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Startups and Company Law: The Competitive Pressure of Delaware on Italy (and Europe?)

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Abstract

US corporate law and, in particular, Delaware law, which leaves ample room to freedom of contract, has been one of the reasons for the successful creation and financing of startups in Silicon Valley. We analyze the Italian attempt to modernize company law in order to promote startup creation within the wider movement of company law simplification and modernization around Europe. In Italy a suitable corporate law statute for early stage startups was missing. Italy is a dual system jurisdiction. The SPA (public company type) has at least part of the required financial flexibility, but it is still burdened by European rules on legal capital and inflexible rules concerning management and controls. The SRL (private company type) offered a lot of leeway as to the management of the company, but left no room for freedom of contract with regard to financing, since it was not imagined as a vehicle for investors. In response to competitive pressure, economic aspirations and social changes, and to general demands from European institutions for some forms of facilitation of firm creation and venture capital, the Italian lawmaker has slowly transformed the SRL and created what is basically a new type of company (the SME SRL), which lies in between the two original types but whose borders are not fully clear. The ambiguous character of this company form makes it a problematic model for venture-funded startups. On the basis of our analysis, we argue that Italian corporate law is under competitive pressure from Delaware rather than from inter-European competition on corporate charters, and that path-dependance and remaining limits to freedom of contract burden Italian company law and prevent economic growth. We make some policy suggestions, among which the introduction of a counter-Satzungsstrenge principle for private companies.

Keywords: company law, innovative startups, private companies, freedom of contract, venture capital, business angels, crowdfunding, financing SMEs, regulatory competition

JEL Classifications: K22, L26, M13

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Abstract
US corporate law and, in particular, Delaware law, which leaves ample room to freedom of contract, has been one of the reasons for the successful creation and financing of startups in Silicon Valley. We analyze the Italian attempt to modernize company law in order to promote startup creation within the wider movement of company law simplification and modernization around Europe. In Italy a suitable corporate law statute for early stage startups was missing. Italy is a dual system jurisdiction. The SPA (public company type) has at least part of the required financial flexibility, but it is still burdened by European rules on legal capital and inflexible rules concerning management and controls. The SRL (private company type) offered a lot of leeway as to the management of the company, but left no room for freedom of contract with regard to financing, since it was not imagined as a vehicle for investors. In response to competitive pressure, economic aspirations and social changes, and to general demands from European institutions for some forms of facilitation of firm creation and venture capital, the Italian lawmaker has slowly transformed the SRL and created what is basically a new type of company (the SME SRL), which lies in between the two original types but whose borders are not fully clear. The ambiguous character of this company form makes it a problematic model for venture-funded startups. On the basis of our analysis, we argue that Italian corporate law is under competitive pressure from Delaware rather than from inter-European competition on corporate charters, and that path-dependance and remaining limits to freedom of contract burden Italian company law and prevent economic growth. We make some policy suggestions, among which the introduction of a counter-*Satzungsstrenge* principle for private companies.

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1 Introduction

Pressure on Italian company law is not coming from other European countries through EUCJ decisions regarding the freedom of establishment and regulatory competition,[1] but from the US, i.e. essentially from Delaware. This process probably involves many other European countries.[2] In Italy, it is driven by young Italian scientists and entrepreneurs that gravitate around Silicon Valley or are exposed to the US experience through research, by Italians who populate the venture capital community or have been exposed to venture capital activities, and by US-financial institutions that are active in Italy. These actors have increasingly started to demand US-equivalent instruments for financing startups, a term which we use in this article exclusively to define firms started by entrepreneurs, usually with small teams of employees, and "backed by outside investment with the goal of developing an innovative product or service, creating high growth, and exiting through a trade sale of the company or IPO."[3]

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[1] For an overview of the issue of freedom of establishment and the main developments of the European market for corporate charters, following the jurisprudence of the ECJ, see, e.g., Lombardo (2019); Bartolacelli (2017), pp 187 et seq; Gerner-Beuerle et al. (2019), pp 1 et seq, exclude that a "European Delaware" will emerge in the near future, with the regulatory competition mainly confined to minimum capital requirements and rules affecting the ease of the incorporation process.

[2] On this argument, see recently Moon (2019), pp 1 et seq.

[3] See Pollman (2019), p 9.

However, Italian law, as many laws around Europe, were not equipped to offer similar instruments. Those laws were shaped at the end of the XIX century by completely different economic forces and actors, which today are apparently no longer able to promote strong economic growth. When this became apparent at the end of the last century, the law of private companies was gradually amended, albeit without a systematic approach and clearly defined policy guidelines.

As a result, Italian company law is in turmoil. Even though not openly, the piecemeal approach is demolishing an old legal institution of Continental Europe, the "Gesellschaft mit beschränkter Haftung" (GmbH) model that was embraced by the majority of European countries between the end of the XIX century and the first half of the XX century, thereby creating a dual model system based on the public company (like the German AG) and the private company (like the German GmbH). From an Italian perspective, the current dual system approach is ill equipped to face the developments of the new millennium, because it is unable to meet the needs of a new social class (the startuppers) and the political aspirations to find easy-to-implement tools to invert falling productivity.

The demolition process is not working smoothly, however, because culture and legal doctrines still influence the approach toward company law, which is not seen as a means to enable contractual freedom. Italian company law remains still a 'prisoner' of explicit or even more dangerous implicit prohibitions that limit economic development.

This article is organized as follows. In Section 2 we briefly introduce the importance of startups and venture capital in economic growth, and why the issue is so important for Europe, and explores the paradigm model, which is of course the US one. We analyze the key features of US startups, especially from a company law perspective, in order to show how important the enabling spirit is of the most important US corporate law, namely Delaware, in order to encourage complex financing deals concerning startups. Section 3 turns to Europe, examining the history of the European dual-class company model, with the process that led to the bifurcation of the UK company model and the Continental Europe model inspired by the German approach. This part aims at showing that the model of the German GmbH and its European progeny, notwithstanding recent modernization efforts, is not amicable to startups. Section 4 describes how the Italian legislator, with a sort of a counter-intuitive move that

may be explained by the limited freedom of manouvre on the public company due to European company law directives, has sought to reshape the private company (SRL) in order to meet the needs of a new social class, the startuppers, whose reference point is US corporate law. Section 5 deals with the many issues that the Italian legal experiment raises. We will show that many problems still persist notwithstanding the significant regulatory effort. The reasons consist in some inherent characteristics of the SRL that makes it still unsuitable for angels' financing and venture capital deals. In Section 6 we offer some empirical data and brief policy recommendations. In the final Section we draw our conclusions.

2. The US Experience: Contractual flexibility and the financing of startups

2.1 Europe is craving for startups

Old Europe craves for US-like startups. Innovative startups have been a major force in commercializing innovative science and revoluzioning the world we live in. Innovative startups that survive and then scale up create jobs and wealth. Today, the five largest companies by market capitalization started as venture capital-backed startups.[4] According to the website 'CB Insights', there are around 300 private companies worth more than USD 1 billion in the world.[5] Among them, there are only a few European "unicorns",[6] such as BlaBlaCar (France) or CureVac (Germany). Therefore, Europe is still lagging behind, and European institutions are trying to ignite a startup revolution through public initiatives and coordination measures, such as the Start-up and Scale-up Initiative.[7] All these initiatives take Silicon Valley as a reference point.[8] In this article we do not take a position on whether this policy is a good one or

[4] The reference goes to Apple, Alphabet, Microsoft, Amazon, and Facebook.

[5] For such information, see also Pollman (2019), p 3.

[6] See Lee (2013).

[7] See European Commission (2016).

[8] The European Commission describes its Startup Europe initiative as intended to "connect local startup ecosystems around Europe and enhance their capacity to invest in other markets such as Silicon Valley and India". For this statement, see European Commission (2019). For a general overview on the policy goals pursued by public intervention into the Silicon Valley venture capital market, see Lerner (2002), pp 73 et seq. For a good description of the (unique) peculiarities of the Silicon Valley venture capital market, see Kuntz (2016), pp 203 et seq.

whether any attempt to recreate the very idiosyncratic Silicon Valley environment is futile. A large literature deals with the issue, and we refer to it for readers who wish to explore the matter.[9] In this paper we focus exclusively on company law.

With regard to Italy, there are no Italian unicorns except Yoox,[10] and there is a visible absence of innovative startups that can aspire to becoming unicorns. In order to create a favourable environment, Italy has adopted some targeted policy interventions, among which a radical transformation of its corporate law. Indeed, some authors discussed the theoretical arguments for and against the importance of appropriate business forms for the growth of start-ups in Europe, discussing the US Limited Liability Company (LLC) as a reference point for a European liberalization process.[11] Italy has taken precisely this route, but not by introducing a new business form, but by reshaping, instead, an old one, the "società a responsabilità limitata" (SRL), the Italian counterpart of the German GmbH. In order to assess whether the Italian company law approach to startup creation is a good one, we need to understand the problems and the main issues of a negotiation between an entrepreneur with almost no capital wanting to start an innovative business and specialized capital providers, and whether corporate law can play an enabling role.

[9] Cf. Gilson (2003), pp 1067 et seq.; Da Rin et al. (2006), pp 1699 et seq.; Armour and Cumming (2006), pp 596 et seq., showing that countries with less liberal personal bankruptcy laws have significantly lower demand for venture capital and private equity; Vermeulen (2018), pp.

[10] Yoox SPA, the first Italian high fashion online discount retailer, was incorporated in 2000. The seed stage was widely supported by Italian private equity funds (firstly, the leading Italian VC Elserino Piol through Kiwi I and Kiwi II) and some Italian entrepreneurs, including Renzo Rosso from Diesel. Only 3 years later, Yoox was already a European leading company in the field of online fashion, operating in more than 15 countries and ready to penetrate the U.S. market, also thanks to the support of the U.S. Benchmark Capital, along with other international venture capital funds. Yoox was listed first on FTSE STAR in 2009, than on FTSE MIB in 2013. In 2015 Yoox merged with the U.S. Net-A-Porter, a company controlled by the Switzerland Compagnie financière Richemont, to become YNAP SPA. In 2018 Compagnie financière Richemont made a successfull 5.3 billion takeover bid of YNAP SPA. The company was subsequently delisted as a result of this transaction. See Financial Times, Richemont bids to take full control of Yoox Net-a-Porter, 22 January 2018.

[11] See McCahery and Vermeulen (2004), pp 227-232. On the "LLC revolution" and its legislative history, see Ribstein (2010), pp 119-123.

