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TYPES OF PREFERENCE SHARES AND RIGHTS OF THEIR OWNERS: LEGAL REGULATION AND PRACTICE IN SELECTED JURISDICTIONS

Master Thesis

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Vilnius, 2020

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LIST OF ABBREVIATIONS

The EMCA - the European Model Company Act.

The EU - the European Union.

The MBCA - the Model Business Corporation Act.

The VC - the venture capital.

INTRODUCTION

The modern economy is characterized by an increasing number of companies as a form of business organisation. The company has attractive features for the investor. Firstly, it is the separability of the company, i.e. the company is a separate legal entity with its own liabilities and obligations. For the investor, this means the absence of the liability and of the additional expenses for the company's debts. Another attractive feature is the transferability of the shares, the shareholders are able to sell their shares (there might be some restrictions in private companies). The investing represents the method of the increasing of the investor's capital, and the preference shares provide for their owners exactly the economic advantages. For the state, investing means additional resources for the development of the state economy. So, the protection of the investors that derives from the legal regulation of their status is significant in attracting additional investments.

Problem of research. The preference share is one of the most issued financial instruments[1]. The preference stock allows the company to increase its capital structure without the dilution of the ownership in the company because the preference shares usually do not bear voting rights. However, lack of voting rights might seem as exposure of the preference shareholders to a risk of losing the investments, especially by referring to the fact, that voting rights are the "constituent element" of the share.[2] As far as, those, who have voting rights, can influence the company's decisions, and, so, control their investments.

On the other hand, the preference shareholders enjoy the priority in payment of the dividends, that also does not put them in line with the ordinary shareholders, but rather indicates the dual nature of the preference share. The hybrid nature of the preference share provides for their holders the "hybrid nature" set of the rights. However, in the framework of the non-existence of the established pattern of such a set of rights, the preference shareholders are also vulnerable. In light of the above-mentioned, the main question of the master thesis is: **how the preference shareholders are protected?**

Relevance of the final thesis. Nowadays the borders in terms of investments and trading are quite conditional due to a high level of integration of states. And, the preferred stock is very popular among the new, so-called start-up, companies throughout the world. However, the regulation of preference shares varies from state to state and from company to company there is

[1] Ф. Фабоцци, *Финансовые инструменты*; [пер. с англ. Е. Вострикової, Д. Ковалевского, М. Орлова]. (М.: Эксмо, 2010). (Frank J. Fabozzi, *The Handbook of Financial Instruments*, (Moscow, Russia: ECSMO, 2010))

[2] Brändel (1992), in *GroßkommAktG* (1992–: § 12 mn. 4); **cited in** Andreas C. Cahn and David C. Donald, *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA* (Cambridge, United Kingdom: Cambridge University Press, 2018), 308.

no single complex approach. So, investors might face difficulties, especially by investing in the foreign countries.

Hence, by considering the above-mentioned, it is relevant to make a research on concerned topic.

Scientific novelty and overview of the research on the selected topic. Analysis of the relevant literature depicts that the preference shares and rights of their owners were poorly investigated. The are several scholars Charles R. Korsmo[3], William W. Bratton and Michael L. Wachter[4], etc, who have examined the preferred stock, however in the framework of the venture capital. The concept preference share was also explored in conjunction with the share capital by Paul L. Davies and Daniel D. Prentice[5], Andreas C. Cahn and David C. Donald[6], Marco Ventoruzzo et al[7], Susan McLaughlin[8], Leonard S. Sealy and Sarah Worthington [9].

In addition, the European Model Company Act (hereinafter referred to as EMCA)[10] should be mentioned separately. As a source of soft law, the EMCA serves as a template for the current survey. It is also a basis for the comparison between the regulation on the preference shares of the civil law and common law jurisdictions. It is a model statute aimed to regulate corporations, prepared by an independent group of 20 law professors and 10 experts, from over 20 countries. The main goal of the drafters was "to offer a coherent and comprehensive model act that might be the basis for further European harmonization". The EMCA is divided into 12 chapters, that are, in particularly, devoted to the general principles, the shares, the financial structure, the capital, the governance and management, the directors' duties and liabilities, the shareholders' meeting and protection of minorities, etc[11].

Taking into account, that there is a lack of complex research on legal aspects of the preference share and rights of their owners, the study is novel.

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[3] Charles R. Korsmo, "Venture Capital and Preferred Stock", *Case Western University School of Law*, (2013): 1163-1230. Accessed February 02, 2020 https://scholarlycommons.law.case.edu/faculty_publications/62.

[4] William W. Bratton and Michael L. Wachter, "Theory of Preferred Stock", *University of Pennsylvania Law Review*, Vol. 161, No. 7 (June 2013): 1815-1906. Accessed February 01,2020 https://www.jstor.org/stable/23527854.

[5] Paul L. Davies and Daniel D. Prentice, *Gower's Principles of Modern Company Law*, 6th ed. (London: Sweet and Maxwell, 1997), 616.

[6] Andreas C. Cahn and David C. Donald *supra* note 2.

[7] Marco Ventoruzzo et al, *Comparative Corporate Law*, American casebook series, (West Academic Publishing: USA, 2015), 190.

[8] Susan McLaughlin, *Unlocking Company Law*, 2nd ed., (London and New York: Routledge, 2013).

[9] Leonard S. Sealy and Sarah Worthington, *Sealy and Worthington's Cases and Materials in Company Law* (Oxford: Oxford Univ. Press, 2013), 556.

[10] *European Model Company Act (EMCA)*, 1st ed., 2017; Nordic and European Company Law Working Paper No. 16-26. Accessed January 09,2020, https://ssrn.com/abstract=2929348.

[11] Marco Ventoruzzo, "The New European Model Company Act", Bocconi University and Pennsylvania State University, October 14, 2015, Harvard Law School Forum on Corporate Governance. Accessed April 14,2020, https://corpgov.law.harvard.edu/2015/10/14/the-new-european-model-company-act/.

Significance of research. The theoretical significance of this research encompasses the determining of the status of the shareholder through the designation of the contractual rights and rights granted by corporate law. In addition, the legal peculiarities of preference share were investigated.

The practical significance lies in an attempt to determine the set of rights that should be attached to the preference share, that allows them not to be in a vulnerable position.

The theoretical and practical would be useful for scholars and practitioners who work in the company law field. In addition, it can be used by law students who are studying company law and want to deepen their knowledge on preference shares. Also, it would be helpful from practical point of view, for instance, while composing statutes of companies.

The aim of research. The main purpose of the master thesis is to **define** the status of the preference shareholders in selected jurisdictions and to **suggest possible solutions** for their protection.

The objectives of research. In attaining the above-mentioned aim, the following objectives should be performed:

1) to determine the peculiarities of the hybrid nature of the preference share; to investigate the preference shareholder's position in the company, namely through the rights that might be granted by the contract and by corporate law.

2) to determine and to compare the status of the preference shareholder in selected jurisdictions; to suggest the "protective set of rights" the preference shareholders should bear.

Research methodology. A few methods are to be used during the current scientific research.

In order to achieve the established aim, with the help of the **data collection and data analysis** methods the legal doctrine and acts should be compiled and examined. The **general scientific dialectic method** allows to define the scope of the research as well as to determine the fundamental notions, such as "preference share". Also, the **linguistic** method is helpful while identifying and understanding the scientific and legislation base. Moreover, the **comparative method** will be used in order to analyze and compare the approaches of different states to the regulation of the preferred stock. Furthermore, the **logical method** is used along with all the above-mentioned methods. It will help to understand the essence, similarities, and differences between various legal concepts. In addition, this method would be used to elaborate on the solution on the issue concerned.

Structure of research. The master thesis consists of the following sections: introduction, two chapters that are also divided into the subchapters, conclusions, recommendations, bibliography, and summary.

The first chapter introduces and defines the conception of the preference share in the framework of its hybrid nature, namely: contractual and corporate. Also, it investigates the status of the preference shareholder in the company by applying to the rights granted according to the contract and corporate law. Additionally, the general standards such as equality of shareholders, "one share, one vote", homogeneity of interest are introduced in the framework of conflicts between preference and ordinary shareholders.

The second chapter introduces and examines the regulation and the legal practice of civil law and common law states, in particular, the UK, the U.S.A., France, Germany, Spain, as the representatives with the developed economy, and Ukraine, as the representative with a transition economy. The approaches of the above-mentioned states on the regulation of the status of the preference shareholder are explored. Also, the "basic" protective measures that should be provided to the preference shareholders are summarised.

The statement to be defend.

As far as the preference shares are of dual nature, the preference shareholders enjoy the contract and the corporate protection.

1. HYBRID NATURE OF THE PREFERENCE SHARES AND RIGHTS OF THEIR OWNERS

Preferred shares are poorly researched by scientists from a legal point of view. Also, there are a lot of debates on the advisability of preferred shares among investors and scientists. This is partly because the preference share is a financial instrument of a dual nature. Nevertheless, the preference shares might be beneficial for its owner along with the issuing company. Also, the preference shares are utilized in the venture financing, which is very popular now, due to their dual nature and "flexibility". And, by taking into consideration the above-mentioned the survey on the regulation of the preference shares is regarded to be relevant.

1.1. Legal Nature of the Preference Share

What does the preference share mean? What is the hybrid nature of preference share? Which rights do the preference shareholders bear?

In order to answer these questions, it is necessary to start from the beginning and define the concept and nature of the **shares** and **rights** of their owners.

First, in the literature it seems to be no generally accepted international detailed definition of the "share". Through the Anglo-Saxon legal environment, one of the most quoted in the literature of definitions of the "**share**" is the one of Farwell J. in *Borland's Trustee v Steel Brothers & Co* case:

> "A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants into by all the shareholders inter se in accordance with [s.14]. The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money […] but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount."[12]

Len Sealy and Sarah Worthington commented on the above-mentioned definition of the share by extracting **three main functions** of the share:

> "It indicated that shares are a means of denoting three things: first, the shareholders' financial stake in the company (including the shareholders' liability to contribute funds to the company, and rights to capital and income receipts from the company); secondly, their interest in the company as an association (including rights as members, especially voting rights and rights conferred by statute and the company's constitution); and, thirdly, their rights as owners of a species of property (which is

[12] "Borland's Trustee v Steel Bros and Co Ltd. (1900) SVC 19", **cited in** Paul L. Davies and Daniel D. Prentice *supra* note 5.

> able to be bought, sold, charged, etc, and in which there can be both legal and equitable interests)."[13]

So, the investor by contributing some funds to the "association" becomes a "member" of this "association" and acquires various rights. Martin Lipton and Steven A. Rosenblum explained the concept of the "collective" investor ownership of this "association":

> "the ownership of a share of stock in a public company is simply not analogous to the ownership of a car or a building […] A share of stock is a financial instrument, more akin to a bond than to a car or a building […] The owner of the building […] is an individual […] in a position to have full knowledge […] [and who] generally views the property or business as a complete entity […] In contrast, the shareholder of the large public corporation is one of a far-flung, diverse, and ever-changing group."[14]

To sum up, on the one hand, the share represents a financial stake in the company and, on the other, "represents" or bears the shareholders' interests, that is, the rights granted to the shareholders according to their financial stake. The share is "an intermediary" between the company and its holders. The holders of shares are an "association of owners". This "association" represents a collective of divergent owners.

Through legal area of the European Union (hereinafter referred to as EU), the EMCA provides for the most neutral definition of the share and defines it as "**an equity participation entitling the holder to be a member of the company**[15]." The emphasis is put on the "equity participation" which refers to the fact that share represents a financial portion or a fraction in the company, and, thus, the owners of these fractions are the owners of the corporations. And the concept of "membership of a company" is also stressed, that is to underline that the shareholders, by acquiring the shares, become a collective of owners.

The above-mentioned definitions provide only for the basic features of the share; also, they are focused more on the nature of rights, rather than the particular rights the shareholder might acquire via buying a share. This is might be explained by the big divergence in the legislations of the states, and thus in the impossibility to create a single detailed definition.

Continuing the study on the nature of share, it is important to stress that shares bear "proprietary interest in the company though not in its property."[16] Nobel laureate Milton Friedman,

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[13] Legal interest is "an interest that has its origin in the principles, standards, and rules developed by courts of law as opposed to courts of chancery". "An interest recognized by law, such as legal title." Equitable interest is "an interest held by virtue of an equitable title or claimed on equitable grounds, such as the interest held by a trust beneficiary." Bryan A. Garner and Henry Campbell Black, *Black's Law Dictionary,* 9th ed. (St. Paul: West, 2009). Leonard S. Sealy and Sarah Worthington *supra* note 9, 556.

[14] Martin Lipton and Steven A. Rosenblum, "Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come," *Business Lawyer* (2003): 59, 67, **cited in** Andreas C. Cahn and David C. Donald *supra* note 2, 308.

[15] *European Model Company Act (EMCA) supra* note 10, 86.

[16] Paul L. Davies and Daniel D. Prentice *supra* note 5, 616.

who is an economist, was reproached for referring to the shareholders as the "owners" of the corporations, and critic carry his point[17]:

> "A lawyer would know that the shareholders do not, in fact, own the corporation. Rather, they own a type of corporate security commonly called "stock."[18] As owners of stock, shareholders' rights are quite limited. For example, stockholders do not have the right to exercise control over the corporation's assets."[19]

There is another example:

> "A share of stock does not confer ownership of the underlying assets owned by the corporation. […] Shareholders have no more claim to intrinsic ownership and control of the corporation's assets than do other stakeholders. […] The rights we choose to confer on shareholders […] cannot be justified on the basis of their intrinsic right as the "owners" to control the corporation."[20]

So, the mere statement that shareholders own the corporation may lead to the confusion, because it is important to detail that shareholders do not directly own the company's assets as such; that is, the shareholders cannot directly dispose of the company's assets, they own the company as a whole through and according to their shares. The corporation is a separate legal entity with its obligations and rights as well as assets. Davies and Worthington explain the concept of shareholders' interests in the company by referring to the above-mentioned definition of the share of Farwell J. in *Borland's Trustee v. Steel Brothers & Co* case[21]:

> "The company itself is treated not merely as a person, the subject of rights and duties, but also as a res, the object of rights and duties. It is the fact that the shareholder has rights in the company as well as against it, which, in legal theory, distinguishes the member from the debenture-holder whose rights are also defined by contract … but are rights against the company and, if the debenture is secured, in its property, but never in the company itself."[22]

To clarify, the "chain: the shareholders – the share – the company" represent the three levels of the property interests: the holders or owners of the shares – the shareholders; the share itself which bear the property rights in the company; the company – is the owner of the assets.[23]

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[17] Andreas C. Cahn and David C. Donald *supra* note 2, 306.

[18] "The distinction between stocks and shares is pretty blurred in the financial markets. Nowadays, the difference between the two words has more to do with syntax and is derived from the context in which they are used. Of the two, "stocks" is the more general, generic term. It is often used to describe a slice of ownership of one or more companies. In contrast, in common parlance, "shares" has a more specific meaning: It often refers to the ownership of a particular company." "Shares vs. Stocks: What's the Difference?", Investopedia. Accessed February 29, 2020, https://www.investopedia.com/ask/answers/difference-between-shares-and-stocks/ .

[19] Lynn A., Stout, "Lecture and Commentary on the Social Responsibility of Corporate Entities: Bad and Not-So-Bad Arguments for Shareholder Primacy," *Southern California Law Review*, 75 (2002): 1189, **cited in** Andreas Cahn and David C. Donald, *supra* note 2, 307.

[20] Martin Lipton and Steven A. Rosenblum *supra* note 14, **cited in** Andreas Cahn and David C. Donald *supra* note 2, 307.

[21] "Borland's Trustee v Steel Bros and Co Ltd.," **cited in** Andreas Cahn and David C. Donald *supra* note 2, 309.

[22] Paul Davies, Sarah Worthington, and MichelerEva, *Gower and Davies: Principles of Modern Company Law*, (London: Sweet and Maxwell Ltd, 2016) **cited in** Andreas Cahn and David C. Donald *supra* note 2, 307.

[23] Andreas Cahn and David C. Donald *supra* note 2, 307.

The proprietary rights encompass both the financial rights and non-financial rights which the share entitles.[24] Pursue to the rights the shares embodied, they are divided into two major classes: ordinary shares[25] and preference shares[26]. Both financial instruments are one of the most issued types of securities by corporations to finance their activities.[27]

The ordinary shares are the most wide-spread type of shares. They bear the financial and non-financial rights to their owners. Some scholars refer to them as a "plain vanilla" because they bear the leverages of control of the company as well as the rights to get the financial benefits.[28]

The preferred stock is "more complicated" than the common. The legal regulation of preference shares and the interests of their owners have been poorly explored.[29] Probably this lack of attention may be explained by "the notion that preferred stock is something of a relic from an earlier era of corporate finance."[30] Another reason is rooted in the nature of preferred stock, that "is both corporate and contractual – neither all one nor other."[31] "It sits on a fault line between two great private law paradigms, corporate and contract law, and draws on both."[32] Benjamin Graham and David Dodd also questioned the expediency of preferred stock by concluding that preference shares were "fundamentally unsatisfactory"[33], "offering many of the respective downsides of equity and debt, and few of the respective upsides."[34]

Nevertheless, nowadays preferred stock is "far from being an outmoded relic"[35] and it is popular among investors, moreover, the preference shares are the leading instruments for financing in the venture capital sector.[36] For instance, such present-day giant corporations as Amazon,

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[24] Alina Szewc-Rogalska, "Official and Actual Proprietary Rights of Shareholders". Accessed April 07, 2020, http://www.rusnauka.com/17_SSN_2007/Economics/22491.doc.htm.
[25] Also named equity shares or common stock in U.S.A.
[26] Also named preferred stock in U.S.A.
[27] Ф. Фабоцци, (Frank J. Fabozzi) *supra* note 1.
[28] Marco Ventoruzzo et al *supra* note 7.
[29] William W. Bratton and Michael L. Wachter *supra* note 4, 1814.
[30] Charles R. Korsmo *supra* note 3.
[31] William W. Bratton and Michael L. Wachter *supra* note 4, 1815.
[32] Ibid.
[33] Benjamin Graham et al., *Security analysis: principles and technique,* 4th ed., 1962, **cited in** Charles R. Korsmo *supra* note 3.
[34] Ibid.
[35] Ibid.
[36] William W. Bratton, "Venture Capital on the Downside: Preferred Stock and Corporate Control", *100 MICH. L. REV.*, (2002): 891. Accessed February 01, 2020, https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1051&context=facpub. "Several scholars have defined **venture capital** differently. According to Kortum and Lerner (1998) **venture capital** is defined as "equity or equity linked investments in young, privately held companies". Balboa and Marti (2003) define **venture capital** as "the professionalized financial activity consisting of investing in companies which are in the start-up or expanding stages"". **See** Kennedy Mulenga, *An overview of venture capital*. Accessed February 13, 2020, https://www.academia.edu/33348402/AN_OVERVIEW_OF_VENTURE_CAPITAL .

