supra* text corresponding to notes 160-171.

[220] See, §§ 1 para. 2, 8 para. 4, and 60 para. 1 of AktG and, §§ 5 para.1 and 3, 29 para. 1 of the GmbHG. As to Italy, see art. 2350, codice civile (It.) (laying down a general principle that is held applicable to both SPAs and SRLs). See *supra* note 140 and accompanying text.

[221] E.U. law requires that in stock corporations dividends be paid out of earnings or retained earnings. See Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, arts. 56 and 57, 2017 O.J. (L 169) 46.

[222] As to German corporate law, cf. KARSTEN SCHMIDT, GESELLSCHAFTSRECHT 515 (4th ed., 2002) (stating that equity shares "typically" do not carry fixed interest entitlements. As to Italian corporate law, see, e.g., SFAMENI, *supra* note 190, at 82-84 (stating that the very concept of shares is incompatible with any form of fixed remuneration and that Italian corporate law "does not allow for hybrid types of shares") (our own translation).

This characterization of equity claims holds despite German and Italian corporate laws permitting hybrid instruments.[223] Such instruments allow for debt conversion into equity but prohibit the resulting equity stakes from carrying guaranteed payment claims.

In Germany a distinction must be made between AGs and GmbHs: the regime governing AGs prohibits contractual "commitments to pay interests to shareholders,"[224] which scholars unanimously interpret as applicable to any arrangement that grants a shareholder the right to receive a fixed return on their equity investment,[225] including in the form of automatic dividends.[226] The rules for GmbHs are more nuanced. On their face, they allow for automatic dividends,[227] because they permit the distribution of dividends regardless of the companies' annual performance, subject only to the capital maintenance regime for GmbHs.[228] However, this regime and applicable accounting standards permit dividend payments regardless of the realization of annual profits only if the firm has established free profit or capital reserves and these reserves are (partly) dissolved in a shareholder resolution.[229] As a consequence, no contractual arrangement can make sure that the VCF will always receive a fixed remuneration of its investment through automatic dividends.

Italian corporate law, in turn, bans automatic dividends through an explicit provision and an interpretation combining several doctrines. It provides that a company cannot distribute any unrealised profits that do not "result from regularly approved annual accounts."[230] No company can commit to distributing dividends unless these two requirements are met. Furthermore, scholars agree that arrangements granting shareholders the right to receive a fixed interest or a guaranteed return are incompatible with the function of the corporate contract.[231] Such arrangements would in fact curtail the "natural" shareholder's exposure to equity risk.[232] These arrangements would also clash with the prohibition against *societas leonina*.[233] Given the foundational nature of the provisions and concepts on which these doctrines rest, the resulting regime applies irrespective of the firm's organizational form.[234]

In addition, both German and Italian corporate laws impose procedural obstacles. Under German corporate law, dividends can only be paid out following a shareholder resolution on

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[223] German corporate law allows AGs to issue convertible bonds, participating bonds, and participating rights. See AktG, § 221. Italian corporate law allows SPAs to issue convertible bonds. See art. 2420, codice civile (It.). Italian corporate law also allows SPAs to issue "participating financial instruments." See art. 2346, comma 6, codice civile (It.). These securities, however, are of limited use in this context chiefly because they cannot incorporate the right to vote in the general shareholder meeting.

[224] § 57 para. 2 of the AktG.

[225] See, e.g., Tim Drygala, *§ 57 in* KÖLNER KOMMENTAR ZUM AKTG - VOL.1 , para. 129 (Wolfgang Zöllner & Ulrich Noack eds., 3rd ed.2011); and Walter Bayer, *§ 57 in* MÜNCHENER KOMMENTAR ZUM AKTG - VOL. 1, para. 202 (Wulf Goette & Mathias Habersack eds., 5th ed., 2019).

[226] See Walter Bayer, *§ 57 in* MÜNCHENER KOMMENTAR ZUM AKTG - VOL. 1, para. 96 (Wulf Goette & Mathias Habersack eds., 5th ed., 2019).

[227] Jens Ekkenga, *§ 29 in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 1, para. 92 (Holger Fleischer & Wulf Goette eds., 4th ed., 2022).

[228] § 30(1) of the GmbHG (stipulating that "[t]he assets which the company requires to maintain its share capital may not be paid out to the shareholders"). According to the prevailing interpretation, this provision prohibits any distribution to shareholders if it would push equity below the minimum capital amount. See, e.g., Sebastian Mock, *§ 29 in* KOMMENTAR ZUM GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG, paras. 229-232 (Lutz Michalski et al. eds., 4th ed., 2003).

[229] For details see Jens Ekkenga, *§ 29*, *in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 1, paras. 92-94 (Holger Fleischer & Wulf Goette eds. 4th ed. 2022).

[230] See art. 2433, comma 2, codice civile (It.). This provision is part of the regime of SPAs, but the the SPAs provisions on the approval of annual accounts govern the annual accounts of any type of company.

[231] See *supra* text accompanying notes 144-147.

[232] See *supra* text preceding note 144.

[233] See, e.g., SFAMENI, *supra* note 190, at 76-85. On the prohibition against *societas leonina*, see *supra* text accompanying note 146.

[234] See *supra* text following note 74.

the allocation of any ascertained surplus.[235] Any deviations from this regime are categorically ruled out in the AG.[236] Similarly, for GmbHs an annual *ad hoc* decision is required,[237] implying that automatic distributions are not permitted. In Italy SPAs can only distribute dividends once the shareholder meeting approves the annual accounts that ascertain profits for a given year and resolves on dividends.[238] Arrangements that seek to bypass this process, for instance by granting the right to receive a fraction of dividends regardless of any shareholder meeting resolution are null and void.[239] The regime for SRLs is more flexible but leads to the same practical outcome. In principle, the firm's charter can assign a right to receive dividends *ad personam* or even incorporate such a right into the shares.[240] These rights allow the shareholder to claim dividends regardless of any corporate resolution on their distribution, but not regardless of a shareholders' resolution on annual accounts that declares the existence of profits.[241]

The requirement under German and Italian corporate laws that dividend distribution be contingent on profits also rules out cumulative dividends. In fact, despite the absence of any explicit ban in either jurisdiction,[242] the corporation has to have a sufficient surplus to cover cumulative dividend payments.

Both corporate law regimes mount absolute prohibitions[243] on automatic and cumulative dividends, that is, they rule out not only U.S.-style arrangements and their functionally equivalent solutions, but any arrangement that, irrespective of its design, leads to the result of granting shareholders the right to receive a payout independent of firm performance. In fact, the broad scope of corporate law's prohibition against AGs paying interest on shareholders' equity investment rules out any alternative arrangement to this effect.[244] In addition, the capital maintenance requirements catch any inadmissible distribution from the guaranteed capital of both the AG and the GmbH, regardless of the form they take.[245]

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235 See §§ 58(3), 174 of the AktG, and §§ 29(2), 46, No. 1, of the GmbHG, respectively.

236 Jens Koch, *§ 174* in AKTIENGESETZ, *supra* note 105, at para. 2 (confirming the mandatory competence of the annual shareholder meeting).

237 See Kristian Kersting, *§ 29 in* GMBHG, para. 46 (Ulrich Noack et al. eds., 23rd ed. 2022) (representing the majority position that an annual decision on the allocation of the surplus is mandatory).

238 See art. 2433, commas 1, 2, codice civile (It.).

239 Cf. Enrico Ginevra, *La partecipazione azionaria*, *in* DIRITTO, *supra* note 139, at 290, 299 (arguing that what corporate law admits are rather private ordering solutions aimed to grant a shareholder the right to receive a predetermined fraction of the dividends that the firm may have decided to distribute).

240 See *supra* note 137.

241 Cf. Daccò, *La s.r.l.: la struttura finanziaria*, in DIRITTO, *supra* note 139, at 660, 672 (enumerating a number of private ordering solutions granting a shareholder a preferential right *ad personam* in the allocation of the company's profits or the distribution of dividends, all of which postulating a shareholder resolution approving the company's annual accounts).

242 German corporate law actually sees cumulative dividends as the default solution for preferred shares without voting rights when they take the form of advance dividends. See AktG, § 139 para 1 sentence 3 (according to which "[u]nless stipulated otherwise in the bylaws, an advance dividend is to be paid in addition" to the regular dividend). Furthermore, scholars conclude that in both the AG and the GmbH even preferred shares that carry voting rights can incorporate the right to receive cumulative dividends. See, e.g. Silja Maul, *§ 3 Die Aktie*, *in* BECK'SCHES HANDBUCH DER AKTIENGESELLSCHAFT, para. 55 (Florian Drinhausen & Hans Martin Eckstein eds., 3rd ed., 2018), and Peter Ulmer & Matthias Casper, *§ 5*, *in* GROSKOMMENTAR ZUM GMBHGESETZ, para. 186 (Mathias Habersack et al. eds., 2nd ed., 2016), respectively for the AG and the GmbH. However, any preferential dividends, whether advance or additional, can only be paid out once the corporation generates sufficient profits.

243 See *supra* text preceding note 34.

244 See *supra* note text accompanying 225-226.

245 AktG, § 57 para. 1 sentence 1 and § GmbHG, § 30 para. 1 sentence 1. For the vast jurisprudence on the comprehensive scope of the statutory prohibitions see, e.g., Holger Fleischer *§ 57*, *in* KOMMENTAR ZUM AKTG, para. 11-28 (Karsten Schmidt & Markus Lutter eds. 5th ed., 2024); Dirk Verse *§ 30*, *in* SCHOLZ GMBHG - VOL. I, para. 18-23 (13th ed., 2022).

Italian corporate law takes an equally broad approach,[246] based on the essential characteristics of the corporate contract and the scope of the prohibition against *societas leonina*.[247]

v. Anti-dilution Provisions

Convertible preferred shares in U.S. VC deals benefit from anti-dilution provisions. These provisions aim to mitigate the risk that the VCF may be diluted in so-called down rounds—that is, the infusion of additional equity at a share price lower than the VCF paid in a previous funding round.[248] Importantly, anti-dilution provisions determine the automatic adjustment of the conversion price of the shares,[249] which implies, in turn, that they are self-enforcing. In addition, the VCF's voting power and cash-flow rights are preserved without the need for any additional investment. While such provisions can imply a significant value shift from the entrepreneur to the VCF,[250] they are crucial to mitigating the risk of expropriation that VCFs face in subsequent financing rounds due to "trilateral bargaining" dynamics[251] or, simply, the new financiers' ambition to price shares as low as possible.[252]

German and Italian corporate laws do not allow for the adoption of these arrangements. The main reason is that German and Italian corporate laws ban U.S.-style conversion rights altogether.[253]

In Germany, contracting parties have devised alternative arrangements: shareholder agreements allocate additional shares to the VCF to compensate for (real or seeming)

[246] On the latitude of the prohibition against any arrangements seeking to grant a shareholder the right to receive a payout regardless of the firm's profitability, see Assonime, Circolare No. 11 of 06 May 2013, *https://www.assonime.it/attivita-editoriale/circolari/Pagine/Circolari.aspx* (describing what private ordering can achieve when defining the attributes of shares issued by SME SRLs); Consiglio Notarile del Triveneto, Orientamento No. I.NO.2 of September 2018, https://www.notaitriveneto.it/dettaglio-massime-triveneto-277-in---srl-pmi.html#inizio (same).

[247] See, e.g., SFAMENI, *supra* note 190, at 94. Some scholars argue that a shareholder can be legally granted the right to receive a fraction of the realized profits as dividends, provided that: (a) the general meeting has regularly approved the firm's annual accounts and the payment of such dividend is in line with the creditor protection regime (as outlined *supra* text preceding note 238); (b) the general shareholder meeting does not resolve *not to distribute* dividends. For a discussion, see SFAMENI, *supra* note 190, at 46-47. Similarly, other scholars argue that contracting parties can include a provision in the firm's charter stipulating that, if the firm has made a profit in a specific year, the VCF has the right to receive it as a dividend, provided, however, that this arrangement does not require the shareholder meeting to distribute all the profits or retain all the profits and, thus, leaves the shareholder meeting's discretion in deciding how to use the firm's profits unprejudiced at least in part. See ZANONI, *supra* note 14, at 154-155. Yet, even assuming these arrangements do not contrast with the essential feature of the corporate contract and the prohibition against *societas leonina*, they are clearly less functional than their U.S. counterparts. The first arrangement makes dividend distribution contingent on a shareholder resolution, implying that the shareholder meeting has a veto power. The second leaves the VCF's right to receive a payout contingent on realized profits.

[248] For an overview of the transactional features of these provisions, see MAYNARD & WARREN, *supra* note 91, at 528-577. Transactional practice knows both "full-ratchet" and "weighted-average" anti-dilution provisions. Full-ratchet anti-dilution provisions adjust the conversion price to match the price of the newly issued shares in the down round, regardless of the number of newly issued shares. *Id.*, at 556-559. Weighted-average anti-dilution provisions adjust the conversion price by an amount intended to offset the dilution in the implied value of the convertible preferred shares issued in the down round. *Id.*, at 559-571.

[249] See FELD & MENDELSON, *supra* note 91, at 62-63 (describing the mechanics of anti-dilution provisions).

[250] See MAYNARD & WARREN, *supra* note 91, at 558 (stressing that this is the case, particularly for full-ratchet anti-dilution provisions: see *supra note* 248).

[251] See Erik Berglöf, *A Control Theory of Venture Capital Finance*, 10 J. L. ECON. & ORG. 247, 249 (1994).

[252] See Robert P. Bartlett, III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation* 54 UCLA L. REV. 37, 78-80 (2006).

[253] See *supra* text accompanying 130-147.

dilution.[254] However, German corporate law prohibits firms from issuing shares below par.[255] Thus, the alternative arrangements found in German VC deals cannot protect the VCF from economic dilution risk by assigning additional shares to the VCFs without any further capital contribution. Instead, these arrangements typically predetermine the steps to be taken, with the cooperation of the entrepreneur, to approve a new share issuance. More specifically, the entrepreneur is obliged to vote in favour of the required shareholder meeting resolution and waive their pre-emptive rights and their right to challenge the resolution for stipulating an "unreasonable low" price for the newly issued shares.[256] Transactional practice appears to reflect these regulatory constraints.[257]

These alternative arrangements, however, are inferior to U.S.-style anti-dilution provisions. To begin with, they may be null and void. Unlike practitioners,[258] scholars stress that the logic of anti-dilution provisions implies a potentially significant transfer of value from the entrepreneur to the VCF[259] and, hence, the entrepreneur's partial expropriation in the sense of the German doctrine.[260] Therefore, the arrangements that replicate U.S.-style anti-dilution provisions, whatever their design, can clash with the general private law doctrine of immorality that translates the constitutional property rights protections into operable private law.[261] This doctrine also applies to private ordering solutions in shareholder agreements,[262]with the same consequences.

Furthermore, these alternative arrangements require the cumbersome procedure we have just described and, therefore, are not self-enforcing.[263] This procedure, however, may not unfold as expected due to the pre-emptive rights shareholders enjoy when the company issues new shares.[264] Anti-dilution provisions that work by adjusting the allocation of new shares can only function if the VCF and the new investor, but not the entrepreneur, may subscribe to the

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[254] See WEITNAUER, *supra* note 136, at B.8..

[255] See AktG, § 9 para. 1 and GmbHG, §14 para. 2.

[256] See WEITNAUER, *supra* note 136, at B.8.1. AktG, § 255 para. 2 grants shareholders the right to challenge that resolution. For details, see, e.g., Jan Schürnbrand & Dirk Verse, *§ 186 in* MÜNCHENER KOMMENTAR ZUM AKTG - VOL. 4, para. 92 (Wulf Goette & Mathias Habersack eds., 5th ed., 2021). This regime applies by analogy to GmbHs. See, e.g., Jan Lieder, *§ 55 in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 3, para. 142 (Holger Fleischer & Wulf Goette eds., 4th ed., 2022).

[257] For the templates of the relevant contractual provisions, see Stefan-Ulrich Müller, *O. 2. Beteiligungsvertrag - Investment Agreement § 2 (2)*, *in* BECK'SCHES FORMULARBUCH ZIVIL-, WIRTSCHAFTS- UND UNTERNEHMENSRECHT (Robert Walz ed., 5th ed. 2022); Christoph H. Seibt, *F.V.1 Beteiligungsvertrag - Investment Agreement*, in BECK'SCHES FORMULARBUCH MERGERS & ACQUISITIONS para. 1 (Christoph H. Seibt ed., 4th ed. 2025).

[258] Practitioners take a more favorable position and consider even full-ratchet anti-dilution provisions viable, either generally (Philip Martinius & Julia Stubert, *Venture-Capital-Verträge und das Verbot der Hinauskündigung*, 15 BETRIEBS-BERATER 1977, 1981 (2006)) or in the presence of a sunset clause (WEITNAUER, *supra* note 120, at para. 131).

[259] See *supra* text accompanying note 251.

[260] See *supra* note 75.

[261] See KUNTZ, *supra* note 14, at 685, 696 (explaining the doctrinal treatment of full-ratchet and weighted-average anti-dilution provisions).

[262] German courts have applied the private law doctrine to provisions leading to a (near) full economic expropriation of shareholders regardless of whether the relevant arrangements are located in the charter or in a shareholder agreement. Bundesgerichtshof, 9 Jul. 1990, 112 BGHZ 103, 107. In the literature, see, e.g., Hans-Joachim Priester, *Drag along- und Call-Option-Klauseln in der GmbH-Satzung*, *in* FESTSCHRIFT FÜR KLAUS J. HOPT ZUM 70. GEBURTSTAG AM 24. AUGUST 2010. UNTERNEHMEN, MARKT UND VERANTWORTUNG 1039, 1049 (Stefan Grundman et al. eds., 2010) (recalling the decision on expulsion clauses by the German supreme court and applying it to drag-along provisions in general, whether featuring in the charter or in a shareholder agreement).

[263] See *supra* text preceding note 256.

[264] See AktG, §§ 186(1) and 203(1) of the AktG. Both scholars and case law converge in affirming that the same regime applies by analogy to the GmbH. See Lieder, *supra* note 256, at paras. 102-103; and Bundesgerichtshof, April 18, 2005, 59 WERTPAPIER-MITTEILUNGEN [WM] 1101 (2005).

newly issued shares. Yet, such an outcome relies on the entrepreneur's prior and binding waiver of pre-emptive rights. German VC deals can achieve the logic of the corresponding U.S.-style arrangements[265] and make the entrepreneur the only shareholder bearing the consequences of any decrease in firm value occurring between financing rounds only if the waiver is irrevocable.[266] Yet, German corporate law, in line with E.U. rules,[267] stipulates that shareholders of an AG may not permanently waive their pre-emptive rights, but must do so separately for each individual share issuance.[268] To be sure, authorised capital may provide some leeway. Entrepreneurs can waive pre-emptive rights at the time the shareholder meeting authorizes the board to issue new shares for a given time period.[269] If, however, the entrepreneur does not confirm the waiver at the time (authorised) shares are issued,[270] the company can only give effect to the anti-dilution provision if excluding the entrepreneur's pre-emptive rights can be deemed necessary and proportionate to pursue the company's interest.[271] While some commentators argue that the VC-backed firm's need for additional funding may justify excluding pre-emptive rights,[272] others hold that safeguarding the smooth functioning of anti-dilution provisions does not pass this test. In their view, the exclusion does not protect the company's interest but only the personal interest of the VCF not to have its voting and cash-flow rights diluted.[273] These commentators consider general waivers of pre-emptive rights as void and stress that anti-dilution provisions may, therefore, not always function as intended.[274]

[265] See *supra* text preceding note 248.