2.2 The economics of the relationship between the innovative entrepreneur with no capital and the capital providers

Financing a startup is not an easy task. A startup is nothing more than an idea and an entrepreneur with a team looking for finance. The investor who decides to finance the entrepreneur has to overcome very significant problems. Firstly, the potential capital provider might wonder why the entrepreneur has not been financed by previous employers or any incumbent within the industry: adverse selection could lie behind an entrepreneur's approach for money.[12] Secondly and even more importantly, the investor has to deal with the entrepreneur's propensity to moral hazard. The entrepreneur may use the money not for developing the project, but for different purposes; or he/she can work leisurely instead of working hard[13].

The deal therefore is structured in order to bind the entrepreneur to his or her promise of working hard for value creation. Since the investor cannot measure the quality and quantity of the work efforts in the development of the project until value creation is visible, the financing is structured in stages ("milestones") following a principle of reward for performance, where the achievement of certain measures of performance is a signal that can persuade the investor to finance further.[14] In order to ring-fence the investment and the ensuing principle of reward for performance, cash-flow rights and control rights over the company are assigned in a way that let the entrepreneur fully enjoy his or her stake only when value is actually created - when the firm is sold on the market or an IPO takes place. Thus, the entrepreneur's interest in the company is vested, and the investor gets preference over dividend distribution (when the firm goes well) and/or liquidation proceeds (when the firm is unsuccessful). Moreover, the investor obtains control rights that allow for the appointment of one or more directors on the board (investor directors) and the taking of full control over the board and the company in case performance is below the expectations and the investor wants to sell or stop the business. On the other side, if value creation occurs, the entrepreneur gains full control of his or her stake, and receives the uncapped benefits of the work done.[15] These

[12] See, e.g., Bankman and Gilson (1999), pp 289 et seq.; McCahery and Vermeulen (2008), pp 159-163.

[13] Cf. Kuntz (2016), pp 48-50; Cumming and Johan (2009), pp 32 et seq.

[14] Generally on these arguments, Hölmstrom (1979), pp 89-91.

[15] See Ross (1977), pp 23 et seq.

complex agency relationships need to be governed by means of an adequate contractual framework, which at the corporate level usually sees the employment of convertible notes and convertible (non-participating or participating) preferred shares.[16]

2.3 The US way to finance startups: incorporation and FFFs

Startuppers initially fund their company with their own money ("bootstrapping") and that of family, friends and fools (FFFs).[17] These initial investors purchase common stocks and share the same rights and risks of the founders, since both personal relationships and the investment size work against the costs and confrontations of a more developed and complex negotiation.[18] The company is usually incorporated in Delaware or, less frequently, in the founders' home state[19] – even though the arrival of investors from a state outside the home state increases the likelihood that the firm reincorporates in Delaware.[20] Indeed, the model documents prepared by the National Venture Capital Association refer to a hypothetical Delaware start-up.[21]

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[16] Cf. the fundamental contributions by Berglöf (1994), pp 247 et seq.; Aghion and Bolton (1992), pp 480 et seq.; Triantis (2001), pp 305 et seq. For an excellent summary and overview of the US venture capital experience, see Kuntz (2016), pp 61 et seq.

[17] See Kotha and George (2012), pp 525 et seq.

[18] In approximately half of crowdfunding offerings, investors are offered non-voting shares, which can be converted in voting common shares upon certain triggering events. The purpose is to avoid an excessive fragmentation of the voting rights, which might later restrain VCs from investing in the company. See on this argument, Wroldsen (2017), p 564.

[19] See Broughman and Ibrahim (2015), p 292 (who show that a start-up firm typically makes a binary choice, incorporating either in its home state or in Delaware. Just over two-thirds (67.8 percent) of the sample firms choose Delaware as the initial state of incorporation, and, of the remaining 32.2 percent, most – 28.7 percent – incorporate in their home states. Only 3.5 percent of sample firms choose to incorporate in a jurisdiction other than Delaware or their home state).

[20] See Broughman et al. (2014), p 867. See also Eldar, Grennan and Waldock (2019), p. 51, table A.1.

[21] See National Venture Capital Association (2019). The model certificate of incorporation form explains the choice as follows: "Delaware is generally the preferred jurisdiction for incorporation of venture-backed companies for many reasons, including: 1. The Delaware General Corporation Law (the "DGCL") is a modern, current, and internationally recognized and copied corporation statute which is updated annually to take into account new business and court developments; 2. Delaware offers a well-developed body of case law interpreting

The dominance of Delaware's company law is the subject of an immense literature, and there are different competing explanatory hypotheses, among which that of an efficient law administered by a highly competent judiciary, network and learning effects, interest groups, investor familiarity.[22] Whatever the reason for this dominance, Delaware's corporate law system is characterized by its extreme respect for private ordering. It is a broad enabling law[23] consistent with a contractarian vision and "much different than one might find in a civil law nation, which would more likely have a prescriptive corporation law chock full of mandatory terms specifying exactly how corporations must conduct their business."[24] Indeed, the enabling spirit of US corporate law in general, and Delaware in particular, have favoured start-up financing in ways that might be not sufficiently appreciated from the inside of the US environment, as the comparison with Italy will show.

2.4 Angels

The next round of financing after FFFs is supported by wealthy individuals ("angels") and their groups (angel groups),[25] who also provide advice to the company. [26]

A typical angel round ranges from USD 100,000 to 1 million.[27] Angels quite often enter into an investment agreement, albeit

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the DGCL, which facilitates certainty in business planning; 3. The Delaware Court of Chancery is considered by many to be the nation's leading business court, where judges expert in business law matters deal with business issues in an impartial setting; and 4. Delaware offers an efficient and user-friendly Secretary of State's office permitting, among other things, prompt certification of filings of corporate documents."

[22] For a review and discussion, see amongst the most recent studies Broughman et al. (2014), pp 865 et seq.; Skeel (2016), pp 1 seq.; Bainbridge (2018), pp 1-16.

[23] See, e.g., *Williams v. Geier*, 671 A.2d 1368, 1381 (Del. 1996) ("At its core, the Delaware General Corporation Law is a broadly enabling act which leaves latitude for substantial private ordering …").

[24] See Strine jr (2005), p 674.

[25] See Ibrahim (2008), pp 1443 et seq.

[26] Cf. Lerner et al. (2018), pp 1 et seq.; Sørheim and Botelho (2016), pp 76-91; Prowse (1998), pp 785 et seq.; Wetzel jr (1983), pp 23 et seq. A new institution form is emerging in the form of investment accelerators, while crowdfunding is not working well as a mechanism to finance early-stage startups: for this argument, see Bernthal (2015), pp 157 et seq.

[27] See Sohl (2003), p 14.

simplified if compared to a VC deal. Previously, angels used to invest in shares, but gradually moved to more protective investment instruments, such as convertible notes with a discounted conversion price cap (seed debt)[28] or simplified convertible stocks (seed equity).[29]

As to seed debt, in order to reduce transaction and management costs, in many deals convertible notes have been morphed into the "convertible security" or the "simple agreement for future equity" (SAFE) - actually, instruments where the debt-type features are stripped away and the call option over future shares is kept.[30] The basic idea behind all these instruments is that angels can call their option when VCs step in, getting shares at a discounted value over the firm's one. In other words, angels pre-finance the company with the expectation of the VCs' arrival and at a price that will be linked to the valuation of the firm given by the VCs, with a premium in the form of a discount.

Simplified convertible stocks, instead, are stripped-down forms of the Serie A financing documents that are the typical financial instruments of VCs' funding rounds. They have an advantage over seed notes for angels (especially angel groups) and other investors that have time and competence to evaluate the startup's value. Indeed, while with seed debt and equivalent convertible securities or SAFEs the conversion value depends on the startup's valuation given by venture capitalists, through seed equity investors assess that valuation and fix their share of the company well before the coming into play of VCs, with the hope of getting a better deal.[31]

[28] On the conversion price cap and its economic functions, see especially Green and Coyle (2014), pp 163-165.

[29] See Kaplan and Strömberg (2003), p 284.

[30] Cf. Green and Coyle (2014), pp 166-171; Green and Coyle (2016), pp 171 et seq.

[31] According to Green and Coyle (2014), p 172, these stripped-down financing documents provide some protections to investors, such as a board seat, a right of first offer on future financings, a non-participating preferred liquidation preference, certain blocking rights, and may also have a "most favored nation" provision that allow them to capture the benefits of more articulated VC terms that they agreed to give up at the seed stage. See also Ibrahim (2008), pp 1405 et seq., who discusses why angels' contracts differ from VC ones, the rationale for this difference and the role of angel groups in developing middle-way forms of financing (seed equity).

2.5 Venture capital

Venture capital funds tend to make substantial investments and therefore step in at a later stage than FFFs and Angels.[32] VCs invest incrementally, making additional investments as the startup meets identifiable milestones. At each round new investors can step in, thereby creating a complex financial structure with many layers of capital[33] that can give rise to interinvestor conflicts.[34] An example of the articulated and complex set of contracts that are signed in each different VC round is offered by the National Venture Capital Association, which provides a set of industry-tested model documents that are usually taken as a reference point in venture capital financing.[35]

VCs investment instrument of choice are preferred stocks, adopted to get additional rights and protections compared to common

[32] See Lerner, p 778.

[33] A recent study of 135 unicorn companies found that the average unicorn has eight share classes, and many have a wide mix of equity holders including founders, employees, VC funds, mutual funds, sovereign wealth funds, and strategic investors. For this account, see Gornall and Strebulaev (2019), p 2.

[34] See Bartlett III (2006), p 61.