Apple, Costco, eBay, Facebook, Google, Medtronic, Staples, and Starbucks were backed up by venture capital.[37]

Preferred stock, as above mentioned, is of a dual nature and unites some characteristics of the debt and the equity. "Debt holders are typically treated as "outsiders" or "lenders" to the corporation, with their rights and obligations exhausted by contract."[38] While, "equity holders are traditionally treated as corporate "insiders", with any contractual rights and obligations they might bargain for augmented – or even supplanted – by fiduciary rights and obligations."[39]The lenders are contractual, stockholders are corporate"[40]. And, the legal treatment of the preference shareholders, due to its hybrid character, has long crossed the line between the contract and company law.[41]

Initially, the appearance of preferred shares is associated **with the aim of the companies to obtain additional funds** for the authorized capital, while providing shareholders with a minimal opportunity to control the company (preference stockholders usually are not entitled to voting rights or they are limited).[42] That is, traditionally the preference shares are issued by companies that experience financial distress.[43] In addition, the issuance of the preferred stock does not create additional debt obligations, i.e., an interest that should be paid regularly. So, the value of preference shares for companies is a possibility to enhance the firm's debt capacity[44] and decrease involuntary bankruptcy risk by equity financing without changes to the company's control.[45] Alongside, the preference shares also bear preferential rights for their owners – kind of the compensation for the lack of voting rights –, namely a right to preferential dividends up to a specified amount. This means that the preference shareholders should be paid before the ordinary one.[46] **The priority in dividends is a defining attribute of the preferred stock.**

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[37] National venture capital association, *Venture impact: The Economic importance of venture capital-backed companies to the U.S. Economy* 2, 6th ed., 2011, **cited in** Charles R. Korsmo *supra* note 3, 1165.
[38] "Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp., 1504, 1507-08, S.D.N.Y., 1989"; William W. Bratton and Michael L. Wachter, *supra* note 4, 1819, **cited in** Charles R. Korsmo *supra* note 3, 1165.
[39] William W. Bratton and Michael L. Wachter, *supra* note 4, 1819 **cited in** Charles R. Korsmo *supra* note 3, 1165.
[40] William W. Bratton and Michael L. Wachter, *supra* note 4, 1819.
[41] Charles R. Korsmo *supra* note 3, 1165.
[42] Заборовський В.В. "Правова природа акцій та процедура їх конвертації в Україні та Російській Федерації: автореф". (дис. канд. юрид., наук, Одес. нац. юрид. акад. 2010). (Zaborovsky VV "The Legal Nature of Shares and the Procedure for Their Conversion in Ukraine and the Russian Federation: Abstract" (candidate of Law, Odessa National Law Academy 2010)). Accessed March 13, 2020, https://dspace.uzhnu.edu.ua/jspui/handle/lib/8058.
[43] Sandra Laurent, "Convertible Debt and Preference Share Financing: An Empirical Study", *University of the West of England*, 42. Accessed February 17, 2020, https://ssrn.com/abstract=251648.
[44] Robert Heinkel and Josef Zechner, "The Role of Debt and Preferred Stock as a Solution to Adverse Investment Incentives", *The Journal of Financial and Quantitative Analysis, Cambridge University Press*, Vol. 25, No. 1 (Mar.,1990), 1-24. Accessed February 16, 2020, http://www.jstor.org/stable/2330885.
[45] Заборовський В.В *supra* note 42.
[46] Nicholas Bourne, *Principles of Company Law 3rd ed., (Principles of law series)*, (London: Cavendish Publishing limited, 1998), 365.

In addition, the preference shares also might be issued for **ex-ante protection** against the hostile takeover. This American method of a pre-bid defence is called a "poisoned pill". It provides for the issuance of the convertible preferred shares with a right to a "hight-than-usual"[47] fixed dividend by the target company. These shares are distributed among the shareholders as dividends in shares. The main feature of this method – is, the preferred shares might be converted into the ordinary only if and after the bidder succeeds. This leads to the dilution of the ownership of the acquiring company. This mechanism also increases the whole value of such a takeover.[48]

Thus, the **preference share might be determined as a hybrid equity, that entitles their holders to be a member of a company and enjoy a priority in receiving of the dividends.**

To sum up, **this subchapter introduces** the concept of the share, and, in particular, explores the main functions of the share. The proprietary interests of shareholders were explored in the sense of their nature: the shareholders are owners of the corporation, but not the owners of its assets, the corporation is a separate legal entity that has its assets and obligations. In addition, the hybrid nature of the preference shares was investigated, which is both the corporate and contractual.

1.1.1 Common and Distinctive Features of the Preference and Common Share

The preference stock, as above-mentioned, is of a dual nature, different from the common stock. However, both these financial instruments are the company's issued securities, and, moreover, they represent the shares.

Equality[49] of shares is presumed.[50] However, this presumption can be modified by dividing the share capital into the different classes[51] which are created by attaching to the shares different rights and liabilities.

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[47] Джафаров Джафар Айгубович, "Операции поглощения акционерных обществ: зарубежный опыт и российская практика". (дис. канд. экон. наук. Финансовая академия при правительстве РФ, 2002). Jafarov Jafar Aigubovich, "Acquisition operations of joint stock companies: foreign experience and Russian practice." (Candidate of Economic Sciences. Financial University under the Government of the Russian Federation, 2002). Accessed April 17, 2020, http://www.finansy.ru/dis/post_1258621763.html.

[48] Robert F. Bruner, "The Poison Pill Anti-Takeover Defense: The Price of Strategic Deterrence", *The Research Foundation of the Institute of Chartered Financial Analysts*, (USA, 1991): 20. Accessed April 11, 2020, https://www.cfainstitute.org/-/media/documents/book/rf-publication/1991/rf-v1991-n1-4431-pdf.ashx .

[49] "All shares shall carry equal rights in the company, unless otherwise provided in the articles of association". *European Model Company Act (EMCA) supra* note 10, 40. "The principle of equality means that all shares of the company shall be treated equally". "The principle of equality of shares and shareholders", *Nordisk tidsskrift for selskabsret*, 2016, p 38-49. Accessed February 27, 2020, https://helda.helsinki.fi//bitstream/handle/10138/236635/The_principle_of_equality_of_shares_and_shareholders.pdf?sequence=1.

[50] Susan McLaughlin *supra* note 8, 157.

[51] "The division of shares into classes and the rights attached to each class will normally be set out in the company's memorandum or articles." Paul L. Davies and Daniel D. Prentice *supra* note 5, 619.

As long as, the different classes of the shares bear the different preferences for their owners, there are a lot of debates where to invest: in the ordinary or preference shares, and the answer is often not in favour of the preference one. The main reason for such a response – is the limited ability of the preferred shareholders to protect their interests as far as they lack voting rights.

The **shareholders' proprietary interests** are the unifying feature for both the ordinary and preference shares. Their interests are not in the property or assets of the company, though they own the corporation. The shareholders are concerned rather about their economic or financial rights which are one of the major. That is, for instance, a stable receiving of dividends according to the articles. However, it is the **receipt of the dividends** that is one of the main differences between those classes of share. Firstly, the preference shareholders have a right to receive the dividends before the common shareholders. Another difference lies in the fact that the preference share might bear a right to the cumulative dividends if the articles provide so, but the ordinary shareholders are not entitled to the cumulative dividends.

Generally, the shareholders, unlike the employees and creditors, **are residual claimants**, and in case of the liquidation of the company, the reimbursement due would be paid after all the other claimants are paid[52]. However, if the preference shareholders enjoy the priority right in the winding-up, they receive any surplus before the ordinary one. In contrast, the ordinary shareholders are entitled to a surplus on the winding-up, while the preference shareholders might be also so entitled if the articles provide.

Most preference stock has a **par value**[53]. Par value or nominal value of share "means that the share represents the fraction of the company capital"[54], and "its fractional value is calculated by dividing the capital by the number of shares"[55]. The aim of the nominal value is the determination of the funds that the shareholders have agreed to invest[56]. The par value is necessary for preference shareholders because: it determined the amount of the reimbursement due in the case of liquidation, and the dividend might be established as a percentage of the par value[57]. As

[52] Andreas Cahn and David C. Donald, *supra* note 2, 579.
[53] Scott Besley and Eugene F Brigham, *Principles of finance*, 4th ed., (Mason, Ohio: South-Western Cengage, 2009), 40.
[54] "However, it is not necessary that the amount of capital should be fixed by reference to the nominal or par amount of the shares issued by the corporation, and it is not necessary that the shares should purport to represent specified sums of money contributed to the capital. (i.e., shares without par value)". Victor Morawetz, "Shares without Nominal or Par Value", *Harvard Law Review*, Vol. 26, No. 8 (Jun. 1913): 729-731. Accessed March 05, 2020, https://www.jstor.org/stable/1326367.
[55] Marc Kruithof and Walter De Bondt, *Introduction to Belgian Law*, 2nd ed., (Kluwer Law International, 2017), 497.
[56] James C. Bonbright, "The Dangers of Shares without Par Value", *Columbia Law Review*, Vol. 24, No. 5 (May,1924): 449-468. Accessed March 06, 2020, https://www.jstor.org/stable/1113988.
[57] "For example, in 2006, New York State Electric and Gas (NYSEG), a utility company that is a subsidiary of Energy East, had an issue of preferred stock with a liquidation value of $100 and a stated dividend of 4,5 percent. Investors

for the common shareholders, the par value of shares is less important in the event of liquidation, as far as they are entitled to the surplus on winging-up and the precise amount due is not specified by the contract; the dividends are paid according to the decision of the general meeting or the board of directors depending on the jurisdiction.

The preference shares might be **convertible**, if it is stated so in the articles, alongside there is no such option for the common shares.

Considering the **non-property rights**, that is an ability to be aware of the companies' activities and financial situation and to control the company's decisions, the common shareholders have all the leverages of impact which are available according to the articles and the law. While the preferred stockholders always have limited by the contract rights to protect their interests.

To sum up, this subchapter introduces the ordinary shares, and in particular the difference between the preference and the ordinary shares. The preference shares provide more economic advantages and protection for their holders in comparison with the ordinary shares. This economic benefit serves es the compensation for lack of voting rights, or as a compensation for risk if we consider the VC investments.

1.1.2 Common and Distinctive Features of the Preference Share and Debenture

The preference shares also encompass the characteristics of the debt.

In order to attract the financial resources, the companies resort to the issuance of preference shares or debts.[58] These securities allow to back up a company without providing the changes to its control, as far as preference shareholders have restricted voting rights if any, while debtholders do not have them.

The debt holders are "lenders" and sit "outside" of the corporation and, they are entitled to contractual protection of their interests. While under the law of common law jurisdictions states, the preference shareholders might be "insiders", and, thus, enjoy not only contractual protection but also protection provided by the corporate law as the other shareholders. Though under the law of civil law jurisdictions states, the preference shareholders are treated as "outsiders" due to lack of the leverages of control granted; they are protected by the contractual law basically, and also by

who held this issue of preferred stock received an annual dividend equal to $4,5 per share." Scott Besley and Eugene F Brigham *supra* note 53.

[58]"The basic methods of funding a company's operations are the equity and debt issuing. Most companies are financed by a combination of debt and equity financing." "Debt financing occurs when a company enters into a contract to borrow money from another person, typically a bank, which lends money to the company". Susan McLaughlin *supra* note 8, 139-140. "Debt is a sum of money due by certain and express agreement; as by bond for a determinate sum, a bill or note, a special bargain, or a rent reserved on a lease, where the amount is fixed and specific, and does not depend upon any subsequent valuation to settle it." Black's Law Dictionary, 4th ed., (1968). Assessed January 27, 2020, http://heimatundrecht.de/sites/default/files/dokumente/Black%27sLaw4th.pdf .

the corporate law[59]. Nevertheless, the share represents **ownership of the company**, meanwhile, the debenture represents **the indebtedness** of a company to a creditor[60] – this is one of the core differences between these financial instruments.

A company in which a debt constitutes a high percentage of its financing is defined as a highly geared company or highly leveraged. Such companies are more vulnerable to insolvency than a company with low gearing, where the debt constitutes a low portion of the financing. The reason for this is that the payments to the debtholders must be made according to the contract, irrespective of the company's profits. In contrast, the preferred shareholders are paid only if the dividends are declared. Moreover, in the UK, it is unlawful for a company to pay dividends to its shareholders unless the company has distributable profits out of which to pay it[61].

In addition, the company cannot unanimously **change the terms of the contract** between the creditor and company, while it can make changes to the articles, and thus, modify the shareholder's rights or obligations. [62] Generally, the majority or super-majority, depends on the provision that should be changed and the legislation, is required to make changes.[63] Basically, the amendments might be made without the consent of the preference shareholder, unless the articles provide otherwise.

It is also important to notice that the **law governing** debt financing is contract law. While, equity financing is regulated by both corporate and contractual law; the contract should contain the accurate rights and liabilities of the preferred shareholders, and the corporate law additionally regulates the relationship between the company and its shareholders.[64]

"Financially, preferred stock resembles debt, its return comes in the form of periodic coupon payments."[65] The debtholders are entitled to **fixed** interest payments, according to the contract; and the preference shareholders also might be entitled to fixed dividends in the Anglo-Saxon law states, however, they might obtain extra payments if the articles provide so.

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[59] William W. Bratton and Michael L. Wachter, *supra* note 4, 1819.
[60] Alan Dignam and John Lowry, *Company Law*, 7th ed. (Oxford: Oxford University Press, 2012).
[61] Susan McLaughlin *supra* note 8, 139.
[62] Mary Anne Waldron, "The Protection of Preference Shareholders in the Closely Held Corporation," *Canadian Business Law Journal* 4, no. 1 (December 1979): 29-53. Accessed April 07, 2020, https://heinonline.org/HOL/LandingPage?handle=hein.journals/canadbus4&div=9&id=&page=.
[63] *European Model Company Act (EMCA) supra* note 10,261.
[64] Susan McLaughlin *supra* note 8, 139.
[65] I William M. Fletcher, *Fletcher's Cyclopedia of The Law of Private Corporations*, § 5289 (West, 2013). "A coupon payment is a payment made on a financial instrument according to a fixed schedule and for a fixed amount". Black's Law Dictionary, 9th ed., (2009); **cited in** Ben Walther, "The Peril and Promise of Preferred Stock," *Delaware Journal of Corporate Law*, 39 (2014): 163. Accessed February 15, 2020, https://digitalcommons.law.msu.edu/cgi/viewcontent.cgi?article=1576andcontext=facpubs.

Debt is a financial instrument with a fixed maturity, it can be short-term or long-term.[66] Alongside, as for the preferred shares: whether they have the maturity, or they are perpetual is indicated in the articles.

In this subchapter, the debt was introduced; the similar and distinctive of the debenture and the preference shares features were explored. Legally, the preference shares are similar to the equity, it entitles the shareholders to the ownership of the company, though often does not entitle to control of the company's decisions; the shareholders' relationships are regulated by the corporate law as well as contract. However, one of the advantages of the preference share is a right to acquire "fixed" dividends, which resembles a right of debtholder to the fixed interest.

1.1.3 Common and Distinctive Features in Statuses of the Preference Shareholder and Limited Partner in the Partnerships

"Every man who has a share of the profits of a trade ought also to bear his share of the loss."[67] This is how the English common law expressed its disapproval with the limited liability of partners in the limited partnership[68]. "**Limited**" means that the partners are not liable for the company's actions by their own assets, only by the contributions they have already made unless they conduct a fraud, negligence, etc in respect to the firm. This expression also describes to some extent the **absence of the shareholders' liability** for the company's actions. The preference shareholders, who profit in form of acquiring dividends, also bears a risk to lose their investments, for example, if, in a case of bankruptcy, the company does not have enough funds to pay the reimbursement to the shareholders. The similar feature is that the shareholders or the limited partners either in the limited partnership or limited liability partnership[69] **would not lose more than they already had contributed**.

However, the distinction is that the company is a separate legal entity, the owners do not serve as an agent of the company. The corporation conducts its own separate activity, has its own assets and liabilities. In contrast, the partners are the **agents** for its partnership (firms); as for the legal entity, the national laws of different states vary. Concerning the assets, in the UK, the

[66] "Short-term assets and liabilities are generally defined to be those items that will be used, liquidated, mature or paid off within one year". Richard H. Fosberg, "Determinants of short-term debt financing", *William Paterson University*. Accessed March 04, 2020, https://www.aabri.com/manuscripts/111008.pdf.