[266] See KUNTZ, *supra* note 14, at 671 (explaining that waiving pre-emption rights is essential for achieving effective dilution protection).

[267] See Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, arts. (4)(1) and 72(1), 2017 O.J. (L 169) 46.

[268] AktG, § 186 para. 3 (stipulating that the pre-emptive right for newly issued shares may be precluded only in the resolution adopted to increase the share capital).

[269] This is the uncontested position of the scholarship. See, e.g., Joachim Herfs, *Bezugsrechtsemission in* UNTERNEHMENSFINANZIERUNG AM KAPITALMARKT para. 5.55 (Mathias Habersack et al. eds., 4th ed., 2019).

[270] Such a scenario may arise if the capital raised in a subsequent funding round exceeds the amounts anticipated when the original VC contract was entered into The authorized capital foreseen at this stage will not suffice to serve anti-dilution provisions, creating the need for a new capital issuance without pre-emptive rights at a stage where consensus on the way forward may have been lost amongst the "old" VCF and the entrepreneur. Beyond prediction errors, an effective dilution protection may also be unachievable because of the cap on authorized capital ("one half of the capital stock given at the time of the authorisation:" AktG § 202 para. 3 sentence 1). Finally, a need to issue new capital in the vicinity of down-rounds may also occur because the authorization of capital must be renewed at least every five years. See AktG § 202 para. 1 sentence 1. Practitioners indeed report that parties may not always agree on the waiver of pre-emptive rights in subsequent funding rounds. See, e.g., Christoph von Einem et al., *'Weighted Average' – Verwässerungsschutz bei Venture Capital-Beteiligungen*, 59 DER BETRIEBS-BERATER 2702, 2704 (2004).

[271] The leading German case is the decision issued in the "*Kali + Salz*" case. See Bundesgerichtshof, 13 March 1978 71 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN 40. The doctrine is derived from fundamental corporate law principles and case law has followed *Kali + Salz* consistently. See TOBIAS H. TRÖGER, TREUPFLICHT IM KONZERNRECHT 252-285 (2000). This doctrine was conceived with respect to AGs. Yet, because it rests upon fundamental corporate law principles, it also applies to firms organized as GmbHs. See, also for further references to case law and legal scholarship, Lieder, *supra* note 256, at paras. 102-103.

[272] Martinius & Stubert, *supra* note 258; NICHOLAS ZIEGERT, DER VENTURE CAPITAL-BETEILIGUNGSVERTRAG. TYPISIERUNG. AMERIKANISIERUNG UND FLEXIBILISIERUNGSELEMENTE EINES FINANZIERUNGSVERTRAGES 199 (2005).

[273] Jens Ekkenga, *§ 186*, *in* KÖLNER KOMMENTAR ZUM AKTG - VOL 4, paras. 78-79 (Ulrich Noack & Wolfgang Zöllner eds., 3rd ed., 2019) (arguing that the interest of individual shareholders does not suffice to legitimise a waiver of preemptive rights).

[274] KUNTZ, *supra* note 14, at 672-678.

To be sure, these restrictions only apply to AGs, while commentators agree that a GmbH's charter can include permanent waivers of pre-emptive rights.[275]

In addition, these alternative arrangements are prone to litigation due to the remedies available to shareholders if the company issues shares at an unreasonably low price.[276] Irrespective of the firm's organizational form, German corporate law provides that, through a so-called avoidance action, shareholders can challenge the shareholder resolution approving a new share issuance without pre-emptive rights if the price of the newly issued shares is unreasonably low.[277] This regime aims to prevent any dilution of existing shareholders and therefore clashes with the very essence of anti-dilution provisions. It invites entrepreneurs to strategically allege and litigate a low price in down-rounds, thus compromising the effectiveness of anti-dilution provisions in their core use case.[278] Even if the time limit for the avoidance action against the authorising shareholder resolution has long passed,[279] the entrepreneur may still request an injunction against the issuance of shares in the down-round on the grounds that the share price was unreasonably low.[280]

Given this context, when practitioners claim that enforcing anti-dilution provisions is fraught with legal uncertainty,[281] they are significantly understating the problem.

In Italy, VC deals include several types of alternative arrangements to mimic U.S.-style anti-dilution provisions in the firm's charter.[282] The most common ones stipulate that, in the event of a down-round, the company must pass a complementary resolution to issue the shares that will then be assigned to the VCF.[283] That means that each shareholder typically has to waive their pre-emptive rights and vote in favour of the capital increase, with the VCF having to contribute the capital required to subscribe to the new shares at par value.[284]

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[275] This position is almost uncontested. See, e.g., Joachim Tebben, *§ 55*, *in* SCHOLZ GMBHG - VOL. 3, para. 64, 69 (13th ed., 2025); Walter Bayer, *§ 55*, *in* GMBH-GESETZ, para. 22 (Marcus Lutter & Peter Hommelhoff eds., 21st ed., 2023).

[276] See *supra* text accompanying note 256.

[277] For references, see *supra* note 256.

[278] KUNTZ, *supra* note 14, at 680-684.

[279] The avoidance action must be brought within one month after the resolution was adopted. See §§ 246(1) and 255(3) of the AktG. The same regime applies to GmbHs, albeit with some minor qualifications. Scholars and case law converge on this point. In the literature, see, e.g, Ingo Drescher, *Anh. § 47 in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 3, para. 348 (Holger Fleischer & Wulf Goette eds., 4th ed. 2022). For case law, see RG, 25 February 1939, 9 DEUTSCHES RECHT 720, 721 (1939).

[280] Bundesgerichtshof, Oct. 10, 2010, 164 BGHZ 241.

[281] Rose & Partner - Rechtahnwälte und Steuerberater, *VC Investment Contracts in Germany (Rose & Partner Briefing Series)*, 13 February 2023, https://www.rosepartner.de/en/startup-vc-investment-contract-german-lawfirm.html#:~:text=Anti%2Ddilution%20in%20Germany&text=These%20determine%20whether%20and%20on,decline%20in%20the%20company's%20value (flagging the significant legal risks affecting anti-dilution provisions).

[282] See Giudici et al., *supra* note 14, at 796-798, 804 (discussing the structure of anti-dilution provisions in a sample of Italian VC-backed firms' charters). A relatively common variation of such arrangements, as they report (*id*., at 805), grants the VCF a veto right on any capital increase. Yet, these arrangements cannot compare with anti-dilution provisions, which strike a very different balance between the interests of the VCF and the entrepreneur. In fact, anti-dilution provisions allow for a capital increase but protect the VCF from economic dilution without the need for it to contribute new capital. Thus, veto rights on capital increases, which can be understood as a bargaining chip to force renegotiations, are an inferior substitute for self-enforcing anti-dilution provisions.

[283] *Id.*, at 805.

[284] *Id.* As a practical matter, these provisions assign a special right to the VCF through different techniques, depending on the VC-backed firm's organizational form. In SPAs, the VCF is issued shares of a special class that incorporate the relevant right. In SRLs, the VCF generally receives a special right *ad personam* (see *supra* note 137). In SME SRLs, the solution is akin to that adopted in SPAs. For details, see Consiglio Notarile di Milano,

This alternative arrangement is problematic irrespective of the VC-backed firm's organizational form for various reasons. First, their validity is uncertain. One reason is that Italian corporate law sees private ordering solutions that allow one contracting party to receive shares without contributing anything *or* contributing "too little" with suspicion.[285] To be sure, Italian blackletter corporate law permits that shares be issued for a contribution lower than their subscription price, provided that the total consideration paid up for all the newly issued shares is at least equal to the overall amount of the capital increase.[286] Scholars, however, infer from blackletter corporate law one additional requirement: namely, the allotment of shares always requires a shareholder to pay up some consideration for their shares.[287] Yet, for anti-dilution provisions to work, the VCF has to receive additional shares without either paying up anything for them or by paying up at most a symbolic price. The alternative arrangement replacing U.S.-style anti-dilution provisions may, therefore, fail to meet the legal requirements that corporate law lays down for allotting newly issued shares.[288]

Second, this alternative arrangement may be null and void because Italian corporate law is concerned with mitigating the potential "unfairness" of the value transfer from the entrepreneur to the VCF that such provisions may cause.[289] Some emphasise that such value transfers insulate the VCF from the firm's risk and thus clash with the prohibition against *societas leonina.*[290] Other scholars view anti-dilution provisions as capable of expropriating the entrepreneur (in the legal sense) and thus as hard to reconcile with the constitutional protection afforded to private property.[291] Further, and somewhat relatedly, anti-dilution provisions have been said to be inconsistent with the "principle of fair value." In essence, this principle, which applies irrespective of the firm's organizational form and the transaction's structure,[292] stipulates that a shareholder who is compelled to sell their shares has the right to

Massima No. 186 of 7 January 2020 "Clausole statutarie anti-diluizione," https://www.consiglionotarilemilano.it/massime-commissione-societa/186/.

[285] Drawing from various arguments and doctrines, prominent scholars stress the importance of fair bargains in corporate ventures, especially regarding proportionality between individual shareholder contributions and the firm's overall capital. See, e.g., Giorgio Oppo, *Quesiti in tema di azioni e di strumenti finanziari*, *in* IL NUOVO DIRITTO DELLE SOCIETÀ. *LIBER AMICORUM* GIAN FRANCO CAMPOBASSO - VOL. 1, 713, 717 (Pietro Abbadessa & Giuseppe B. Portale eds., 2006); and Paolo Ferro Luzzi, *La "diversa assegnazione delle azioni" (Art. 2436, comma 4, c.c.)*, *in* ID., 583, 588.

[286] See artt. 2436, §§ 4, 5, and 2468, § 2, codice civile (It.). In other words, if a company issues two new shares with a subscription price of one euro each, one shareholder may contribute 0.5 euro if the other contributes 1.50 euro.

[287] See, e.g., MARIO CAMPOBASSO, DIRITTO COMMERCIALE 2: DIRITTO DELLE SOCIETÀ 180 (9th ed., 2015).

[288] Scholars hint at these frictions. See, e.g., Awwad, *supra* note 284, at 180-181, 190-192.

[289] See *supra* text preceding note 250.

[290] In contributing to the academic debate on the matter, some notaries have voiced their concern about the validity of full-ratchet anti-dilution provisions (see *supra* note 248) and made the point mentioned in the text. See Lorenzo Salvatore, *Le* startup *innovative tra dato normativo e prassi contrattuale* in LE OPERAZIONI DI FINANZIAMENTO 1513, 1551 (Elisabetta Panzarini et al. eds., 2016).

[291] See Amal Abu Awwad, *Il problema delle clausole «anti-diluitive»*, 44 NUOVE LEGGI CIVILI COMMENTATE 175, 191-192 (2021). For details on the constitutional protections on private property as a source of corporate law prescriptions, see *supra* note 75.

[292] According to scholars and practitioners, the principle of fair value governs any transaction that causes or is even just capable of causing a transfer of value from one shareholder to another. See, e.g., Consiglio Notarile di Milano, *supra* note 293 (laying down the principle and accounting for its scope in functional terms). Scholars' inclination to apply the principle of fair value beyond the area of private ordering solutions governing divesting transactions to encompass anti-dilution provisions confirms its breadth. Awwad, *supra* note 291, at 191-192. Practitioners take the same approach. See Consiglio Notarile di Milano, *Massima No. 153 of 17 May 2016 "Riscattabilità delle quote di s.r.l"*, https://www.consiglionotarilemilano.it/massime-commissione-societa/153/ (listing, in the motivation, a number of heterogeneous arrangements subject to the principle of fair value).

do so at a price no lower than the compensation they would be entitled to if they were to exercise their withdrawal right.[293]

Third, the Italian regime governing pre-emptive rights significantly complicates the functioning of these alternative arrangements as it makes their self-enforcement a chimera. The proper functioning of anti-dilution provisions that work by adjusting the allocation of new shares requires the entrepreneur to waive their pre-emptive rights at the onset of the cooperation with the VCF.[294] Under Italian corporate law, however, private ordering solutions excluding pre-emptive rights either are unviable, partly as a consequence of E.U. company law,[295] or trigger mandatory requirements that would generate other impractical consequences. On the one hand, in SPAs, the shareholder meeting can pass a resolution that excludes pre-emptive rights only in specific instances, including when "the interest of the company so requires."[296] The interpretation of this statutory provision varies, with some scholars holding that the company has an interest in excluding pre-emptive rights only if this is "*strictly necessary* for

[293] Under Italian corporate law, shareholders have, under specific circumstances, withdrawal rights. See artt. 2437, 2473, codice civile (It.). For details, see MARCO VENTORUZZO, RECESSO E VALORE DELLA PARTECIPAZIONE NELLE SOCIETÀ DI CAPITALI 9-39 and 174-202 (2012) (describing the regime for withdrawal rights in SPAs and SRLs). Statutory corporate law stipulates the criteria for the determination of the fair value of withdrawing shareholders' shares: simplifying a bit, the divesting shareholder has the right to receive a price that reflects their pro rata share of the firm's value. See artt. 2437-ter, § 2, 2473, § 3, codice civile (It.). For details, *id.*, 61-106. This regime also applies, in firms organized as SPAs, if a shareholder or the company redeems shares and, in firms organized as SRLs, if a shareholder is excluded. See artt. 2437-sexies, 2473-bis, codice civile (It.). For further details, see e.g., Alessandro Benussi, *Considerazioni in ordine alla estromissione forzosa del socio nelle società di capitali: esclusione e riscatto in* IL DIRITTO SOCIETARIO OGGI - PERSISTENZE E INNOVAZIONI. STUDI IN ONORE DI GIUSEPPE ZANARONe 63 (Paolo Benazzo et al. eds., 2011), 63. The predominant view amongst scholars is that the provisions governing the determination of shares' fair value in such cases are mandatory. See, e.g., Mario Stella Richter jr., *Diritto di recesso e autonomia statutaria*, 45 RIVISTA DEL DIRITTO COMMERCIALE 389, 400 (2004). They are in fact thought of as a "minimum protection" of shareholders against opportunistic behaviour. Cf. also Giuseppe B. Portale & Alessandra Daccò, *Criteri e modalità "penalizzanti" per il recesso del socio di minoranza nella società a responsabilità limitata*, 3 RIVISTA DI DIRITTO SOCIETARIO 22, 28 (2009). Drawing from the mandatory nature of those provisions, notaries, with the support of prominent scholars, have concluded that a shareholder is entitled to receive the fair value of their shares also in other cases in which the company or another shareholder has the right to redeem the shares or the company has the right to expel a shareholder. Cf., also for references, Consiglio Notarile di Milano, *Massima No. 88 of 22 November 2005 "Clausole statutarie disciplinanti il diritto e l'obbligo di 'covendita' delle partecipazioni","* https://www.consiglionotarilemilano.it/massime-commissione-societa/88/. On the assumption that the regime determining the value of shares in the event of a redemption is mandatory, and that drag-along rights provisions are similar to redemption provisions (in that they enable one shareholder to cause another shareholder to divest), notaries have also argued that drag-along rights provisions are valid only if they include a proviso specifying the dragged-along shareholders shall receive "at least" the value that they would have received if they had exercised their withdrawal rights. *Id.* Courts then followed on that path. See Tribunale di Milano, 1 April 2008. By then, due also to the concurring theorization of the fair value of shares as the measure of the individual shareholder "property" in the firm (see *supra* note 75), the rule that protects fair value if a shareholder exercises their withdrawal right had already evolved into a wide-ranging principle—the "principle of fair value"—that with time became an unquestioned component of Italian corporate law in action. For details on the evolution of this regime, see, e.g., Mario Notari, *Exit forzato ed equa valorizzazione: un binomio indissolubile?* 20 ANALISI GIURIDICA DELL'ECONOMIA 383 (2021). Not only scholars but also courts and notaries consider the principle of fair value as part of mandatory corporate law. As the literature has reported, "the relevant charters constantly refer to the fair value determination, so that no contractual attempt can be observed to escape a principle that is clearly considered imperative." Giudici et al., *supra* note 14, at 811. On the other hand, courts have recently invoked it not only when examining the validity of expulsion provisions, but also, and above all, to curtail "new" private ordering solutions, such as those including a contract-based cap on the price that a shareholder exercising their withdrawal right can claim. See Tribunale di Roma, 15 January 2020.

[294] See *supra* text following note 264.

[295] See *supra* note 267.

[296] See art. 2441, commas 4, 5, codice civile (It.) (our own translation). For details, see, e.g., Enrico Ginevra, *Le azioni. Creazione ed estinzione*, *in* DIRITTO, *supra* note 139, at 259, 274-280.

the company's survival",[297] and others favouring a less stringent interpretation. This interpretation acknowledges that the subscription of shares by a third party is preferable to preserving pre-emptive rights if such a solution is itself instrumental to pursuing the interest of the company.[298]

Further, scholars who have addressed the issue opine that excluding pre-emptive rights to allow for the smooth functioning of anti-dilution provisions would serve exclusively the VCF's interest. This exclusion would only protect the VCF from having its cash-flow and control rights diluted, and hence cannot be held to be instrumental, let alone strictly necessary, to the pursuit of the company's interest.[299] As a consequence, no private ordering solution can permanently rule out the entrepreneur's pre-emption rights.

In SRLs, scholars point out that the relevant regime does not contemplate specific instances in which the firm's charter can exclude pre-emptive rights[300] and yet hold that private ordering enjoys some latitude in denying such rights,[301] including when this is necessary to allow for the smooth functioning of the arrangements aimed at protecting VCFs from economic dilution.[302] However, under Italian corporate law, any shareholder who has not voted in favor of a resolution that excludes pre-emptive rights has withdrawal rights,[303] and any ex ante waiver of these rights is null and void.[304] Scholars have stressed that such appraisal rights enable the entrepreneur to hold up the VCF, making the the relevant transactions much more friction-laden than in the U.S.[305]

Finally, the alternative arrangements found in Italian VC deals are not self-enforcing. VCFs simply have no guarantee whatsoever that the capital increase on which the issuance of additional shares to them is contingent will ever take place.[306]

[297] See, also for references, *id.*, at 278 (arguing that in SPAs blackletter corporate law defines the instances in which private ordering can exclude preemptive rights, that these instances are a *numerus clausus*, and that the requirement that the exclusion of preemptive rights "is allowed if the interest of the company so requires" warrants the very strict interpretation reported in the text).