[35] See National Venture Capital Association (2019), which provides a preliminary non-binding term sheet containing the main term and condition of the final agreement, and several model contracts which include: (a) a stock purchase agreement, by which investors receive newly issued shares of preferred stock in exchange for money; (b) an amended and restated certificate of incorporation, establishing the rights, preferences, privileges and restrictions of each class and series of the corporation's stock, the classes of shares, and certain investor protections; (c) an investor rights agreement, providing certain rights for the investors (such as information and control rights, registration rights, rights of first offer or preemptive rights); (d) a separated right of first refusal and co-sale agreement; (e) a voting agreement, providing the investors with the right to designate the election of certain members of the board of directors and the terms and conditions to execute such a right; (f) a management rights letter, indicating the "contractual rights running directly from the portfolio company to the [venture, ed.] fund that give the fund the right to participate substantially in, or substantially influence the conduct of, the management of the portfolio company"; (g) an indemnification agreement, providing indemnification rights by the company in favor of its directors or officers, in case they are part of certain proceedings connected to their role in the company; (h) a legal opinion, concerning the existence and composition of the company and the actual power and authorizations to execute the obligation under the transaction documents; (i) HR policy documents; (l) a code of the company's conduct policy; and a disclosure and confidentiality agreement, regarding proprietary and confidential information of the company.

stockholders.[36] Preferred stocks offer upside gains in the form of dividend preference, and downside protection through liquidation preference in the event of a winding up. The preference entitles VCs to a specified value before common shareholders receive anything; and preferred stocks usually earn a cumulative dividend which, if unpaid, progressively increases the liquidation preference.[37] Preferred usually incorporate convertible rights and are assisted by anti-dilution protections, preemptive rights, redemption rights, rights of first refusal, tag along and drag along rights.[38] VCs preferred stocks usually bring the right to elect one or more board members,[39] offering VCs the possibility to gain potential, if not actual, control of resolutions concerning the CEO and the main portfolio company's business decisions.[40]

Since the liquidation preferences often far exceed the original purchase price of the stock, VCs' preferred stocks have cash-flow rights similar to debt. There are situations where the VCs can prefer liquidation and payment to business continuation that can put at excessive risk the liquidation premium.[41] However, preferred stocks are favoured over debt because VCs, as equity securityholders, can control decisions in a way that they would not be able to achieve as debtholders, at least without putting in danger their limited liability.[42] Preferred stocks and the control rights they give to VCs are also accompanied by negative covenants (protective provisions or veto rights)[43] that limit the entrepreneur's discretion and protect the

[36] Kaplan and Strömberg (2003), p 286 (94% of VC investments from 1987 to 1999 were conducted through preferred stock). The dominance of preferred stocks is also due to tax reasons: Gilson and Schizer (2003), pp 874 et seq.

[37] In a plurality of deals, VCs' convertible preferred stock enjoy "participation rights". VCs are thus entitled not only to a liquidation preference, but also to share pro-rata with common shareholders any additional value available for distribution to shareholders, usually up to a specified amount. See Fried and Ganor (2006), p 982.

[38] For a thoroughly analysis, see Smith (1997), pp 107-133.

[39] Usually VCs gain additional board seats with each round of investment. There is therefore a gradual transition from the initial board with a minority of VCs' appointed directors to a board controlled by the VCs: see Smith (2005), pp 326-327.

[40] Hellmann (1998), pp 57 et seq.

[41] This is one of the many scenarios where preferred and common stockholders can have different interests, and where the board's position and composition becomes fundamental.

[42] See Bratton (2002), p 915.

[43] Those protective provisions are usually set in the term sheet and then inserted in the charter as preferred stocks' rights.

preferred stocks' interests from those, potentially conflicting, of common stocks[44]. Thus, through preferred stocks VCs get disproportionately more control than equity[45] - a rather unique corporate governance structure, where preferred, rather than common shares, control the company.[46]

Before venture capitalists invest, they plan for exit. VCs' exit can happen through sale of shares (after an IPO or a trade sale of the portfolio company), redemption of the shares pursuant to a contractual put option, liquidation of the portfolio company and ensuing distribution of cash.[47]

In order to motivate the entrepreneur to work hard after the VC investment is done, the VC links the entrepreneur's pay to performance; and to avoid the risk of the entrepreneur's seeking to renegotiate the deal by threatening to leave (the hold-up problem), the VC offers sequential option vesting to the entrepreneur and key personnel.[48]

2.6 A view from Continental Europe: The importance of contractual freedom

A great amount of economic and law & economics research offers an explanation to the problems and the incentive logic that underpins the architecture of VC deals.[49] Maybe not enough emphasis has been put on the role that the enabling character of US law and, in particular, Delaware law has played in framing the VC market. In truth, US scholars have discussed the VC phenomenon to explain why US statutes (or statutory sections) concerning close corporations have not been as successful as legislatures hoped for.[50] Indeed, the problems that affect the VC-entrepreneur relationship are a specific

[44] Negative covenants restrict the company from engaging in business combinations and other key transactions without prior approval from VCs, thus protecting preferred stockholders from common stock maneuvers.

[45] See Gilson (2003), p 1082.

[46] See Fried and Ganor (2006), p 971.

[47] See Smith (2005), p 339.

[48] See Levin and Rocap (2018), Ch. 2-14 et seq. (discussing performance vesting and time vesting).

49 For some starting points, cf. Gompers and Lerner (2001), pp 145 et seq.; Gompers et al. (2016), pp 1 et seq.; Kaplan and Lerner (2016), pp 1 seq.

50 Cf. Stevenson (2001), pp 1142 et seq.; Bartlett III (2006), pp 37 et seq. For the argument that contractual flexibility is not enough, see Wortman (1995), pp 1362 et seq.

sub-set of the more general problems concerning close corporations, where the real issue does not concern the manager-shareholder relationship, as is the case in public companies, but inter-shareholders' conflicts.[51] Contractual freedom and flexibility have granted a solution to these problems without any need for specifically tailored corporate forms or paternalistic mandatory rules aimed at protecting one or the other part of the deal.[52] Accordingly, freedom of contract granted by the general law of corporations has been sufficient to develop a superb VC market able to finance startups. When the general law of corporations has not been enough, the explosion of the Limited Liability Company (LLC) has offered an alternative vehicle for investments, a venue able to grant full freedom of contract.[53] Yet, the general law of corporations has generally sufficed, and the VCs invest in corporations rather than in LLCs, where both tax problems and formalities required transforming an LLC into a corporation at the time of exit discourage VCs.[54]

As mentioned, the capital structure of startups, with many different layers of equity and related preference/subordination relationships, is fertile ground for conflicts of interest amongst each class of investors.[55] Indeed, one of the issues that concerns Delaware corporate law with regard to VC transactions is the inherent conflict between preferred and common in a situation where, because of the liquidation preference, the former wants liquidation while the latter wants prosecution with the hope of some upside. The issue is whether directors' fiduciary duties protect a common stock minority when a preferred stockholder in control exercises its contract rights to impair the common's interest. Delaware's leading case, *Trados*, covers the issue, holding that, when a company has no common equity value but it is still a viable business, there is an inherent

51 Cf. McCahery and Vermeulen (2010), pp 31 et seq.; Faccio and Lang (2002), pp 365 et seq.

52 For the importance of a more flexible company law for VC-financed companies see already, among European corporate law scholars, Baums (2003), p 182.

53 Cf., for a general overview, Macey (1995), pp 433 et seq.; Ribstein (2010), pp 119 et seq.

54 See Ribstein (2010), pp 237-238. However Eldar et al. (2019), pp 18 et seq. present data according to which LLC startups are a minority but still significantly present.

55 Cf. Pollman (2019), p 33; Benchmark Capital IV, L.P. v. Vague, No. Civ. A. 19719, 2002 WL 1732423 (Del. Ch. July 15, 2002).

conflict of interest between preferred stockholders with an in-the-money liquidation preference and common stockholders. In boards with a majority of VC appointed directors this conflict is enough to move the standard of review up to the rigorous entire fairness standard.[56]

In Delaware, therefore, the main issue concerning mandatory provision attaches to boards' fiduciary duties.[57] Apart from that, the law looks, at least to a European observer, smoothly settled, with no interferences from provisions or doctrines built to induce the existence of hidden mandatory prohibitions, as would be the situation in some European environments (as the case of Italy will show), plus a great respect for contractual outcomes.

3 Europe and the GmbH-tradition

3.1 Italian startuppers in search of a vehicle

Italian startuppers who had worked, came into contact or simply heard of the Silicon Valley model experienced major problems in finding a vehicle similar to the Delaware-corporation.[58] The Italian public company ("società per azioni"), the equivalent of the German "Aktiengesellschaft" (AG) and the French "société anonyme" (SA), had some traits that could cope well with some startup features, in particular in terms of financial flexibility.[59] However, two main obstacles prevented young, capital deprived startuppers from

[56] See In re Trados Inc. S'holder Litig., 73 A.3d 17 (Del. Ch. 2013). The shift to the entire fairness standard is a significant factor in litigation. The board is not protected by the business judgment rule. Moreover, since "the entire fairness standard is inherently fact-intensive, requiring evidence about process and price, it can be very difficult in that setting for directors to have litigation terminated at an early stage when the factual record has not yet been developed": for this statement, see Bochner and Simmerman (2016), p 8. The topic is thoughtfully discussed, among others, by Bratton and Wachter (2013), pp 1874 et seq.; Bartlett III (2015), pp 263 et seq.; Korsmo (2013), pp 1163 et seq.; for critics see Strine jr (2013), pp 2025 et seq.

[57] Cf. Pollman (2019), p 56; Sepe (2013), pp 329 et seq.

[58] We consider as a good representation of this social group some of the members of the task-force that was established in 2012 to advise the government on reforms aimed at fostering startups' creation and venture capital: see, for further references, below 4.1.

[59] A certain degree of financial flexibility is granted by the possibility to issue different classes of shares (Art. 2348 c.c.), or to allocate shares to shareholders non proportional to the contributions made (Art. 2346 c.c.), etc.

initiating business from scratch through an SPA: mandatory minimum capital of Euro 50,000 and a compulsory board of three statutory auditors ("collegio sindacale"), which means, anecdotally, a fixed cost of around Euro 15,000-20,000 per year.

The new social class of startuppers then turned back to the SRL, the family business type of corporation. However, also the old SRL could not satisfy the needs of this new social class, for reasons that are mainly embedded in the history of company law in Continental Europe.[60]

3.2 Regulatory models in European company law: one-law model vs two-law model

The corporate forms belonging to the broader GmbH-family, which represents the prototype of the European closely held business forms, were constructed in order to prevent their access to capital markets, which substantially meant outside equity investors. The Italian legislator went even further in the 'closing' of its paradigm model of close corporation, the SRL. In order to better understand the relevant development, we will look briefly at the historical roots of European company law.