[67] "Grace v. Smith, 2 Bi. Wm. 998, 1000, 96 Eng. Rep. 587, 588 (1774)." **cited in** Fred W. Chel, "The Limited Partnership," *UCLA Law Review 2*, no. 1 (December 1954): 105-123. Accessed April 01, 2020, https://heinonline.org/HOL/LandingPage?handle=hein.journals/uclalr2&div=10&id=&page=.

[68] There are two types of investors in the limited partnership: general and limited. General partners are those who manage the partnership and fully liable for its actions.

[69] Limited liability partnership is formed by the investors, who, by contributing the funds, become the limited partners. The relationships between the limited partners are established by the agreement.

partnership owns the assets but also might use also "other" assets, which are of the partner.[70] (It depends on whether the partnership is a legal entity and on the national legislation.) As for liability, the general partner is fully liable for the company's actions, while the liability of the limited partner is restricted. The limited liability partnership is a legal entity that owns its assets.[71]

The shareholders as owners are separated from management of the company. While, in the partnership, there is no separation, however for the general partners. The limited or so-called "sleeping" or "silent" partners either in the limited partnership or in the limited liability partnership are not entitled to run the firm, though they are entitled to vote on the issues established by the agreement (oral or written, according to the national law); while the preference shareholders usually do not have voting votes.[72]

The partnerships do not entitle the partner to the dividends, basically, the partners "earn what they earn". However, the entitlement to a dividend is crucial to the preferred stock.

Also, the shareholders own the share of the company, alongside the partners own the part in a firm. The share is a freely transferable financial instrument (there might be some restrictions in the private companies), while the part is not (it varies whether the parts are transferable or transferable with the restrictions according to the national legislation of the states). Generally, the partner is deprived of selling its part but can cease it.[73]

In this subchapter, the limited partnership and limited liability partnership were introduced. In addition, the similar and distinctive features of the statuses of the limited partner and preference shareholder were investigated. The status of the limited partner in the limited liability partnership is a bit similar to the status of the preference shareholder in the private company. Nevertheless, their main unifying feature is limited liability.

1.2. Contractual Rights Attached to the Preference Share

> "You must be very pleased to have become a member of our company," said the managing director, March Hare. Alice looked, carefully, at her (preference) share certificates and the company's regulations. "But I don't see here any rights which could properly be said to make me a member. There aren't any," said March Hare."[74]

[70] "Partnerships - general notes: property." Gov.UK. Accessed April 14, 2020, https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg27200 .
[71] Alan Dignam and John Lowry *supra* note 61, 4-5.
[72] Nicholas Bourne, *Bourne on Company Law*, 6th ed. (London: Routledge, Taylor and Francis Group, 2013): 2-5.
[73] "Limited Liability Partnerships Act 2000" (UK). Accessed April 13, 2020, http://www.legislation.gov.uk/ukpga/2000/12/pdfs/ukpga_20000012_en.pdf. "Limited Partnerships Act, 1907" (UK). Accessed April 13, 2020, https://www.nexus.ua/images/legislation/Ireland_LP_1907.pdf.
[74] Murray A. Pickering, "The Problem of The Preference Share", *Modern Law Review*, Vol.26, Issue 5, (September 1963): 516. Accessed May 03, 2020, https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1468-2230.1963.tb00727.x.

It is how Murray A. Pickering described the preference shareholders and the rights they are granted, comparing the preference shareholders "with the mere lender". Indeed, as above-mentioned, the preference share inserts some characteristics of debt, but it also encompasses the features of the equity. Also, Richard M. Buxbaum declared that the preference stock is the "anomalous security" referring to its dual nature.[75] Nevertheless, the preference share entitles its owners to membership, though, often without the voting power.

Yes, the preferred stock does not constitute "a single thing". And the "platonic ideal" for preferred stock does not exist. There is no common pattern for the preference share because the rights attached to shares are divergent from the company to the company.[76] The reason is also rooted in the freedom, provided to the shareholders and companies, though, in the established by the law frameworks. In addition, the approaches of the regulation of the preferred stock are a bit different in the national legislation of the states. Preferred stock can be issued by the public and private companies. The rights of the preference shareholders are established in the articles of association or the constitution in the UK[77], or articles of incorporation in the U.S.A. and Canada.

Nevertheless, there are some common features of the preferred stock[78]. First, the main characteristic of preference stock is **an entitlement to a priority in receiving the dividends** before the ordinary one. The dividends may be ordinary, fixed or floating. ""Specified" or "fixed" means a well-defined (specified) dividend but not necessarily a constant amount."[79] Another type of dividend – is a so-called "floating". ""Floating" means that the dividend is linked to some benchmark[80] rate, for instance, the average of several banks' rates".[81] In the common law jurisdictions, the preference stock usually bears the fixed dividend rights, alongside, in the civil law jurisdictions, less attention is paid to the regularity of payments.[82] As for the declaration of the dividends, in the Anglo-Saxon countries, the board of directors is responsible, though the directors are not obliged to declare the dividends at the general meetings.[83] Alongside, in continental Europe, the general meeting of shareholders is entitled to decide on the distribution of the dividends, as far as, the "shareholders have an intrinsic right to share the company's profits."[84] In addition, in some EU states, such as Denmark, Finland, and Sweden, the distribution should be

[75] Richard M. Buxbaum, "Preferred Stock – Law and Draftsmanship", 42, *CALIF. L. REV.*, (1954): 243. Accessed April 07, 2020, https://heinonline.org/HOL/LandingPage?handle=hein.journals/calr42anddiv=28andid=andpage= .
[76] Charles R. Korsmo *supra* note 3, 1171.
[77] *European Model Company Act (EMCA) supra* note 10, 45.
[78] Charles R. Korsmo *supra* note 3, 1171.
[79] Marcin Liberadzki and Kamil Liberadzki, *Contingent Convertible Bonds, Corporate Hybrid Securities and Preferred Shares, Instruments, Regulation, Management,* (Switzerland: Palgrave Macmillan, 2019), 229.
[80] "An interest rate against which other interest rates are calculated." Farlex Financial Dictionary. S.v. "Benchmark Rates." Accessed April 7, 2020, https://financial-dictionary.thefreedictionary.com/Benchmark+Rates .
[81] AP Faure, *Equity Market: An Introduction*, 1st ed. (Quoin Institute (Pty) Limited and bookboon.com, 2013), 150.
[82] Marcin Liberadzki and Kamil Liberadzki *supra* note 80, 196.
[83] Nicholas Bourne *supra* note 73; 52, 419.
[84] Marcin Liberadzki and Kamil Liberadzki *supra* note 80, 196.

proposed or approved by the general meeting, as the general meeting "has the knowledge and understanding of the company's financial position and future prospects."[85] Thus, there is no established obligation to pay the dividends regularly, this is at the directors' or shareholders' discretion. Consequently, the preference shareholders might not acquire the dividends due, when the company has a profit. In order to protect themselves, the preference shareholders may insert a provision that provides for the fixed dividends and allows for the non-payment in case of the absence or lack of enough profit to be distributed. However, such provisions are forbidden by the French Law, for instance.[86]

Preferred shareholders may be entitled to a **cumulative dividend**: unpaid dividends will accumulate, and it will be distributed to preference shareholders before any dividend may be paid to the ordinary shareholders. The dividend due is not revoked but only postponed.[87] The right to cumulative dividends prevents the shareholders or directors from intentional non-declaration of the dividends because they should be paid inevitably.

Preference shares may be **participating**, i.e., the shareholder might enjoy a right to the additional dividends.[88]

The preference shareholders may be entitled to **a priority in a winding-up**. That is in case of liquidation they are after the creditors and before the ordinary shareholders for the reimbursement of capital.[89] The preference shareholders may indicate the agreed amount they would be paid. The preference shares do not participate in any surplus assets on a winding-up unless the articles provide otherwise. If they are entitled so they additionally can participate alongside the ordinary shareholders, after they have acquired predetermined reimbursement due.[90]

These are more standard rights which the preference share may embody. Nevertheless, as far as preference stock is of dual corporate-contract nature, its holders confer additional rights to the share to protect their investments and interests.

Historically, **a shareholder who is entitled to vote is rather the exception than the rule.**[91] The lack of voting rights and the right to beneficial dividends as compensation has long

[85] *European Model Company Act (EMCA) supra* note 10, 139.
[86] Art. 232-15 of "Commercial Code (Law n° 83-1 of 3, 1983)." Accessed April 30, 2020, https://www.legifrance.gouv.fr/Media/Traductions/English-en/code_commerce_part_L_EN_20130701.
[87] Marcin Liberadzki and Kamil Liberadzki *supra* note 80, 196.
[88] Ibid.
[89] Ibid.
[90] Jidesh Kumar and Richa Mehra, "Beware Rights of Shareholders", *International Financial Law Review* 25, no. 10 (October 2006): 40-41. Accessed April 30, 2020, https://heinonline.org/HOL/LandingPage?handle=hein.journals/intfinr25&div=240&id=&page=.
[91] "Preferred stock probably cannot vote in the election of corporate management but may have some contingent voting rights for certain proposed actions and upon default in dividend payments." Richard M. Buxbaum, *supra* note 75. "The classic case involved such a share structure, where preferred stockholders gained the ability to vote in board elections if four consecutive dividend payments were missed". "Zahn v. Transamerica Cor 162 F.2d 36, 39 (3d Cir. 1947)", **cited in** Charles R. Korsmo *supra* note 3, 1172.

regarded as the main features of the preference shares. However, the right to vote is a fundamental feature and a "constituent element" of share.[92] The voting right allows for control of the corporation's activities and decisions. The allocation of voting rights throughout the shares defines "the balance of power among shareholders as well as their leverage over management"[93]. As long as the preference shares do not embody the right to vote, the preference shareholders are deprived of a possibility to influence the companies' decisions. And that is also why the preference shares should bear a set of "protection" rights, which should be established in the articles.

However, nowadays, the pattern has changed, and the preferred shareholders **might have voting rights**. In the face of fierce competition, the companies, especially new ones or so-called start-up companies, are interested in the investments more than investors; thus, they provide attractive and beneficial conditions for investing and might grant the preference shareholders with voting rights. VC investors are frequently entitled to voting rights[94]. Moreover, for instance, in the U.S.A. the survey shows that the VC preferred stockholders frequently constitute the majority of the board and, thus, control it.[95]

There are three major regimes of the preferred shares which allow for the vote: the preferred shares with the permanent voting right, preferred shares with the temporary voting right, and preferred shares with the consent voting right.[96]

There are two approaches to the exercising of voting rights: "**share voting**" and "**class voting**". The "share voting" allows for the preference shareholders to vote on all issues, established by the articles, alongside, with the ordinary shareholders. The "class voting" provides a possibility for the preference shareholders to make independent proposals or decisions as a class. The votes of preferred are not counted with the votes of common, as in the share voting. The class voting serves as a tool for the "protecting preference share rights by prohibiting any change in those rights without the consent of the preference shareholders at a separate meeting of their class has enjoyed great popularity in Canada."[97]

The preference shares with the **permanent voting rights** entitle their holders to the perpetual right of participating in the voting process.[98] These shareholders have all the leverages

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[92] Brändel, *Großkommentar zum Aktiengesetz*. Hopt, Klaus J., and Wiedemann, Herbert, 4th ed., (Berlin: de Gruyter, 1992), **cited in** Andreas Cahn and David C. Donald, *supra* note 2, 577.
[93] Mike Burkart and Samuel Lee, "One Share – One Vote: The Theory", *Review of Finance*, 12 (2008): 1–49. Accessed March 01, 2020, http://rof.oxfordjournals.org/ .
[94] Charles R. Korsmo *supra* note 3, 1172.
[95] "Finding that in more than three-quarters of the firms where sole control was exercised by either the common or the preferred, control was held by the preferred." D. Gordon Smith, "The Exit Structure of Venture Capital", 53, *UCLA L. REV.* (2005): 327, **cited in** Charles R. Korsmo *supra* note 3, 1173.
[96] Joseph F. Bradley, "Voting Rights of Preferred Stockholders in Industrials", *The Journal of Finance, Wiley for the American Finance Association,* Vol. 3, No. 3, (Oct. 1948): 78-88. Accessed March 03, 2020, http://www.jstor.org/stable/2975490 .
[97] Mary Anne Waldron *supra* note 62.
[98] Joseph F. Bradley, *supra* note 96, 78.

of control to influence the company's decisions. Such a model is widespread in the U.S.A. among the VC investors.

As the name suggests, the **temporary voting rights** are temporal, the preference shareholders may vote only if some contingent happens. The widespread example of such a contingent – is a failure to pay the dividends due. Such voting rights continue to exist while this event exists[99]. Even if the preferred stockholders already are entitled to the permanent voting rights, they may additionally acquire the temporary voting rights[100].

The concept of the **consent voting rights** means that shareholders should give their approval to the certain actions defined in the articles. The voting is frequently carried on a class basis.[101] The consent-voting right implies the **veto right** of the shareholders, which allows blocking the company's actions. This model serves as the protection of the preference shareholders against the actions of the company that may adversely affect them, for instance: the issuance of new securities, the removal of assets from the business, amendments to the articles, mergers or demergers, etc[102]. It is worth noting that the articles should contain all the events which require the preference shareholders' approval. For instance, in the Delaware case *Elliott Associates, L.P. v. Avatex*, the court stated that the mere expression in the event "which would materially and adversely affect any right, preference, privilege or voting power" is quite ambiguous, and the list of particular events should be included in the articled in order to protect shareholders[103].

Notwithstanding the fact that the preference shareholders with voting rights are widespread in the U.S.A., this pattern is not common to the rest of the world. Thus, the preference shareholders should insert the rights which provide additional protection in the articles, in order to protect their investments and to balance their position in the company.

Firstly, the inclusion of **the redemption clause** to the articles secures the shareholders. The redemption of such shares might be compulsory, i.e., the shares will be bought back at a fixed date or in case if certain contingency happens; or it may be non-compulsory, at the option of the holder of the shares or the company[104]. The issuance of redeemable preference stock is regarded

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[99] Ibid., 82.

[100] For example, "Artkraft Manufacturing Corporation issued 6 per cent Cumulative Preferred Stock in 1945. Each share of this stock carries **permanent voting rights at the rate of one vote per share**. And, if the Artkraft Manufacturing Company should at any time have dividend arrearages on the preferred stock equal to or greater than the sum of eight quarterly dividends, **the preferred stockholders are granted temporary voting rights on the basis of five votes per share**. **The five votes per share granted to these preferred stockholders is in lieu of one vote per share**". Ibid., 85.

[101] Ibid., 86.

[102] Ibid.

[103] "Avatex, 715 A.2d 845", **cited in** Ben Walther *supra* note 65, 178.

[104] Jr., E. Merrick Dodd,"Purchase and Redemption by a Corporation of Its Own Shares: The Substantive Law," *University of Pennsylvania Law Review and American Law Register* 89, no. 6, (1940-1941): 697-734. Accessed February 28, 2020,

"as future return of the certificate to the corporation and distribution of corporate funds to the holder"[105]. However, redemption might not be always probable. For instance, in the Delaware case *SV Investment Partners, LLC v. Thoughtworks, Inc.* the court stated that redemption is not possible if it "diminishes the ability of the company to pay its debts", even if the company has a profit.[106] Generally, it is mean that the company in stagnation may decide not to redeem the shares, however, the shareholders are likely to require the redemption exactly in such times.

Futhermore, the **anti-dilution** clause is also widespread provision among the contracts of preferred shareholders. When the company undergoes the economic difficulties, the price of the share declines, and might be less than the price paid by the investors initially, it is here the anti-dilution mechanism helps[107]. This mechanism allows the preference shareholder to maintain the ownership percentage of their initial invested stake.

In order to prevent hostile takeover and "keep the company's shares in friendly hands, and to allow the existing shareholders to benefit from a sale of company shares if they are offered at an attractive price", the contracts of the preference shareholders include the **right of first refusal clause**[108]. The shareholders may sell their shares only after the negotiations with a third party regarding the price and proposing the shares at the determined price to their "fellow shareholders."[109]

In the U.S.A., the co-sale right or tag-along right and drag-along right clauses are also frequently included in the contract to protect the preference shareholders.

The **tag-along right** provides the shareholders with a possibility to insert their shares in any on-going sale of shares by the other shareholders under the same terms and conditions. It is an opportunity to take advantage of the third-party sale[110].

The **drag-along clauses** are "designed to counter expropriation risk in efficient or productive sales."[111] The drag-along right allows the shareholders to force a sale of the company.

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https://heinonline.org/HOL/Page?collection=journalsandhandle=hein.journals/pnlr89andid=732andmen_tab=srchresults .

[105] J. M., Jr., "Redemption of Preferred Shares", *University of Pennsylvania Law Review and American Law Register*, Vol. 83, No. 7 (May 1935): 890. Accessed March 04, 2020, https://www.jstor.org/stable/3308583?seq=1#metadata_info_tab_contents.

[106] "Thoughtworks I, 7 A.3d 976(Del. Ch. 2010), aff'd 37 A.3d 205 (Del. 2011)", **cited in** Ben Walther *supra* note 65, 181.

[107] Harm F. De Vries et al., *Venture Capital Deal Terms: A Guide to Negotiating and Structuring Venture Capital Transactions*, (July 2016: HMS Media Vof).

[108] Harm F. De Vries et al., *supra* note 107.

[109] David I. Walker, "Rethinking rights of first refusal", *Harvard Law School*, (1999). Accessed March 19, 2020 http://www.law.harvard.edu/programs/corp_gov/papers/No261.99.Walker.pdf .