[298] *Id*., at 278-279.

[299] See, e.g., Awwad, *supra* note 284, 1 at 85.

[300] Blackletter law generically provides that the firm's charter can include provisions authorising the firm to increase its capital by offering its newly issued shares to third parties. See art. 2481-bis, codice civile (It.). For details, see MARCO SPERANZIN, DIRITTO DI SOTTOSCRIZIONE E TUTELA DEL SOCIO NELLA S.R.L. 23-32 (2012). Scholars interpret this provision in relatively broad terms. See, e.g., Awwad, *supra* note 291, at 186. Practitioners endorse this view. Cf. Consiglio Notarile di Milano, *Massima No. 156 of 17 May 2016 "Contenuto della clausola che consente alla maggioranza di escludere o limitare il diritto di opzione nelle s.r.l.,"* https://www.consiglionotarilemilano.it/massime-commissione-societa/156/.

[301] For details, see Daccò, *supra* note 241, at 665-666.

[302] See, e.g., Awwad, *supra* note 291, at 185.

[303] See art. 2481-bis, comma 1, codice civile (It.).

[304] See art. 2473, codice civile (It.).

[305] Agstner et al., *supra* note 12, at 417; Awwad, *supra* note 291, at 187-189.

[306] Cf. Giudici et al., *supra* note 14, at 805 (acknowledging the imperfections of these provisions due to the procedural steps required to deliver the VCF the protection it has bargained for). One way out of the impasse could be, in theory, buy-sell agreements in shareholder agreements, which would enable VCFs and entrepreneurs to rebalance their equity positions as the changing circumstances require. In practice, however, these arrangements would only work if the VCF could buy a given fraction of the entrepreneur's shares at a low price. U.S-style anti-dilution provisions protect the VCF by automatically adjusting the conversion price of its shares, thus, preventing dilution without requiring the injection of new capital (see *supra* text corresponding to note 227). Thus, resorting to buy-sell agreements to grant the VCF a similar protection requires contracting parties to design them in such a way that the price at which the VCF can buy the shares is low enough to make up for the excessively high valuation it had assigned to the firm in the first round of financing or the artificially low price that the entrepreneur has agreed upon with the new funder(s). That is, these arrangements would work only if they were to assign the VCF a call option with a strike price of or near zero (we discuss the regulatory constraints preventing contracting parties from achieving that outcome when analysing the transplant of U.S.-style bad leaver provisions. See *infra* text

To conclude, the alternative arrangements delivering VCFs protection from economic dilution commonly found in German and Italian VC deals are of doubtful legality, prone to litigation, practically dysfunctional, and certainly not self-enforcing. It is apparent that they are not functionally equivalent to U.S. anti-dilution provisions.

2. Governance

U.S. VC-backed firms exhibit a peculiar governance model that ties the board's composition to the firm's performance, adapts shareholder and director duties to the peculiarities of the VC business model, and enables the VCF to exercise a significant influence, if not control, over the company. Other governance arrangements lock both the VCF and the entrepreneur in, give the VCFs to protect the size of its stake in the company, and empower them to severely punishes the entrepreneur in case of misbehaviour.

U.S. VC deals achieve this outcome via arrangements that grant VCFs director appointment and removal rights, corporate opportunity doctrine waivers, and protective provisions, as well as share transfer restrictions, pre-emptive rights regarding future share issuances, and bad leaver provisions.

i. Directors Appointment and Removal

Under U.S. VC contracts, convertible preferred shares carry special control rights until they are converted, namely: (1) the right to appoint a given fraction (generally half) of the directors;[307] (2) the right to appoint additional directors, and thus secure control of the board, if the firm performs poorly or in case of so-called "default events"—which include the VC-backed firm's failure to comply with the obligation to buy back the VCF's shares following its exercise of redemption rights.[308] VCFs exercise these rights by voting as a separate class.[309] To make sure that these directors advance the VCF's interest, U.S. VC contracts also include specific provisions in shareholder agreements that govern the voting process in the general shareholder meeting and assign the VCF the exclusive right to remove the directors it has appointed.[310] Appointment and removal rights are generally considered key in bridging information asymmetries and mitigating opportunism risk through board composition.[311] In addition, they ensure that VCF-appointed directors advance the VCF's interests and uphold the VC contract in a way that is consistent with its underlying economic rationale.[312]

Under German corporate law VCFs can be granted the right to appoint and remove corporate directors. In the AG, the charter can grant individual shareholders the right to appoint ("delegate") up to one third of the members of the supervisory board and also remove or replace

accompanying notes 417-470). German corporate law, however, prevents contracting parties from freely setting the strike price (see *supra* note 256). Under Italian corporate law, such buy-sell agreements would be incompatible with the principle of fair value—which applies irrespective of whether a given arrangement features in the firm's charter or in a shareholder agreement (see *supra* note 293). Moreover, these arrangements would not be self-enforcing. Consistent with these obstacles, to the best of our knowledge, transactional practice does not resort to such arrangements, which is a strong indicator that they are not a viable option.

[307] MAYNARD & WARREN, *supra* note 91, at 592-596.

[308] *Id.*, at 595. On the VCF's redemption rights, see *infra* text accompanying note 538.

[309] See again MAYNARD & WARREN, *supra* note 91, at 592, 594 (discussing the mechanics of voting for election appointment and removal).

[310] *Id.*, at 594-595.

[311] See Fried & Ganor, *supra* note 57, at 989-990.

[312] See, e.g., Robert P. Bartlett, III, *Shareholder Wealth Maximization as Means to an End*, 38 SEATTLE U. L. REV. 255, 262-269 (2015) (explaining that VC-backed firms' boards serve as the venue for dynamic bargaining between VFCs' and entrepreneurs' representatives and implementing the corporate contract).

the appointed directors at will.[313] The binding maximum number of supervisor board members to be delegated by individual shareholders precludes arrangements that would allow VCFs to appoint additional directors in a "default event" to have a majority of delegated directors dominate the board. The charter of a GmbH may allow individual shareholders to appoint and remove a given number, or even all, of the company directors,[314] and even grant them ad hoc appointment rights to take board control in the presence of "default events." Yet, in removing directors, VCFs are subject to fiduciary obligations *qua* shareholders: more specifically, the duty of loyalty implies that VCFs must exercise their removal rights in the company's interest, taking other stakeholders' interests into account.[315] In addition, shareholders' fiduciary duties have a horizontal dimension, requiring shareholders to adequately consider other shareholders' company-related interests.[316] Private ordering cannot depart from this mandatory regime,[317] which invites entrepreneurs to litigate any alleged "selfish" VCF decision to remove directors who do not act in its interest.

Italian corporate law takes an even stricter approach. It is interpreted as allowing arrangements that grant VCFs the right to appoint directors of a SPA in a separate meeting.[318] However, it erects obstacles to the complementary arrangements described above.[319]

On the one hand, it rules out the arrangements granting the VCF the right to appoint additional directors under specific circumstances. If a company issues shares with limited voting rights, such shares cannot exceed half of the company's overall outstanding capital.[320] From these blackletter law provisions scholars extrapolate the rule that the shareholders holding half of the company's outstanding capital—more specifically, of its common stock—

[313] §§ 101(2) and (4) and 103(2) of the AktG. These are mandatory provisions. See *supra* note 85 (explaining the rigidity of the AktG).

[314] Bundesgerichtshof, October 5, 1973, 27 WERTPAPIERMITTEILUNGEN 1295, 1296 (1973) (confirming that the charter can substitute appointment rights of individual shareholders for the shareholder meeting's competence under the default rule in § 46, No. 5 of the GmbHG). No such arrangements are permissible, though, if the GmbH is subject to co-determination, i.e. has more than 500 employees. See §§ 31, 33 of the Mitbestimmungsgesetz.

[315] Case law acknowledges that shareholders in the AG and the GmbH have fiduciary duties similar to those of directors. See, e.g., Bundesgerichtshof, 5 June 5, 1975, 64 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN 325, 329 and Bundesgerichtshof, 8 October 2007, 61 NJW 517, 519 (2008). German corporate law codifies directors' duties in §§ 93(1), sentence 1, and 116, sentence 1, of the AktG (respectively, for the members of the AGs' executive and supervisory boards), and in §43(1) of the GmbHG. These duties prescribe that directorial decision-making ought to advance the interest of the firm, which includes the interests of other stakeholders. See, e.g., Andeas Cahn, *§ 76*, *in* KÖLNER KOMMENTAR ZUM AKTG - VOL. 7, para. 25 (Ulrich Noack & Dirk Zetzsche eds., 4th ed., 2023); and *Id.*, *§ 93*, *in* ID., para. 112-113; Holger Fleischer, *§ 43*, *in* MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 2, para. 13 (Holger Fleischer & Wulf Goette (Eds), 4th ed. 2023).

[316] Bundesgerichtshof 1 February 1988, 103 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN 184, 195 (AG) and Bundesgerichtshof, June 5, 1975, 65 ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN 15, 18-9 (GmbH).

[317] For a discussion, see Alexander Hellgardt, *Abdingbarkeit der gesellschaftsrechtlichen Treuepflicht*, in FESTSCHRIFT FÜR KLAUS HOPT, *supra* note 262, at 765, 776-778.

[318] The general shareholder meeting has the exclusive competence to appoint directors. See art. 2364, §2, 2383, comma 1, codice civile (It.). Yet, the firm's charter may stipulate "special rules" for the appointment of directors. See art. 2368, comma 1, codice civile (It.). Drawing from these provisions, many scholars argue that arrangements enabling different classes of shareholders to vote in separate meetings are viable. For details and references, see Pierpaolo M. Sanfilippo, *Gli amministratori in* DIRITTO, *supra* note 139, at 461.

[319] See text accompanying note 308.

[320] See art. 2351, comma 2, codice civile (It.).

have to appoint the majority of directors.[321] Notaries' views on this issue diverge.[322] Arrangements that grant a specific class of shares the right to appoint the majority of directors are therefore of uncertain validity.

On the other hand, Italian law rules out arrangements granting the VCF the right to remove directors. As the Civil Code expressly provides, the general shareholder meeting can remove a director with or without cause.[323] This provision is interpreted as granting the shareholder meeting an unfettered right to remove directors as it sees fit.[324] This principle, in turn, implies that any arrangement that directly or indirectly limits the general meetings' power to remove directors, for instance by requiring a special majority or vesting other corporate actors with removal rights, is null and void.[325] Contracting parties could bypass this regulatory constraint in shareholder agreements. These arrangements, however, would not be self-enforcing.

Italian corporate law takes a different approach to directors' appointment and removal rights for SRLs, but the outcome is not much different than for SPAs. Shareholders of an SRL enjoy a significant latitude in defining the firm's internal structure,[326] particularly in designating the management body and appointing and removing directors.[327] Blackletter corporate law also permits shareholder rights *ad personam*, including rights relating to "the management of the company."[328] In interpreting blackletter corporate law, most scholars conclude that the firm's charter can include arrangements granting a shareholder the right to appoint some of the directors.[329] In SME SRLs,[330] the same result can be achieved by incorporating that right in special class of shares.[331] However, according to many scholars, private ordering is limited by another general principle of corporate law, namely that there must be a correlation between the "size" of an equity investment and the number and significance of the rights that come along with it.[332] This principle implies that a minority shareholder cannot

[321] See, e.g., Niccolò Abriani, *Art. 2351*, *in* IL NUOVO DIRITTO DELLE SOCIETÀ 310, 325 (Gastone Cottino et al. eds., 2004), 310, 325; and, also for further references, Sanfilippo, *supra* note 318, at 467 (arguing that private ordering cannot achieve the result of assigning the right to appoint a majority of the directors to a minority shareholder).

[322] Compare Consiglio Notarile di Milano, *Massima No. 142 of 19 May 2015 - "Categorie di azioni e diritto di nomina di amministratori e sindaci (artt. 2348 comma 2, 2351 commi 2, 4 e 5 c.c.)*," https://www.consiglionotarilemilano.it/massime-commissione-societa/142/ (concluding for the validity of charter provisions that grant one or more shareholders the right to appoint a majority or even the totality of directors irrespective of the number of shares they hold) with Consiglio notarile dei distretti di Firenze, Pistoia e Prato, *Orientamento No. 15/2010 in tema di "Categorie di azioni e nomina degli amministratori*," https://www.consiglionotarilefirenze.it/index.php/orientamenti/societa-di-capitali/azioni-e-quote/79-categorie-di-azioni-e-nomina-degli-amministratori-15-2010.html (concluding the opposite).

[323] See art. 2383, comma 3, codice civile (It.).

[324] See, e.g., Sanfilippo, *supra* note 318, at 480.

[325] *Id.*

[326] See Marco Cian, *La S.r.l.: la struttura organizzativa*, *in* DIRITTO, *supra* note 139, 696, 696.

[327] *Id.*

[328] Article art. 2468, comma 3, codice civile (It.). On rights *ad personam* in firms organized as SRLs, see generally *supra* note 137 and accompanying text.

[329] See, e.g., see Daccò, *supra* note 241, at 672.

[330] See *supra* note 64.

[331] cf. Consiglio, *Massima No. 171*, *supra* note 138 (shares may incorporate any of the rights *ad personam* that, under the general regime for SRL, the charter can assign to specific shareholders: see *supra* note 137).

[332] See, e.g., EUGENIO BARCELLONA, RISCHIO E POTERE NEL DIRITTO SOCIETARIO RIFORMATO FRA *GOLDEN QUOTA* DI S.R.L. E STRUMENTI FINANZIARI DI S.P.A. 12-13 (2012). This principle stems from the conviction that only shareholders who have made adequate investments have appropriate incentives to run the firm "responsibly." *Id.*

appoint a majority of directors.[333] Other scholars dispute the existence of such a principle and recognize the validity of private ordering solutions that grant one shareholder the right to appoint a majority of directors.[334] Although practitioners share the latter view,[335] it is at least uncertain whether Italian courts would sanction these arrangements as viable.

In addition, all directors, including those appointed by a shareholder, are always bound by the duty of loyalty.[336] They thus have to advance the interest of the firm as a whole and cannot further the interest of a specific shareholder.[337] This duty cannot be opted out of and implies, *inter alia*, that directors cannot make decisions that would harm the firm, irrespective of the expectations and instructions of the shareholders appointing them.[338] These restrictions on appointed directors' powers increase litigation risk and thus decrease the arrangement's functionality relative to its U.S. counterpart.

VCFs and entrepreneurs seek to bypass constraints under German and Italian corporate laws, particularly those stemming from the directors' duty of loyalty, through alternative arrangements granting VCFs the right to appoint so-called board observers. Indeed, board observers have always been rather common in U.S. VC deals too.[339] Although they attend board meetings, provide valuable insights, and contribute to discussions with a view to reporting back to their sponsors, board observers have no voting rights and, therefore, cannot steer the firm in any direction.[340] Board observers are therefore an imperfect substitute for VCF-appointed directors.

To sum up, German and Italian corporate laws prevent VCFs and entrepreneurs from adopting directors' appointment and removal rights *à la Delaware*. While arrangements relating to board representation are valid to some extent, arrangements allowing VCFs to secure board control in default events and steer the firm's decision-making in a self-serving direction are ruled out. Alternative arrangements may address information asymmetries but fail as tools to ensure that the board makes choices favourable of the VCF.

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[333] See, e.g, Eugenio Barcellona, *«*Control enhancing mechanisms*» e «*governance*» della società a responsabilità limitata: quali limiti all'autonomia privata?*, 7 RIVISTA ORIZZONTI DEL DIRITTO COMMERCIALE 61, 71-76 (2019).

[334] See.e.g., Mario Notari, *Diritti "particolari" dei soci e categorie "speciali" di partecipazioni*, 3 ANALISI GIURIDICA DELL'ECONOMIA 325, 331 (2003).

[335] See Consiglio Notarile di Milano, *Massima No. 39 of 19 November 2004 - "Diritti particolari dei soci nella s.r.l.,"* https://www.consiglionotarilemilano.it/massime-commissione-societa/39/. Note, however, that the same document stresses that private ordering solutions should be deemed viable only within the boundaries set by the "general limits of the legal system." *Id*. The specific meaning of such "general principles" is hardly discernible ex ante, though. This implies an additional layer of legal uncertainty.

[336] For details, see Domenico Mosco & Salvatore Lopreiato, *Doveri e responsabilità di amministratori e sindaci nelle società di capitali*, 63 RIVISTA DELLE SOCIETÀ 117, 117-121 (2019) (discussing in depth the foundations of fiduciary duties and their prescriptive contents under Italian law).

[337] In the case law, see Corte di Cassazione, 24 August 2004, No. 16707 (stressing the crucial role of the company's interest in guiding directors' decision-making and assessing their actions). In the literature, see, e.g., Mosco & Lopreiato, *supra* note 336, at 120 (explaining that corporate directors have the duty to advance the interest of the firm and to ignore the incentives stemming from any "other interest").

[338] Cf. Cian, *supra* note 326, at 699-700 (explaining that the firm's charter can grant shareholders the right to instruct the directors as to the course of action they should take, but that directors must refuse to implement shareholders' instructions if their implementation has "the potential to harm the company and expose directors to liability").

[339] See FELD & MENDELSON, *supra* note 91, at 68-69.

[340] For details, Nizan Geslevich Packin & Anat Alon-Beck, *Board Observers* (2024), https://ssrn.com/abstract=4745278, 6.

ii. Protective Provisions

In U.S. VC contracts, "protective provisions" (also known as "negative covenants") stipulate that the VCF has a veto right on specific actions, as long as a majority of the convertible preferred shares are outstanding.[341] The actions that require the VCF's approval typically are those that (i) can impair its convertible preferred shares' attributes, (ii) result in distributions to shareholders, including through dividends, (iii) can result in the sale of the company, regardless of the transaction's form, or its winding up, and (iv) typically fall within the scope of the traditional covenants that a lender imposes on a borrower.[342] These provisions enable the VCF to protect their investment irrespective of their equity share.[343]

Some scholars contend that U.S.-style protective provisions are unnecessary in German and Italian VC deals because default corporate law already mandates shareholder approval for some of the transactions falling within their scope.[344] However, the set of transactions requiring shareholder approval is more limited than that covered by standard protective provisions.[345] Therefore, U.S.-style protective provisions would hold significant value also in German and Italian VC deals. Yet, both German and Italian corporate laws make their transplant a complicated exercise.

The corporate law regime for German AGs lays down board and shareholder competences through mandatory provisions.[346] Granting shareholders veto rights on matters falling within the management or supervisory board's remit is therefore unlawful. Moreover, although statutory law allows for the creation of a special class of shares vested with the right to approve certain transactions in a separate resolution,[347] special resolution rights can only be established for shareholder competences stipulated in the Stock Corporation Act.[348] They cannot increase the space for U.S.-style protective provisions by shifting board competences to shareholders. Even within these strict limits, the exact boundaries of the enabling provision remain unclear,[349] raising additional doubts as to the extent to which protective provisions *à la Delaware* would be valid in the AG. Finally, German corporate law prohibits voting caps[350] and veto rights can be understood as content-specific voting caps for the entrepreneur. Hence,

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[341] See generally, MAYNARD & WARREN, *supra* note 91, at 596.