A classical distinction in European company law is the one between public and private companies (AG/GmbH, Plc/Ltd, SA/SARL, NV/BV, etc.). Differences among Member States arise with respect to the regulatory model chosen for the governance of these two company forms. On one hand, we encounter jurisdictions (e.g. Germany, Austria) that follow a two-law model, according to which public limited and private limited companies are regulated in distinct and separate legislative acts. Similarly, other Member States, although comprising the relevant regulation in one Code (France, Italy, Switzerland) or in a Consolidated Act (Spain), clearly treat public and private companies as different forms of organisations, with the majority of provisions addressing either the former or the

[60] The Report of the task force established by the Ministry for Economic Development in 2012, in order to propose reforms to the Italian regulatory system aimed at favouring startups' creation, describes the situation that startuppers would have faced at the time as follows: "they can settle for contractual forms that are not suitable for their purposes, as those forms where imagined for different kind of objectives, and are unable to satisfy their competence and entrepreneurship. Alternatively, they can go abroad - or decide to abandon any further attempt": see Report (2012), p 13 (our translation from Italian).

latter. On the other hand, different Member States, like the Nordic countries (Denmark, Finland and Sweden), all following the common law example of the United Kingdom[61], adopt a one-law system for the regulation of the substantially uniform company model.[62]

Historically, the outlined distinction between public and private companies is much less natural than one would believe at first sight.[63] In fact, at the beginning companies were all public, given that incorporation required a royal charter or a special act of Parliament and the company typically aimed to raise capital from the public.[64] The differentiation became clear-cut in Europe only with the abolition of the concession system and the consequent introduction of freedom of incorporation in the mid-19th century. Following this turning point, general limited liability was granted also to entrepreneurs who did not intend to raise capital from the public, but more simply wished to establish a partnership-like company in order to partition and shield their assets.[65]

In this regard, two jurisdictions represent the paradigmatic benchmark of comparison, namely Germany and the UK. Both countries had the most industrialized economies at that time. Furthermore, between them a competitive race for the incorporation of private limited liability companies was already ongoing.[66] In fact, although the German legislator in 1892 was the first to enact an Act on private limited liability companies (*GmbH-Gesetz*),[67] in the United Kingdom the phenomenon of small private companies,

[61] Outside Europe, South Africa and Japan follow the one-law model with a single overarching legal form for (non-listed) limited liability companies. For such references, see Fleischer (2016a), pp 62-63.

[62] Cf. Fleischer (2015a), pp 411-415; Wymeersch (2009), pp 71 et seq.; European Model Companies Act (2017), p 16.

[63] See Harris (2013), p 340: "Unlike living organism, and contrary to a common misconception, business corporations did not begin small (and private) and only then grew bigger (and public)".

[64] See Harris (2013), p 342.

[65] For the concept of affirmative asset partitioning and its historical impact on the evolution of legal organizations, see especially Hansmann and Kraakman (2000a), pp 387 et seq.

[66] Fleischer (2015b), Introd., marg. no. 56, who makes references to the position expressed by one of the fathers of the German GmbH Act (Wilhelm Oechelhäuser): The latter saw in the English limited the "most dangerous competitor".

[67] Lutter (1992), p 49, pointedly states that the *GmbH-Gesetz* represents "Germany's most important and successful legal export product".

though receiving formal recognition only in the Companies Act 1907 (sec. 37), was already established in legal and economic practice.[68]

During the last decades of the XIX century, important stock market bubbles plagued both Germany and the UK. However, the policy reactions to the financial scandals differed.[69] Germany experienced in 1873 the so-called 'founders' crash' (*Gründerkrach*), the first major stock exchange crash. In response, in 1884 the *Aktienrechtsnovelle* was passed, i.e. a reform of the law on joint-stock companies (AG) at that time contained in the General German Commercial Code (ADHGB), which tightened the rules on company formation and the duties of the supervisory board.[70] The purpose was to prevent abuses in the use of the limited liability regime. However, although this overhaul was deemed necessary for large public companies, the protective rules were considered both superfluous and burdensome for small and medium enterprises with a limited number of shareholders and no intention of offering the shares to the market.[71] For this purpose, with a legislative gestation period of only 4 months, unequalled in German history, the Act on limited liability companies, elaborated in autonomy by a ministry of justice civil servant Eduard Hoffmann, was promulgated in 1892.[72] With it, a closed organizational form was created for the exercise of business activities by SMEs, characterized by limited liability and freedom of contract in shaping the tailor-made governance structure.[73]

Similarly, in the United Kingdom, especially under the Joint Stock Companies Act 1856, incorporation was a simple and inexpensive process, with the consequent formation of numerous fraudulent companies. Thus, the Companies Act 1900 strengthened the regulatory requirements, intervening, contrary to the German legislator, not on the formation regime, but rather on the disclosure regulation.[74] Again, the needs of SMEs were bypassed and not

[68] See Harris (2013), p 346.

[69] For a good overview, see Gerner-Beuerle (2017), pp 263 et seq.

[70] H Fleischer (2015b), Introd., marg. no. 51.

[71] See Lutter (2006), p 4; Gerner-Beuerle (2017), p 295. For similar arguments expressed in the 1920s during the discussions for the introduction in Italy of the *società a garanzia limitata*, see Asquini (1939), p 237.

[72] See for historical references, Fleischer (2015b), Introd., marg. no. 64-68.

[73] Noteworthy is the fact that in the period between 1892 and 1922, GmbH operated mostly in risky business sectors, like the mining, transport, metallurgical and chemical industries, confirming the usefulness of the new form also for highly speculative enterprises.

[74] For details, see Gerner-Beuerle (2017), pp 272 et seq.

adequately reflected. Therefore, on the basis of recommendations formulated by a reform commission, the Companies Act 1907 differentiated for the first time between public and private companies[75] and relaxed regulations for the latter.[76]

In conclusion, starting from a comparable social-economic context, the two lawmakers moved in opposite directions that still path-dependently influence European company law. The British choice characterized by the protection of market integrity through a transparency approach with stricter prospectus and disclosure rules; the German option in favour of a more demanding formation regime inspired by the conviction that the repetition of past financial scandals could only be avoided if the capital structure of corporate issuers were tightened.[77] All this, at the end, brought to the emergence in Germany of the private company as a distinct form of organization, while the United Kingdom remained loyal to the uniform company model, with the public and private company being mere variants of the basic form, and with very liberal capital requirements in comparison to the German counterparts.

3.3 Italy's further "closing" of the SRL

As mentioned above, the Italian lawmaker, especially during the overall corporate law reform of 2003, emphasized the concept of closely held ownership structure in the SRL even more strongly than some of its European counterparts. In fact, while at the time of its introduction in 1942 the SRL was considered a "simplified" or "minor" public corporation, in 2003 this corporate type was reshaped in a completely new way. The public corporation-centric view was substantially dismissed and replaced by a quotaholder-centric perspective.[78] In fact, the leitmotif of the reform was to enhance the central role of the quotaholder in the governance structure, meant to

[75] See sec. 37(1) Companies Act 1907, according to which a private company is "a company which by its articles (1) restricts the right to transfer its shares; (2) limits the number of its shareholders to fifty; and (3) prohibits any invitation to the public to subscribe for any shares or debentures of the company". Today, only the last restriction is still in place.

[76] See Fleischer (2015a), p 413.

[77] See Gerner-Beuerle (2017), p 295.

[78] We refer here to quotaholders instead of shareholders, in order to stress that persons participating in an SRL are somewhere in between partners and shareholders, but are distinctly something different.

be an important element of modernization.[79] The distinctive features of the newly designed SRL found expression in numerous provisions, which, for instance, allow the attribution of special rights to individual quotaholders,[80] offer the possibility to choose between different management structures,[81] or grant quotaholders the inalienable right to decide on specific resolution matters (appointment and removal of directors and auditors, dividend payments, charter amendments, fundamental corporate transactions).[82] The result was the construction of a corporate form centred on partnership-like quotaholders actively involved in the conduct of the business.[83] Thus, the possibility to fund the private company by way of appeal to public savings, both on the equity and debt side, was forbidden.[84] Equally forbidden was the issuance of different classes of quotas or the carrying out of operations on the company's own quotas. This regulatory approach was not suitable to adequately reflect the needs and aspirations of outside equity investors such as VCs, which want to safeguard corporate interests – as seen – different from those belonging to "entrepreneurial" quotaholders.

3.4 The modernization trend across Europe: a true response to startup needs?

The two different regulatory models described above entered into competition at the end of the last century, with the fundamental *Centros* decision by the ECJ and its progeny.[85] As a consequence, the law of private companies, starting from 2003, has been profoundly overhauled all around Continental Europe.[86] The different legislators

[79] Cf. Zanarone (2010), p 53 seq.; Buonocore (2003), 170 ("new era of shareholder rights").

[80] Art. 2468(3) c.c.

[81] Art. 2475 c.c.

82 Art. 2479(2) c.c. For all these arguments, see extensively Campobasso (2015), pp 555 et seq.

[83] See Campobasso (2015), p 557.

[84] Art. 2468(1) c.c.: "The shareholders' quotas can neither be represented by shares nor be offered to the public as financial instruments". Also the newly allowed possibility to issue debt securities (Art. 2483 c.c.) suffers important limitations in the SRL: for more details see below 5.1.

[85] Case C-212/97, 9 March 1999. For a historical overview of the relevant ECJ case law, see recently Lombardo (2019), pp 1 seq.

[86] For a good overview, cf. Fleischer (2014), pp 1081 et seq.; Neville and Sørensen (2014), pp 545 et seq.

followed a reform agenda aimed at the modernization of the outdated legal framework. The focus, obviously, was on SMEs (so-called 'think small first' approach),[87] whose incorporation and internal corporate governance structure was meant to be made more attractive, flexible and less expensive and burdensome.

Inspired by those rationales, a flood of innovative legislative actions ensued, contributing to a completely new shaping of the law of private companies. Noteworthy, among many, is the French *Loi Dutreil pour l'initiative économique* of 2003, the already mentioned Italian reform of 2003, the German *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen* of 2008, the Spanish *Ley de la sociedad limitada Nueva Empresa* of 2003 and, more recently, the Dutch *Wet vereenvoudiging en flexibilisering bv-recht* of 2012.

As mentioned, all of these national reforms pursue a common policy objective of regulatory relaxation inspired by the common law experience. In particular, the efforts concentrated on the facilitation of the formation of new enterprises, the emancipation from the public corporation-centric view that was still influencing doctrines around Europe, the strengthening of freedom of contract, and the introduction of new types or subtypes of close corporations.[88] The national legislators have focused their modernization efforts particularly on the first and last of these goals.

With reference to the former, a constant move towards the abolishment or, at least, the relaxation of the minimum capital requirements can be observed in a comparative perspective. In fact, while up to the beginning of the 20th century the lawmakers required also for private companies the paying-up of a minimum share capital, varying between Euro 7,500 (France), Euro 10,000 (Italy), Euro 18,000 (Netherland), Euro 25,000 (Germany) and Euro 35,000 (Austria), nowadays most of them allow the formation of

[87] Such leitmotif has been expressly stated in the preparatory works of several national reform laws. E.g., for Italy see the *Relazione* on the SRL reform of 2003 (§ 11: "the reform is intended to satisfy the needs particularly observed in the area of small and medium enterprises"); for Spain see the explanatory notes of the reform of 2003, which emphasises the role of the new *sociedad limitada nueva empresa* for the promotion of small and medium corporations as the backbone of Spanish and European economy and key to creating new jobs (Ley 7/2003, BOE núm. 79, 2.4.2003, 12679, 12680). On the supranational level, see the Small Business Act for Europe of 2008 (COM(2008) 394 Final). For further references, see Fleischer (2014), p 1085.