[110] Harm F. De Vries et al., *supra* note 107.

[111] Ma Isabel Sáez Lacave and Nuria Bermejo Gutiérrez, "Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses", *European Business Organization Law Review, T.M.C. ASSER PRESS*, (2010): 423-458, 433. Accessed March 19, 2020, https://link.springer.com/article/10.1017%2FS1566752910300061#citeas .

This right represent an obligation and an agreement between all the shareholders to sell their shares if a (qualified) majority of the preferred shareholders benefit from such a sale.[112]

According to the all abovementioned characteristics shares may be divided into groups. Depending on the redeemability (maturity) there are three types of preference shares: compulsory maturity, maturity at the option of the issuer company, no maturity (the perpetual preference share)[113]. These three types of preference shares also can be classified pursuant to the rights they bear: the "normal" or "common" preference shares, the non-cumulative preference shares, the participating preference shares, convertible preference share, and the preference share hybrids[114].

Taking everything into consideration, **this subchapter** introduced and explored the basic and frequent rights embodied into the preference share. Generally, the preference shareholders' rights will depend on the articles of the company. However, there is a feature that indicates belonging to the preference class of shares – it is **a priority in the payment of dividends**. In addition, the shareholders frequently are entitled to cumulative dividends. As for other rights and leverages of the corporation's control, it depends on the articles.

Due to the lack of voting rights, the contract serves as a protection tool for the preference shareholders. As above-mentioned, there is a wide range of rights that grants an additional defence to the shareholders and prevents the abuse from the common shareholders. Also, the rights should be accurately and unambiguously indicated in the articles.

1.3. Protection of the Preference Shareholders Under the Corporate Law

The preference stock is of dual nature, its holder, consequently, should enjoy the dual protection: contractual, by inserting the additional rights in the articles, as above-mentioned, as well as corporate protection, as all the shareholders. Indeed, in the EMCA stated that "**non-voting shares shall carry all shareholder rights except voting rights**."[115]

Conventional, the shareholders' protective rights might be divided into those which provide indirect or implied and direct protection.

Indirect protection is represented by **a right to be informed** as well as **a right to participate at the general meeting**[116] might be considered as protective. Though the preference

[112] Harm F. De Vries et al., *supra* note 107, l.
[113] AP Faure *supra* note 82, 31-32.
[114] Ibid.
[115] *European Model Company Act (EMCA) supra* note 10, 95.
[116] "All shareholders may participate at the general meeting and make use of their rights according to the provisions of this Chapter." *European Model Company Act (EMCA) supra* note 10, 252. Е.Б. Сердюк, *Акционерные общества и акционеры. Корпоративные и обязательственные правоотношения: учебное пособие,* (Юриспруденция, 2005), 1-121. (E.B. Serdyuk, *Joint-stock companies and shareholders. Corporate and legal relations: a textbook,* (Jurisprudence, 2005), 1-121.)

shareholders are not entitled to vote, they are, nevertheless, entitled to request the information from the board. They have access to the balance sheet, and reports, etc, which allow them to track the financial situation of a company and take appropriate measures to protect their investments: require the redemption, for instance. However, according to the EMCA, the volume of such information is limited: directors "must provide the requested information if this can take place without material harm to the company."[117] In the U.S.A., for example, the shareholders are granted by the inspection right. This right provides for "every shareholder of a private corporation has the right, by reason of his interest therein, to inspect and examine the books and papers of the corporation at "reasonable times and places" and for "proper purposes.""[118]

Direct protection encompasses the voting right, redemption right, anti-dilution, tag-along, and drag-along rights, according to the articles, alongside the rights of shareholders for a derivative suit and sell-out and squeeze-out rights, etc.

Generally, the company is managed by the directors who should act in the best interests of the company. **The directors are under a fiduciary duty to the company, but not to the shareholders**. The fiduciary duty covered the duty of care and the duty of loyalty. The duty of care means that "a director of a company must exercise reasonable care, skill and diligence."[119] The duty of loyalty means that "directors must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole."[120] However, the formulation "of its members as a whole" may lead to confusion, as far as it could be considered as referring either to the shareholders only or to the employees, creditors, etc as well as to the stakeholders. In Portugal, for example, the law requires managers to observe "duties of loyalty, in the interest of the company, taking into account the long-term interests of shareholders and concerning the interests of other stakeholders relevant to the sustainability of the company, such as their employees, clients, and creditors."[121] Basically, in the EU the director while "promoting the success of the company" should also take into account the interest of the shareholders, creditors, employees, etc, as a whole. Such an approach, however, does not distinguish the shareholders as the owners, instead, it put them on a par with everyone. Notwithstanding this, "the success of the company" implies the increasing of value the company, which should benefit shareholders and, in particular, the participating preference shareholders.[122]

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[117] *European Model Company Act (EMCA) supra* note 10, 256.
[118] Brian C. Griffin, "Shareholders' Inspection Rights," *Oklahoma Law Review* 30, no. 3, (Summer 1977): 616-621. Accessed March 04, 2020, https://heinonline.org/HOL/LandingPage?handle=hein.journals/oklrv30&div=25&id=&page=.
[119] *European Model Company Act (EMCA) supra* note 10, 212.
[120] Ibid.
[121] Ibid.
[122] *European Model Company Act (EMCA) supra* note 10, 210.

And, if the directors have breached their fiduciary duty, which covers default, negligence, breach of trust, the shareholder is entitled to file a **derivative suit**[123].

As long as the preference stock represents the separate class of shares, which deprived of voting rights, the issue might arise, whether the preference shareholders are entitled to the **additional fiduciary protection**. According to the Delaware case *Jedwab v. MGM Grand Hotels, Inc.*, the preference shareholders do not have any extra protection against the ordinary shareholders, but rather "share" the protective measures established by the law.[124] This might be explained if compare with the additional protection provided to the minority shareholders. For instance, in France, Spain, Portugal, Belgium,[125] etc, minority shareholders enjoy the fiduciary protection against the abuse of the majority shareholders since they are vulnerable in comparison to the majority in that part of exercising their voting power because they do not have any influence on the company decisions. That is to say, the minority shareholders are "impliedly deprived" of the right granted to them by the law because nothing would have changed if they did not vote. However, the position of the preference shareholder is different. First, the preference shareholder knew in advance that the voting power would not be provided. Secondly, the preference shareholders enjoy the priority in the dividends against the ordinary shareholders. Thirdly, the preference shareholders are entitled to the contractual protection as well. So, in view of the above-mentioned, the preference shareholders are not that vulnerable to enjoy the extra protection granted by the corporate law.

In addition, the preference shareholders might enjoy the **minority protection**. Minority constitutes of the shareholders who represent less of the 50% of the company's capital[126]. EMCA provides for the protection of the minority by stating, that "the General Meeting may not pass a resolution which obviously is likely to give certain shareholders or others an undue advantage over other shareholders of the company."[127] However, in some states for the application of this rule, damage to the company alongside the damage to the minority shareholders is required (for instance, in France, Belgium, Italy, U.S.A., etc).[128] For example, in the Delaware case *Orban v. Field*, where the preference shareholders were defendants and constitute a majority, the court held

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[123] Leonard S. Sealy and Sarah Worthington *supra* note 9, 674; *European Model Company Act (EMCA) supra* note 10, 210.
[124] "Jedwab v. MGM Grand Hotels, Inc 509 A.2d 584 (Del. Ch. 1986)" **cited in** Lawrence E. Mitchell, "The Puzzling Paradox of Preferred Stock (And Why We Should Care About It)", *The Business Lawyer*, Vol. 51, No. 2 (February 1996): 447. Accessed May 03,2020, http://www.jstor.org/stable/40687647 .
[125] *European Model Company Act (EMCA) supra* note 10, 262.
[126] Eleni Gologina-Economou, "Rights of Minority Shareholders," *Revue Hellenique de Droit International* 55, no. 1 (2002): 117-140. Accessed March 04, 2020, https://heinonline-org.skaitykla.mruni.eu/HOL/Page?public=true&handle=hein.intyb/rhelldi0055&div=13&start_page=117&collection=intyb&set_as_cursor=0&men_tab=srchresults.
[127] *European Model Company Act (EMCA) supra* note 10, 263.
[128] Ibid.

that the interest of ordinary shareholders might be ignored, if the actions of preference further the best interests of a company.[129]

In addition, the EU law allows the minority shareholders in the listed public companies "to exit from the company" on fair conditions, by exercising the **squeeze-out** or **sell-out** right.[130] Pursuant to the EMCA, squeeze-out right is provided for "any shareholder holding more than nine-tenths of the shares in a limited liability company and a corresponding share of the votes may demand that the other shareholders have their shares redeemed by that shareholder"[131]. Sell-out allows minority shareholders to demand redemption by such a shareholder. The different percentage is stipulated by the national legislation of the states. The price of the share is established either by the agreement between parties or if they cannot reach an agreement by an expert appointed by the court.[132] The various formulas might be utilized in defining the fair price, according to the national legislation of the states.

The U.S.A. provides for an **appraisal right,** which allows the shareholder to sell their shares at a fair price in case of extraordinary corporate events, for example, merger transactions.[133]

In this subchapter, the protective rights granted to the preference shareholders by the corporate law are introduced and analysed. Generally, the preference shareholders are entitled to the same protection as the ordinary, except voting rights, and no additional protection is provided. However, as long as the preference shareholders are lack of voting power, they, for instance, cannot exercise some protective measures granted to the minority ordinary shareholders (for example, to block resolutions). So, the protection granted to the preference shareholders by the corporate law at first glance may seem insufficient. Though, on the other hand, the preference shares encompass the economic advantages for their owners, and they mostly aimed at the increasing of their capital, rather than the governance of the company. Hence, for the preference shareholders to be protected, and fully compensate for the lack of voting rights, as above-mentioned, the articles should entitle the preference shareholders to the "protective" rights.

[129] "Orban v. Field, No. 12820, 1997 Del. Ch. LEXIS 48, at *29-32 (Del. Ch. Apr. 1, 1997)", **cited in** Charles R. Korsmo, *supra* note 3, 1184.
[130] Art. 15, 16 "Directive 2004/25/EC of The European Parliament and of The Council of 21 April 2004 on Takeover Bids". Accessed May 03, 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32004L0025.
[131] *European Model Company Act (EMCA) supra* note 10, 264.
[132] Ibid.,
[133] Alexandros Seretakis, "Appraisal rights in the US and the EU", *Springer*:1-24. Accessed April 12, 2020, https://ssrn.com/abstract=3136548.

1.4. General Standards in the Framework of the Conflicts Between Common and Preference Shareholders

The above-mentioned principle of **equality of shares** also reflects the **principle of equality of shareholders**. This principle means that "all shareholders who are in the same position must be afforded equal treatment by the company"[134]. Also, "the company may not make decisions or take other measures that are capable of causing a shareholder or another person an undue benefit at the expense of the company or a shareholder of the company[135]". That is, all the shareholders should be treated equally and fairly, and all their legal interests, according to the shares they hold, should be respected.

This presumption is closely related to the "**one share – one vote principle**". "One share, one vote" is defined as "the most basic statutory rule of corporate voting[136]" and it reflects "democratic institution and liberal tradition"[137]. The "one share, one vote" rule provides for "equal voting weight" of each share of the stock[138]. That is, the voting power should be proportional to the amount of the acquired shares.

However, the EMCA stated: "Unless otherwise provided in the articles of association, each non-par value share shall carry one vote. Unless the articles provide otherwise, each nominal value share shall carry voting rights proportionate to its nominal value. In case of shares with different nominal values issued by the same company, the shares with the smallest nominal value shall carry one vote."[139] That is to say, the "one share, one vote" principle is modified by substituting it with the conception that the volume of the voting power of each share is proportional to its value. Moreover, Grant M. Hayden and Matthew T. Bodie declared that: ""One share, one vote" is not the "timeless and natural" voting structure as it appears". "It is neither a requirement in the United States nor in Europe."[140] For instance, in Germany and Poland, where the "one-share, one vote" is a fundamental principle, also it is allowed for the non-voting preference stock.[141]

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[134] *European Model Company Act (EMCA) supra* note 10, 32.
[135] "The principle of equality of shares and shareholders" *supra* note 1.
[136] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law*, (1991): 72, **cited in** Grant M. Hayden and Matthew T. Bodie, "One Share, One Vote and the False Promise of Shareholder Homogeneity", *Cardozo Law Review*, 30, (2008): 447. Accessed March 01, 2020, https://scholarlycommons.law.hofstra.edu/faculty_scholarship/40.
[137] Colleen A. Dunlavy, "Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights", *WASH. and LEE L. REV.*, 63, (2006): 1347, 1367, (quoting Caroline Fohlin, *The History of Corporate Ownership and Control in Germany, in A History of Corporate Governance Around The World: Family Business Groups To Professional Managers*, (Randall K. Morck ed., 2005): 223, 262 , **cited in** Grant M. Hayden and Matthew T. Bodie, *supra* note 136.
[138] Grant M. Hayden and Matthew T. Bodie, *supra* note 136, 475.
[139] *European Model Company Act (EMCA) supra* note 10, 104.
[140] Colleen A. Dunlavy, "Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights", 63 *WASH. and LEE L. REV.*, (2006); **cited in** Grant M. Hayden and Matthew T. Bodie *supra* note 136, 463.
[141] *European Model Company Act (EMCA) supra* note 10, 31.

Moreover, this concept becomes even more questionable by considering the different classes of shares, which bear divergent rights. Nowadays companies commonly resort to the issuance of the preference stock – in addition to the existing ordinary – as a tool to back-up themselves financially. The preference shareholders are usually not entitled to voting rights; however, they own their stake in the company. This might constitute the significant violation of the "one share, one vote" principle. Nevertheless, the issuance of preferred stock without voting rights is authorised by the national law of different states and regarded as "adaptation" of the "one share, one vote" principle.

Furthermore, "one share, one vote" principle is derived and is a "logical consequence" of the **shareholder primacy theory.**[142] This is a fundamental theory of corporate law and corporate governance. The shareholder primacy theory means that the "shareholders have the priority interest in both economics and governance of the corporation: shareholders are said to be the principal in a principal-agent relationship on whose behalf the corporate enterprise serves[143]". In addition, this principle holds "that all shareholders have **homogeneity of interest**"[144], namely **the wealth maximization.**[145] The wealth maximization is regarded as the "goal for the corporation", and moreover, as "the only legitimate goal". Yes, Hansmann and Kraakman have declared: "there is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value"[146]. As long as all the shareholders will benefit, if the company flourishes, for instance, by virtue of the dividends, or by participating in surplus on winding-up as the residual claimants. So, at the first glance, the increasing of the company's value seems to be the main intent of all the shareholders.

However, the shareholders might have their own intents which are different from the maximization of the company's value. Grant M. Hayden and Matthew T. Bodie declared that: "It is simply not true that the "preferences of shareholders are likely to be similar if not identical[147]"". The shareholders are not the "homogenous share-value maximisers" as the "one share, one vote" theory promotes. Instead, the shareholders might have different interests, moreover, the shareholders' interests can have a contest.[148] In the Australian case *Peters' American Delicacy Co*

[142] Frank H. Easterbrook and Daniel R. Fischel, *supra* note 136, **cited in** Grant M. Hayden and Matthew T. Bodie, *supra* note 136, 475.
[143] Mark J. Roe, "Political Preconditions to Separating Ownership from Corporate Control", *53 STAN. L. REV.* (2000): 539, 545, **cited in** Robert J. Rhee, "A Legal Theory of Shareholder Primacy", *Minnesota Law Review* (2018): 1951-2016. Accessed March 11, 2020, https://www.minnesotalawreview.org/wp-content/uploads/2018/06/Rhee_MLR.pdf
[144] Grant M. Hayden and Matthew T. Bodie *supra* note 136, 448.
[145] Ibid., 492.
[146] Henry Hansmann and Reinier Kraakman, "The End of History for Corporate Law", *GEO.L.J.*, 89, (2001), 439; **cited in** Grant M. Hayden and Matthew T. Bodie *supra* note 136, 492.
[147] Shaun Martin and Frank Partnoy, "Encumbered Shares", *U. ILL. L. REV.*, (2005), at 778 (quoting Frank H. Easterbrook and Daniel R. Fischel, "Voting in Corporate Law", *26 J.L. and ECON.*: 395, 405), **cited in** Grant M. Hayden and Matthew T. Bodie *supra* note 136, 477.
[148] Grant M. Hayden and Matthew T. Bodie *supra* note 136, 449.

Ltd v Heath (1939), J. Dixon, for instance, hold that the shareholders "vote in respect of their shares, which are property, and the right to vote is attached to the share itself as an incident of property to be enjoyed and exercised for the owner's personal advantage."[149] Furthermore, the shareholders expect that others will enjoy their voting rights in their own self-interest.[150] The stockholders should predict that they may "suffer" due to the exercising of voting rights by the other shareholders. It is the risk that shareholders "inevitably" bear.

The deviations from these standards give rise to conflicts. In particular, by considering the different classes of shares, it is notable that they have not only divergent interests, but also bear divergent economic risks[151]. The preference shareholders are usually more protected financially, while the ordinary shareholders usually have control of the company. The difference in their positions in the company may lead to conflicts.