[342] Id., at 597-598, 599, 599-600, 600-603 (discussing the various types of protective provisions).

[343] PEARCE & BARNES, *supra* note 91, at 145.

[344] See, e.g., KUNTZ, *supra* note 14, at 564 (arguing that some of the transactions that in U.S. VC deals require shareholder approval because of protective provisions are already subject to shareholder approval under default German corporate law), and ZANONI, *supra* note 14, 174 (making a similar point, albeit only for SPAs).

[345] PEARCE & BARNES, *supra* note 91, at 145 (noting that the protective provisions cover a broader set of transactions than those with regard to which the VCF may already enjoy special protection under the default corporate law regime, "for example[,] under German law."). Compared to standard U.S. protective provisions, the Italian corporate law regimes are similarly underinclusive. *Cf.* ZANONI, *supra* note 14, at 174, 181 (hinting at the underinclusiveness of the regime governing SPAs and discussing solutions that may overcome or at least mitigate it).

[346] See AktG, §§ 76 para 1, 111, 112, and 119 (defining the competences of the management and supervisory board).

[347] See AktG, § 138. In the literature, see, e.g., Jochen Vetter, *§ 138*, *in* KÖLNER KOMMENTAR ZUM AKTG – VOL 3.1, para 71 (Ulrich Noack & Wolfgang Zöllner eds., 3rd ed., 2019) (contracting parties use separate resolution rights for certain share classes to implement veto rights).

[348] Jens Koch, *§ 138*, *in* AKTIENGESETZ, *supra* note 105, at para. 2.

[349] The literature has debated extensively whether and to what extent the firm's charter can include special resolution requirements. For a discussion, see, e.g., Vetter, *supra* note 347, at para. 71-75 (explaining that the preconditions and criteria under which the firm's charter can establish special resolution requirements are not clearly defined).

[350] See AktG, § 134 para. 1 and 5.

one can conceptualise them as functional substitutes for such caps, implying that they would fall within the scope of the relevant prohibition and generally be null and void.[351]

Even under the more permissive corporate law regime for GmbHs, protective provisions may not unleash their full potential. Contracting parties may shape the competencies of a GmbH's internal bodies as they see fit[352] and shareholders can give instructions to the firm's management.[353] Therefore, private ordering solutions granting VCFs veto rights would appear to be viable in principle. Yet, shareholder veto rights may not be designed in such a way as to interfere with managerial decisions aimed to: (a) prevent payouts to shareholders in violation of capital maintenance rules, (b) ensure proper book-keeping, and (c) avoid making payments that would reduce corporate assets once the company is close to insolvency.[354] For VCFs in poorly performing firms, this mandatory reserve of managerial power may prove problematic because it also prevents establishing veto rights with regard to some critical transactions, such as bankruptcy filings.[355] Even more importantly, shareholder actions are subject to the duty of loyalty also in the GmbH,[356] preventing veto rights from becoming tools the VCF could use in their sole interest.[357]

Protective provisions are similarly problematic in SPAs and SRLs. Contracting parties may be reluctant to implement the entire set of protective provisions and/or to freely exercise the ensuing rights to avoid the risk of liability under the regime governing corporate groups.[358] Under Italian group law, any entity that, in directing the operations of a controlled corporation, acts in its own interest and thereby induces the management of such controlled company to take actions that are contrary to what is vaguely termed "principles of correct corporate management" is liable towards shareholders and creditors of the subsidiary for any resulting damage.[359] Case law, with the support of some scholars, has concluded that this regime may also apply to investment funds with respect to their portfolio firms.[360] As a result, if VCFs are granted significant veto rights over a portfolio company and, as VC firms often do, take an active role in its management, they risk being qualified as directing the corporation's operations. On these grounds, they can be held liable for the damages caused at the subsidiary by unlawfully instructing it to act or refrain from acting in a specific manner. The prospect of such liability has reportedly given rise to significant concerns amongst VC firms.[361]

[351] KUNTZ, *supra* note 14, at 621.

[352] See GmbHG, § 45 para. 1. In the literature, see, e.g., Ulrich Noack, *§ 46*, *in* GMBHG, paras. 5-6 (Ulrich Noack et al. eds., 23rd ed. 2022).

[353] See GmbHG, § 37 para. 1. In the literature, see, e.g., Michael Beurskens, *§ 37*, *in* GMBHG, *supra* note 352, at para. 30.

[354] *Cf.* GmbHG, §§ 30, 41, and 64.

[355] See Klaus-Dieter Stepan & Johannes Tieves, *§ 37* in MÜNCHENER KOMMENTAR ZUM GMBHG - VOL. 2, para. 137 (Holger Fleischer & Wulf Goette eds., 4th ed. 2022).

[356] BGH, Nov. 19, 1990, 44 NEUE JURISTISCHE WOCHENSCHRIFT 848 (1991).

[357] Fiduciary obligations also apply if veto rights are established in shareholder agreements See Johannes Wertenbruch, *Beschlussfassung und Pflichtverletzung im Stimmrechtskonsortium*, 12 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 645, 648 (2009).

[358] See artt. 2497-2497-septies, codice civile (It.).

[359] Artt. 2497, codice civile (It.).

[360] See Tribunale di Milano, 4 May 2017, and Tribunale di Milano, 9 January 2018 (both concluding that the regime described in the text applies to fund managers). In the literature, see, e.g., Giuseppe Ferri jr., *Soggettività giuridica e autonomia patrimoniale nei fondi comuni di investimento*, 19 RIVISTA ORIZZONTI DEL DIRITTO COMMERCIALE 3 (2015); Fabio Nieddu Arrica, *Partecipazioni di controllo, gestione «attiva» delle* portfolio companies *e attività di direzione e coordinamento*, 20 ANALISI GIURIDICA DELL'ECONOMIA 287 (2021).

[361] See Andrea di Castri, *Quanto la disciplina della responsabilità da direzione rischia di travolgere le SGR?*, *Il Quotidiano Giuridico – online*, 2 December 2020, https://www.altalex.com/documents/2020/12/02/quanto-la-disciplina-della-responsabilita-da-direzione-rischia-di-travolgere-le-sgr (reporting that the relevant case law generated concerns amongst local private equity and VC investors and that the increased risk of liability may deter investments).

Contracting parties cannot resort to shareholder agreements to get around the critical rigidities we document. In Germany, these arrangements cannot expand the remit of shareholder competences.[362] Besides, shareholder agreements could not guarantee unconditional veto rights for the VCF to pursue their own interests because the exercise of voting rights would remain subject to the fiduciary duty of loyalty, requiring voting behaviour to be in line with the company's interest.[363] Moreover, even if these shareholder agreements were viable, they would not be self-enforcing.[364] In Italy, shareholder agreements cannot reduce the liability risk arising from the position of *de jure* or *de facto* control and the exercise of the related influence that protective provisions entail and enable.

To conclude, German and Italian corporate laws do not make it easy to replicate protective provisions in VC deals. If available at all, the protective provisions featured in German and Italian VC deals may fail to extend as broadly as the corresponding arrangements of U.S. VC deals. Even when protective provisions have a broad scope, the exercise of the resulting veto rights is, unlike in the U.S., subject to some scrutiny through standards of various types, leading to litigation risk and/or exposing VCFs to liability. One way to secure the same level of protection would be to hold a majority equity stake in the portfolio company. Empirical evidence suggests that this is what VCFs operating locally do.[365] However, this alternative obviously comes with the drawback of lower portfolio diversification and higher risk for VCFs, which implies a higher cost of capital for entrepreneurs.

iii. Corporate Opportunity Waivers

Under U.S. VC contracts, VC-backed firms' charters include broad corporate opportunity waivers. With such waivers, the corporation relinquishes its interest in all or some potential business opportunities and allows the VCF *qua* controlling shareholder and the directors it has appointed to exploit business opportunities with no need for board or shareholder approval and no litigation risk.[366] By reallocating ex ante property rights in future business opportunities, these private ordering solutions facilitate their efficient exploitation, as well as help VCFs save on transaction costs.[367] Empirical evidence shows that private ordering in this context has been key to stimulating VC investments in the U.S. without increasing managerial malfeasance.[368]

While German corporate law is partly hospitable towards these solutions, Italian corporate law rejects them altogether.

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[362] See, e.g., Andreas Pentz, *§ 23 in* MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ - VOL. 1, para. 195 (Wulf Goette & Mathias Habersack eds., 6th ed., 2024) (explaining that only shareholder affairs can be regulated in shareholder agreements).

[363] BGH, Nov. 24, 2008, 179 BGHZ 13 para. 15 (explaining that the duty of loyalty constraints voting predetermined in shareholder agreements). The majority of commentators agrees. See, e.g., Koch, *supra* note 105, at para. 45.

[364] See *supra* note 38 and accompanying text.

[365] See Guler & Guillén, *supra* note 10, at 190, 196 (hypothesising that VCFs active in countries with more rigid legal regimes secure a majority stake in portfolio firms to obviate the impossibility of writing U.S.-style state-contingent agreements).

[366] See § 122(17) of the DGCL. The case law has clarified that corporate opportunity waivers can be broad but not generically refer to "all" the business opportunities that a firm may potentially have an interest in. See *Alarm.com Holdings, Inc. v. ABS Capital Partners Inc*., No. 360, 2018 (Del. Feb. 7, 2019).

[367] See Gabriel Rauterberg & Eric L. Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1104-1113 (2017) (explaining how private ordering can contribute to the efficient allocation of business opportunities).

[368] Ofer Eldar et al., *Common Venture Capital Investors and Startup Growth*, 37 REV. FIN. ST. 549 (2023).

Both German and Italian corporate laws include corporate opportunity doctrines as codified or uncodified specifications of the duty of loyalty[369]—which, as discussed, cannot generally be opted out.[370]

Under German corporate law, shareholders and members of the management board, and, where applicable, the supervisory board need the authorization from the corporation's competent bodies if they intend to exploit corporate opportunities.[371] Although German corporate law rules out a general waiver of the underlying fiduciary duty in both AGs and GmbHs,[372] it allows contracting parties to specify the duty of loyalty in the charter of GmbHs. That includes waiving the corporate opportunity doctrine not only for specified business opportunities but also for classes of opportunities.[373]

Directors and controlling shareholders of Italian companies must obtain an authorization if they want to exploit a corporate opportunity,[374] but less room is left to private ordering than in Germany. According to legal scholars, the corporate opportunity doctrine is key to preserving the corporation's ability to appropriate potential future business opportunities that may contribute to expanding its assets,[375] and thus to protecting not only its shareholders' but also its creditors interests.[376] This regime, which is held to apply irrespective of the firm's organizational form,[377] is regarded as mandatory.[378] Therefore, explicit waivers of the corporate opportunity regime *à la Delaware* are not an option in Italy.

To the best of our knowledge, VCFs and entrepreneurs in German AGs and in Italian companies have not sought to elaborate alternative arrangements that, where required, may make up for the unavailability of the U.S.-style solutions we have described.

To conclude, under German law VCFs and entrepreneurs may opt out of the duty of loyalty as regards corporate opportunities, so long as they choose the GmbH, while in Italy parties may not do so. To be fair, the risk of fiduciary duties litigation in Italy is much lower

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[369] German legal scholars have elaborated an uncodified business opportunity doctrine that courts have then applied. For details, see generally HELLGARDT, *supra* 317; Klaus J. Hopt & Markus Roth, *Die Treuepflicht des Vorstands der Aktiengesellschaft in* GEDÄCHTNISSCHRIFT FÜR LEONIDAS GEORGAKOPOULOS – VOL. 1, 293 (Dēmētrēs Tzouganatos ed., 2016). Under Italian corporate law, the relevant rule can be found in art. 2391, comma 6, codice civile (It.).

[370] See, respectively *supra* text accompanying note 315, for Germany, and *supra* text accompanying note 86 for Italy.

[371] For details and references, see *supra* notes 315 and 317 and accompanying text. The duty of loyalty is tied to the corporation's purpose. See *supra* note 74. Thus, it is binding not only for shareholders but also executive and supervisory board members in both the AG and the GmbH. See also §§ 93 and 116 of the AktG and § 52(1) of the GmbHG.

[372] See GREGOR BACHMANN ET AL., RECHTSREGELN FÜR DIE GESCHLOSSENE KAPITALGESELLSCHAFT, Berlin 103 (2012).

[373] See, e.g., Holger Fleischer & Lars Harzmeier, *Zur Abdingbarkeit der Treuepflichten bei Personengesellschaften und GmbH*, 18 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 1289, 1296 (2015); and KUMPAN, *supra* note 372, at 505-506.

[374] See, e.g., Francesco Barachini, *L'appropriazione delle* corporate opportunities *come fattispecie di infedeltà degli amministratori di S.p.a.*, *in* IL NUOVO DIRITTO DELLE SOCIETÀ – *LIBER AMICORUM* GIAN FRANCO CAMPOBASSO – VOL. 2 (Pietro Abbadessa & Giuseppe B. Portale eds., 2006), 603, 625-629 and 653.

[375] *Id.*, at 320.

[376] *Id*. The reason why Italian scholars connect the business opportunity to creditor protection is that creditors have the right to sue directors if they fail to comply with their duties as regards the preservation of the firm's assets. See artt. 2394, 2476, comma 6, codice civile (It.), respectively for SPAs and SRLs.

[377] Italian corporate law scholars agree that this regime, formally laid down for SPAs, applies to SRLs as well. See, e.g., GIUSEPPE ZANARONE, DELLA SOCIETÀ A RESPONSABILITÀ LIMITATA 960 (2010).

[378] Italian scholars generally consider the duty of loyalty and the regime governing conflicts of interest mandatory. See *supra* note 86.

than in the U.S.,[379] which makes restrictions on private ordering less consequential than they would otherwise be.

iv. Share Transfer Restrictions

U.S. VC-backed firms' charters stipulate that the VCF and/or the entrepreneur cannot transfer their shares until specific events materialize (e.g., a trade sale) as opposed to lock-ins for a given timespan (e.g., five years).[380] Constraining VCFs' and entrepreneurs' ability to trade in their shares is crucial for both parties. On the one hand, the VCF may want to lock the entrepreneur in because innovative firms' success largely depends on entrepreneurs' firm-specific human capital investment, particularly during their early stage.[381] On the other, the entrepreneur may want to lock the VCF in because its expertise and sustained engagement may be crucial for the success of the venture.[382]

Under German and Italian corporate laws, such bans on share transfers are problematic. Contracting parties can, in principle, agree on limitations on share transfers. However, commitments not to divest are subject to various limits.

In principle, German corporate law allows parties to restrict the transfer of AGs' shares through arrangements in the firm's charter.[383] However, the relevant arrangements cannot be drafted as purely state-contingent restrictions. Instead, they need to make a share transfer contingent on the discretionary decision of the executive board or another corporate body.[384] These procedural requirements also prohibit arrangements that seek to mimic state-contingent restrictions and stipulate that the relevant corporate body must withhold their consent in predetermined cases (e.g., a share transfer, independent of a liquidity event), which the majority of scholars sees as *de facto* bans on share transfers, therefore considering them void.[385] Thus, bans on share transfers *à la* Delaware are simply unviable in AGs.

On the contrary, the charter of GmbHs may ban share transfers.[386] However, mandatory law protects shareholders from the "risk of imprisonment" granting them an "extraordinary

[379] See, e.g., Pierre-Henri Conac, Luca Enriques, & Martin Gelter, *Constraining Dominant Shareholders' Self-dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. COMP. & FIN. L. REV. 491, at 507-523 (discussing the regime against self-dealing in Italy, and pointing out the weaknesses in the enforcement apparatus).

[380] See FELD & MENDELSON, *supra* note 91, at 93 (pointing out that the standard solution to enable VCFs to have full control over the shareholder basis has historically been radical bans on share transfers, implying that entrepreneurs could not sell their shares "until the investors could sell their shares, through either an IPO or a sale of the company.").

[381] Edward B. Rock & Michael L. Wachter, *Waiting for the Omelette to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 1999 J. CORP. L. 913, 918-921 (1999) (stressing the importance of human capital in early-stage firms).

[382] See, e.g., PEARCE & BARNES, *supra* note 91, at 203-204 (stressing also that the entrepreneur's interest in constraining VCF's ability to sell its shares has become even more important as so-called "secondary funds" have emerged).

[383] To be sure, German corporate law explicitly permits this option only for registered shares. See § 68 para. 2 sentence 1, of the AktG. Legal scholars consider transactions that violate these share transfer restrictions as void. See, e.g., Andreas Cahn, *§ 68 in* BECKONLINE GROßKOMMENTAR ZUM AKTIENRECHT, para. 31 (Eberhard Stilz & Rüdiger Veil eds., 2024).

[384] See Markus Lutter & Tim Drygala, *§ 68 in* KÖLNER KOMMENTAR ZUM AKTIENGESETZ, para. 66 (Wolfgang Zöllner & Ulrich Noack eds., 3rd ed., 2011).

[385] See, e.g., Walter Bayer, *§ 68 in* MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, para. 62 (Wulf Goetthe & Mathias Habersack, 6th ed. 2024); for the minority position permitting such prohibtions, see Markus Lutter & Tim Drygala, *§ 68*, *in* KÖLNER KOMMENTAR ZUM AKTIENGESETZ, para. 70 (Wolfgang Zöllner & Ulrich Noack eds., 3rd ed., 2011).

[386] GmbHG, § 15 para. 5. German corporate law stipulates that the firm's charter may make the transfer of shares contingent on "further conditions," allowing for a U.S.-style state-contingent design of the restrictions on

right to leave the company," regardless of the restrictions on share transfers in the company's charter.[387] Courts may find compelling reasons for an extraordinary exit from the company in situations where the arrangements seek to lock parties in.[388] Therefore, these arrangements suffer from significant limitations and cannot compare with their U.S. counterparts.

Italian corporate law takes a similar approach. In SPAs, such bans are only valid if they include a proviso stipulating a five-year limit.[389] In SRLs, the charter can include bans with an indefinite lifespan, but each shareholder shall then have the right to withdraw from the company at any time.[390] The charter may postpone the exercise of this exit option for a maximum of two years after the ban's adoption.[391] The logic of this regime is to prevent the shareholder's "imprisonment,"[392] which comes at the cost of preventing parties from achieving the desired results.