[88] For this systematization, see Fleischer (2014), pp 1085 et seq.

a(n)(ordinary or simplified) private limited liability company with a share capital of Euro 1 or even below.[89] At the same time, some legislators acknowledge the importance of speeding-up the incorporation process, a policy objective pursued by allowing online registration (proposal for a *Societas Unius Personae* directive[90]) or by smoothening and debureaucratising the formation formalities (Spain, Portugal, Denmark). Other countries (e.g., Italy, Germany) are still hesitant on this front, mainly because of the still pending discussion on the role and value of the public notary in the formation process. In any case, all these measures are meant to simplify and accelerate the setting-up of new businesses and, thus, boost national economic growth.[91] However, this process was not specifically and expressly targeted at creating an environment favourable to the rise of European startups.

Turning now to the other central focus point of the legislators' modernization efforts, the competitive race led everywhere to the introduction of a simplified version or a subtype of the 'standard' private limited liability company. Mostly, such new vehicles have been established in order to better suit the particular needs of newly formed companies. Among such vehicles, Spain introduced in 2003, but without gaining substantial success[92], the *sociedad limitada nueva empresa* (SLNE), which is a simplified form of the *sociedad de responsabilidad limitada*. Five years later, the German lawmaker introduced the Entrepreneurial Company (*Unternehmergesellschaft* - UG) as a new variant of the classical GmbH without a minimum capital requirement. At this point, all barriers seemed to have fallen and a wave of imitating reform actions were put on track. In Belgium a new private company subtype was developed in 2010, the so-called *société privée à responsabilité limitée-starter* (SPRL-S), now

[89] Two prominent exceptions are Austria and Switzerland, where the law requires respectively Euro 35,000 (§ 6 *GmbHG*) and CHF 20,000 (§ 773 *OR*) as minimum capital for the incorporation of a *GmbH*, although in Austria the peculiar regime of the *Gründungsprivilegierung* is allowed (§ 10b *GmbHG*). For detailed comparative references, cf Grimm (2013), pp 51 et seq.; Bartolacelli (2017), pp 197 et seq. For some empirical data, see Braun et al. (2013), pp 399 et seq.

[90] See European Commission, 9.4.2014 COM(2014) 212 final: see explanatory memorandum, par. 3, part. 2, ch. 4: "The Directive requires Member States to offer a registration procedure that can be fully completed electronically at a distance without requiring the need of a physical presence of the founder before the authorities of Member State of registration".

[91] See for similar conclusions, Fleischer (2014), p 1086.

[92] See Bartolacelli (2017), p 199.

abolished by the recent massive company law reform of 2019.[93] The Italian legislator introduced in 2012 a simplified version of the *società a responsabilità limitata* (*s.r.l.s.*), originally available only to founders aged under 35 – a restriction then lifted in 2013 – and without noteworthy incorporation costs due to the compulsory use of a statutory template. Similarly, the Danish legislator established in 2014 the *ivaersaetterselskab* (IV) as a domestic version of the German UG.[94]

Although all Member States have made significant efforts for the promotion of entrepreneurship and competitiveness, a specific approach addressing the problems and needs of startups was missing. It is clear that the tradition of Continental Europe never envisaged the GmbH and its progeny as the cradle for European startups, which in the US inspiring experience are rapid-growth companies with external investors and an IPO as the final outcome. The GmbH-like form around Europe is the one used for family businesses, with no external professional investors and certainly not imagined as a fast-track for IPOs.[95]

In order to accommodate the needs of startuppers and given the barriers created by the European law of public companies Italy, with a curious and totally unexpected turn of events, opted to reform once again the SRL model. This meant turning the SRL's history on its head, and this is exactly what Italy has done from 2012 onwards.

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[93] See *Code des sociétés et des associations* of 23 March 2019. For the new regulation of LLCs (*société à responsabilité limitée* or *SRL*), see especially book 5 (Art. 5:1 et seq.) of the mentioned Act.

[94] For detailed comparative references on the above subtypes and the legislative evolution process, cf. Fleischer (2014), pp 1088-1089; Portale (2010), pp 1237 et seq. For empirical data on the costs of incorporation of Italian simplified SRL, see Lavecchia and Stagnaro (2019), pp 277 et seq.

[95] The European Model Company Act (EMCA) group has sought to induce a cultural change in the approach to the law of the private company around Europe. Its proposal is to abandon the two-law model in favour of the one-law model, and to give to European private companies the maximum possible financial flexibility, by taking the Finnish and Italian experience of public companies as a reference point for private companies as well. Therefore, even though the US startup experience is not at the core of the proposal of a European Model Company Act, it is clear that it represents a strong signal of disaffection with the rigid approach that has been typical of Continental Europe so far. See European Model Companies Act (2017), pp 15-16. For the pros and cons of the transition from a one-law to a two-law model and vice versa, see Fleischer (2016a), pp 63-65.

4 Startups by law: The Italian silent abandonment of the GmbH tradition

4.1 The 2012 reform: startups and crowdfunding

After less than 10 years since the 2003 reform, in the middle of a deep economic crisis and pressed by European institutions and the need to do something to reignite economic growth, the lawmaker decided once more to overhaul corporate law. The Ministry for Economic Development formed a task force of 12 experts in the field of startups, accelerators, incubators and venture capital. Most of them had matured significant experience in the US startup and venture capital world.[96] The task force drafted a report, titled "Restart, Italia!" that contained proposals for an "iSRL package", as it was termed in the document, envisaging almost all the instruments that are used in VC financing: work-for-equity and a less restrictive regime of legal capital for startups, convertible notes, different class of shares in the form of performance shares for the founders and the team and seeding shares for investors, with attached all the typical rights given to investors in VC financing, such as tag-along and drag-along rights, liquidation preference, right to appoint directors, etc.[97] The report envisaged also amendments to the regulation of management companies in the area of Venture Capital, a specific regulatory regime for crowdfunding, and a more favourable insolvency law regime.

Following the "Restart, Italia!" report, the government enacted a 2012 legislative package called 'Growth Decree' (Artt. 25-32 of the Decree Law 18th October 2012, no. 179, converted into Law 18th December 2012, no. 221). The Decree contained an explicit policy statement according to which its stated purpose was to foster the formation, development and financing of technologically innovative

[96] According to mass media, the task force was composed of Paolo Barberis (founder of Dada SPA); Giorgio Carcano (ComeNExT); Annibale D'Elia (Bollenti Spiriti); Luca De Biase (journalist and founder of the association Startup Italia); Andrea Di Camillo (Banzia, Principia); Riccardo Donadon (founder of H-farm, a venture incubator); Mario Mariani (Net Value, a venture incubator); Massimiliano Magrini (Annapurna Ventures, then merged with Jupiter Ventures to form United Ventures, a VC); Enrico Pozzi (academic and founder of Eikon); Giuseppe Ragusa (academic interested in innovation and startups), Selene Biffi (social entrepreneur) e Donatella Solda-Kutzmann, an officer at the Ministry with international academic studies. Apparently, no company law experts were involved.

[97] See, in particular, Report (2012), pp 51-52.

enterprises, thus boosting the growth and competitiveness of the entire economic system.[98] The 2012 reform amended the law of SRL to the benefit of a very limited set of SRL – called by law "innovative startups." The relevant provisions define the innovative startup as an entity incorporated in the form of a private company, public company or, even co-operative, whose quotas or shares are not traded on a primary or secondary market. Furthermore, such a company has been in existence for no more than 60 months,[99] is not the result of an extraordinary corporate transaction (e.g. merger, division), and has its headquarters in Italy or in another Member State (but in the latter case with a branch in Italy). Additional conditions are: annual revenues not higher than Euro 5 million starting from the second year; non-distribution of profits since incorporation; company activities consisting exclusively or predominantly in the development, production or trading of innovative products or services having a high technological value. Finally, the innovative startup must meet at least one of the following requirements: (a) minimum threshold of R&D expenses,[100] or (b) minimum number of highly qualified employees,[101] or (c) holder of at least one intellectual property right. If the above conditions for the qualification as an innovative startup company are satisfied, the latter is registered in a special section of the company register.[102]

The package was aimed at targeting a specific population of firms, granting regulatory advantages over standard SRL. From a corporate law perspective,[103] the changes allow innovative startups incorporated in the form of an SRL to: a) issue classes of quotas with

[98] For these policy guidelines, see the ministerial report accompanying the first reform on innovative startups of 2012. Similarly, Council Recommendation (2012), rec. no 6. ("Improve access to financial instruments, in particular equity, to finance growing businesses and innovation").

[99] The original limit was four years. This means that qualification as an innovative startup is necessarily limited in time.

[100] The research and development expenses must be equal to, or greater than, 15% of the higher value between the company's productions costs and the company's production value.

[101] At least one-third of the personnel shall be represented by individuals having a Ph.D., or carrying out a Ph.D. or having a degree and having completed a research program of three years at public or private research entities in Italy or abroad. Alternatively, at least two thirds of its workforce shall be composed of individuals with a master degree.

[102] Art. 25(8), Decree Law 2012, no. 179.

[103] Here less relevant are tax benefits enjoyed by startups, as well as some exemptions from general labor and bankruptcy law.

different rights and, within the limits imposed by the law, freely determine the content of said rights;[104] b) offer their quotas to the public, also by means of online equity crowdfunding campaigns;[105] c) carry out transactions (buybacks) on their own quotas functional to implement incentive plans for the allocation of quotas to employees and directors;[106] d) issue hybrid financial instruments; e) enjoy more favourable rules with regard to the reduction of capital for losses and to balance sheet insolvency.[107] This reform sought to kill two birds with one stone by offering: (i) financial flexibility in order to attract angels and VCs, and (ii) access to crowdfunding. The regulatory distance between the public and the private corporate forms was reduced,[108] and the GmbH tradition was broken through measures that do not find equivalents in the comparative landscape.[109]

The 2012 reform introduced also measures concerning crowdfunding platforms, which were detailed in a specific regulation issued by the Italian regulatory authority in 2013.[110] Probably the coeval intervention and the contextual link between the 2012-2017 company law amendments and the crowdfunding regulation,[111] plus the attention and hypes generated by the latter, distracted Italian academics working on the company law reform. In fact, they substantially ignored the VC model of startup financing, even though it was referred to in the "Restart, Italia!" report and in the documents

[104] See Art. 26(2), Decree Law 2012, no 179. Thus, it is legitimate to grant corporate rights not proportional to the holding in the company; or to assign special rights to the class of quotas (and not the single shareholder), thereby derogating from the general rules set forth for private companies in Art. 2468(2-3) c.c. Furthermore, it is possible to create classes of quotas without voting rights, with multiple voting rights or with voting rights limited only to particular resolution matters [Art. 26(3)].