The conflicts between the shareholders inside the company defined as **horizontal**, because "it occurs between two classes of participants in the corporate capital structure and is centred around their competing legitimate interests in the corporate pie". Horizontal conflicts are opposed to **vertical** conflicts, "which arise between corporate directors (and officers) and the corporation itself and other corporate constituent grounds, typically stockholders, who are subject to their virtually exclusive exercise of corporate power do so in a responsible manner."[152]

As far as the directors run the company, the "alleged vertical" conflicts, where the directors, "even acting in good faith", promote the interests of the ordinary shareholders, and the interest of the company as a whole, are regarded as highly dangerous from a financial perspective. This, however, represents the horizontal conflict – the conflict between the preference and ordinary shareholders who act via the directors.[153]

The capital structure, where the contributions of the preference shareholders support the company financially, might be beneficial for all the shareholders, however, when it comes to the actual distribution of money the interests of the shareholders may conflict.[154] The preference shareholders invest their funds with the aim of stable and regular dividends. The ordinary shareholders, as those who participate in the surplus on winding-up and do not have a fixed rate

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[149] "Peters' American Delicacy Co Ltd v Heath (1939) 61 C.L.R. 457 at 504, HC," **cited in** Robert Flannigan, "Fiduciary Duties of Shareholders and Director", *Sweet and Maxwell and Contributors*, (May 2004): 277-302. Accessed April 02,2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=628775 .

[150] Ibid., 285-286.

[151] Sekar Langit and Desi Adhariani, "Ownership Structure and Company's Risk-Taking Behavior*", Advances in Economics, Business and Management Research, Atlantis Press*, vol. 36, (2018): 52-64. Accessed April 04, 2020, https://www.researchgate.net/publication/323143497_Ownership_Structure_and_Company's_Risk-Taking_Behaviour .

[152] Lawrence E. Mitchell *supra* note 124, 450-451.

[153] Lawrence E. Mitchell, "Fairness and Trust in Corporate Law", *Duke LJ.*, 43 (1993): 1182, 1213-15, **cited in** Lawrence E. Mitchell supra note 124, 451.

[154] Charles R. Korsmo *supra* note 3, 1175-1176.

of the dividends, seek to the long-term development of the company, and, thus, might be in favour for direction all profit to the development of the company and not for the payment of dividends to preference shareholders.

Historically, the ordinary shareholders constitute the majority and influence the company's decisions. Alongside, the preference shareholders, due to the different interests with the ordinary shareholders, might be at risk of the exploitation. Such behaviour may take various forms; however, the main idea is the removal of dividend arrearages.[155]

In this subchapter, the fundamental standard such as the equality of shares and shareholders were introduced. In addition, the conceptions which derive from this presumption were analysed: "one share, one vote", the shareholder's primacy and the shareholder's homogeneity. However, in the modern legal environment, these conceptions are modified.

The issuance of the different classes of shares has changed the usual concept of the rights to which shareholders are entitled. The amount of companies, which allow for alternative voting structures, is growing.

The "modern" presumption of equality imply the equality between the shareholders and shares inside each class of shares; alongside the principle provides for the respecting of the legal interests of all shareholders as a whole, as well as for preventing the shareholders or another person from obtaining an undue benefit at the company's or shareholders' expenses. The "one share, one vote" rule is also adapted, and rather means the "equal value, equal vote" for noting shares. The shareholder's homogeneity also is not observed in the framework of the existing conflicts between preference and common shareholders.

[155] William W. Bratton and Michael L. Wachter *supra* note 4, 1830; Charles R. Korsmo *supra* note 3, 1176.

2. STATUS OF THE PREFERENCE SHAREHOLDERS IN SELECTED JURISDICTIONS

There are two major legal systems in the western world, namely, the civil law and common law systems.[156] The preference shares are represented in both different systems. Both legal systems provide the freedom for the company and preference shareholders to regulate their relationship, in the framework established by the laws. However, due to different legal traditions that prevail in the legal systems as well as in the different states, the legislation on the regulation of the preference shares has its own peculiarities.

2.1. Status of the Preference Shareholders in Common Law Jurisdictions

The common law system evolved in England since the XI century and was adopted in the USA, Canada, Australia, New Zealand, and other countries of the British Commonwealth.[157] Generally, the company and the preference shareholders enjoy the freedom in establishing the rules of their relationship. The law imposes some restrictions, however, they, basically, are related to the protection of the shareholders.

2.1.1. Status of the Preference Shareholders in the UK

The United Kingdom is a common law state. Autonomy is considered to be one of the core values. "Contracting and contract law, the freedom of commerce, the freedom to conclude contracts, this is where the heart of English contract law lies. Freedom of contract, therefore, means first and foremost the economic freedom to voluntarily engage in economic transactions without any risk of statutory interferences, with the exception of paying taxes to the Crown."[158] The contract represents rather the economic functions and intervention is possible only for political needs.[159]

The preference shares are authorised under the Company Act 2006 by stating that the company may issue the shares with various rights attached forming the different classes of shares.[160] The rights of the preference shareholders should be precisely indicated in the articles.

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[156] Àlex Levin Canal, "Spanish and American Approaches to Contract Formation: A Comparative Study", 2016-2017. Accessed April 13, 2020,http://diposit.ub.edu/dspace/bitstream/2445/124065/5/TFG_Levin_Canal_Alex.pdf.
[157] Ibid.
[158] Henry James, *The Rise and the Fall of British Empire,* 1994; **cited in** Hans-W. Micklitz, "On the intellectual history of freedom of contract and regulation", EUI Working Paper LAW 2015/09, ERC-ERPL-12, European University Institute Department of Law, "European Regulatory Private Law" Project, European Research Council (ERC) Grant, European University Institute 10-12, Italy, 2015.
[159] Hans-W. Micklitz *supra* note 158, 7-9.
[160] Art. 630, "Corporate Act 2006", UK. Accessed April 30, 2020,

The preference shares should bear the "relevant priority" whether in the distribution or voting.[161] The law does not indicate the particular priority the preference shareholders should enjoy, only implies that the preference shareholders should enjoy the priority; and leaves this at the discretion of the company and the investors to decide.

The preference shares may bear a right to a **fixed, cumulative, or non-cumulative dividend**. In the UK, the preference shareholders often have the right to fixed and cumulative dividends. In addition, there is a **presumption of the cumulative dividend**, unless the articles provide otherwise[162]; that outlines the importance of the cumulative dividend to the preference shareholder. The directors decide on the distribution of dividends. The dividends should be paid out of the accumulated and realised profits.[163] If the payment of the dividends violates this rule the payment is regarded to be unlawful. The directors, who knew or should have known that the payment made in violation, are liable to reimburse the dividends.[164] **The directors are not obliged to declare dividends**. And, in *the Burland v Earle case* of 1902, the Privy Council held that the distribution of the dividends is at the discretion of the directors and the court would not intervene.[165] However, the failure to pay the dividends may serve as a "just and equitable" ground for ordering the winding up.[166] There is no such presumption in respect of the priority on winding up, the preference shareholders are entitled to a priority only if it is stated in the articles.[167]

The preference shareholders usually are not entitled to vote. However, the preference shareholders might be entitled to a **consent-voting right** and acquire the voting power to decide on amendments that may change their position. The decision is considered to be approved by a majority of three-quarters.[168] However, for instance, the issue of the shares that ranks equally or in priority to an existing preference class of shares is out of this scope, unless in the articles indicted otherwise.[169] The consent-voting aims to provide a possibility to the preference shareholders to approve certain actions as "a class." Consequently, the approved decision should be "fair" towards the preference shareholders. For instance, in *the Re Holders Investment Trust Ltd (1971) 1 WLR*

http://www.legislation.gov.uk/ukpga/2006/46/contents.

[161] "London India Rubber Co. (1869) LR 5 Eq 519; and Ferran (2008: 152)." **cited in** Andreas C. Cahn and David C. Donald *supra* note 2, 320.

[162] "Henry v. Great Northern Ry Co (1957) 1 De G & J 606 at 638"; "Andreas Webb v Earle (1875)." **cited in** Alan Dignam and John Lowry *supra* note 61.

[163] Art 830, 910 *supra* note 160.

[164] "Bairstow v Queens Moat Houses plc (2001)", **cited in** Alan Dignam and John Lowry *supra* note 61, 127.

[165] "Burland v Earle (1902)." **cited in** Leonard S. Sealy and Sarah Worthington *supra* note 9.

[166] "Harman J in Re a Company (1988) 4 BCLC 506." **cited in** Leonard S. Sealy and Sarah Worthington *supra* note 9, 579.

[167] "Birch v. Cropper (1889) 14 App Cor 525. Andreas", "Scottish Insurance Corp Ltd v Wilson and Clyde Coal Co Ltd (1949)" **cited in** Alan Dignam and John Lowry *supra* note 61.

[168] Art. 630(4), 334. *supra* note 160.

[169] A. Boyle and J. Birds, *Boyle and Birds' Company Law*, 4th ed. (Bristol: Jordans, 2000), 242; **cited in** Mads Tonnesson, Andenas and Frank Wooldridge, *European Comparative Company Law*, (Cambridge: Cambridge University Press, 2008).

583 (Chancery Division) case, where the 90% of the preference shares was owned by the ordinary shareholders, the court refused to confirm the buyout of the preference shares even after the preference shareholders had approved it, because this reduction benefited the ordinary shareholders as a class, and not the preference shareholders.[170]

The preference shares are **convertible** into another preference class or ordinary either at the option of the shareholders themselves or at the option of the company.[171] The preference shares might be **redeemable** at the option either of the shareholder or the company if the articles provide so.[172] The shares in the public companies might be bought out either out of the "profits of the company", or out of the "proceeds of a fresh issue of shares made for the purposes of the redemption"; in the private companies, the shares might be bought out of the capital.[173] As for **the pre-emptive** right, the Company Act 2006 does not provide it for the preference shareholders[174], however, it might be provided by the articles.

The preference shareholders are entitled to **attend the general meetings**.[175] The preference shares also encompass the **information rights** such as possibility to inspect the records and resolutions of the general meetings[176], to receive the annual accounts or reports for each financial year.[177] However, the information right of the individual preference shareholder granted by the UK law is limited in comparison with the U.S.A., for instance, because it is restricted only to a particular source of information the shareholders might receive. The shareholders who hold 10% of the share capital are entitled to require an audit of the company.[178]

The directors own their **fiduciary duty** towards the company and are obliged to "act in good faith" and promote the "interests of the company."[179] The directors are perverted from the running of the company in their interests.[180] The UK provides a "shareholder value" approach. The shareholders are entitled to bring a **derivative claim** on behalf of the company "in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company."[181] However, firstly, the shareholder

[170] "Re Holders Investment Trust Ltd (1971) 1 WLR 583 (Chancery Division)" **cited in** Leonard S. Sealy and Sarah Worthington *supra* note 9.
[171] Art. 971, 989 *supra* note 160.
[172] Ibid., Art. 684.
[173] Ibid., Art. 687.
[174] Ibid., Art. 560-561.
[175] Ibid., Art. 310.
[176] Ibid., Art. 358.
[177] Ibid., Art. 423.
[178] Ibid., Art. 476.
[179] "Re Smith and Fawcett Ltd (1942) Ch 304," 306 (CA); and "Brady v. Brady (1989) AC 755 (HL)". **cited in** Andreas C. Cahn and David C. Donald *supra* note 2, 404.
[180] "Regal (Hastings) Ltd v. Gulliver (1967) 2 AC 134", **cited in** Andreas C. Cahn and David C. Donald *supra* note 2, 404.
[181] Art. 260 *supra* note 160. Ibid., The derivative claim was firstly recognized in "Foss v. Harbottle (1843)."

should apply to the court for permission.[182] Also, the shareholders are authorized to ratify the directors' conduct "amounting to negligence, default, breach of duty or breach of trust in relation to the company." The ratification is held through the resolution of the members of the company. The ratification deprives the members of the company of the subsequent challenge of the directors' conduct. However, the Act does not provide a comprehensive vote for the non-voting preference shareholders. The conduct that amounts to the breach of the directors' fiduciary duties can be approved without the preference shareholders, and, consequently, this "approval" deprives the preference shareholders of a possibility to challenge the concerned directors' conduct. So, the articles should provide a possibility for the preference shareholder to vote on such issues. Concerning the rules on the **nullification** of the shareholders' resolutions, the preference shareholders may apply to the court if the company's affairs appear to be unfairly prejudicial (to bring an **unfair prejudice action**).[183] Also, in particular, the resolution on re-registration of the public company into the private company[184], the resolution on the variations of share capital[185], and the resolution on the redemption or purchase of the company's own shares may be challenged.[186]

The shareholders of the public and private companies are also entitled to **exit** rights. There is a possibility of the sell-out and squeeze-out if the dominant shareholder of the company holds 90% of the share capital.

This subchapter introduced and investigated the rights of the preference shareholder in the UK. Generally, the company and preference shareholders enjoy freedom in defining the rights and the priority the preference shareholders are entitled to. According to the law, the preference shareholders enjoy the same right as the ordinary ones. However, the law does not entitle the preference shareholder to the pre-emptive right. So, in order to maintain the ownership percentage stake, the articles should insert the anti-dilution provision. Also, the procedures on the convertibility and redeemability of the shares should be indicated. On the other hand, there is a presumption of the cumulative dividends to the preference shareholders. However, information rights are limited regarding the information that might be provided. So, the articles should insert the provision on extension of the information that might be revealed to the preference shareholders.

[182] Ibid., Art. 261.
[183] Ibid., Art. 994.
[184] Jeffrey N. Gordon and Wolf-Georg Ringe, *The Oxford Handbook of Corporate Law and Governance*, Oxford University Press, (United Kingdom, Oxford: 2018), 98.
[185] Ibid., 633.
[186] Ibid., 721.

2.1.2. Status of the Preference Shareholders in the U.S.A.

The United States of America is a common law federal country (except Louisiana, which is a civil law State). Each of 50 States has its own legislation, and, consequently, its own corporate law. The Federal government only sets the minimum standards. However, the Model Business Corporation Act[187] (hereinafter referred to as MBCA), prepared and revised few times by the American Bar Association, served as a model for the States and used by 24 of them. This Act aimed to uniform American corporate law.[188]

According to this Act the ""preferred shares" means a class or series of shares whose holders have **preference** over any other class or series of shares with respect **to distributions**."[189] That is to say, the preferred shares should enjoy a priority in the distribution of profit, however, nothing is mentioned about the limitation of the voting power. The preference shares might be voting, non-voting, or with limited voting power, cumulative, non-cumulative or cumulative in part, convertible, redeemable, enjoy the priority on winding up or not, etc.[190] The rights attached to the preference shares should be indicated in the articles of the incorporation.[191] In addition, the MBCA does not provide the limitation on the issuance of the preferred shares.

However, concerning the **cumulative dividend**, the case law reveals that, if there is no indication of cumulation or non-cumulation of dividends in the articles the court might decide that the shareholders are entitled to the cumulative dividends.[192]

The board of directors is authorized to decide on the **distribution**.[193] The distribution encompasses the "payment of dividends, redemption, purchase or other acquisition of share, distribution on liquidation", etc.[194] However, no distribution may be made if it may lead the corporation to inability to pay debts, or "the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to

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[187] The Model Business Corporation Act. Accessed April 30, 2020, https://www.americanbar.org/content/dam/aba/administrative/business_law/corplaws/2016_mbca.authcheckdam.pdf

[188] Elliott Goldstein and Robert W. Hamilton, "The Revised Model Business Corporation Act", *American Bar Association, The Business Lawyer*, Vol. 38, No. 3 (May 1983): 1019-1029. Accessed April 21, 2020, https://www.jstor.org/stable/40686493; **cited in** Hugo Kerbib, "Comparative Corporate Law: The US Corporation and the French SA" (Master I droit, Université Paris-Dauphine, 2016-2017). Accessed April 04, 2020, https://www.lepetitjuriste.fr/wp-content/uploads/2017/06/MEMOIRE-ANGLAIS.pdf.

[189] 13.01 *supra* note 187.

[190] Ibid., 6.01(c).

[191] Ibid.

[192] "Whabarton v. John Wanamaker, Philadelphia, 329 PA. 5, 196 ATL. 506 5 (1938)", **cited in** Hugo Kerbib *supra* note 188, 20.

[193] 6.40 *supra* note 187.