Contracting parties have devised alternative arrangements in both jurisdictions. In Germany the arrangement of choice is an outright ban on share transfers in shareholder agreements, which most scholars deem viable.[393] Placing the ban within a shareholder agreement, however, means the VCF would need to seek injunctive relief if the entrepreneur attempts to sell shares in violation of the prohibition.[394] Thus, this alternative arrangement comes at the price of higher enforcement risk and is, therefore, functionally inferior to its U.S. counterpart.[395] Including outright bans on the transfer of Italian SPAs' shares into shareholder agreements would not help, because blackletter law stipulates that shareholder agreements are also subject to a five-year sunset clause.[396] No such sunset clause exists for shareholder agreements regarding SRLs.[397] Yet, for the reasons mentioned above,[398] limitations on share transfers included in shareholder agreements are functionally inferior to those included in the firm's charter.[399]

Another alternative arrangement in German and Italian VC deals grants each contracting party a right of first refusal. Rights of first refusal, however, cannot prevent contracting parties from abandoning the VC-backed firm. To be sure, those arrangements do succeed in protecting either contracting party's interest not to see any change in share ownership, but even that only

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share transfers. See § 15(5) of theGmbHG. In the case law, see RGZ 80, 179, and BayObLG DB 1989, 214, 215-216. In the literature, also for further references, see, e.g., Marc Löbbe, *§ 15*, *in* GMBHG - VOL. 1, at para. 221 (Mathias Habersack et al. eds., 2021).

[387] See BGH, Dec. 16, 1991, 116 BGHZ 92. In the literature, see, e.g., Marc-Philippe Weller & Jochem Reichert, *§ 15*, *in* MÜNCHENER KOMMENTAR ZUM GESETZ BETREFFEND DIE GESELLSCHAFTEN MIT BESCHRÄNKTER HAFTUNG, paras. 5-6 (Holger Fleischer & Wulf Goette eds., 4th ed., 2022).

[388] The literature has sought to map the reasons that can justify such an exit. See, e.g., Jonas Bühler, *Der Austritt aus der GmbH*, 27 NZG 811 (2024) (showing that both the personal circumstances of shareholders and the state of the firm may legitimise divestment).

[389] See 2355, comma 1, codice civile (It.). For details, see, e.g., Lorenzo Stanghellini, *Articolo 2355-bis c.c. Limiti alla circolazione delle azioni in* COMMENTARIO ALLA RIFORMA DELLE SOCIETÀ – VOL. 2: AZIONI. ARTT. 2346-2362, 559 (Mario Notari ed., 2008).

[390] art. 2469, comma 2, codice civile (It.). For details, see Danilo Galletti, *Art. 2469 c.c.*, *in* CODICE COMMENTATO DELLE S.R.L., *supra* note 304, 148.

[391] See again art. 2469, comma 2, codice civile (It.). For details, see *id*.

[392] *Id.*, at 148-151.

[393] See, also for further references, e.g., Cahn, *supra* note 383, at para. 39.

[394] *Id.* (highlighting this specific aspect).

[395] Generally on the effectiveness of relocating private ordering solutions that would be optimally included in the firm's charter into shareholder agreements, see, also for references, *supra* text preceding note 37.

[396] See *supra* note 78.

[397] Under current case law a shareholder has the right to terminate a shareholder agreement with indefinite duratioNo. See Tribunale di Milano, 4 January 2022. Contracting parties could sidestep this requirement by agreeing on a relatively long, but not indefinite and therefore not state-contingent, duration.

[398] See *supra* text preceding note 395.

[399] See *supra* text preceding note 37.

at the cost of making additional investments. A scenario in which a cash-strapped entrepreneur may actually buy out the VCF is implausible and one in which the VCF buys out the entrepreneur is not ideal for the VCF, because it would have to commit additional funds without providing fresh capital to the firm. Moreover, the additional acquisition of shares may well be incompatible with the VCF's investment policy and strategies.[400] Finally, the right of first refusal may also serve as a hold-up tool for the entrepreneur, who could threaten to leave to extract value from the VCF.

Overall, VCFs and entrepreneurs bargaining under German and Italian corporate laws cannot adopt the share transfer restrictions commonly found in U.S. VC deals. Rather, they must content themselves with inferior alternative arrangements.

v. Pre-emptive Rights

In U.S. VC deals, VCFs frequently negotiate provisions granting them pre-emptive rights tailored to the specific needs of VCFs and entrepreneurs.[401] These arrangements are key to protecting VCFs from dilution.[402] Practitioners emphasize that customised pre-emptive rights arrangements have significantly helped high-growth companies secure VC financing. They caution that regimes prohibiting such customization along dimensions valued by VCFs and entrepreneurs may place these companies at a competitive disadvantage when raising capital.[403]

German and Italian corporate laws provide pre-emptive rights for shareholders when the company issues new shares.[404] This implies that VCFs and entrepreneurs do not have to negotiate over these protections. Yet, the law codifying pre-emptive rights is largely mandatory,[405] and, as we have seen,[406] even where waivers are permissible, the relevant regimes subject private ordering to significant strictures. In fact, statutory pre-emptive rights in Germany and Italy alter the functioning of the alternative arrangements supplanting U.S.-style anti-dilution provisions.[407] Therefore, the German and Italian regimes impose unjustified costs on contracting parties, because they grant VCFs protections that they would bargain for anyway but leave less room for tailoring them to the economic rationale of the VC deal.

vi. Bad Leaver Provisions

VCFs cannot fully assess the personal qualities of the entrepreneur before they invest.[408] After the investment, information asymmetries entail the risk that the entrepreneur may opportunistically take advantage of their controlling position within the VC-backed firm to

[400] Portfolio diversification is a key objective in the investment policy of any VC firm. See *supra* note 95 and accompanying text. The agreement governing VC funds typically stipulates that VCFs will lay down the policy and strategies to achieve optimal portfolio diversification, including, *inter alia*, by defining the size of the investments in each portfolio company, to prevent that VCFs salvage poorly performing companies. See Paul A. Gompers & Josh Lerner, *The Use of Covenants: An Empirical Analysis of Venture Partnership Agreements*, 39 J. L. & ECON. 463, 480 (1996).

[401] See, e.g., PEARCE & BARNES, *supra* note 91, at 185-190.

[402] *Id.*, at 185.

[403] *Id.*, at 185-186.

[404] German corporate law explicitly provides pre-emptive rights for shareholders of AGs and extends the relevant provisions by analogy to GmbHs. See *supra* note 264. Italian corporate law stipulates the same protections as regards firms organized as both SPAs and SRLs. See artt. 2441, comma 1, 2481-bis, codice civile (It.).

[405] See *supra* text accompanying notes 268 and 296.

[406] See *supra* text accompanying note 275-280.

[407] *Cf.* Ginevra, *supra* note 296, at 277-278 (emphasising the costs that this regime imposes on contracting parties under Italian corporate law).

[408] See Gilson, *supra* note 5, at 1077.

advance their own agenda[409] or otherwise jeopardise the relationship with the VCF by engaging in grossly negligent or self-serving behaviour.[410] U.S VC contracts mitigate this problem by including bad leaver provisions in the firm's charter.[411] These provisions grant the VC-backed firm and/or the VCF the right to buy the entrepreneur's shares following misbehaviour.[412]

Standard bad leaver provisions have two key features. First, they define a number of trigger events, including fraud, theft, gross misbehaviour or exceeding limits of authority.[413] Second, they impose a highly punitive purchase price,[414] thus discouraging rent-seeking behaviour and motivating entrepreneurs to provide optimal effort while refraining from opportunistic actions.[415]

German and Italian corporate laws erect insurmountable obstacles to U.S.-style bad leaver provisions. This is because both corporate law regimes in action view any transaction resulting in the forced buyout of a shareholder unfavourably.[416]

One transactional form in which under German law a buyout can be executed is a share redemption. While AGs' charters may include arrangements granting the company the right to redeem shares,[417] bad leaver provisions building upon such redemption rights are likely unenforceable for two reasons. First, building on blackletter law[418] and with the support of scholars,[419] courts argue that the AGs charters may not require shareholders to contribute anything beyond the capital that they have contractually committed to provide.[420] Hence scholars qualify arrangements that even have the mere potential of exacting ancillary contributions from shareholders, including managerial services, as null and void.[421] Drawing from this construct, scholars argue that the threat of redemption can serve to obtain additional contributions from a specific shareholder and thus consider the relevant arrangements null and void.[422] Bad leaver provisions that rely on redemption rights may therefore be declared null and void on these grounds, regardless of whether they grant the redemption right to the firm or to the VCF. Second, case law requires charters to specify the trigger events for the exercise of

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[409] Fried & Ganor, *supra* note 128, at 989.

[410] Klausner & Litvak, *supra* note 5, at 56 (hinting at the risk that entrepreneurs *qua* managers might act carelessly or divert firm resources to themselves).

[411] Luc Wynant et al., *How Private Equity-backed Buyout Contracts Shape Corporate Governance*, 25 VENTURE CAPITAL 135 (2023). To be sure, VC contracts address this problem also via board representation, which enables VCFs to monitor entrepreneurs. See Fried & Ganor, *supra* note 57, 989-990. Still, bad-leaver provisions enable VCFs to punish entrepreneurs for misbehavior that the board may have failed to prevent and thus discourage entrepreneurs' misconduct ex ante.

[412] See PEARCE & BARNES, *supra* note 91, at 181.

[413] *Id*.

[414] Wynant et al., *supra* note 411, at 147 (explaining the economic rationale for penalizing pricing in bad leaver provisions).

[415] See Hellmann, *supra* note 5, at 58 (discussing the incentivizing function of arrangements setting a low buyout price).

[416] We use the term "forced buyout" for the convenience of international readers, although we are aware that German (and, with some qualifications that are of no relevance here, Italy's) corporate law doctrine construes the relevant transactions as heteronomous expulsions, requiring, as a matter of law, compensation for the lost equity stake.

[417] See AktG, § 237 para. 1.

[418] See AktG, § 54 para. 1 (providing that "[t]he duty of the stockholders to make contributions is limited by the issue price of the shares of stock") and AktG, § 55 para. 1 (allowing "incidental" shareholder obligations "in addition to making contributions to the capital stock" only under narrow circumstances that must be prespecified in the charter).

[419] In the literature, see, e.g., BARBARA GRUNEWALD, DER AUSSCHLUSS AUS GESELLSCHAFT UND VEREIN 55 (1987).

[420] In the case law, see e.g., OLG Karlsruhe OLGR 43, 309.

[421] See *supra* text accompanying notes 182-183.

[422] See, KUNTZ, *supra* note 14, at 725-729.

redemption rights by the company,[423] unless the redemption is resolved upon *ad hoc* by a supermajority of shareholders.[424] Failure to comply with this specification requirement implies that the relevant arrangement is null and void,[425] invalidating clauses that, in an attempt to replicate U.S. provisions,[426] generically allow for redemptions in case of "misconduct" or "breach of fundamental obligations."

GmbH charters may grant the firm—yet not the VCF—the right to buy out the entrepreneur through "expulsion provisions."[427] Such provisions are permissible, *inter alia*, to ensure the diligent execution of the entrepreneur's management duties[428] and are not subject to stringent pre-specification requirements.[429] Nonetheless, the exact perimeter for private ordering is hazy.[430] Notably, courts and scholars generally recognize the legitimacy of share redemption provisions designed to remove disruptive shareholders whose presence endangers inter-shareholder relationships and, consequently, the firm's continued viability.[431] However, they also consider a forced buyout as a severe "sanction" that can only be applied as the "extreme solution."[432] A forced buyout must also be just and reasonable from the perspective of the shareholder whose equity interest is at stake. Therefore, the shareholder can demand a judicial review of the underlying resolution under a duty of loyalty standard.[433] Whether the preconditions for a forced buyout are met in the typical circumstances in which bad leaver provisions are triggered in VC-backed firms ultimately depends on a case-by-case determination ex post. Entrepreneurs may take advantage of this legal framework to litigate the

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[423] The firm's charter must specify the reasons for the redemption in such a precise manner that the management decision is limited to formally ascertain that the relevant facts have come into existence or the relevant requirements have been met. In other words, the management must have no leeway in deciding about the redemption. See, e.g., OLG Muenchen, AG, 2017, 441, 443. In the literature, see, e.g., Kai-Steffen Scholz, *§63*, *in* MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS - VOL. 4, para. 9 (Michael Hoffmann-Becking & Andreas Austmann eds. 5th ed., 2020).

[424] AktG, §§ 222 para.1 sentence 1, and 237 para.2 sentence 1 and 2. The predominant view amongst courts and scholars is that, under these provisions, the firm's charter can include redemption clauses without pre-determined reasons. In the case law, see, e.g., LG Stuttgart, NZG 2021, 1227, para. 50. In the literature, see Jürgen Oechsler, *§ 237*, *in* MÜNCHENER KOMMENTAR ZUM AKTG - VOL. 4, para. 42 (Wulf Goette & Mathias Habersack eds., 5th ed., 2021).

[425] See *supra* note 423.

[426] See *supra* text accompanying note 413.

[427] On this so-called compulsory redemption, see GmbHG, § 34 para. 1.

[428] See BGH, Jun. 20, 1983, 36 NJW 2880, 2881 (1983) (concluding that, when a GmbH's charter stipulates that a shareholder must provide management services to the company, failure to fulfill this obligation constitutes an "important reason" justifying the company's exercise of its redemption right). Therefore, scholars argue that provisions in the firm's charter granting the VC-backed firm the right to redeem the shares of the entrepreneur are valid if they stipulate that the redemption can occur in case the entrepreneur refuses to continue working as the company's manager. See WINKLER, RECHTSFRAGEN, *supra* note 181, at 192.

[429] Case law has concluded that a provision in the firm's charter stipulating that shares may be redeemed for "important reasons" is in line with both requirements. See BGH, Feb. 13, 1995, 48 NJW 1358, 1359 (1995). The literature endorses this approach. See, e.g., Lutz Strohn, *§ 34*, *in* MÜNCHENER KOMMENTAR ZUM GMBHG , para. 44 (Holger Fleischer & Wulf Goette eds., 4th ed. 2022).

[430] WEITNAUER, *supra* note 120, at para. 222 note 412 (conceding that the precise meaning of an "important reason" justifying the expulsion remains controversial amongst courts and scholars and it is at least questionable whether the stipulations in the shareholder agreement are relevant for the interpretation of codified law). For a comprehensive discussion of the partly inconsistent case law, see Detlef Kleindiek, *§ 34*, *in* GMBHG, paras. 45-55 (Marcus Lutter & Peter Hommelhoff eds., 21st ed., 2023).

[431] See BGH, March 9, 78 GMBHR 302, 303 (1987). For scholarly assessment see Strohn, *supra* note 429, at para. 114 (explaining that the duty of loyalty serves as the analytical framework to account for the viability of such provisions).

[432] See e.g. BGH, Dec. 12, 2014, 18 NZG 429 para. 37 (2015). See also Strohn, *supra* note 429, at paras. 45, 114, 140 (summarising the relevant case law and literature).

[433] For details, see *supra* text accompanying note 315.

buyout, for instance by alleging that the firm had other, less drastic solutions at hand to avert the problems stemming from their continued presence in the firm. Therefore, it is unsurprising that practitioners have voiced their concerns over the viability of bad leaver provisions.[434]

Furthermore, German corporate law significantly constrains contracting parties' freedom to set the forced buyout price. Share ownership enjoys the constitutional protection of property against expropriation.[435] Against this background, the law rejects private ordering solutions entailing the loss of share ownership without full compensation of its economic value. As a consequence, bad leaver provisions stipulating that a disproportionately low buyout price shall be paid to the entrepreneur violate public policy[436] and are thus null and void.[437] Courts generally consider the shares' market value as the benchmark for their fairness assessment.[438] Moreover, they decide what price is too low by balancing the company's need for cash against the departing shareholder's financial interests based on the specific circumstances of each case.[439] They do not consider how these arrangements might influence future behaviour. While this means that in some circumstances the court might accept a price lower than the market value and possibly even no compensation whatsoever for the bad leaver,[440] this would be a rare outcome at best. Accordingly, practitioners strongly advise parties to draft bad leaver provisions with a fallback provision enabling the buyout of the entrepreneur at "the lowest

[434] See Orrick Law Firm, *Venture Capital Deals in Germany* (Legal Ninja Series), 11 November 2021, https://media.orrick.com/Media%20Library/public/files/insights/2021/olns-9-venture-capital-deals-in-germany.pdf, 115 (pointing out the enforceability risk of such provisions regardless of the VC-backed firm's organizational form).

[435] See *supra* note 75.

[436] Under the doctrine of immorality: see *supra* note 261.

[437] Case law has confirmed this time and again. See, e.g., Bundesgerichtshof, Jan. 22, 2023, 16 NZG 220, para. 16 (stating that in a privately held AG the constitutional guarantee requires that arrangements causing the loss of share ownerhip must imply safeguards against unfair expropriation, namely the fair value protections under the general clause of BGB, § 138(1), prohibiting contracts that offend common decency). See also OLG München, AG 2017, 441, 445 (same). As to the GmbH, see, e.g., Bundesgerichtshof, Jan. 22, 2013, 201 BGHZ 65 (holding that exclusion without compensation may gravely affect the shareholder's economic existence and freedom and thus justifies declaring the relevant provision null and void pursuant to § 138(1) of the BGB). The logic that courts have followed in reaching this conclusion is that even the grossest breach of duty by a shareholder is adequately punished by the exiting shareholder's loss of the company's future upside, whereas depriving them of the value of their past investment in the company by not granting any compensation would be unfair. BGH, Apr. 29, 2014, 17 NZG 2014, 820 paras 17-18 (2014). See also BGH, Jan. 22, 2013, 16 NZG 220 para. 16 (2013) (voiding a clause contemplating an inappropriately low compensation). Scholars largely share this view. See, e.g., GRUNEWALD, *supra* note 436, at 174-175.

[438] See, e.g., BGH, Dec. 16., 1991, 116 BGHZ 359, 375-376.

[439] Christian Kersting, *§ 34*, *in* GMBHG, para. 27 (Ulrich Noack et al. eds., 23rd ed., 2022). As regards VC contracts more specifically, see Tim Drygala, *Gerklärte und ungeklärte Fragen von Beteiligungsverträgen*, *in* VENTURE CAPITAL-BETEILIGUNGSVERTRÄGE UND "UNTERKOMPLEXITÄTSPROBLEME", 187, 202 (Tim Drygala & Gerhard H. Wächter eds., 2018) (reporting that VC-relevant factors in this weighting include the reason for the exclusion (a bad leaver case involving a serious breach of duty reduces the shareholder's legitimate interest in compensation) and the (intangible) value added to the company by the entrepreneur).