[105] See Art. 26(5), Decree Law 2012, no. 179, thus derogating from the principle laid down in Art. 2468(1) c.c. For equity crowdfunding see also the newly introduced Art. 100-*ter* of the Consolidated Financial Service Act (CFSA) of 1998, no. 58.

[106] See Art. 26(6), Decree Law 2012, no. 179, thus derogating from the general rule set forth in Art. 2474 c.c. In the legal literature on all the above-mentioned regulatory innovations, cf. Benazzo (2017), pp 467 et seq.; Cian (2018), pp 818 et seq.; Campobasso (2019), pp. 140-141.

[107] See Art. 26(1), Decree Law 2012, no. 179.

[108] On this last argument, see Benazzo (2017), p 470.

[109] See, for references, Cian (2015), pp 969 et seq.

[110] National Commission for Companies and the Stock Exchange (CONSOB), Regulation no. 18592 of 26 June 2013.

[111] Cf Art. 26 (company law amendments) and Art. 30 (crowdfunding), Decree Law 2012, no. 179.

mentioned in the law reform,[112] focusing instead almost exclusively on crowdfunding as an instrument to finance early stage startups.[113] Perhaps surprisingly, the discussion that will follow in Section 5 on the application of the new rules to VC financing has not taken place yet, to the best of our knowledge, on Italian law journals.[114]

4.2 The 2015-2017 reforms – the GmbH tradition collapses

The Italian legislator continued to pursue its policy objective to innovate the law of private companies. In fact, already in 2015 the so-called Investment Compact was enacted (Decree Law 24th January 2015, no. 3, converted into Law 24th March 2015, no. 33). Pursuant to it, all the changes originally introduced only for innovative startups were extended to innovative SMEs,[115] as defined in accordance with the Recommendation 2003/361/CE.[116] Again, innovative SMEs need to respect some qualificatory requirements.[117]

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[112] Art. 25, Decree Law 2012, no. 179 mentions the recommendations by the European Council and the Program of National Reform 2012, which do not mention crowdfunding and refer, instead, to venture capital: see Council recommendation 2011, premises no. 11 and recommendation no. 5.

[113] This point is also remarked by De Luca et al. (2017), p 164. For an excellent exam of the crowdfunding phenomenon, see Schedensack (2018), pp 37 et seq.

[114] Cf., among the many authors that have examined the new startup reform, Benazzo (2017), pp 467 et seq.; id. (2014), pp 101 et seq.; Cagnasso (2015), pp 79 et seq.; id. (2016), pp 2285 et seq.; Cossu (2014), 1705 et seq.; Cian (2018), pp 818 et seq.; id. (2015), pp 969 et seq.; Guaccero (2014), pp 699 et seq.; Speranzin (2018), pp 335 et seq.

[115] See Art. 4(9), Decree Law 2015, no. 3.

[116] The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million (see Annex, Art. 2 of the mentioned Recommendation). According to the EU Commission, SMEs represent 99% of all businesses in the EU.

[117] See Art. 4(1), Decree Law 2015, no. 3. In particular, the company's headquarters must be located in Italy or in an EU Member State (with at least one branch in Italy); the balance sheet has to be audited; the shares or quotas cannot be listed on regulated markets; the company shall not be registered as innovative startup in the special section of the company register. Furthermore, innovative SMEs must comply with two (and not only one as stated for innovative startups) of the following technology benchmarks: a) R & D expenses must be equal to, or greater than, 3% of the higher value between the company's productions costs and the company's production value; b) one fifth of company's workforce must have a

However, the legislative remodeling did not complete the re-regulation in this area of company law. In 2017, those amendments were extended to all SMEs, also if non-innovative in the sense specified, and thus *de facto* to all SRLs (Decree Law 24th April 2017, no. 50, converted into Law 21st June 2017, no. 96). This result was achieved by simply replacing the words 'innovative start-up' with the word 'SME'.[118] The only exception, probably due to a lack of coordination, is represented by the impossibility for (non-innovative) SMEs to issue hybrid securities, the so-called *strumenti finanziari partecipativi*.

These, in short, are the salient stages of the 'disruptive' regulatory evolution in the Italian law of private companies. Innovative startups and SMEs incorporated as SRL can now be structured openly with a target towards the public equity and debt market, subject to the limits that will be evidenced in para. 5.1. Surprisingly, only the (few) "big" SRLs continue to preserve their traditional closely held characterization, a systematic incongruity that a more thorough legislator would correct. However, although very important progress has been made, still many critical barriers remain for startup companies and VCs. In fact, freedom of contract still suffers important restrictions in the design of the ideal or best-fitting financial structure.

5 Problems of a silent revolution: The construction of the new rules on innovative startups

5.1 Issuance of convertibles

Convertibles, either in the form of convertible debt or shares, are considered essential for the financing of startups.[119] However, there are doubts as to whether the private company can issue convertible notes.

All private companies, including startups, are allowed to issue 'standard' debt securities, the so-called *titoli di debito*.[120]

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doctoral degree or, alternatively, at least one third shall be composed of individuals with a master degree; c) holding of at least one intellectual property right.

[118] Art. 57 of the above mentioned Decree Law, thereby referring to Art. 26(2, 5 and 6) of the Decree Law 2012, no. 179.

[119] Cf. Black and Gilson (1998), p 260; Gilson and Schizer (2003), pp 874 et seq.; Gilson (2003), pp 1067 et seq.; Leitner (2009), p 19.

[120] See Art. 2483 c.c.

Considering that such financing tools were typically used by public companies,[121] their availability also for SRLs was considered a significant innovation at the time of the statutory intervention in 2003.[122] However, the possibility to add a conversion right, perfectly legitimate for public companies,[123] was on the contrary not foreseen by the law. Faced with this legislative gap, scholars debated whether convertible debt notes could be issued by SRLs.[124] Rather surprisingly for reforms aimed at promoting startups and financial flexibility, the 2012-2017 overhauls did not address the issue. Accordingly, this uncertainty prevents the adoption of such a fundamental instrument for the financing by business angels and eventually venture capitalists.

In any event, a series of restrictions apply to the issuance of *titoli di debito* and therefore would operate with regard to convertible notes as well. First, the issuance is subject to an explicit authorization by the articles of incorporation. Second, such debt securities can be bought on the primary market only by professional investors subject to prudential regulation,[125] such as banks, insurance

[121] See Art. 2410 c.c.

[122] See the accompanying report to the Reform Law of 2003, § 11, which emphasizes the importance of the new rules, evidencing that they were enacted in order to "obtain a balance between the need of SRLs to get access to debt financing and the necessity to protect the investors' interests". In practice, on 31 March 2013 only 18.90% of all SRLs (1,357,936) amended their bylaws in order to allow the issuance of *titoli di debito*. For such data, see Bellavite Pellegrini and Pellegrini (2014), pp 19 et seq.

[123] See Art. 2420-bis c.c.

[124] For the negative opinion, cf. Fimmanò (2005), pp 99 et seq.; Spada (2003), p 806. For the affirmative solution, see Campobasso (2007), pp 786-787. The most important obstacle to the issuance of convertible *titoli di debito* is represented by Art. 2468(1) c.c., which forbids that quotas can be represented by negotiable financial instruments. In fact, the assignment of an equity conversion right could represent a mechanism apt to bypass this mandatory provision. It is well possible, though, and also known to the practice, that the quotaholder grants a loan to the company, incorporating also a contractual conversion right, i.e. the classical debt-to-equity swap. Still, this *contractual* solution bears many inconveniences, considering that at the time of conversion the interested loanholder has to acquire the consent of all current quotaholders, including the ones who eventually became members afterwards, willing to transfer the necessary interests to the loanholder or to increase the share capital specifically for this purpose. Furthermore, the breach of any contractual obligation incurred gives rise only to compensation for damages and not to specific performance.

[125] Italian law does not provide any definition of such type of investors, so that interpretative doubts arise. Annex 3, Regulation no. 20307 of 15 February 2018 of the National Commission for Companies and the Stock Exchange provides

companies, and pension funds. Finally, administrative rules fix the minimum price of each issued note to Euro 50,000.[126] In addition, the total amount of all issued debt securities has in any case to be below the amount of the share capital plus retained earnings.[127] Moreover, the first (professional) holder of the *titoli di debito* is responsible for the solvency of the company towards the subsequent purchaser, unless the latter is a professional investor or a quotaholder.[128]

Apart from these general limitations, another potential obstacle to the issuance of convertible notes is given by current pre-emptive rights regulation.[129] In fact, if such instruments were legitimately offered to external investors, such as business angels or VCs, appraisal rights of dissenting quotaholders may be triggered, throwing the financial burden onto the SRL or the remaining quotaholders. Finally, a further constraint in the use of convertible notes as normally drafted in the US venture capital practice might follow from the rules on legal capital formation, which apply both to public and private companies, since the 2012-2017 measures have not wholly liberalized the applicable rules.[130] Indeed, doubts arise with reference to the provision of valuation caps and discounted conversion prices and the correlated possibility to fix a conversion rate "below par", which would make the conversion price of the

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the definition only of "private professional investors". The definition of prudential supervision, on the other hand, concerns the consistency and financial stability of the investor, and is strictly related to bank supervision.

[126] Cf. Art. 11 Banking Act; Interministerial Committee for Credit and Savings, resolution of 19 July 2005; Bank of Italy, Provisions on the collection of savings by entities other than banks, 8 November 2016.

[127] Also Italian public companies, for the issuance of debt securities, are subject to the limit of the double amount of the share capital plus retained earnings pursuant to Art. 2412 c.c., but with many exceptions, among which one for listed companies and another for convertibles.

[128] It is noteworthy that, among the articles of incorporation examined in our empirical research (see, for further details, below 6.1), in one case the innovative SRL is allowed to issue hybrid financial instruments (the above mentioned *strumenti finanziari partecipativi*) with a conversion right into equity. Italian scholars discuss if the limitations foreseen in Art. 2483 c.c. for *titoli di debito* are applicable also to the issuance of hybrid financial instruments. For the affirmative solution, see Maltoni and Spada (2013), p 1130, although not considering the eventuality of the attachment of a conversion right.

[129] See Art. 2481-bis c.c.