[194] Ibid., 1.40.

those receiving the distribution."[195] The distribution should be made from the profit of a company, not the capital of the company.[196] However, according to the case-law, the intentional and unjustified non-declaration of dividends is a ground for the direct action of the shareholders.[197]

The preference shareholders are entitled to **vote** in case of the amendments that would adversely change the status of the preference shareholder, for instance, "change the rights, preferences, or limitations of all or part of the shares", "create a new class of shares having rights or preferences with respect to distributions that are prior or superior" or "limit or deny an existing pre-emptive right of all or part of the shares", etc.[198] The voting should be held through the **class-voting** method, even if the articles provided for the share-voting method, or stated that the other shareholders are entitled to vote along with the preference shareholders as the "part of the same voting group."[199] The decision should be approved by a majority of votes unless the articles indicate otherwise.[200] This provision provides protection to the preferred shareholders, who even are not entitled to vote, have an opportunity to decide on the alterations that would change their position in the company. In addition, the voting preference shareholders should approve the merger plan proposed by the board of directors. The voting is held through the class-voting method, unless the plan of merger and share exchange affect a substantive business combination.[201] In addition, the temporary voting rights might be granted to the shareholders in case of certain contingency is happened, for instance, non-payment of dividends.[202] The shareholders also might elect the dedicated number of the directors if the certificate provides so.[203]

The preference shares may be **redeemable.** The preferred stock might be "**convertible** into shares of any other class or series or into cash, indebtedness, securities, or other property of the corporation or another person." The price should be paid by each share in case of the

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[195] Ibid., 6.40(c).
[196] "Morse v. Boston & Maine R. R., 263 Mass. 308, 160 N. E. 894 (1928)", **cited in** Hugo Kerbib *supra* note 188, 20.
[197] "Knapp v. Bankers Sec. Corp., 230 F.2d 717 (3d Cir. 1956)", **cited in** J.B., "Distinguishing between direct and derivative shareholder suits", *University of Pennsylvania Law Review*, Vol.110:1137, Accessed April 25, 2020, https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=6920&context=penn_law_review .
[198] 10.04 *supra* note 187. The list of the events, indicated in the Act, is limited, however, the articles of the incorporation may provide for another event.
[199] "Voting group" means all shares of one or more classes or series that under the articles of incorporation or this Act are entitled to vote and be counted together collectively on a matter at a meeting of shareholders. All shares entitled by the articles of incorporation or this Act to vote generally on the matter are for that purpose a single voting group." 1.40 *supra* note 187.
[200] Ibid., 7.25.
[201] Ibid., 11.04 (g). For instance, "if a corporation with preferred and common shares merges into a wholly-owned subsidiary with all shares being exchanged for common shares of the subsidiary, the authorization to eliminate the separate group vote of the preferred shares would not apply because the transaction would be in effect an amendment of the preferred stock without separate substance as a business combination". Though, "if the subsidiary (assuming it was significant) was only 60% owned and the holders of the remaining 40% were being cashed out in the merger, elimination of the separate group vote would be effective because the merger would have substance as a business combination." Ibid., 292.
[202] Ibid., 6.01.
[203] Ibid., 8.04.

redemption or conversion as well as the amounts of the shares that might be redeemed are to be established in the articles of incorporation or "determined in accordance with a formula." [204]

The preference shareholders do not have the **pre-emptive right** unless the articles provide otherwise.[205] However, usually, the non-voting preference shareholders have a pre-emptive right only with respect to the non-voting preference stock because the issuance of this stock is likely to affect their interests; alongside the issuance of the common stock normally does not affect the preference shareholders.[206] Hence, each class of shares has a pre-emptive right with respect to a similar class of share. This should be detailed by the articles.

The preference shareholders are entitled **to attend the general or special meetings**. The **information right** represents the inspection right. The shareholders have a right to inspect and copy the records of the corporation including the financial statements of the corporation "during regular business hours" either "at the corporation's principal office", or "at a reasonable location specified by the corporation"; provided that such a demand is "in with a good faith and for a proper purpose."[207] The shareholders are entitled to acquire the wide range of the information, however, they should proof the "proper purpose".

The directors should act in good faith and **further the best interest of the corporation**.[208] Also, the directors should run the company with the aim of wealth maximization for the shareholders.[209] The directors cannot take advantage of the business opportunities "directly, or indirectly through or on behalf of another person."[210] The directors should not take the personal advantage of the opportunities may be offered by the company. The doctrine of the "corporate opportunity" constitutes a part of the doctrine of the director's duty of loyalty.[211] The MBCA also provides the shareholders with a possibility to file a **derivative suit**, in case if directors have breached the standards of conduct.[212]

Also, the case law provides for the **minority protection**, for instance, the California Supreme Court in the *Jones v. H. F. Ahmanson Co. case 1969*, held that the "majority of shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority", while "any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not

[204] Ibid., 6.01(b), 6.01(c).
[205] Ibid., 6.30.
[206] Ibid., 107.
[207] Ibid., 16.02. "Proper purpose" under section 16.02(c) has been defined in case law to involve a purpose that is reasonably relevant to the demanding shareholder's interest as a shareholder."
[208] Ibid., 8.30.
[209] "Dodge v. Ford Motor Company, 170 NW 668 (Mich 1919)" **cited in** Hugo Kerbib *supra* note 188.
[210] 8.70 *supra* note 187.
[211] Ibid., 238-239.
[212] Ibid., 7.40.

conflict with the proper conduct of the corporation's business."[213] In addition, the Appeals Court of Massachusetts in *the Smith v. Atlantic Properties, Inc. case* in 1981 stated that "[…] a stockholder may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."[214] That is to say, the majority shareholders are deprived from promoting their own interests as far as this interest do not comply with the interest of all the shareholders and the company. In addition, many statutes of the closely held companies authorize the courts to the dissolution of the company if the majority shareholders are guilty of the fraud or oppression towards the minority.[215]

The preference shareholders might **enjoy an appraisal right**: obtaining the payment of the fair value for the shares, in case of the merger, share exchange, disposition of the assets, etc. "Statutory appraisal is made available only for corporate actions that will result in a fundamental change in the shares to be affected by the action and then only when uncertainty concerning the fair value of the affected shares may cause reasonable differences about the fairness of the terms of the corporate action."[216] However, the appraisal right might be limited, if the preference shareholders have a right to vote on the concerned action as a separate voting group.[217]

Hence, the MBCA authorise the preference shares by stating that the preference shares should enjoy the priority in distribution.[218] The Act provides a template on how the relationship between the company and preference shareholders should be regulated. The rights attached to the preference shares should be indicated in the articles.[219] However, the MBCA provides for the comprehensive protection of the preference shareholders in case of the certain amendments[220], this list may be extended by the articles. The case law reveals that, as in the UK, there is a presumption of the cumulative dividends, under the law of some states[221]. Also, the articles should insert anti-dilution clause for the preference shareholders, because they are not entitled to under the MBCA.[222] The procedures on the redeemability and convertibility of the shares are also not indicated by the Act, and, so, they should be indicated in the articles. In addition, as above-mentioned, according to the case law, the minority preference shareholders are protected from the

[213] Borut Bratina and Dušan Jovanovič, "Shareholders' Duty of Loyalty and Positive Voting Duty", *David publishing, China-USA Business Review*, May 2014, Vol. 13, No. 5, (University of Maribor, Maribor, Slovenia), 347-355. Accessed April 24, 2020. http://www.davidpublisher.com/Public/uploads/Contribute/5508f1558508a.pdf .
[214] Ibid.
[215] Robert A. Ragazzo and Frances S. Fendler, *Closely Held Business Organizations* 2nd ed., (2012),126. Jeffrey N. Gordon and Wolf-Georg Ringe *supra* note 184, 976.
[216] 315 *supra* note 187.
[217] Ibid., 13.02(c).
[218] Ibid.,13.01.
[219] Ibid.,6.01.
[220] Ibid.,10.04.
[221] "Whabarton v. John Wanamaker, Philadelphia, 329 PA. 5, 196 ATL. 506 5 (1938)", **cited in** Hugo Kerbib *supra* note 188, 20.
[222] 6.30.

abuse of the majority shareholders, and, vice versa, prevent the majority preference shareholders from abuse.

The **Delaware State** is a "pro-corporation state", and a half of the listed companies of the U.S.A. are incorporated there.[223] Delaware does not follow the MBCA and has its own Law on companies, namely Title 8 of the Delaware Code[224].

The Delaware Code authorizes the issuance of the preference shares, by stating that any class with any rights, preferences or limitations might be issued by the company.[225] The rights of the preference shareholders are indicated in the certificate of the incorporation.[226] The Code does not impose the limits on the preference shares that might be issued.

The Delaware Code stated that the preference shareholders should acquire their **dividends** before the other classes of shares "on such conditions and at such times as shall be stated" in the certificate or the resolutions providing for the issue of such stock adopted by the board of directors. Also, whether the preference shareholders entitled to cumulative dividends as well as the rate and regularity of the dividends should be indicated in the certificate or in the resolutions. The board of directors is authorized to decide on the distribution of dividends.[227] The dividends are paid out of the surplus of the company, or if the company does not have the surplus, the payments should be made out of the company's "net profit for the fiscal year in which the dividend is declared and/or the preceding fiscal year"[228]. The dividends shall not be declared if the capital of the company has been reduced by the depreciation in the value of the company's property, or by losses, or otherwise, "to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets."[229] The preference shareholders also might enjoy a **priority in winding-up** if the certificate or the resolution provides so.[230]

The preference stock might be **redeemable** by the corporation at its option or at the option of the shareholders or in case if the contingency happened.[231] The preference stock may be redeemable under "for cash, property or rights, including securities of the same or another corporation, at such time or times, price or prices, or rate or rates, and with such adjustments", as

[223] Hugo Kerbib *supra* note 188, 20.
[224] "The Delaware Code, Title 8 Corporations Chapter 1, General Corporation Law". Accessed April 23, 2020, https://delcode.delaware.gov/title8/c001/sc05/index.shtml.
[225] 151(a) *supra* note 224.
[226] "The term "certificate of incorporation," as used in this chapter, unless the context requires otherwise, includes not only the original certificate of incorporation filed to create a corporation but also all other certificates, agreements of merger or consolidation, plans of reorganization, or other instruments". § 104 Certificate of incorporation; definition.
[227] 151(c) *supra* note 224.
[228] Ibid., 170(a).
[229] Ibid.
[230] Ibid., 151(d).
[231] Ibid., 151(b).

stated in the certificate or in the resolution.[232] The preference shares are **convertible** "at such price or prices or at such rate or rates of exchange and with such adjustments"[233] as established in the certificate or in the resolution.

The preference shareholders are entitled to **participate in the general and the special meetings**. However, the Code does not require for comprehensive voting of the non-voting shareholders in case of the amendments to the articles that could affect their status, including the mergers, consolidations, or conversion. For the non-voting preference shareholders to be protected the articles should insert the provision on comprehensive voting on the amendments that may adversely change the rights of the preference shareholders[234] including, but not limited, to the precise list of such events. On the other hand, the preference shareholders as a class might be entitled to a specific right to elect a certain amount of the directors.[235] Moreover, the shareholders might be authorized to reduce the board of directors and grant the management power to the other body or group.[236]

The Delaware Code provides the shareholders with the **information right** of shareholders, by stating that the shareholders are entitled to inspect and copy the books and records during the usual business hours. According to the case law, the information right is considered fundamental.[237] However, in order to access to the books and records, the shareholders should demonstrate "a proper purpose."[238]

The Code imposes **fiduciary duties** on the directors and requires them to act in good faith and further the best interest of the corporation.[239] The fiduciary duty encompasses the duty of care and duty of loyalty. Case law explained the duty of care as the directors' obligation "to be well informed"[240] "prior to making a business decision, of all material information reasonably available to them"[241] and "follow the process."[242] The duty of loyalty prohibits the directors "to use their position of trust and confidence to further their private interests."[243] The directors cannot compete

[232] Ibid., 151(b).
[233] Ibid., 151(e).
[234] "Avatex, 715 A.2d 845", cited in Ben Walther *supra* note 65, 178.
[235] 141(d) *supra* note 224.
[236] Ibid., 141(a) in connection with 151(a). Andreas C. Cahn and David C. Donald *supra* note 2, 323.
[237] "Williams v. Geir, 671 A2d 1368, 1381 (Del.1998)", **cited in** Hugo Kerbib *supra* note 188.
[238] "Security First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 568 (Del.1997)", **cited in** Hugo Kerbib *supra* note 188.
[239] 145 *supra* note 224.
[240] "Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)," **cited in** Zachée Pouga Tinhaga, "Fiduciary Duties of Corporate Directors: a Comparative Study of the US Corporate Law and the Organization for Harmonization of Business Law in Africa (OHADA)", *University of Michigan Law School*: 3. Accessed May 03, 2020, https://www.law.umich.edu/events/junior-scholars-conference/Documents/Zach%20Pouga%20-%20Paper.pdf.
[241] "Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)," **cited in** William M. Lafferty et al, "A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*", Penn State Law Review,* Vol. 116:3, 2012. Accessed April 24, 2020, http://www.pennstatelawreview.org/116/3/116%20Penn%20St.%20L.%20Rev.%20837.pdf.
[242] "Smith v. Van Gorkom" *supra* note 240.
[243] "Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)," **cited in** William M. Lafferty et al *supra* note 241.

with the corporation and promote their own interests.[244] The preference shareholders have a right to file a derivative action on behalf of the company in case of breach by the directors their duties.[245] The minority shareholders also enjoy the protection from the self-dealing of the majority shareholders. The self-dealing takes place in case if the minority shareholders do not benefit from the transaction.[246]

Hence, the Delaware Code does not provide the obligatory set of rights and the certain preference that should be attached to the preference share. All the rights should be indicated in the certificate, however, the shareholders enjoy some basic rights as information right, a right to attend the meetings as well as the protection against the abuse of the majority shareholders and in case of the directors breach their fiduciary duties.

To sum up, the statuses of the preference shareholder under the MBCA and the Delaware Code were introduced and investigated. Generally, the approaches of the MBCA and the Delaware Code are similar, they both provide only the template on the regulation of the relationship between the company and preference shareholders. However, the Delaware Code, in comparison with the MBCA, provides for more freedom. While, the MBCA imposes some restrictions on freedom, for instance, it requires the company and shareholders to insert the protective rights of the preference share, such as obligatory consent-voting of the preference shareholders that should be held as a class-voting. Nevertheless, the status of preference shareholders under the Delaware law or the law of the state under MBCA is defined mainly by the articles or the certificate.

2.1.3. Summary

To sum up, these subchapters introduced and examined the status of the preference shareholder in the common law states. In general, the company and preference shareholders under the common law are free to structure their relationship and set the rights attached to the preference shares, however, the law establishes some limits. For instance, the preference shareholders are entitled to the "basic" rights such as information right and right to attend the meetings as well as a right to file a derivative suit, etc. The common law does not restrict the issuance of the preference shares; thus, the preference shareholders might constitute a majority.

In the common law jurisdictions, due to the freedom granted, the articles or the certificates should contain the precise list of rights provided to the preference shareholder. Also, the right to

[244] "Guth v. Loft. Inc., 5 A.2d 503, 23 Del. Ch.255 (1939)", **cited in** Hugo Kerbib *supra* note 188.
[245] 327 *supra* note 224.
[246] "Sinclair Oil, 280 A.2d at 720-22;" "Gilbert v. El Paso Co., 490 A.2d 1050 (Del. Ch. 1984), aff'd, 575 A.2d 1131 (Del. 1990)." **cited in** Kerry E. Berchem, Ron E. Deutsch, Nicholas J. Houpt, "Duties of controlling stockholders Murky Waters: Tread Carefully", Accessed April 30, 2020, https://www.akingump.com/a/web/22475/aohG6/duties-of-controlling-stockholders-pli_article_june-2012.pdf .

cumulative dividends is one of the core rights for the preference shareholders, that, also, outlines the importance of the economic interests of the preference shareholder. And deprive the board of intentional non-declaration of the dividends, as long as they should be paid, however, later than due.

2.2. Status of the Preference Shareholders in Civil law Jurisdictions

The civil law system is a modern legal system originated from Roman law and mainly developed in Continental Europe. The rationalism prevails in civil law.[247] In civil law, the companies and preference shareholders, also, enjoy the freedom in structuring their relationship, however, it is limited in comparison with the common law.

Through the EU legal area, the Directives[248] harmonize the rights of the shareholders, however, the status of the preference shareholder was not regulated separately. The rights of the preference shareholders are regulated by the national law of every Member State. The legislation is different from state to state. Also, not in every Member State the preference shares are popular, for instance, in Italy the preference shares are not frequently issued.[249] In addition, the status of the preference shareholder is far different in the states outside the EU legal area.

2.2.1. Status of the Preference Shareholders in France

France belongs to the states of civil law jurisdiction. "This means that Company law judges will be very faithful to the letter of the law, rather than the spirit."[250] However, the "spirit" has its influence on the "letter of law". Hans-W. Micklitz stated that the vision of the French Revolution might be tracked in the Constitution as well as in the French Commercial and Civil Codes, etc. Yes, for instance, the equality of rights and the freedom of contract are regarded as the ones of the basic principles throughout the French private law. The freedom of contract, in France, is regarded "more than just an exercise to maximize mutual economic benefit", rather as "the

[247] H. Patrick Gltnn, *Legal Traditions of The World Sustainable Diversity in Law*, 2nd ed., (Oxford University Press: 2004), 134.
[248] "Directive 2007/36/EC of The European Parliament and of The Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies." Accessed May 04, 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32007L0036. "Directive 2004/25/EC of The European Parliament and of The Council of 21 April 2004 on Takeover Bids"; *supra* note 130."Directive (EU) 2017/828 of The European Parliament and of The Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement." Accessed May 04, 2020, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017L0828.
[249] Mads Tonnesson. Andenas and Frank Wooldridge *supra* note 169, 182.
[250] "Study on Minority Shareholders Protection, Final report", *TGS Baltic, Publications Office of the European Union*, Luxembourg, January 2018. Accessed May 09, 2020, https://op.europa.eu/en/publication-detail/-/publication/1893f7b8-93a4-11e8-8bc1-01aa75ed71a1/language-en.

product of a "reasonable decision." However, this principle may be limited "via statutory intervention" for the benefit of the equality and support of the vulnerable.[251] That is to say, the rationalism prevails through the French legal area.[252]

In France, the preference shares, or *les action de préférence* were authorized in 2004 by the Ordinance in the 2004 year[253]. This financial instrument replaces the former various types of priority shares "with one single and more flexible regime."[254] Before the Ordinance, the Commercial Code provided for the "prototypes" of today's preferred shares, namely the preferred shares or *les actions de priorité*[255], the non-voting preferred shares or *les actions de préférence sans droit de vote*[256] or *les actions à dividende prioritaire sans droit de vote* and the investment and voting certificates *or certificates de droit de vote.*[257]

Preferred shares or *les actions de priorité*[258] entitle their owners to the dividends which are higher than for the ordinary shareholders is provided. The shares also bear the priority right against the ordinary ones to be reimbursed in the case of liquidation. In addition, they might be converted in the ordinary by a decision of the extraordinary general meeting of shareholders and the special meeting of the preferred shareholders; and redeemed by a company.[259] Furthermore, the preference shareholders are entitled to appoint one or more persons through the special meeting to represent their interests on the general meeting of the shareholders in case of the mergers, spin-off[260], and modifications of their rights attached.[261]

The non-voting preferred shares *or les actions de préférence sans droit de vote* or *les actions à dividende prioritaire sans droit de vote* bear the priority right against preference and ordinary shareholders to any payments. As the term suggests, the non-voting preferred shares do not provide their owners with the right to vote. However, the shareholders might acquire temporary

[251] Hans-W. Micklitz *supra* note 158, 10-12.
[252] Ibid.
[253] "Ordonnance n° 2004-604", Légifrance, le service public de l'accès au droit - Accueil, June 24, 2004. Accessed April 04,2020, https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000000804070&dateTexte=&categorieLien=id.
[254] Pierre-Henri Conac, "The New French Preferred Shares: Moving towards a More Liberal Approach," *ECFR*, (4/ 2005): 487-511. Accessed May 02, 2020, https://core.ac.uk/download/pdf/6468962.pdf.
[255] "Law №66-537 of July 24, 1966" **cited in** Pierre-Henri Conac *supra* note 254.
[256] "Law № of July 13,1978" **cited in** Pierre-Henri Conac *supra* note 254.
[257] "Commercial Code (Law n° 83-1 of 3, 1983)." *supra* note 86.
[258] "Law №66-537 of July 24, 1966" **cited in** Pierre-Henri Conac *supra* note 254.
[259] Christopher Joseph. Mesnooh, *Law and Business in France: A Guide to French Commercial and Corporate Law* (Dordrecht: M. Nijhoff, 1994), 120.
[260] Auke Jongbloed, "A spin-off separates diverse units of the firm and results in two companies that have dissimilar assets." "Spin-Offs: Implications for Corporate Policies," *Tijdschrift Voor Economie En Management*, April 2004, 569-588. Accessed April 30, 2020, https://core.ac.uk/download/pdf/6468962.pdf .
[261] Christopher Joseph. Mesnooh *supra* note 259.

voting rights in case if the dividends due are not paid for three fiscal years[262]. These shares are redeemable[263] and convertible[264].