[440] Some scholars have argued that setting the buyout price by reference to the initial investment is permitted. See Drygala, *supra* note 439, at 204. Scholars have also defended the viability of bad leaver provisions that set the price by reference to share book value. See, e.g., Oechsler, *supra* note 424, at para. 67 (representing the majority view that book value compensations are acceptable in closely held entrepreneurial firms organized as AGs); Strohn, *supra* note 429, at paras. 240, 270 (reaching similar conclusions for GmbHs). Courts have occasionally confirmed this. See BGH, Jun. 12, 1975, 65 BGHZ 22 (upholding a price reflecting the net asset value of a GmbH). An influential scholar has held that bad leaver provisions allowing a buyout of the entrepreneur with no compensation whatsoever are viable in GmbHs. See Holger Altmeppen, *§ 34*, *in* GMBHG, para 59 (Holger Altmeppen eds., 11th ed., 2023).

permissible price."[441] This way, courts are prevented from invalidating the clause, but the arrangement is clearly inferior to U.S.-style bad leaver provisions.

Italian corporate law imposes similar hurdles, first, in the form of special safeguards that make bad leaver provisions impractical. For SPAs, blackletter corporate law explicitly allows for arrangements granting the firm or a shareholder a redemption right over the shares of another shareholder.[442] However, with a view to protecting the status of shareholders and/or their property rights,[443] courts require that such arrangements specify in detail the circumstances that trigger the forced buyout: more precisely, the trigger events must comprise factual circumstances that every shareholder can know *ex ante* and a court can ascertain *ex post*.[444] Provisions that generically identify "misconduct" as the trigger event, or employ comparably broad language, would not qualify.

A forced buyout implies a share buyback, which is in turn subject to two further safeguards deriving from EU law.[445] First, the shareholder meeting must have approved the buyback and its terms.[446] Second, the firm may only buy back shares to the extent that its latest financial statements display distributable profits or disposable reserves, unless a special resolution is taken to reduce the company's legal capital.[447] The first requirement is troublesome for any VCF that does not control the shareholder meeting. The second one implies that, because cash-strapped VC-backed firms' legal capital is usually set at a symbolic amount, share buybacks are rarely an option.

For SRLs, the charter may include provisions enabling the forced buyout of a shareholder, provided that specific circumstances justifying it are identified.[448] Building on unanimous scholarship,[449] courts have repeatedly held that the requirement that circumstances be specified is of quintessential importance to protect the shareholder's status and/or property in their shares, and, hence, must be strictly interpreted.[450] Similar to SPAs, the events that trigger the shareholder's forced buyout must thus comprise specifically described factual circumstances, so that every shareholder can know them *ex ante* and a court can ascertain them *ex post*.[451] Arrangements that identify as triggers "misconduct" or even "severe misconduct

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441 BANK & MÖLLMANN, *supra* note 15, paras. 295-297 (acknowledging enforcement risks and advocating fallback provisions that set "the lowest permissible value" as compensation). The case law generally supports the viability of fallback provisions but does not indicate if a proviso stipulating a reduction to the "lowest permissible value" would be valid. See, e.g., Bundesgerichtshof, DStR 2418 (2011).

442 See art. 2437-sexies, codice civile (It.). For details, see, e.g., MATTEO L. VITALI, LE AZIONI RISCATTABILI 51-107 (2013) (discussing the regime on share redemptions, including the general limits within which SPAs can buy back).

443 As discussed, Italian corporate law in action reflects the view that shareholders are entitled to benefit from the constitutional protection of private property. See *supra* note 75. Besides, it also reflects the view that the shareholder enjoys a right to preserve their position *qua* shareholder that severely limits contracting parties' ability to craft forced buyback clauses as they see fit.

444 See, e.g., Tribunale di Milano, 2 May 2017.

445 See Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017, relating to certain aspects of company law, Arts. 60 and 61, 2017 O.J. (L 169) 46.

446 See art. 2357, comma 2, codice civile (It.).

447 See art. 2357-*ter*, comma 2, codice civile (It.).

448 See art. 2473-bis, codice civile (It.).

449 See, e.g., Paolo Ghionni Crivelli Visconti, *Selezione ed operatività delle cause di esclusione del socio di s.r.l.*, *in* SOCIETÀ, *supra* note 75, at 1769.

450 Most recently see Tribunale Napoli 11 Aprile 2023; and Tribunale Catanzaro, 31 October 2023. Well-established scholarship supports these courts' arguments. See, e.g., Paolo Piscitello, *Recesso e esclusione nella s.r.l.*, *in* IL NUOVO DIRITTO DELLE SOCIETÀ. *LIBER AMICORUM* GIAN FRANCO CAMPOBASSO - VOL. 3, 718 (Pietro Abbadessa & Giuseppe B. Portale eds., 2006), at 737.

451 For references to the case law see the previous footnote. In the literature, see, e.g., Gionni Crivelli Visconti, *supra* note 448, at 1777-1783.

implying an important breach of the obligations stemming from the corporate contract" are therefore to be regarded as insufficiently determined and thus to be declared null and void.[452]

A third set of constraints affects parties' freedom to set the forced buyout price. Arrangements that enable the firm or a shareholder to compel another shareholder to divest are valid solely if they are drafted in compliance with the principle of fair value.[453] Bad leaver provisions compel divestment, implying that the shareholder who is being bought out on the basis of the bad leaver has the right to receive at least the price that they would have received if they had exercised their withdrawal right.[454] Bad leaver provisions that do not include this proviso are null and void.

VCFs and entrepreneurs seeking to work around these corporate law constraints would not achieve much. In AGs, contracting parties have resorted to shareholder agreements that grant the VC-backed firm or the VCF a call option on the entrepreneur's shares.[455] But this may prove an illusory solution. To begin with, courts could see a call option as a circumvention of the prohibition on exerting pressure on shareholders.[456] Besides, a call option forces a shareholder to sell their shares, triggering the legal framework established in case law for expulsion provisions. This makes the call option's validity dependent on the existence of an important reason,[457] regardless of whether such arrangements appear in the firm's charter or in shareholder agreements.[458] Even if one accepts that bad-leaver provisions are in line with the relevant case law,[459] the precise scope for private ordering would remain unclear. Commentators argue that "quasi-expulsion rights" arising from bad leaver provision are only acceptable for a limited period.[460] Transactional practice regularly conforms to these observations.[461] Finally, contracting parties cannot bypass constraints on setting the redemption or purchase price by resorting to shareholder agreements because those constraints apply irrespective of whether the price is set in the firm's charter or in a shareholder agreement.[462]

In Italian VC deals, contracting parties could resort: (a) in SPAs, to arrangements on shareholder expulsion;[463] (b) in SRLs, to arrangements granting one shareholder the right,

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[452] See, e.g., Tribunale di Napoli, 23 March 2022. For a comprehensive overview of the consistent case law on this point, see Giovanni Romano & Casimiro A. Nigro, *Diritto vivente e istituti morenti: l'esclusione del socio di s.r.l. (venti anni dopo la riforma organica)* (on file with authors), 19-21.

[453] See *supra* note 293.

[454] See *supra* text preceding note 293.

[455] See, e.g, WINKLER, *supra* note 181, at 203 (proposing this workaround). This approach has gained traction over time, as the literature reports. See, e.g., KUNTZ, *supra* note 14, at 733.

[456] See *supra* note 418. Some commentators have argued against qualifying these call options as illegitimate avoidance of the law. See KUNTZ, *supra* note 14, at 732 (arguing for the validity of such arrangements); WINKLER, *supra* note 181, at 203 (same). To date, courts have not resolved on the matter yet.

[457] For a summary of the case law, see Priester, *supra* note 262, at 1142.

[458] *Id.*, at 1142-1143.

[459] Two precedents can be read as allowing expulsion for a "special reason" if shareholders no longer provide the managerial services they owe under a labor or service contract. See BGH, Sep. 19, 2005, 164 BGHZ 98 and BGH, Sep. 19, 2005, 164 BGHZ 107. Scholars come to similar conclusions. See KUNTZ, *supra* note 14, at 731; Denga, *supra* note 67, at 745 (arguing that bad leaver provisions can amount to an established trade custom).

[460] Priester, *supra* note 262, at 1148-49 (stressing that sunset clauses play a crucial role for the justification of the respective provisions and concluding that a 10-year call option is not justifiable).

[461] See BANK & MÖLLMANN, *supra* note 15, at para. 262 (suggesting a period of validity between two and five years).

[462] BGH, 22 Jan. 2023, 16 NZG 220, para. 17 (for the AG); BGH, Dec. 16, 1991, 116 BGHZ 359, 374 (for the GmbH).

[463] Scholars consider such arrangements viable. See, e.g., Benussi, *supra* note 293, at 63 (holding arrangements on shareholder expulsion in closely held firms organized as SPAs as legal).

possibly *ad personam*, to redeem the shares of another shareholder.[464] Yet, the regulatory constraints we refer to above[465] are applicable to any arrangement compelling a shareholder to divest, because they address deeply rooted scholars', legal gatekeepers', and courts' concerns that extend to any arrangement causing a shareholder to divest regardless of its transactional structure.[466] Alternatively, contracting parties could resort to arrangements granting the VC-backed firm and/or, depending on its organizational form,[467] the VCF the right to redeem the shares of the entrepreneur or cause their expulsion, in combination with an arrangement requiring the entrepreneur to pay a "penalty." Scholars and practitioners consider these arrangements viable, because the entrepreneur would formally receive the fair value of their shares, although they would subsequently return a fraction thereof to the firm as payment of the penalty.[468] Yet, these arrangements suffer from at least one main limitation that stems from the general regime governing penalty clauses.[469] Under general contract law, the penalty may not be "excessive," which means that the entrepreneur may ask a court to review its amount under that (vague) standard.[470]

To sum up, not only do German and Italian corporate laws thwart contracting parties' attempt to import U.S.-style bad leaver provisions into local VC deals, but they also compel them to adopt alternative arrangements that, although with some differences in the two jurisdictions, are themselves subject to regulatory constraints. These constraints stand in the way of their smooth, unchallenged use and rule out the possibility of defining the trigger events in broad terms and setting a punitive price. As a result, the German and Italian versions of bad leaver provisions perform weakly as a deterrent against opportunistic behaviour and therefore are not functionally equivalent to its U.S. model.

3. Exit

VCF investments' success is contingent on the effective exit from portfolio companies. Regulatory constraints on exit rights and their exercise inevitably affect VCFs' portfolio valuation and, *ex ante*, their decision to invest, ultimately with an impact on the development of the VC market.[471] In the U.S., VCFs secure special prerogatives to trigger and control the process leading to divestment transactions. They also contract for protections in the reverse scenario in which the entrepreneur triggers an exit event.[472]

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[464] See, e.g., Renato Santagata, *Art. 2468*, *in* S.R.L. COMMENTARIO DEDICATO A G.B. PORTALE, 284, 287 (Angelo A. Dolmetta & Gaetano Presti eds., 2011). See also Consiglio Notarile di Milano, *supra* note 463. Practitioners also admit the possibility of granting a shareholder a right incorporated in their shares (thus, not a right *ad personam*). See Consiglio Notarile di Milano, *supra* note 292.

[465] See supra text accompanying notes 442-454.

[466] According to scholars, the principle of fair value applies irrespective of the transaction's structure. See *supra* note 293.

[467] Recall that SRLs may not buy back shares other than to service stock compensation plans in SME SRLs. See *supra* note 68.

[468] Scholars seem to defend the viability of these arrangements. See, e.g, Luca Barchi, *L'esclusione del socio nella società a responsabilità limitata*, 19 NOTARIATO 149 (2006). Practitioners endorse this appoach. See Consiglio Notarile di Milano, *Massima No. 198 of 23 November 2021 "Penali statutarie e liquidazione delle azioni in caso di riscatto o esclusione,"* https://www.consiglionotarilemilaNo.it/massime-commissione-societa/massima-n-198-del-23-novembre-2021-penali-statutarie-e-liquidazione-delle-azioni-in-caso-di-riscatto-o-esclusione-artt-2342-2345-2437-sexies-2473-bis-c-c/.

[469] See artt. 1382-1384, codice civile (It.).

[470] Art. 1384, codice civile (It.). Practitioners share this view. See Consiglio Notarile di Milano, *supra* note 468.

[471] See Douglas Cumming et al., *Legality and Venture Capital Exits* (2006) 12 J. CORP. FIN. 214, 216.

[472] See, e.g., D. Gordon Smith, *The Exit Structure of Venture Capital* (2005) 53 UCLA L. REV. 315.

An example of the latter are tag-along rights provisions—that is, arrangements allowing VCFs to sell their shares, possibly on a *pro rata* basis, under the same terms and conditions if the entrepreneur sells their shares to a third party.[473] Leaving registration rights aside,[474] these are indeed the only U.S.-style arrangements that VCFs and entrepreneurs bargaining under both German and Italian corporate laws can plainly transplant.[475] The array of exit-related provisions in U.S. VC contracts is, however, much richer. It includes waivers of the fiduciary duty of loyalty and drag-along rights to govern trade sales as well as redemption rights.

i. Provisions Related to Trade Sales, including Drag-along Rights Provisions

VCFs exit their companies mainly through trade sales[476]—that is, a sale of the entire company to a competitor or a financial acquirer.[477] Trade sales can be executed through various transactional techniques: mergers, share transfers, and asset sales.[478] These transactions are exposed to litigation risk, particularly when the VCF decides to (a) sell an underperforming portfolio firm or (b) liquidate it as the fund approaches its maturity and must generate liquidity to pay back its own investors.[479] Whether due to temporary inefficiencies in the M&A market and/or the liquidity pressure under which the VCF takes the relevant decisions, the resulting trade sales often end up sacrificing value.[480] Due to liquidation preferences, VCFs may be largely or even entirely insensitive to the value-decreasing consequences of such transactions.[481] This can leave entrepreneurs with little if not nothing at all. From a purely *ex post* perspective, entrepreneurs can be viewed as victims of VCF opportunism. Entrepreneurs will find it more or less rewarding to challenge trade sales depending on whether judges give more weight to the original deal terms or to how the parties actually behaved.[482]

By default, Delaware law provides for significant protections for dissenting shareholders in the situations just described, in the form of both derivative suits for violations of the duty of loyalty and appraisal rights.[483] Empirical evidence shows that entrepreneurs use fiduciary standards to challenge trade sales in court and extract more money from these transactions.[484]

[473] See PEARCE & BARNES, *supra* note 91, at 214-218.

[474] See *supra* note 99.

[475] See Holger Fleischer & Stephan Schneider, *Tag along- und Drag along-Klauseln in geschlossenen Kapitalgesellschaften,* 65 DER BETRIEB 961, 961-962 (2012) (discussing such arrangements and concluding for their viability); Nicola De Luca, *Vengo anch'io, no tu no. Tre lustri di clausole di accodamento* e *trascinamento*, 20 ANALISI GIURIDICA DELL'ECONOMIA 329, 333 (2021) (same).

[476] Klausner & Venuto, *supra* note 99, at 1403. For recent data about the exit channel deployed by U.S. VC-backed firms, see Salma Ben Amor & Maher Kooli, *Do M&A Exits Have the Same Effect on Venture Capital Reputation as IPO Exits?*, 111 J. BAN. & FIN. 1, 1-2 (2020).

[477] Casimiro A. Nigro & Jorg R. Stahl, *Venture Capital-Backed Firms, Unavoidable Value-Destroying Trade Sales, and Fair Value Protections*, 22 EUR. BUS. ORG. L. REV. 39, 56 (2021).

[478] For details and references, *Id*., at 57.

[479] These transactions are the function of the termination option that VCFs receive under standard U.S. VC contracts. This termination option is the function of the braiding of the contract governing VCFs and the contract governing VC-backed firms and it aims at enabling VCFs to terminate investments that perform poorly and/or divest at the latest as the VCF approach its maturity and thus needs to generate the liquidity required to meet its own investors capital calls. For details and references, *Id*. at 54.

[480] See *Id*., at 58-63 for the relevant theoretical framework. For empirical evidence, see Bo Bian et al., *Conflicting Fiduciary Duties and Fire Sales of VC-backed Start-ups* (LawFin Working Paper No. 35) (2023), https://ssrn.com/abstract=4139724 (finding an up to 23% discount for VC-backed firms sold as the VCF approaches its end).

[481] Nigro & Stahl, *supra* note 477, at 70-73.

[482] U.S. case law includes a very illustrative example: the *Trados* case. See *supra* note 57. For a detailed account of the litigated facts, see Abraham Cable, *Does Trados Matter?*, 45 J. CORP. L. 311, 312-320 (2019).

[483] See §§ 144 and 262 of the DGCL.

[484] Brian Broughman & Jesse Fried, *Renegotiation of Cash-flow Rights in the Sale of VC-backed Firms*, 95 J. FIN. ECON. 384 (2010).

Parties respond to the risks that trade sales pose by opting out of the relevant rules and doctrines, thus reducing the risk of litigation.[485]U.S. VC contracts stipulate in shareholder agreements that the entrepreneur must abstain from suing VCFs and directors for any breach of their duty of loyalty connected to a sale of the firm, including a trade sale.[486] Besides, drag-along rights provisions specify that, in the event of a trade sale, the VCF has the right to instruct the entrepreneur on how to vote their shares. If entrepreneurs comply with the instructions and actually vote in favour of the transaction, they lose their appraisal right.[487] Finally, drag-along rights provisions stipulate that, if the board approves the transaction, the VCF has the right to sell the entrepreneur's shares at the same terms and conditions as their own, without depending on the entrepreneur's cooperation.[488]

Trade sales are the predominant exit channels for VCFs in Europe as well.[489] However, German and Italian corporate laws prevent VCFs and entrepreneurs from transplanting U.S. private ordering arrangements and, thus, from achieving comparable outcomes irrespective of the trade sale's transactional form.

Let us start with mergers. German and Italian corporate laws preclude VCFs and entrepreneurs from choosing how to structure trade sales. Under both corporate law regimes, the shareholders of merging firms, consistent with E.U. law,[490] have the right to receive shares—rather than solely cash—as compensation, even though in Italy this applies only to mergers involving SPAs.[491] This requirement rules out straightforward cash-for-stock mergers, which in turn implies that mergers as a transactional technique to execute a trade sale are not an option to liquidate an investment, except if the acquirer is a large publicly listed firm with highly liquid stock, allowing for the immediate and unimpaired realization of the cash-value of the shares the VCF receives.

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[485] Jill E. Fisch, *A Lesson from Startups: Contracting out of Shareholder Appraisal*, 107 IOWA L. REV. 941, 961 and 976-977 (2022).

[486] NVCA, *Model Legal Documents – Voting Agreement (dating January 2024)* 8, https://nvca.org/recommends/nvca-va-updated-january-2024/. Recall that, according to case law, such covenants not to assert claims for breach of fiduciary duty in connection with a drag-along sale is valid if it is explicit and does not exculpate "intentional wrongdoing." See *supra* note 57.

[487] On appraisal waivers as components of the contractual framework for VC deals, Fisch, *supra* note 485, at 961. Case law has explicitly confirmed their enforceability. See *supra* note 57.

[488] MAYNARD & WARREN, *supra note* 91, at 687. Note that the approval of the board in the case of a share transfer is not required under the applicable corporate law regime but commonly required by the acquirer, who wants to be sure that the transaction has a "friendly" nature.