[130] One must consider that while Art. 2346(5) c.c. is a direct application for public companies of mandatory European rules (Art. 8, Directive 2012/30/EU), art. 2464(1) for private companies is the result of a free choice of the Italian legislator.

converted shares lower than their nominal value or, in case of no par shares, lower than the accountable par value.[131]

5.2 Classes of quotas and quotaholders' rights

Pursuant to the reform of 2012-2017, the articles of incorporation of startups and SMEs may allow the creation of classes of quotas "within the limit imposed by law".[132] The problem is that these limits are not specified. Accordingly, scholars either refer by analogy to the law of public corporations, where those limits exist,[133] or derive them from the partnership-like features of the traditional SRL or from general principles of company law.

Within the first group of limits fall provisions according to which multiple votes cannot number more than three[134] and the maximum amount of shares with limited voting rights shall not exceed half the share capital.[135] The latter rule in particular, which is read as an expression of a principle of minimal proportionality between economic risk and voting power,[136] may represent a severe obstacle to VC financing rounds, in which preferred shares with limited voting rights are issued.

The second group refers to limits derived from the (apparent) mandatory nature of some quotaholders' rights. Notably, startups' governance is generally characterized by overlapping roles of shareholders and other participants.[137] Thus, regulatory flexibility is crucial for the startup sector to thrive. Unfortunately, the present rules on SRLs corporate governance do not fully provide this

[131] Among Italian authors, opinions on how to cover the difference vary from those requiring non-proportional contributions by the other shareholders [Giannelli (2006), p 278], or the destination of retained earnings until the expiration of the conversion date [Portale (1975), p 213], or the parity only between nominal value of shares and debt obligation arising from the security (see Notary Bar of Milan, Guideline no. 61/2005).

[132] See Art. 26 (2), Decree Law 2012, no. 179.

[133] Cf. Maltoni and Spada (2013), p 1127; Benazzo (2017), p 479; Cian (2018), pp 850 et seq.

[134] See Art. 2351(4) c.c.

[135] Art. 2351(2) c.c.

[136] See Tombari (2016), p 559.

[137] See Pollman (2019), 1.

flexibility, as they impose the attribution of a penetrant influence on the company's affairs and management.[138]

Consequently, debate has been over the following issues.

First, the reform of 2003, certainly inspired on this front by the German GmbH rules,[139] stated the fundamental principle according to which quotaholders must vote on crucial corporate issues, such as the approval and removal of directors, the amendment of the articles of incorporation and the carrying out of any operation which determines a substantial modification of the company's purpose or a significant change to quotaholders' rights.[140] Thus, recent decisions of Italian courts have ruled that directors cannot sell the company's entire business without the quotaholders' express authorization and that, without this consent, the contract should be null and void.[141] Dissenting quotaholders, in any case, benefit from appraisal rights. Moreover, a qualified stake of quotaholders representing at least 1/3 of the share capital can remove any decision from the board, even on day-by-day matters, and directors can devolve the decision-making power on any issue to quotaholders. In both cases, the board is withheld from taking any decision until the quotaholders adopt a resolution.[142] As the rule does not explicitly qualify itself as mandatory, Italian scholars are divided over the possibility to waive it,[143] and therefore once again uncertainty can discourage a free contractual design of the deal.

From a startup's perspective, other drawbacks stemming from private companies' governance regulation are connected to the individual quotaholders' right to control directors, common also to other European corporate laws[144]. Indeed, any non-director

[138] For a general overview of private companies' governance model, see Pederzini and Guidotti (2018), pp 1 et seq.

[139] See § 46 *GmbHG*, under which, since the enactment in 1892, a catalogue of fundamental resolutions always falls within the competence of the shareholders. See, e.g., Paefgen (2014), § 37, marg. no. 24 et seq. For comparative references, see Fleischer (2018), pp 679 et seq.

[140] See Art. 2479(2) c.c.

[141] See Trib. Roma, 3 August 2018. For the voidability of the operation, see Trib. Piacenza, 14 March 2016.

[142] See Cian (2009), p 25.

[143] See, for the negative solution, Lener (2011), p 789; for the positive, Benazzo (2016), p 2042.

[144] See, e.g., § 51a *GmbHG*, introduced by the first major reform of the Act in 1980, under which the directors must without undue delay provide each shareholder, upon their request, with information on the company's affairs and allow them to inspect the books and company records. The articles of incorporation

quotaholder is entitled to obtain information and to inspect the corporate books and documents, if requested also with the support of a partisan expert.[145] Hence, the quotaholder is empowered with a strong individual right of control over the board. Even though inspection rights must be exercised in good faith, they may be in practice used in an obstructive manner, especially considering that, according to the relevant case law, directors may limit quotaholders' discretion in exercising such rights only if significant third parties' interests have to be protected.[146] Before the 2012-2017 reform, almost all authors accepted that such control rights could not be restricted or eliminated.[147] The situation has partially changed today, since some authors admit a similar contractual option (only) for non-voting quotas.[148]

Another important quotaholder's prerogative is the individual right to bring the derivative action.[149] Even though the relevant provision, which does not indistinctively find equivalents in other jurisdictions,[150] does not expressly qualify itself as mandatory, it is again discussed whether or not such a remedy can be excluded for non-voting quotas.[151] A last constraint might be represented by the so-called leonine clause, according to which quotaholders cannot be totally exempted from company liabilities or profits – a principle that

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cannot waive such fundamental inspection rights. For references, see Raiser and Veil (2015), p 466 seq. Similarly, for the Swiss law on private companies Art. 802 *OR*: for references, cf. Schmidt (2018), pp 115-118; Meier-Hayoz et al. (2018), p 704. For the Austrian *GmbHG*, the relevant provision is contained in § 22(2): for references, see Nowotny (2017), pp 1266-1267. In the Spanish *LSC* see Art. 272(3) for the minority quotaholder representing at least 5% of the share capital: for references, see Vincent Chuliá (2012), pp 597-598.

[145] See Art. 2476(2) c.c.

[146] See Trib. Milano, 13 May 2017.

[147] See Zanarone (2010), p 1117.

[148] For an overview, see Cian (2018), pp 834 et seq.

[149] See Art. 2476(3). On the argument, see Zanarone (2010), pp 1062 et seq.

[150] See § 43(2) of the German *GmbHG*, according to which derivative shareholder actions are allowed only if authorized by the general meeting pursuant to § 46 Nr. 8 *GmbHG*. On this argument, see Fleischer (2008), p 1128. Sometimes a similar right of action is denied if the director is a non-shareholder: see for an *obiter dictum*, BGH, 28.6.1982 - II ZR 199/81. Under the Austrian *GmbHG*, an *actio pro socio* is in general forbidden according to § 25: for details, see Nowotny (2017), p 1271. On the contrary, Swiss law refers in Art. 827 *OR* to the regulation applicable to public companies (in particular, Art. 754 *OR*), thus conferring the right to sue also to single quotaholders. The same is true for the shareholders of a French SARL [art. L. 223-22 (3) c. com].

[151] See Cian (2018), p 837.

Italian courts and scholars have from time to time interpreted in a very broad way to hold an agreement null and void, creating *ex post* havoc in private equity deals.[152]

In conclusion, the uncertain legitimacy of possible waivers of the above-mentioned quotaholder rights represents an obstacle to the creation of a contracting environment in which founders and VCs can efficiently and freely allocate the different corporate rights.

5.3 Rules on legal capital

Work-for-equity incentives schemes are an essential part of most startup deals in order to foster commitment by employees and co-founders.[153] In order to favour similar vesting schemes, the prohibition of transactions on the company's own quotas traditionally stated for SRLs[154] were lifted with the 2012-2017 reform if such transactions are functional to the implementation of incentive plans for employees and directors.[155] This new provision seems to be influenced by the Italian regulation on public companies,[156] which use share buybacks to promote employee's incentive schemes. However, the purchase of own quotas is not a viable option for startups since the quotas are already in the hands of founders, FFF and business angels, which are certainly not interested in reselling them to the company at an early stage. Therefore, the only suitable way to implement vesting agreements is by issuing new quotas.

Such issuing could in theory be made in different ways. First, according to a recent interpretation of the Notary Bar of Milan, which sets important guidelines for Italian corporate practice, especially with reference to the incorporation of companies and charter amendments, legitimate would be the subscription of newly

[152] As a matter of fact, the leonine clause prohibition is only mentioned by Art. 2265 c.c. for non-commercial partnerships. Nevertheless, Italian Courts extend it also to commercial partnerships and corporations. See lastly Cass., 4 July 2018, no. 17500. Other jurisdictions do not know such prohibition: e.g. for Germany, see Ekkenga (2015), § 29, marg. no. 68; Fleischer (2016b), pp 201 et seq.; in the case law, BGH, 14.07.1954 - II ZR 342/53; for the Dutch private company (*besloten vennootschap*), see Art. 2:228(7) *NBW*, which permits a contractual exclusion of all or part of the shareholder's profit rights.

[153] See, in general and for problems regarding the transplant of US vesting arrangements in German corporate law, Kuntz (2016), p 152 and p 724.

[154] See Art. 2474 c.c.

[155] Art. 26(6), Decree Law 2012, no. 179.

[156] See Art. 2357 c.c.

issued quotas by means of a free share capital increase decided by unanimous vote of all quotaholders.[157] In this case, the newly issued quotas have to be paid-up by retained earnings or distributable profits. In practice, this option seems not to be realistically available to early stage startups, which usually do not have retained earnings or distributable profits. An alternative approach for the implementation of incentive schemes could be the classical work-for-equity, where work or services are contributed to the formation of the legal capital as consideration-in-kind. However, this option did in general not find any meaningful application[158] and is certainly not suitable for vesting schemes. Indeed, the relevant provisions require the subscriber to produce a certified valuation report by an auditor[159] and, in addition, a bank or insurance surety, which covers the entire value assigned to the contribution of work or services.[160] Besides the financial burden represented by the mandatory release of the mentioned surety, the true obstacle is represented by the fact that the corresponding allotment of the quotas has to be made by the SRL simultaneously to subscription. Thus, a progressive or accelerated assignment of quotas, as typically foreseen in startup vesting schemes, is simply not possible under the Italian legal capital rules of the SRL.[161]

5.4 Exit rights

With reference to exit rights, many (supposed) mandatory provisions characterize standard private company regulation. First, a long list of mandatory appraisal rights is provided to the dissenting quotaholder of various ordinary and extraordinary business transactions.[162]

[157] See Notary Bar of Milan, Guideline no. 178/2018.

[158] See for this remark, Nieddu Arrica (2018), p 500.

[159] See Art. 2465 c.c.

[160] See Art. 2464(6) c.c.