The voting and investment certificates – *certificats d'investissement* – resulted from the division of the financial and non-financial rights attached to shares (1966). The voting certificates *or certificates de droit de vote* entitle its owners only to the non-financial rights, that is the right to vote and to be informed. While the investment certificates encompass only financial rights. The holder of the voting and investment certificates automatically becomes the ordinary shareholder.[265]

Thus, before the Ordinance of 2004, the law provided for the various "versions" of nowadays preference share, which nowadays cannot be issued[266]. These types of securities provide the determined set of rights. And the shareholders are "lack of freedom": they are limited to the particular rights attached to each type of security which is established by the law. On the one hand, the determined rights provide for the legal certainty, and as a result for the high-level protection of the shareholders and at the same time prevent the shareholders from the abuse. On the other hand, the investment society of the XXI century demand the freedom and flexibility of establishing their own terms. The state to be investment-attractive should provide "understandable" and "flexible" conditions to invest alongside the decent protection of the investors. The law should allow the investors to negotiate on provisions of the contract – that is to say, provide some freedom, but in the established by the law frameworks. And the Ordinance of 2004 meets the requirements of the investors, namely it "harmonized"[267] the law on preference shares and provided more freedom for the investors. It should be noticed that this reform is purely an outcome of "bottom-up approach", what is the purely French spirit. The French professional organizations were promulgating and defending the idea of the "flexible" and more liberal regime for the preferred shares.[268]

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[262] Ibid.

[263] Barthelemy Mercadal and Philippe Janin, "New French Law on Nonvoting Preferred Dividend Shares," *Journal of Comparative Corporate Law and Securities Regulation* 2, no. 2, (1979): 99-110. Accessed April 07, 2020, https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1025&context=jil .

[264] Christopher Joseph. Mesnooh *supra* note 259.

[265] Ibid.

[266] "Companies can no more create this kind of share and those shares and certificates already issued will circulate until their conversion into ordinary or preference shares". Mads Tonnesson, Andenas and Frank Wooldridge *supra* note 169.

[267] "Introduction of Preferred Shares in French Law", *Jones Day Commentaries*, September 2004. Accessed April 07, 2020, https://www.jonesday.com/-/media/files/publications/2004/09/introduction-of-preferred-shares-in-french-law/files/introduction-of-preferredpdf/fileattachment/introduction-of-preferred.pdf .

[268] Christopher Joseph. Mesnooh *supra* note 259, 492.

The preference shares are spread in France. Such companies as L'Oréal, Air Liquide[269], and Renault[270] issue the preference stock. The issuance of the preferred stock is authorised by the French Commercial Code. According to the Commercial Code, the **preferred shares** can be issued by *sociétés anonymes* or joint-stock companies and by *sociétés par actions simplifiées* or simplified joint-stock companies or simplified public limited liability.[271] The French Supreme Court, or *Cour de cassation,* held that the shareholders might be deprived of voting rights only by the valid law,[272] and it is defined so by the Commercial Code. The preference share might be "with or without voting rights[273]" as well as equipped by "special rights of all kinds, either temporarily or permanently[274]". The preference stock without voting rights cannot constitute more than 50% of the share capital of the company and 25% of the listed companies.[275] Thus, the preference shareholders in France cannot constitute a majority and are entitled to enjoy the minority protection on par with the rights granted by the contract.

Basically, the preference share would bear the set of rights which is established in the articles or by the decision of an extraordinary general meeting[276]. The Law does not detail the particular rights that might be attached, and leaves this at the discretion of the companies and shareholders. However, if the special regime for preference shares is not provided in the articles of incorporation, the preference shares shall be governed by default by the standard provisions applicable to the ordinary shares.[277]

The preferred shareholders may be entitled to **voting rights**, double-voting rights in listed companies or multiple voting rights in non-listed companies.[278] This is only for so-called loyal shareholders, that are shareholders who have held their shares for an uninterrupted period of two years.[279] To clarify, this is only for the nationals of the Members State of the European Community or European Economic Area.[280] In case, if the shareholders cannot attend the shareholders'

[269] Paul Davies et al., *Corporate Boards in Law and Practice, A Comparative Analysis in Europe,* Oxford University Press, (Oxford, United Kingdom: 2013), 219.
[270] "Securities report", Renault, May 18, 2018. Accessed May 09, 2020, https://group.renault.com/wp-content/uploads/2018/05/e-annual-securities-report_filed-on-may-18-2018-translation.pdf.
[271] Pierre-Henri Conac *supra* note 254.
[272] "Cass. Com, 9th of February 1999, Cнвteau d'Yquem" **cited in** Hugo Kerbib *supra* note 188.
[273] Art. 228-11 *supra* note 86.
[274] Ibid.
[275] Ibid.
[276] Mads Tonnesson, Andenas and Frank Wooldridge *supra* note 169.
[277] "Ministry of Justice, Official Report to the President of the Republic", **cited in** Pierre-Henri Conac *supra* note 254, 8.
[278] "Law No. 2019-486 of 22 May 2019 relating to the growth and transformation of companies", **cited in** Pierre-Henri Conac *supra* note 254.
[279] Art. 225-123 *supra* note 86. *European Model Company Act (EMCA) supra* note 10, 97.
[280] Art. 225-123 *supra* note 86.

meetings, they are authorized to appoint a proxy.[281] "The proxy can only be given for a precise meeting and can't be a perpetual given right."[282]

The preference shareholders might have a right to receive the increased dividends, priority dividends, and cumulative dividends.[283] The law also allows to pay the dividends to preferred shareholders in a form of capital securities,[284] or even in the property as the *Court de cassation* implicitly established[285]. It is important to notice that, in contrast to common law countries, in France, the fixed or interim interest for the benefit of preference shareholders is prohibited[286]. That is to say, the preference shareholders "cannot be protected from all losses and cannot receive all dividends whereas ordinary […] would lose all rights to dividends."[287] By implementing this provision, the French legislator follows their legal traditions and puts all of the shareholders on an equal footing regarding the risks. The preference shares might be **participating.**[288] Also, the holders of preference shares also may enjoy **a priority right** in case of the liquidation, sale, or merger of the company.[289]

Also, the preference shares might be **convertible**[290], and **redeemable**. The procedures should be established by the articles. However, the decision to redeem or convert the preference shares into ordinary or preference shares of the different types can only be taken by the extraordinary meeting.[291]

As for the rights granted by Commercial Code that the preference shareholders enjoy along with the ordinary shareholders, the preference shareholders are entitled to the **information rights.** They have a right to obtain the disclosure of such documents as the annual accounts, reports, etc., relating to the last three financial years.[292] However, the requests to have information on certain transactions constitutes a difficult and costly process.[293] The shareholder, in addition, may **attend the ordinary** and **extraordinary general meetings**.[294] The French Supreme Court, *le Cour de cassation,* held that the shareholders cannot be deprived of the right to participate in the shareholder's meeting, it is regarded as an unalterable right of the shareholder.[295] In addition,

[281] Ibid., Art. 225-106.
[282] "CA Paris, 12th of December 2006", **cited in** Hugo Kerbib *supra* note 188.
[283] Christopher Joseph. Mesnooh *supra* note 259.
[284] Art. 228-18 *supra* note 86.
[285] "C. Com, 31 of May 1988, Bull. Civ. IV N°181" **cited in** Hugo Kerbib *supra* note 188.
[286] Art. 232-15 *supra* note 86.
[287] Pierre-Henri Conac *supra* note 254.
[288] Art. 228-11 *supra* note 86.
[289] Christopher Joseph. Mesnooh *supra* note 259.
[290] Art. 228-14 *supra* note 86.
[291] Ibid., Art. 228-12.
[292] Ibid., Art. 225-117.
[293] Hugo Kerbib *supra* note 188.
[294] Art. 225-113 *supra* note 86.
[295] "Cass. Com. 22nd of February 2005, JCP E 2005. 1067" **cited in** Hugo Kerbib *supra* note 188.

the shareholders, one or more shareholders representing at least 5% of the capital, also are entitled to demand for the inclusion of the exciting issues on the agenda of the general meeting.[296]

Also, the shareholders are entitled to **pre-emptive,** or so-called **subscription,** rights. The shareholders enjoy a priority in the subscription to shares issued in connection with a capital increase according to the proportion of the value of their shares.[297] This right is considered to be "irreducible."[298] It serves as a protective measure for the shareholders to maintain their ownership percentage. The law indicates that the shareholders are entitled to the subscription in the proportion of the shares held.[299]

Moreover, the Law provides **additional protection in case of mergers or demergers**, namely, "the preference shares may be exchanged for shares in the companies benefiting from the transfer of assets which confer equivalent special rights, or in accordance with a specific exchange of shares for parity which takes account of the special rights abandoned."[300] Nevertheless, the concept of "equivalent special rights" is "weak" and "ambiguous", it is left at the discretion of the company or the court (in case of the lawsuit), as it does not indicate the specific rights which may be substitutable. Notwithstanding the fact that this article is unconditionally is recognized as protective for the preference shareholders, at the same time it creates a place for abuse. In order to avoid the possibility of being abused for the preference shareholders, the articles should contain a detailed clause concerning this issue.

Generally, the **directors own the fiduciary duties** to the company. This duty is not precisely determined by the Commercial Code; however, it has detailed by the jurisprudence practice. The French Law provides a **stakeholder approach**, or so-called *"pluralist approach"*, for the concept of the interests of the company.[301] The duty of loyalty represents the directors' duty "to act in a good faith towards the company and its shareholders as well as to put the interests of the company and its shareholders ahead of any interest's."[302] In other words, directors while running the company should also take into account the stakeholders' interests, not only the company's. The directors' duty of loyalty towards the shareholders was recognized in the *Vilgrain case*, where the officer had purchased the shares, without mentioning to the shareholders that the

[296] Art. 225-105 *supra* note 86.
[297] Ibid., Art. 225-132.
[298] "Cass. Com, 18th of April 2000, n° 97-21.569" **cited in** Hugo Kerbib *supra* note 188.
[299] Art. 228-35-7 *supra* note 86.
[300] Art. 228-17 *supra* note 86.
[301] *European Model Company Act (EMCA) supra* note 10, 213.
[302] "Cass. Com, 27th of February 1996, Vilgrain." "The duty of loyalty is owed to the shareholders". (Cass. Com. 27 February 1996, JCP 6d. E 1996, II, 838, n. D. Schmidt and N. Dion). "The duty of loyalty is owed to the company" (Cass.Com., 24 February 1998, Bull. Joly 1998, p. 913, n. B. Petit.) **cited in** Pierre-Henri Conac, Luca Enriques and Martin Gelter, "Constraining Dominant Shareholders' Self-dealing: The Legal Framework in France, Germany, and Italy," *European Company and Financial Law Review* 4, no. 4 (December 2007): 501. Accessed May 02, 2020, https://www.degruyter.com/view/journals/ecfr/4/4/article-p491.xml.

third party also wanted, and after sold them on profit.[303] This judgment determined the boundaries of the duty of loyalty in relation to corporate opportunities. Namely, the decision confirms that the shareholders may benefit from the corporate opportunities if these actions are also "in line with the interest of the company", while, the corporate representatives should not benefit from the opportunities.[304] The directors are also restricted to manage the company's affairs in the interests of the majority shareholders.[305] The preference shareholders are entitled to bring a **derivative suit** on behalf of the company in case of breach by directors of their fiduciary duties. There are no requirements on the amount of the share capital holding to file such a lawsuit.

The preference shareholders are entitled to challenge **the resolutions of the general meetings**. The ground for the nullification of the resolutions amending the company's articles is a breach of the specific provisions, or so-called "express provisions" established by the Commercial Code. The ground for the nullification of other resolutions is a breach of the mandatory provision established by Law.[306]

Considering the additional protective measures granted to the preference shareholders which constitute a minority, it is notable that in France there is no such notion as a minority shareholder. However, the majority shareholders are restrained of the ability to exercise their powers to the detriment of the other shareholders (***abus de majorité***). According to the case law, "there is an abuse of majority if a majority shareholder votes against the "corporate interest" of the company, in order to pursue her own personal interest and to detriment of the minority shareholders."[307] So the actual harm to the company's interests is required in order to fulfil the requirements of the *abus de majorité doctrine.* However, the minority shareholders rarely succeed in the such cases.[308]

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[303] Evan J. Criddle, Paul B. Miller and Robert H. Sitkof, *The Oxford Handbook of Fiduciary Law,* Oxford University Press, (Oxford: United Kingdom, 2019*).*, 598.

[304] "Since the 1996 decision in Vilgrain (Cass. com., 27 February 1996, no.94-11.241, Bull. civ, IV, no.65, Bull. Joly sociétés 1996, p,485, note A. Couret), the Cour de cassation considers that directors and managers owe a duty of loyalty to the shareholders." Julien Koch, Member of the Paris Bar, Vivien & Associés, "Law of Corporate Opportunities: A Comparative Analysis." Accessed April 30, 2020, http://actlegal.com/files/references/julienkoch-lawofcorporateopportunities-acomparativeanalysis-....pdf.

[305] Pierre-Henri Conac, Luca Enriques and Martin Gelter *supra* note 302, 501.

[306] Paul Davies et al., *supra* note 269.

[307] "B. Lecourt, Cass. Com. 1" July 2003, Société Mécano soudure c/ Antoine Balice, Rev. Sociétés (2004), 337" ; **cited in** Pierre-Henri Conac, Luca Enriques and Martin Gelter, *supra* note 302, 501.

[308] Conac, P-H., "Shareholders and Shareholder Law", in M. Siems and D. Cabrelli, *Comparative Company Law. A Case-Based Approach* (Hart Publishing, 2013), **cited in** Maria Isabel Sáez and Damaso Riaño, "Corporate Governance and the Shareholders' Meeting: Voting and Litigation", *European Business Organization Law Review*, Vol. 14, Issue 03, (September 2013): 370-371. Accessed May 04, 2020, https://www.researchgate.net/publication/259437424_Corporate_Governance_and_the_Shareholders'_Meeting_Voting_and_Litigation.

Also, the preference shareholders can bring a **class action suit**,[309] however, they are not popular in France.[310] The French Law authorizes specific associations to represent and act in the interests of the shareholders. For instance, in the *Vivendi case*, the minority shareholders were represented by the association for the defence of minority shareholders, namely, the ADAM, who brought a suit against Vivendi's CEO for the breach of US stock exchange regulations.[311]

The preference shareholders in listed companies are entitled **to exit** on the fair and beneficial conditions. If the articles provide for squeeze-out, the shares may be bought out by the controlling shareholder who holds more than 95% of the share capital. They also might have a right to demand a fair market price. Also, the shareholders are entitled to a sell-out right, if the majority shareholder holds 95% of a share capital.[312]

In this subchapter, the rights of the preference shareholder in France were investigated. The status, established by the Ordinance 2004, generally reflects the approach of the United States. It provides freedom on the regulation of the status of the preference shareholder. Basically, the preference shareholder enjoys the rights that are established in the articles. However, there are some restrictions provided by the law, in particular, the preference shareholders cannot be entitled to the fixed or interim dividends – that reflects the French spirit. Also, the special protection is granted to the preference shareholders in case of the mergers or demergers; however, the articles should insert the explanation on the concept of the "equivalent special rights", otherwise the preference shareholders are not decently protected. Besides, the law does not provide a comprehensive consent-voting to the non-voting preference shares on the amendments to the articles, so the articles should entitle the preference shareholders to such a right and indicate the list of the amendments. Also, the procedure on the redeemability and convertibility should be detailed in the articles as well.