[489] See Ulf Axelson & Milan Martinovic, *European Venture Capital: Myths and Facts* (LSE Research Online Documents on Economics No. 118976), https://personal.lse.ac.uk/axelson/ulf_files/EuroVC_MythsFacts%20v17.pdf.

[490] See Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, arts. 89 and 90, 2017 O.J. (L 169) 46. But see also id., art. 166 (authorising Member States to subject functionally equivalent transactions to a regime that does not provide for such a cap on cash payments to shareholders).

[491] See UMWANDLUNGSGESETZ [UMWG] [MERGER ACT], Oct. 28, 1994, BGBl. I at 3210, last amended by G Oct. 23, 2024, BGBl I No. 323, § 54 para. 4 (limiting the cash component in the compensation of the shareholders of the acquired company to 10% of the nominal value of the shares the acquiring company allotted for the share exchange pursuant to UmwG, § 5 para. 1, No. 3). The prevailing view is that the 10% cap for cash compensation is mandatory. See Bundesfinanzhof, 14 February 2022, 276 ENTSCHEIDUNGEN DES BUNDESFINANZHOFS [BFHE] 216, para. 19. In the literature, see, e.g., Dieter Mayer, *§ 54*, *in* UMWANDLUNGSRECHT KOMMENTAR, para. 65 (Sigfried Widmann & Dieter Mayer eds., 172nd suppl., 2018). For Italy, see art. 2501-ter, codice civile (It.) (stipulating that the cash component of a merger cannot exceed 10 percent). *But* see art. 2505-quater, codice civile (It.) (stipulating that art. 2501-*ter* does not apply to mergers involving companies other than SPAs). Building on these provisions, the prevailing view amongst scholars is that the cash component in mergers involving SPAs can *never* exceed 10%. See, e.g., Giuliana Scognamiglio, *Le fusioni e le scissioni semplificate nella riforma del diritto societario*, 57 RIVISTA DEL NOTARIATO 889, 891-892 (2003).The 10% limit does not apply to SRLs. *Id*.

If VCFs were willing to execute trade sales as stock-for-stock mergers, the relevant regime would still erect insurmountable obstacles to arrangements that are commonplace in U.S. VC deals, especially in Germany.

Under German corporate law, mergers require approval at both the shareholder and board level.[492] Directors and controlling shareholders have to comply with a duty of loyalty that commands them to advance the firm's interest, rather than that of an individual shareholder, and take other stakeholders' interests into account.[493] This duty of loyalty is mandatory in nature.[494] The board's and general shareholder meeting's resolutions to initiate and execute a trade sale serving the liquidity needs of the VCF or its termination interest in an underperforming venture may be challenged as instrumental to pursuing exclusively the interest of one shareholder. In addition, merging firms' shareholders can have their shares appraised, regardless of whether they vote in favour or against the merger.[495] The regime on appraisal rights is also mandatory.[496] Against this background, any attempt to deflate the significant litigation risk ex ante would prove pointless. Arrangements such as the covenant not to sue *à la Delaware* as well as waivers of the German remedy corresponding to the U.S. appraisal right would simply be null and void.[497]

In Italy, mergers require approval at both the shareholder and board level.[498] Directors are generally under the duty to advance the interest of the company.[499] Controlling shareholders, instead, can take any action they want, subject only to the constraint of the so-called abuse of majority doctrine, which prevents those in control from using their prerogatives to advance their own interest (as opposed to the firm's interest) through actions aimed to harm minority shareholders.[500] This implies that a shareholder who wants to have the shareholder resolution approving the merger voided by a court must prove that those in control (a) have secured a special benefit (b) by taking actions that were deliberately aimed to jeopardise the minority's interest.[501] However, once recorded in the companies' register, the transaction can

[492] See §§ 13(1), 50, and 65 of the UmwG (requiring a shareholder resolution in the GmbH and the AG, which is typically initiated by the board).

[493] For details and references, see *supra* note 315.

[494] For references, see *supra* note 314.

[495] See § 15 and 34 of the UmwG (stipulating the shareholder's individual right to bring an action to have the value of their shares determined by a court and the exclusive competency of the court to determine fair value). This appraisal procedure is a remedy that the shareholders of any company involved in a merger can use irrespective of its organizational form. For details, see, e.g., Tobias Quill & Florian Follert, *Spruchverfahren als Geschäftsmodell: Wenn die "angemessene" Abfindung negativ ist – Betriebswirtschaftliche Überlegungen zur vollen Kompensation von Berufsantragstellern*, 66 DIE AKTIENGESELLSCHAFT 696 (2021).

[496] The German regime governing mergers is generally mandatory. See § 1(3) of the UmwG.

[497] *Cf.*, e.g., Tim Drygala, *§ 1 in* UMWANDLUNGSGESETZ, para. 63 (Marcus Lutter ed., 7th ed., 2023), (discussing the very narrow room for private ordering solutions).

[498] See artt. 2501, 2502, codice civile (It.) (stipulating that the board initiates the process by drafting and approving the merger plan and stipulating the requirement of shareholder approval of such a plan).

[499] For details, see *supra* note 337 and corresponding text.

[500] The abuse of the majority doctrine is chiefly an offspring of the duty of good faith—which informs the implementation of any contract. See art. 1375, codice civile (It.). Yet, the corporate law provisions on conflicts of interest of shareholders have traditionally played a complementary role in elaborating the construct of the abuse of the majority. See artt. 2373, 2479-ter, codice civile (It.). For a discussion, see Mosco & Lopreiato, *supra* note 337, at 122-123.

[501] See, e.g., Tribunale di Milano, 30 January 2017 (accounting for the preconditions required for the existence of an abuse of the majority). In the literature, see, e.g., ALESSANDRO SIMONIATO, PROFILI E LIMITI DEL CONTROLLO SULLA MAGGIORANZA NELLE SOCIETÀ DI CAPITALI 39-47 (2023) (also accounting for how case law has defined over time and currently definesing abuse of the majority). A similar regime also applies to minority shareholders under the so-called abuse of minority doctrine. For details, see ANTONIO NUZZO, L'ABUSO DELLA MINORANZA. POTERE, RESPONSABILITÀ E DANNO NELL'ESERCIZIO DEL VOTO (2003).

no longer be challenged. After that, disgruntled shareholders are left with the sole option to sue the company or its successor for damages.[502]I

This regime is mandatory and applies irrespective of the firm's organizational form.[503] Additionally, shareholders who have not voted in favour of the merger are granted withdrawal rights. To be sure, unlike for SRLs, for SPAs, blackletter law does not stipulate that shareholders can exercise their withdrawal rights in the event of a merger. Yet, when it is the case that, first, the charter of the incorporating company contains clauses that are absent from the charter of the incorporated one and, second, their inclusion in the charter of a stand-alone company via an amendment would have given rise to withdrawal rights[504] then a merger with such characteristics also leads to withdrawal rights for the shareholders of the incorporated company.[505]

Such withdrawal rights are similar to U.S. and German appraisal rights,[506] and similarly, cannot be waived contractually.[507] Under such a regime, trade sales executed to advance the sole interest of VCFs to terminate underperforming firms or generate liquidity would be exposed to litigation risk under the abuse of majority doctrine.[508] Yet, as we have seen,[509] after the merger is recorded in the companies' register, the entrepreneur's hand is much weaker and its litigation threat hardly credible..

VCFs and entrepreneurs may want to further deflate litigation risks at the bargaining table. Courts may accept a shareholder agreement that prevents entrepreneurs from suing VCFs in their capacity as controlling shareholders but would certainly take a critical view of provisions that limit shareholders' rights to sue directors. Such limitations are held to be problematic because they could make directors unaccountable and encourage irresponsible management of the firm. For this reason, courts typically rule that agreements limiting shareholders' rights to sue directors are null and void.[510] Besides, arrangements waiving the right to sue the company for the damages caused to an individual shareholder would likely be null and void, too, because the shareholder's individual right of action in this context is considered key to ensuring appropriate levels of minority protection in mergers.[511] Finally,

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[502] See art. 2504-quater, § 1, codice civile (It.)) of the ICC (stipulating that, once all the formalities of a merger have been executed, a court cannot declare the invalidity of the transaction and that, after that moment, shareholders only have an action for damages). This regime applies to mergers in general, irrespective of their business organizational form. For details, see DANILO BELTRAMI, LA RESPONSABILITÀ PER DANNO DA FUSIONE 1-23 (2008).

[503] See *supra* note 86 and accompanying text.

[504] See art. 2437, codice civile (It.) (outlining the instances in which the shareholder has such a withdrawal right in SPAs).

[505] See Vincenzo Di Cataldo, *Il recesso del socio di società per azioni*, *in* IL NUOVO DIRITTO, *supra* note 450, 219, 227.

[506] See Paolo Guaragnella, *Diritto di disinvestimento: un'analisi comparatistica tra diritto di recesso e "*appraisal right*" statunitense*, 7 RIVISTA DI DIRITTO SOCIETARIO 766 (2013).

[507] See art. 2437, comma 6, codice civile (It.) ("any agreement that impedes or complicates the exercise of withdrawal rights" is null and void. Based on the term "any agreement," scholars rule out not only waivers of such withdrawal rights included in the firm's charter, but also analogous provisions in shareholder agreements. A similar provision is in place for SRLs. See art. 2473, comma 1, codice civile (It.). For details, see Casimiro A. Nigro & Demetrio Maltese, Private equity*,* mergers *e* waiver *dell'*appraisal right*: note su un caso statunitense con cenni all'esperienza italiana*, 22 RIVISTA DI DIRITTO SOCIETARIO 631, 655-658 (2022).

[508] See *supra*, text accompanying note 501.

[509] *Supra* text preceding note 502.

[510] See Alberto Picciau, *Sulla validità dei patti parasociali di rinunzia all'azione di responsabilità e di manleva nella S.p.A.*, 61 RIVISTA DELLE SOCIETÀ 282, 288-292 (2016) (summarising the case law that concludes for the invalidity of shareholder agreements preventing the acquirer of a controlling stake from suing directors for breach of their fiduciary duties).

[511] BELTRAMI, *supra* note 502, at 191.

arrangements in shareholder agreements instrumental to waiving withdrawal rights would also be void.[512]

Nor could VCFs and entrepreneurs achieve results comparable to those of U.S. deals practice by structuring a trade sale as a share co-transfer based on drag-along rights. Most commentators consider drag-along rights provisions included in the charter of AGs as null and void, because they add an additional shareholder obligation to those resulting from mandatory corporate law, which private ordering cannot alter.[513] And while drag-along rights provisions are permitted in GmbHs[514] regardless of whether they are included in the firm's charter or in shareholder agreements,[515] transactions executed on the basis of these arrangements are subject to judicial review along two critical dimensions. On the one hand, fiduciary standards apply to the compelled transfer, enabling courts to ascertain whether the decision to sell aligns with the company's interest.[516] On the other, German courts have a tradition of carefully reviewing the sale price.[517] This regime generates two problems. First, it creates uncertainty as to what actions the VCF can or cannot take to further its own interest in creating liquidity and/or terminating ailing ventures.[518] Second, it deprives the VCF of the unfettered discretion to set the deal's terms and price. Transactional practice responds to this regime by incorporating into drag-along right provisions a proviso that assigns to a designated third party the task of determining firm value,[519] thereby increasing transactional uncertainty further.

Italian corporate law complicates the execution of trade sales in the form of compelled share co-transfer in two ways. First, under existing case law, the dragging shareholder (the VCF in the VC-backed company) has a fiduciary duty to act fairly towards the dragged shareholder (the entrepreneur).[520] The ex post determination of fairness[521] follows categories

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512 See *supra* note 507.

513 See, e.g., Fleischer & Schneider, *supra* note 475, at 964. On the rigidity of AG law, see generally *supra* note 85.

514 Fleischer & Schneider, *supra* note 475, at 964.

515 To be sure, it is not entirely clear whether drag-along rights provisions are valid. Because they give one shareholder the right to compel another shareholder to divest, such provisions are regarded as functionally equivalent to expulsion clauses. See, e.g, Priester, *supra* note 262, at 1139; and Barbara Grunewald, *Wann kann ein geschäftsführender Gesellschafter ohne besonderen Anlass aus seiner Gesellschaft ausgeschlossen warden?*, 42 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT 433, 436 (2021). As such, they are subject to judicial review under a public policy test. See *supra* text preceeding note 261. In the case law, see, e.g., OLG München, 13 May 2020, 23 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 903 (2020). Scholars frequently conclude that drag-along rights provisions pass this test, because the entrepreneur divests along with the VCF, and this represents a legitimate objective criterion rooted in the VC business model, ruling out the risk of arbitrary expulsion of the entrepreneur. See, e.g., Priester, *supra* note 262, at 1147; and Fleischer & Schneider, *supra* note 475, at 966. Yet, conclusive case law is missing, leaving some uncertainty as to the limits of permissible arrangements. See Denga, *supra* note 67, at 763.

516 Drag-along provisions function as expulsion rights since they compel entrepreneurs to sell their shares. Courts primarily review the *exercise* of such rights based on fiduciary standards. See, e.g., Fleischer & Schneider, *supra* note 475, at 967. See also Heribert Heckschen & Jannik Weitbrecht, *Die Kontrolle des Gesellschafterkreises*, 24 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 709, 712 (2021) (showing that, when they engage in this review, courts conduct a holistic assessment of the circumstances of the individual case).

517 The judicial tendency echoes what we reported for bad leaver provisions. See *supra* text accompanying notes 435-440.

518 See *supra* notes 493-494 and accompanying text.

519 See, e.g., WEITNAUER, *supra* note 120, at para. 202; and Christoph H. Seibt, *§ 2*, *in* MÜNCHENER ANWALTS HANDBUCH GMBH-RECHT, para. 314 (Volker Römelmann ed., 4th ed., 2018).

520 Lodo Arbitrale, 29 July 2008, 61 BANCA BORSA E TITOLI DI CREDITO 506 (2009) (incidentally affirming the existence of such a fiduciary duty and elaborating on its legal basis).

521 Scholars have further elaborated on the implications of the underlying fiduciary duty and held that the VCF has full discretion in executing the transaction and defining its terms and conditions, provided that it does not: (a) seek to secure any special advantage for itself; (b) take decisions driven by the goal of cashing out the

that are not transaction-specific and thus generate problems of under- and/or over-inclusiveness as to what constitutes legitimate and abusive conducts.[522] Further, the case law makes the validity of drag-along right provisions contingent on the inclusion of a proviso stipulating that the dragged shareholder will not receive a price lower than the one determined according to the criteria that define the value of shares in the case of withdrawal.[523] These implicit rules and standards imply that the VCF can be exposed to the claim that it has carried out a trade sale just to secure the special advantage of cashing out its own liquidation preferences and/or that it has acted with no concern for the consequences that its action may have on the entrepreneur.[524] The risk of judicial second-guessing is particularly concerning for VCFs because these transactions often result in asymmetric distributions of firm value between VCFs and entrepreneurs[525]—a situation Italian courts, with their tendency to only aim at *ex post* fairness,[526] may find problematic. Since these implicit rules build upon the law on fiduciary relationships, an opt-out is ruled out.[527] Contracting parties cannot draft drag-along rights provisions that omit the prescribed floor either.[528]

Alternative arrangements in this area are unavailable. Under German and Italian corporate laws, arrangements that may insulate directors, the VCF *qua* controlling shareholders, and the company itself from litigation risk are hard to design: the relevant regimes apply very broadly to any alternative arrangements that may substitute for ex ante waivers. The same is true for arrangements aiming to curtail the entrepreneur's right to receive the fair value of their shares. In German VC deals, such arrangements are difficult to justify even in the more flexible GmbH structure. This is because they are only considered legitimate when they serve the purpose of preventing a liquidity drain at the company.[529] However, this concern is not relevant in a trade sale where the drag-along right is exercised between shareholders, as such transactions do not affect the VC-backed company's existing cash reserves. These arrangements are similarly void under Italian corporate law.[530]

One could also structure trade sales as asset deals. However, such strategic transactional arbitrage would prove both fraught with pitfalls and largely ineffective. Under German and Italian corporate laws, directors must abide by the duty of loyalty also in asset deals,[531]

value of its investment regardless of the consequences this may have on the entrepreneur. See Mazzoni, *supra* note 86, at 249-250 (detailing the contents of the dragging shareholder's fiduciary duty by noting that, in implementing the corporate contract, the dragging shareholder, being formally a shareholder, must pursue the interest of a prototypical shareholder, with the consequence that they are not allowed to advance their own interest as if they were a creditor by, for instance, cashing out their investment through a sale of the assets of the company regardless of the costs that the company may bear as a consequence) and 251 (suggesting that any transaction whereby a shareholder secures a special advantage for themselves is tantamount to self-dealing).

[522] See *supra* note 86.

[523] See *supra* note 293.

[524] Mosco & Nigro, *supra* note 86, at 276.

[525] See *supra* text preceding note 169.

[526] Mosco & Nigro, *supra* note 86, at 276.

[527] See *supra* note 87.

[528] See *supra* text accompanying note 523. Transactional practice is consistent with this assessment. Cf. Giudici et al., *supra* note 14, 811 (reporting that the charters of the VC-backed firms they analyse "constantly refer to the fair value determination" and "that no contractual attempt can be observed to escape a principle that is clearly considered imperative").

[529] In the case law, see BGH, Dec. 16, 1991, 116 BGHZ 359, 376 (declaring restrictions that are disproportionate to the objective of retaining a sound liquidity base for the company null and void). In the literature, see Barbara Dauner-Lieb, *Angemessenheitskontrolle privatautonomer Selbstbindung des Gesellschafters?*, 86 ZEITSCHRIFT FÜR GESELLSCHAFTS-, UNTERNEHMENS- UND STEUERRECHT GMBHR 836 (1994) (describing the underlying general principle).

[530] For references to the relevant case law, see *supra* note 293.

[531] As to the directors' duty of loyalty under German corporate law and the regime defining directors' liability under Italian corporate law, see *supra* text preceding notes 315-317 and 499.

implying that they cannot execute transactions serving chiefly or exclusively the VCF's interest.[532] As mentioned, private ordering is nearly powerless in redefining the contents of the duty of loyalty in both jurisdictions.[533] Besides, under both corporate law regimes, the sale of substantially all assets requires the approval of shareholders,[534] with their voting subject to duty of loyalty review, at least in Germany.[535] Finally, asset deals trigger fair value protections under German corporate law and, to a lesser extent, under Italian corporate law. [536] These protections cannot be substantially customized or waived altogether, as previously discussed.[537]

To conclude, German and Italian corporate laws prevent parties from insulating trade sales from litigation risk and streamlining the divestment process—be it by transplanting U.S.-style arrangements or by devising alternative arrangements.

ii. Redemption Rights

U.S. VC contracts grant VCFs so-called redemption rights, that is, the right to sell their shares back to the firm, some years after the original investment, at a price reflecting the value

[532] See *supra* text preceding note 476 for German corporate law and note 483 for Italian corporate law.