[161] In fact, according to our first empirical investigation (see below 6.1), some few Italian innovative SRLs foresee certain work-for-equity schemes, all of which are embedded in operations of share capital increase, to be paid up either by contributions (in cash or in kind) or by using retained earnings.

[162] See Art. 2473(1) c.c., according to which quotaholders are in any case entitled to exit in the following cases: change of the corporate purpose or form, merger, division, revocation of the company's winding up, removal of one or more causes of withdrawal, transfer of the registered office to another country or a transaction that leads to fundamental modification of the company's objects. Still,

Moreover, the law requires that the compensation shall be proportional to the fair value of the company's assets.[163] Scholars therefore deny the possibility to assess the appraisal consideration below the stake's real value,[164] at least in the cases where the quotaholder is entitled with a mandatory exit right. This can result in long and expensive litigation, considering especially that a liquid market does not exist, the evaluation criteria for the assessment of the stake's fair value are uncertain, and partial appraisal is not unanimously allowed by scholarship, since the quota is considered unique in its entirety.[165] In all these cases, a startup business on the verge of success may falter due to an obstructive or arbitrary exercise of exit rights, supported by a strong network of mandatory rules which leave no space to freedom of contract.[166]

6 Considerations on the Italian experiment

6.1 Assessment and support by some preliminary empirical data

Constrained by on the one hand European rules on capital and self-imposed strict rules on statutory auditors, and on the other the GmbH tradition of a private company that cannot access public markets nor, in the Italian construction, have outside equity investors but only partner-like quotaholders, whilst at the same time pushed by economic needs and social pressure, the Italian lawmaker decided to break with tradition and gradually morphed the SRL into a semi-liberal creature that, in the legislation's intent, should offer Italian startuppers an instrument to finance their business through VCs and also allow access to crowdfunding and capital markets.
This reshaping of the Italian GmbH-counterpart has been the clear product of US company law competition. There are no signs of European regulatory competition in it. In order to further test this

Art. 2473(2) c.c. grants a right to exit at will if the company is established for an indefinite term.

[163] Art. 2473(3) c.c.

[164] The reimbursement shall be aimed at achieving a fair evaluation of the stake in order to protect the shareholder's interests: see Zanarone (2010), pp 830 et seq. In general on this argument, cf. Schmolke (2012), pp 393-396; Fleischer and Bong (2017), pp 1957 et seq.

[165] See Zanarone (2010), pp 775 et seq.

[166] Cf. Zanarone (2010), pp. 786 et seq.; Speranzin (2012), p 149.

conclusion we have also gathered empirical data concerning Italian startups and innovative firms incorporated as SRLs. In particular, we wanted to understand how widespread is the phenomenon of "dual companies", which in startuppers' parlance defines European teams that establish a US company for accessing venture capital funding and simultaneously maintain an entity in their home jurisdiction with laboratories, research and other operational infrastructures there located.[167]

For this purpose, we have identified all the Italian SRLs with a US shareholder and have then restricted the research to all SRLs that qualify as "innovative startup" or "innovative SMEs". Then we have investigated each of those companies and identified around 16 Italian SRL startups (out of 64) that can be classified as "dual companies", since they have a US controlling entity established by the Italian founders and an Italian SRL that retains at least some of the operational activities.[168]

At the same time, we have identified among those Italian SRLs participated by US quotaholders many companies that are financed by early stage US VCs.[169] Moreover, we have collected the constitutional documents of other Italian startups that are known for being participated by outside investors and have found, as expected, many of the essential features of US VC financing, even though adapted to the still existing constraints of Italian company law that

[167] Mind the Bridge, European Dual Company: Scaleup Migration (2017), https://startupeuropepartnership.eu/reports/

[168] Our data have been provided by *InfoCamere*, the digital innovation company that operates for the Italian Chambers of Commerce managing the single Company Registers. Among the dual companies that we have identified there are ventures that are very famous in startuppers' circles. However, we are not able to assess whether this small number is nevertheless a significant one or not. In Italy, more than 11,000 companies are registered as innovative startups or SMEs, among which more than 8,000 are SRLs according to a research we have conducted on 31 July 2019 through the website http://startup.registroimprese.it. We have collected the data of those SRLs that are registered in the Company Register of Bolzano, and among almost 100 companies not a single one looks like a firm financed by VC or other outside investors – the 2012-2017 Reform accords significant tax benefits to companies that qualify as innovative startups in accordance with the law requirements. Therefore, any new company that can qualify as "innovative startup" may be formed and registered as such. We consider the presence of a tag-along and/or drag-along clause as the most significant indicator of a company with outside investors.

[169] In particular, one US VC seems to be very active in the early stage Italian startups' market according to our data, Alan Advantage Inc., which holds stakes in nine innovative SRLs.

we have analysed in the previous paragraphs, among which the absence of convertibles, either in the form of convertible notes or preferred quotas, is the most notable.[170] The articles of incorporation of the companies we have been able to analyse confirm how the SRL model has been moulded by competitive pressure from the US and Delaware in particular. This competitive pressure has been generated by the forces of economic logic, example and competitive pressure,[171] but also and totally unexpectedly by the force of direct competition for charters, which is clearly visible with regard to Italian startups that have gone to Delaware (or California) and have adopted the "dual company" scheme.

6.2 Policy recommendations

We advocate a complete liberalization of corporate forms, which could take two different routes.[172] The first less traumatic route would continue to work on the SRL and in the direction taken by the 2012-2017 Italian reforms. It should open up financial flexibility by at least amending the rules on capital formation in order to make work-for-equity and vesting more easily feasible, and liberalizing the rules on debt instruments in order to make convertible notes usable and able to attract FFFs and angels. Furthermore, and even more important, it should introduce a strong policy statement, providing an explicit rule of construction of the company's constitutional documents and shareholder agreements. Indeed, as we have seen, doctrinal discourses tend somehow to limit the impact of the 2012-2017 reforms by deriving implicit limits to the possibility of using the new-SRL as a true enabling corporate form. Those limits are drawn from what remains of the original law of the SRL, from the limits and barriers contained in the law of the public company through reasoning by analogy, and by potential limits that are drawn

[170] But see above fn. 128, with regard to the articles of association of at least one company with convertible hybrid instruments.

[171] Hansmann and Kraakman (2000b), pp 450-451. See also Kaplan et al. (2007), p 275 ("Our results indicate that US style contracts can be implemented across a wide range of legal regimes and are used by the more experienced and successful VCs. Although it is not possible to establish causality, we believe a plausible interpretation is that US style contracts are relatively efficient across a wide range of institutional environments").

[172] In general on the theory of law-making and the different regulatory techniques available for the reform of company law in an innovative economy, see McCahery et al. (2010), pp 71 et seq.

from the general principles of company law.[173] Competition comes from Delaware, but interpretation of the new provisions appears still to be subject to the widespread enthusiasm of Continental Europe jurists, or at least those in Italy, for the construction of mandatory, paternalistic provisions through doctrinal legal thought.[174] Accordingly we propose a rule of construction stating that if a provision is not explicitly identified as mandatory, it has to be treated as a default one, allowing the contracting parties to amend it as they wish. This construction rule would be basically the opposite of the famous principle of *Satzungsstrenge* [§ 23(5) *AktG*] governing the German law of public companies.[175] These interventions would complete the reform and change forever the Italian SRL, making it an enabling instrument for VC deals.

The second route can address the same policy purposes by creating *ex novo* an equivalent of the US Limited Liability Company (LLC), a company where the parties can take the benefit of limited liability and arrange their relationship as they wish, with almost no limits. A new business organization form would so be offered, without the burden of doctrines that, for the sake of creditor or minority shareholder protection, might limit freedom of contract in the course of VC transactions.[176]

7 Conclusions

The Italian 2012-2017 reform sets a new direction for the GmbH progeny in Continental Europe. It is in some ways unprecedented, and cannot be considered a mere extension of the modernization movement that, following *Centros* and the other EUCJ decisions, occurred around Europe in the first decade of the new millennium.

[173] This process has been analyzed by Enriques (2005), pp 171-173 and, with regard to the SRL, pp 181-182, as a form of rent-seeking by academics, notaries and judges.

[174] For a critic of this gusto and its problems, and some proposals to change it, see again Enriques (2009), pp 510-512 (with reference to the political and legal culture determinant); in a broader perspective, see Hopt (2016), pp 13 et seq.

[175] On the above principle cf., among many, Hüffer and Koch (2018), § 23 marg. no. 34 et seq.; Bayer (2008), E 27 et seq.; Mertens (1994), pp 426 et seq.

[176] McCahery and Vermeulen (2004), pp 227-232, had foreseen this path as a possibility for European countries wishing to increase startups and innovation, highlighting that the US LLC "provides virtually a complete shield against personal liability (this is important given the risk inherent to a highly innovative start-up) without cumbersome formation and capital maintenance rules" (p 228).

Indeed, the social and political forces that drove the reform were mainly influenced by the US experience and therefore, from a corporate law perspective, by Delaware. Thus, regulatory competition within the European Union has not been a significant legislative and policy driver of the 2012-2017 Italian reform.

The infusion of financial flexibility into the almost inflexible corporate finance law of the Italian SRL has been the purpose of the reform, to make this corporate form attractive both for VC and for crowdfunding campaigns. This infusion has turned the Italian SRL on its head. However, the SRL is an institution with a rich historical background and a complex texture of doctrines, principles, beliefs attached to it. There is a very strong path dependency, and even though Italian scholars hold that the SRL is a liberal corporate form that allows partner-like shareholders to do almost what they like, the presence of mandatory rules, whether explicit or inferred by analogy or through other argumentative techniques, is still significant and would be hardly characterized by a common law jurist as "enabling."[177] Thus, the aspiration to redirect the SRL towards completely different uses from those that justified its creation, by means of a few amendments to some of its key financial provisions, looks over-optimistic. A company form with access only to a very restricted type of bond investors (i.e. professional investors subject to prudential regulation), and that, at the same time, cannot issue with a sufficient level of legal certainty convertible notes and easily frame proper vesting schemes, is not yet an efficient vehicle for early stage startups.

We propose two alternative routes, which can be of interest to any European jurisdiction facing similar barriers to freedom of contract and VC deals. The first one is to increase financial flexibility and adopt a counter-*Satzungsstrenge* principle for private companies. The second option, even more radical, is to introduce a US-like LLC.

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[177] See Ribstein (2010), p 134, who correctly recalls the "differences among European countries in law, language, and custom, the greater role of interest groups (particularly labor) in opposing changes in business association law, and lower incentives to compete by European countries as compared to U.S. states", thus concluding that "business forms for closely held firms are less flexible and more regulatory than the LLC and other partnership-based business forms in the United States".

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