[533] As to Germany, see note 314 and text accompanying note 494. As to Italy, see *supra* note 86..

[534] German corporate law requires a supermajority vote. As to the AG, See AktG, §§ 179a para 1 and 179. Courts extend this regime also to those potentially elusive scenarios in which the company sells all but its insignificant assets. See RG, May 13, 1929, 124 RGZ 279, 294 f.; BGH, Feb. 25, 1982, 83 BGHZ 122, 128. Finally, case law has also established an unwritten competency for significant transactions involving more than 80% of the AG's assets. See BGH, Feb. 25, 1982, 83 BGHZ 122, 131-137; BGH, Apr. 26, 2004, 159 BGHZ 30, 41-46. A similar regime governs these transactions in GmbHs, because a shareholder meeting must "be convened where it appears necessary in the company's interest" (GmbHG, § 49 para. 2) and courts have drawn on this provision to require the approval of the shareholder meeting before directors initiate the sale of all the company's assets. See, e.g., BGH, Jan. 8, 2019, 220 BGHZ 354. Italian blackletter corporate law does not mandate the vote of shareholders on a sale of substantially all assets of SPAs. Yet, scholars argue that such transactions do require shareholder approval, because they are apt to strike a fatal blow to the very existence of the firm and, thus, naturally fall within the "primordial" competencies of the shareholder meeting. See Giuseppe B. Portale, *supra* note 75, at 142. Other scholars reach the same conclusion in different ways. See, e.g., Pietro Abbadessa & Antonino Mirone, *Le competenze dell'assemblea nelle s.p.a.*, 55 RIVISTA DELLE SOCIETÀ 270, 277 (2010). Italian courts support these conclusions by constantly stressing that directors' function and role cannot go beyond the actions required to implement the company's business object. See, e.g., Corte di Cassazione, 3 March 2010, No. 5152 (stressing that "the powers of a director are limited to those falling within the company's business object"). As a matter of fact, such transactions are routinely subject to prior approval by the shareholder meeting. Blackletter corporate law does not stipulate explicitly any such requirements for SRLs. It nonetheless provides that directors are responsible for managing the firm, and shareholders must decide on any transaction that causes any significant change in the company's business object. See artt. 2475-bis, 2479, commas 2 and 5, codice civile (It.). Case law has regularly concluded that a sale of substantially all assets executed without shareholder approval is voidable. See, e.g., Tribunale di Roma, 27 January 2020.

[535] As to controlling shareholders' duty of loyalty under German corporate laws, see, also for references, *supra* note 315. For its application in the context of trade sales, see generally *supra* note 493.

[536] Under German law, the appraisal remedy is only available in the enumerated cases. See Gesetz über das gesellschaftsrechtliche Spruchverfahren (Spruchverfahrensgesetz - SpruchG) [Appraisal Proceedings Act], June 12, 2003, BGBl. I at 838, § 1 No. 5. Asset sales do not trigger appraisal. However, courts may void the essential shareholder resolution on the grounds that the purchase price was inadequate, that one shareholder pursued special advantages, and that, therefore, the votes cast in favour of the transaction violated shareholders' fiduciary duties. See, e.g., BGH, Oct. 9, 2006, 169 BGHZ 221, 228. Consequently, disgruntled entrepreneurs can indirectly challenge the pricing in asset deals. In Italy, a sale of substantially all assets does not trigger shareholder withdrawal rights in firms organized as SPAs, but it does in firms organized as SRLs. To be sure, blackletter corporate law stipulates that, if a company organized as SRL undertakes any transactions that causes a substantial change of its business object as determined in the firm's charter, then any shareholder who has not voted in favour can withdraw from the company. See art. 2473, comma 1, codice civile (It.). Case law has repeatedly held that a sale of substantially all assets implies a substantial change of the company's object and thus triggers withdrawal rights. See, e.g., Tribunale di Roma, 11 November 2022.

[537] See *supra* text accompanying notes 496 and 512.

of their liquidation preferences—the original issue price or a multiple thereof, plus any unpaid dividends.[538] Standard arrangements stipulate that redemption will occur if a specified percentage of convertible preferred shareholders so resolves[539] and the firm's legally available funds allow for a share buyback.[540] These arrangements also apply in the so-called vampire scenario: if the VC-backed firm's funds are insufficient to redeem all the VCF's shares, the firm must buy as many shares as its financial conditions permit, and, as more funds become legally available, any remaining shares until the VCF is fully divested.[541] These arrangements benefit from the support of other clauses enabling the VCF to secure board control and to initiate actions that produce the cash required to liquidate the VCF's shares, such as prompting the sale of the firm's crown jewels.[542]

Redemption rights provisions serve three key functions. First, they provide VCFs with an easy-to-activate downside protection in case the VC-backed firm underperforms.[543] Second, they offer VCFs a route for an exit from portfolio companies that they do not want to stay invested in but can neither go public nor find a buyer.[544] Third, and most importantly, they give VCFs leverage vis-à-vis the entrepreneur: by threatening their exercise, which would make the VC-backed firm go bankrupt, they can discipline the entrepreneur, particularly in the run-up to a trade sale.[545] Hence, by making entrepreneurs' defection and opportunism less likely, they mitigate moral hazard in many ways at crucial junctures of the business relationship and indirectly support other contractual components.[546]

German and Italian corporate laws do not allow for redemption rights *à la* Delaware.

German corporate law allows AGs to redeem shares either in events pre-specified in the charter or in a voluntary acquisition of the shares by the company.[547] Only in the latter case is a pre-specification of events triggering redemption not required,[548] the underlying rationale being that the redemption is underpinned by a voluntary at-arm's-length tender of the redeemed shares. Yet, the redemption still requires an ad hoc supermajority shareholder resolution.[549] This non-waivable[550] precondition implies that the entrepreneur's consent is necessary for the redemption to proceed. Moreover, such a redemption requires a prior share buyback and, therefore, the relevant regime protecting creditors' interests also applies. Accordingly, the VC-backed firm is allowed to buy no more than 10% of its shares unless it concomitantly reduces its share capital (though not below the statutory minimum, of course).[551] Such a share capital

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[538] On liquidation preferences, see *supra* text accompanying notes 159-171. On automatic and cumulative dividends, see *supra* text accompanying notes 214-219.

[539] MAYNARD & WARREN, *supra* note 91, at 584.

[540] *Id.*, at 579-580.

[541] MAYNARD & WARREN, *supra* note 91, at 586-587.

[542] *Id.*, at 595 (explaining that the failure of the portfolio company to redeem the VCF's shares is a default event enabling the VCF to appoint additional directors, as discussed *supra* note 308 and corresponding text).

[543] See Gilson, *supra* note 5, at 1075.

[544] See PEARCE & BARNES, *supra* note 91, at 45 (defining these provisions as granting a "drop-dead right to be bought out, should the VC still be stuck in an investment after a defined period.").

[545] Gilson, *supra* note 5, 1075.

[546] *Id.*

[547] See § 237 para.1 of the AktG.

[548] For the demanding pre-specification requirements that apply in compulsory redemptions and that thwart U.S.-style redemption rights, see *supra* III.C.2.vi.

[549] See §§ 222 para. 1, 237 para. 2 sentence 1 of the AktG (requiring a "majority amounting to at least three quarters of the share capital represented").

[550] Rolf Sethe, *§ 237*, *in* GROßKOMMENTAR ZUM AKTG - VOL. 7.1, para. 60 (Klaus J. Hopt & Herbert Wiedemann eds., 4th ed., 2012). See also Marcus Lutter, *§ 237*, *in* KÖLNER KOMMENTAR ZUM AKTG - VOL. 4, para. 44 (Ulrich Noack & Wolfgang Zöllner eds., 3rd ed., 2019).

[551] See AktG, § 71 para. 1, no. 6, 8 (stipulating that the general meeting cannot authorise share buybacks exceeding 10% of the company's share capital, unless it resolves on a share capital reduction).

reduction, in turn, also requires a supermajority shareholder vote.[552] Hence, to make sure that the required supermajority will not be of obstacle to having their shares redeemed, VCFs will need to enter into shareholder agreements granting them control over the entrepreneur's voting behaviour.[553] Yet, such shareholder agreements do not suspend shareholders' fiduciary duties, implying that the entrepreneur may litigate a shareholder resolution redeeming and/or reducing the share capital for the sole benefit of the VCF and have it invalidated.[554] All in all, buybacks are unviable to serve VCFs' redemption interests.[555]

The regime for GmbHs is relatively more permissive. In addition to generally permitting redemptions in voluntary share buybacks,[556] it also gives more leeway to execute such repurchases, for instance by allowing GmbHs' charters to empower directors with the authority to decide on the redemption.[557] Yet, it also imposes constraints on the exercise of these rights. The regime for capital maintenance, for one, may stand in the way of a share buyback by requiring that the expenditures be paid from unappropriated retained earnings.[558] Therefore, particularly in an unprofitable venture, redemptions will often necessitate a capital reduction in the GmbH as well, which raises the same concerns previously outlined for the AG due to the mandatory requirement of a shareholder vote.[559]

Italian corporate law does not allow redemption right provisions *à la* Delaware either. Unlike the regime for SPAs, which allows for shareholder rights to sell their shares back to the company,[560] the regime governing SRLs explicitly forbids share buybacks,[561] thereby ruling out the viability of any arrangement granting the VCF redemption rights. Yet, the inclusion of redemption rights in SPAs' charters would be another means to insulate the VCF from the firm's losses, contravening the prohibition against *societas leonina* and thus proving null and void.[562] Even assuming that the prohibition against *societas leonina* does not come in the way, redemption requires a share buyback that the VC-backed firm can plausibly implement only

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[552] See AktG, §§ 222 para. 1 and 237 para. 2, sentence 1.

[553] KUNTZ, *supra* note 14, at 746.

[554] See *supra* notes 315 and 343.

[555] See also Baums & Möller, *supra* note 12, at 60.

[556] See GmbHG, § 34 para.1 (restricting only compulsory redemptions).

[557] The delegation is not explicitly foreseen in the relevant statute. However, the majority view applies the general rule of GmbHG, § 45 para. 2 also to the general meetings' default competence for redemptions and permits delegations in the company's charter on these grounds. See, e.g., Harm Peter Westermann & Christoph Seibt, *§ 34*, *in* SCHOLZ GMBHG - VOL. I, para. 41 (13th ed., 2022).

[558] GmbHG, § 33 para. 2 sentence 1 (specifying that payouts must not reduce the share capital or utilise reserves to be formed in accordance with the firm's charter).

[559] See *supra* text following note 549. Note that scholars qualify the capital reduction as an amendment to the firm's charterthat falls within the exclusive remit of shareholders. Joachim Tebben, *§ 58*, *in* SCHOLZ GMBHG - VOL. III, paras. 2 and 31 (13th ed., 2025).

[560] Such arrangements are not explicitly covered by the regime on redeemable shares. See *supra* text preceding note 442. Yet, building on scholarly work that deems them viable, some practitioners defend the validity of these arrangements, at least in principle. See Consiglio Notarile dei Distretti Riuniti di Firenze Pistoia e Prato, *Massima No. 67/2018 "Azioni riscattande, prezzo di vendita e patto leonina*," https://www.consiglionotarilefirenze.it/index.php/orientamenti/societa-di-capitali/azioni-e-quote/240-azioni-riscattande-prezzo-di-vendita-e-patto-leonino-67-2018.html. Regulatory uncertainty is, however, pronounced on this matter. See *infra* note 564.

[561] See *supra* text accompanying note 68.

[562] Even scholars who take a more liberal approach and attempt to defend the validity of redemption rights cannot help but cast doubts over the validity of arrangements contemplating price-setting provisos shifting the consequences of firm underperformance from one shareholder to another, making the beneficiary look insulated from the firm's downside risk. See, e.g., GIORGIO MARASÀ & NICOLETTA CIOCCA, RECESSO E RISCATTO NELLE S.P.A. COMMENTO AGLI ARTICOLI 2437–2437-SEXIES C.C. 41 (2011).

subject to the cumbersome rules and limitations for such a transaction.[563] Moreover, the exact boundaries of private ordering in this area are blurred to say the least.[564]

Needless to say, the regulatory obstacles that stand in the way of transplanting U.S.-style redemption rights arrangements also rule out the viability of the complementary arrangements governing the vampire scenario.[565]

To obviate the German corporate law constraints, charters grant the VCF the right to sell back its shares to the firm at the price of one euro.[566] These arrangements can play no role in disciplining the entrepreneur.[567] Indeed, if the VCF's equity is worth more than 1 euro, the VCF's decision to exercise their redemption right would result in a windfall for the entrepreneur. Such arrangements could be defended on the ground that their function is not to protect against downside risk. Rather, they prevent the prolonged participation in poorly performing portfolio companies, because being "stuck" in such firms may entail significant opportunity costs and potentially also negative reputational consequences, a rationale that also buttresses U.S. redemption rights. However, an alternative arrangement that serves only one of the two functions of the U.S. corresponding clause is obviously inferior.

Alternative arrangements like those that are commonplace in German VC deals are also known in Italian VC deals.[568] But the solution of choice are provisions in shareholder agreements granting the VCF the right to sell shares to the entrepreneur—rather than to the firm. These arrangements grant VCFs leverage to threaten entrepreneurs with transactions that could trigger personal bankruptcy, creating powerful incentive effects.[569] Consequently, they may prove even more effective than U.S. redemption rights.[570] Yet, these alternative arrangements suffer from two severe limitations. Even if courts retained their more recent stance on the validity of redemption rights included in shareholder agreements,[571] the VCF could not rely on the self-enforcing tools that come with board control, which can only be

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[563] See *supra* text accompanying notes 446-447.

[564] Scholars and practitioners debate crucial details of these arrangements, such as whether the right to sell can be against the company or against other shareholders only, whether the redemption right must be exercised within a specific timeframe, or whether legal restrictions exist on the redemption price. Compare Consigli Notarili di Roma e di Firenze, *supra* note 582, with Consiglio Notarili Runiti di Roma, Velletri e Civitavecchia, *Massima No. 5 "Azioni riscattande" – July 2016*, https://www.edotto.com/download/consiglio-notarile-di-roma-massime-societarie-luglio-2016.

[565] See *supra* text accompanying note 541.

[566] Wolfgang Weitnauer, *Teil H - Exit*, in HANDBUCH, *supra* note 15, at para. 20.

[567] See *supra* text preceding note 545.

[568] Gardina & Pairona, *supra* note 15, at 435 (suggesting that, under Italian corporate law, in lieu of redemption right provisions, the charter could grant the VCF a put option at a "symbolic price" to enable VCFs to "clean its financial statements from the participation held in the start-up.").

[569] See Ryan McMorrow, Wenjie Ding, & Nian Liu, *Chinese Venture Capitalists Forced Failed Founders on to Debtor Blacklist*, *Financial Times*, 5 January 2025, https://www.ft.com/content/38f1e51b-83b8-45cb-9cbf-2bc63f18e6ce. For a discussion of how forcing the entrepreneur into personal bankruptcy affects their incentives to start a business and ultimately reduces the demand for VC see John Armour, *Personal Insolvency Law and the Demand for Venture Capital*, 5 EUR. BUS. ORG. L. REV. 87 (2004).

[570] See *supra* text accompanying note 545.

[571] Courts, with the generalised support of scholars, have in the past tended to consider these alternative arrangements as instrumental to insulating the shareholder from bearing the firm's losses and thus as in violation of the prohibition against *societas leonina*. On the prohibition against *societas leonina*, see *supra* text following note 146. An abundant case law spanning more than three decades considered provisions granting one shareholder a redemption right toward another shareholder null and void. See, e.g., Corte di Cassazione, 29 October 1994, No. 8927; Tribunale di Milano, 30 December 2011; and Tribunale di Milano, 23 July 2020. Scholars have been supportive of these rulings by regularly arguing that this regime applies irrespective of whether a shareholder has a redemption right towards the firm or another shareholder. See, e.g., MARASÀ & CIOCCA, *supra* note 562, at 41. More recent rulings tend to acknowledge their validity. See Corte di Cassazione, 4 July 2018, No. 17498; Tribunale di Bologna, 15 May 2023; and Tribunale di Milano, 8 May 2023.

established through redemption rights included in the firm's charter.[572] Further, the VCF intending to enforce its redemption right would have to start a lengthy judicial proceeding against a likely cash-constrained entrepreneur—with the prospect of facing significant costs without realising much, if anything at all. In other words, mounting a credible threat carries a significant price tag for the VCF.

To conclude, the alternative arrangements that typically appear in German and Italian VC deals fail to perform all the functions of U.S. redemption rights arrangements and/or are less effective in performing the ones they do serve. Perhaps most importantly, at least in Germany, they are by design unfit to serve as disciplining tools.

IV. CONCLUSION

The success of the U.S. VC industry also builds on the flexibility of Delaware corporate law. This legal regime allows VCFs and entrepreneurs to craft a contractual framework that effectively addresses the problems of uncertainty, moral hazard, and information asymmetries typical of their relationship and braids the contract the VCF enters with the entrepreneur, on the one hand, with the one it enters with its investors, on the other.[573]

In this article, we have investigated whether VCFs and entrepreneurs bargaining under German and Italian corporate laws can transplant U.S. VC contracts into their local deals—whether by replicating *verbatim* the contractual arrangements used in the U.S. or by resorting to other arrangements that, although possibly different in their design, may achieve the same allocation of cash-flow and control rights. German and Italian corporate laws exhibit an *über*-mandatory structure.[574] They look like a labyrinth of prescriptions. This maze only occasionally originates from E.U. mandatory corporate law. Instead, it nearly always stems from national corporate laws. Notably, the relevant restrictions originate much less frequently from blackletter corporate law than from the various rules and standards that scholars elaborate. The resulting regulatory constraints rarely come in the form of absolute prohibitions that prevent VCFs and entrepreneurs from adopting any arrangement apt to tackle a specific governance challenge. Rather, they mostly come in the form of relative prohibitions that allow for alternative arrangements. These arrangements are, however, inferior to those used in U.S. VC deals, leading to a functionality gap in the contractual technology available to VCFs and entrepreneurs. As pointed out in a companion paper,[575] this may, at the margin, have an impact on VC-backed firms' cost of capital and, ultimately, on the vibrancy of the VC market and its ability to support innovation and growth. This finding holds several critical lessons for policymakers, which we present in another companion paper.[576]

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[572] See *supra* text accompanying note 542.
[573] See *supra* text accompanying notes 93-94.
[574] See *supra*, text accompanying note 23.
[575] Enriques et al., *supra* note 18.
[576] Enriques et al., *supra* note 22. In that paper we further dig into the question of whether regulatory arbitrage may assuage the implications of the present paper's findings and counter the objection that aversion to litigation within the VC industry makes these findings less relevant. *Id*.

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