2.2.2. Status of the Preference Shareholders in Germany

Germany is a civil law country. The German legal area is characterized by the liberal dimension, attached to the freedom of contract, and the political dimension, inspired by the expectations of the citizens. Though, the German liberalism, is different to the UK, has its roots in the heritage of pre-democratic times, where the state was "a key regulator […] and in charge to realize not only economic but also political objectives", what is similar in France.[313] Freedom of

[309] "Study on Minority Shareholders Protection, Final report" *supra* note 250, 181.
[310] Carsten Gerner-Beuerle and Michael Anderson Schillig, *Comparative Company Law*, Oxford University Press, (Oxford, United Kingdom: 2019), 713.
[311] "CA Paris, 2e ch., 28 April 2010, n°10/01643, SA Vivendi"; **cited** in Paul Davies et al., *supra* note 269 ; 237, 238.
[312] "Study on Minority Shareholders Protection, Final report" *supra* note 250; 50, 48.
[313] Hans-W. Micklitz *supra* note 158, 12-15.

contract is derived from the so-called "will" theory, that means "the individual is bound through his/her will, not through his or her declaration."[314] However, "in the German stock corporation law, freedom of contract has no meaning."[315] According to the law, the articles can only deviate from the law if it is explicitly permitted.[316] One the one hand, it is a restriction of freedom, thought, on the other hand, it provides for shareholders certainty and protection. This also derives from the German legal tradition: the freedom of contract is provided, but in the law frameworks which represent the expectations of the shareholders.

The preference shares are familiar to Germany from 1844; the shareholders of a railway company hold the preferred stock. The preferred shares commonly issued either as a protective measure against hostile take-over, namely "the poison pill" method[317], or as raising capital without dilution of the ownership control. For instance, Schaeffler AG, a family-held company aimed to raise its capital but did not want non-family members to vote. The company went public at the Frankfurt Stock Exchange and placed 75 million preference shares that contributed capital of 938 million Euros. These preferred shares represented about 11% of the corporation's value and did not confer any voting power.[318]

The German preferred shares (*vorzugsaktien*) are regulated by the German Stock Corporation Act[319] (*Aktiengesetz or AktG*). They can be issued by the Private limited company or GmbH (*Gesellschaft mit beschränkter Haftung*) and Public limited company or AG (*Aktiengesellschaft*).

The AktG provides that every share shall bear voting rights[320], however, there is an exception for the preferred shares, which may bear no voting rights. According to the article 139 of the AktG, the preference shares are voting or non-voting shares that "carry the benefit of a preference right with respect to the distribution of profits."[321]

According to the law, the preference shareholders should enjoy all the statutory rights, except for the right to vote, if they are not provided.[322] The issuance of the cumulative preference

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[314] Ibid.
[315] "Vetter, in: Henssler/Arnold § 23, recital 22", **cited in** Katie Bentel and Gabriel Walter, "Dual Class Shares", *University of Pennsylvania Carey Law School*, Comparative Corporate Governance and Financial Regulation (Spring 2016): 1-50.
[316] Art.23 (5) "German Stock Corporation Act (Aktiengesetz)", English translation as at May 10, 2016. Accessed April 30, 2020, https://www.nortonrosefulbright.com/en/knowledge/publications/bc19a262/german-stock-corporation-act-aktiengesetz.
[317] Marcin Liberadzki and Kamil Liberadzki *supra* note 80, 203.
[318] "October 8, 2015." "Schaeffler Gruppe | Pressewelt | Pressemitteilungen | Schaeffler startet Aktienplatzierung", **cited in** Katie Bentel and Gabriel Walter *supra* note 315.
[319] "German Stock Corporation Act (Aktiengesetz)" *supra* note 316.
[320] Ibid., Art. 12(1).
[321] Ibid., Art. 139.
[322] Ibid., Art. 140(1).

shares without voting rights is limited, in particular, the total nominal value cannot exceed half of the share capital.[323]

The preference dividend may be **fixed** and **cumulative**.[324] However, if the preferential dividends are not paid or not fully paid, and if the amounts due are not paid in the next succeeding year, the preference shareholders become entitled to vote alongside the ordinary shareholders.[325] The preference shareholders acquire the voting rights after the deficit becomes apparent in case of the approval of the respective annual financial report by the supervisory board or general meeting. Such a right exists until all the arrears are paid.[326] This provision protects the preference shareholders not to be abused by the common shareholders, as well as compensates for the lack of economic advantages they are entitled to.

The shares also might be **redeemable** and **convertible**. Usually, the one preference share is converted into the one ordinary share without additional payments and compensations. However, in the case of Metro AG, where the preferred stock was traded with a 45% discount in comparison with the ordinary shares, the preference shareholders should have paid a conversion fee of some 1/3 of the price difference between the price of the preference and ordinary shares during the last three months before the official announcement[327].

The preference shareholders have a **subscription** or **pre-emptive right *(Bezugsrecht)***. The shareholders are entitled to the subscription to the new shares in proportion to their holdings in the existing share capital.[328]

Also, the shareholders are **protected from the amendments to the articles** that might adversely alter and harm their status. The preference shareholders, irrespectively of their stake, are entitled to so-called **consent-voting**. Pursuant to the law, the non-voting preference shareholders acquire the right to vote in case if there is an intent to withdraw or limit the rights of the preference shareholders as well as issue of the preference shares having priority over or the same rights as non-voting preference shareholders in respect of the distribution of profits or assets.[329] This consent-voting should be carried as the class voting; it is required a majority of three-quarters of

[323] Ibid., Art. 139(2).
[324] "Raiser and Veil, Recht der Kapitalgesellschaften", **cited in** Mads Tonnesson, Andenas and Frank Wooldridge *supra* note 169, 282.
[325] Art. 140 *supra* note 316.
[326] Ibid., Art. 140, "Hüffer, Aktiengesetz", **cited in** Mads Tonnesson, Andenas and Frank Wooldridge *supra* note 169, 282.
[327] Olaf Ehrhardt, Jan Kuklinski and Eric Nowak, "Unifications of Dual Class Shares in Germany, Empirical evidence on the effects of related changes in ownership structure, market value, and bid-ask spreads on the cost of capital" (January 15, 2005), 8-10. Accessed May 04, 2020, https://www.researchgate.net/publication/4932222_Unifications_of_Dual-Class_Shares_in_Germany_Empirical_Evidence_on_the_Effects_ofRelated_Changes_in_Ownership_Structure_Market_Value_and_Bid-Ask_Spreadsnce_from_the_German_Stock_Market.
[328] Art.186 *supra* note 316.
[329] Ibid., Art. 182 (2).

the votes for approval.[330] In addition, the shareholders might be entitled to elect a certain number of the directors "with respect to no more than one-third in aggregate of the shareholder representatives in the supervisory board."[331]

Regarding the **information right**, the preference shareholders are entitled **to attend the general meetings** and are authorized to request all the information at and "outside of" the shareholders' meeting from the management board regarding the company's affairs, "to the extent that such information is necessary to permit a proper evaluation of the relevant item on the agenda", as well as irrespective of its relevance for the agenda.[332] However, this right is restricted by the Law: the board may refuse on a request if such information "likely to cause damage to the company" or "relates to tax valuations or the amount of certain taxes", etc.[333] Also, the shareholders have right to receive the additional specific data on issues that affect the company and shareholders, for instance, merger, or the squeeze out of minority shareholders, etc.), usually by way of a detailed report on that issue; such reports should be made and available to the shareholders well in advance of the general meeting on concerned issue.[334]

Concerning the fiduciary duties of directors, the German Law provides for **the stakeholder approach**. The shareholders have the possibility to bring a collective **derivative lawsuit** since 2004. In order to file a lawsuit on behalf of the company, in case the directors have breached their duties, the shareholders should hold at least 1% of the share capital or an amount of 100,000 euros.[335]

It is notable, that in Germany **the majority shareholders own the fiduciary duties**, namely a duty of loyalty, *(Treuepflichten)*, towards the minority. It was recognized by the Federal Court of Justice, *(Bundesgerichtshof)*, in the seminal *Linotype* case of 1988**;** the Court nullified the resolution of a majority shareholder who holds 96 % of shares because it found that the majority shareholder had violated the duty of loyalty owned to the minority shareholders by using voting right to obtain a special advantage to the detriment of the minority, namely, to merger a company with its own.[336] Also, the Federal Court of Justice *in* the *Girmes* case of 1995 held that the shareholders owe fiduciary duty towards each other and to the company[337] and, that the duty is

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[330] Ibid., Art. 141.
[331] Ibid., 101 (2).
[332] "Study on Minority Shareholders Protection, Final report" *supra* note 250; 255-260.
[333] Art. 131 *supra* note 316.
[334] "Study on Minority Shareholders Protection, Final report" *supra* note 250.
[335] Art. 148 *supra* note 302, "as amended by the Gesetz zur Unternehmensintegritit und Modernisierung des Anfechtungsrechts (UMAG), of September 22, 2005, BGBI. I 2005, No. 60, 2802 (Sept. 27, 2005)," **cited in** Pierre-Henri Conac, Luca Enriques and Martin Gelter *supra* note 302, 501.
[336] "BGH 1.2.1988, II ZR 75/87, BGHZ 103, 185; see also BGH 22.6.1992, II ZR NJW 1992, 3167." **cited** Pierre-Henri Conac, Luca Enriques and Martin Gelter *supra* note 302, 501.
[337] "GH 20.3.1995, BGHZ 129, 136¼NJW 1995, 1739," **cited in** Thomas Bachner, *Creditor Protection in Private Companies, Anglo-German Perspectives for a European Legal Discourse,* (Cambridge University Press: 2009), 155.

proportionate to their influence. Besides, the minority also under the duty of loyalty towards the majority.[338]

The shareholders are entitled to **challenge** in the court the validity of the **shareholders' resolutions**.[339] For instance, in *the Deutsche Bank* case and *the Springer case,* the Court nullified the resolutions of the general meeting because the supervisory board did not report on conflicts of interests.[340] Also, in the *ARAG/Garmenbeck case*, the Court nullified the resolution of the supervisory board.[341] The shareholder is entitled to bring a direct action "when a shareholder suffers individual, direct loss over and above the indirect losses suffered due to damage to the corporation's assets."[342]

In addition, concerning the minority protection rights on the "**exit** from the company", the shareholders in the listed companies may demand of the shareholder who holds 95% of the share capital to buy their shares at a fair and adequate price; or undergone the buyout due to the request of such shareholder. In case if the company enters into a domination agreement, hereby becoming the dominated company; the shareholders of this company are entitled to demand to buy their shares by the dominating (parent) company.[343]

In this subchapter, the status of the preference shareholder in Germany is introduced and analysed. The preference shareholder enjoys the same rights as the ordinary shareholders except for voting and the priority in payments. Also, additional protection is provided for the preference shareholders in case of the amendments to the articles that might adversely affect the status of the preference shareholders. However, in order to avoid ambiguity, the articles should insert the non-limited particular list of such events. Also, the articles should contain the procedure on the redemption, convertibility as well as on the subscription to the newly issued shares.

2.2.3. Status of the Preference Shareholders in Spain

Spain is a civil law country. The development of current the legal framework is associated with the adoption of the Spanish constitution of 27 December 1978 (three years passed after the

[338] "High court of Frankfurt decision 5 U 183/07, 13.01.2009", **cited in** Borut Bratina and Dušan Jovanovič *supra* note 213.
[339] Art. 241,243 *supra* note 316.
[340] "Bundesgerichtshof, 16 February 2009, II ZR 185/07, BGHZ 180, 9 (Kirch/Deutsche Bank)"; "Bundesgerichtshof, 21 September 2009, II ZR 174/08, BGHZ 182, 272 (Springer, also called Umschreibungsstopp)"; **cited in** Paul Davies et al., *supra* note 269 ;348.
[341] "Bundesgerichtshof, 21 April 1997, II ZR 175/95, BGHZ 135, 244 (ARAG/Garmenbeck)," **cited in** Paul Davies et al., *supra* note 269; 349.
[342] "BGHZ 95, 330, 340"; "Hanno Merkt, in *Münchener Kommentar zum GmbH-Gesetz* § 13 marg. n°. 310, 2nd ed. (Holger Fleischer & Wulf Goette eds., 2015)"; **cited in** Jeffrey N. Gordon and Wolf-Georg Ringe *supra* note 184, 875.
[343] "Study on Minority Shareholders Protection, Final report" *supra* note 250; 50.

death of General Franco and the start of Spain's political transition to democracy). The constitution has changed the prior regime into a democratic that conforming to standards of freedom characteristic of Western democracies.[344] Freedom, and in particular, freedom of contract is a "pillow" of the Spanish private law.[345]

The status of the preference shareholder is regulated by The Corporate Enterprises Act 2010 *(Ley de Sociedades de Capital)*.[346] The preference shares might be issued by the limited liability companies (*sociedad limitada*) and by the joint stock companies (*sociedad comanditaria por acciones*)**.** The law defines that "the rights attributed to […] shareholders by [...]shares shall be the same, subject to the exceptions provided for in the act."[347] That is to say, all the shareholders enjoy the same rights unless the law indicates otherwise. The law provides freedom on the creation of the classes of shares which can bear different rights to their owners.[348] In any case, the issue of the shares that provide for the interest shall be invalid, as well as the issue of the shares that may either directly or indirectly change the proportionality "between par value and voting or pre-emptive rights."[349] Multiple voting is prohibited. In particular, Spanish law provides for the issuance of the shares that confer privilege in the distribution of company earnings – the privileged shares and separately regulates the non-voting stock.

The privileged share entitles its owner to obtain a preference dividend before the other shareholders may acquire any. The general meeting of the shareholders is authorised to decide on the distribution of the dividends. The company is **obliged** to approve the distribution of the dividends unless the by-laws indicate otherwise [350]. "Dividends may only be drawn on the year's profits or freely available reserves after meeting the requirements laid down by law and in the by-laws, and if the value of the corporate equity is not, or as a result of such distribution would not be, less than the company's capital."[351] In addition, the consequences of the non-payment of such dividends in whole or in part should be indicated in by-laws.[352]

Concerning the **non-voting stock**, its total par value should represent less than half of the paid-up share capital.[353] The shareholders are entitled to acquire either a fixed or variable

[344] Javier Martínez-Torrón, "School and Religion in Spain": 133-150. Accessed April 17, 2020, https://www.jstor.org/stable/23920543?seq=1#metadata_info_tab_contents.
[345] Antoni Vaquer, *Legal tradition Contract Law in Spain*, Wolters Kluwer, 3rd ed, (March 1, 2018): 256.
[346] "The Corporate Enterprises Act 2010" Art. 96. Accessed April 30, 2020, https://law.au.dk/fileadmin/Jura/dokumenter/Corporate_Enterprises_Act__28Ley_de_Sociedades_de_Capital_29.pdf .
[347] Ibid., Art. 94(1).
[348] Ibid., Art. 94.
[349] Ibid., Art. 96.
[350] Ibid., By-laws means the Act of the company, its constitution, bear the same meaning as the articles of the association or incorporation.
[351] Art. 273 *supra* note 346.
[352] Ibid., Art. 95.
[353] Ibid., Art. 98.

minimum dividend established by the by-laws before the ordinary shareholders. Alongside this, the non-voting shareholders have a right to **the same dividend as paid to ordinary shareholders**. The payment of the dividends is comprehensive unless there is insufficient or no distributable profit. However, in such a case, the shareholders are entitled to the minimum predetermined dividend during the five financial years. Until such a minimum dividend is paid up, the non-voting stock bears the same rights as the ordinary stock including the voting powers.[354] The law provides for a possibility of interim dividend approved by the general meeting.[355] In the event of the liquidation, the non-voting stock enjoy the priority in obtaining the reimbursement due.[356]

In the case of the **capital reduction**, the non-voting stock remains unaffected until all the other classes have been affected and "unless the reduction exceeds the par value of the remaining […] shares." In case if all the ordinary shares are redeemed due to the capital reduction, the holders of the non-voting shares shall be entitled to the same rights as ordinary shareholders until the legally defined balance between non-voting and ordinary shares is re-established.[357]

The holders of the non-voting stock enjoy the **consent-voting right** in case of the "any amendment to the by-laws that directly or indirectly encroaches" their rights.[358] The majority is required for the approval of the amendment. However, the law does not detail the events which directly or indirectly changes the status of holders of non-voting stock, it should be indicated in the by-laws.[359]

The non-voting shares also might encompass the **pre-emptive right**[360] *(derecho de preferentia)*, the procedure should be indicated in the by-laws.

These are the rights defined by law, that only the preference shareholders should enjoy due to the ownership of these shares. However, the preference shareholders entitled also to the same rights as the ordinary.

The shareholders have a right **to attend the general meetings** of the company. In particular, in limited liability companies, all the shareholders are entitled to attend the general meeting; in joint-stock companies, there are might be restrictions concerning the ownership of a minimum number of shares, however, the number shall not exceed the one-thousandth of the share capital.[361] The shareholders have a right to **access to the data** of the company, in particular, they

[354] Ibid., Art. 99.
[355] Ibid., Art. 277.
[356] Ibid., Art. 101.
[357] Ibid., Art. 100.
[358] Ibid., Art. 103.
[359] Ibid., Art. 103.
[360] Ibid., Art. 102.
[361] Ibid., Art. 179.

might request the information until the seventh day before the general meeting as well as participate in the general meeting and ask the questions regarding the items on the agenda.[362]

The shareholders are entitled to **challenge** the resolutions of **the general meetings** and the **directors' board**.[363] The resolutions of the general meeting are considered to be void if they are contrary to the law, and voidable if they are contrary to the by-laws or damage corporate interest for the benefit of some shareholders or third parties resolutions. Considering the void resolutions of the general meeting, every shareholder, that can prove legitimate interest, is entitled to challenge them. While, the voidable resolutions only may challenge those shareholders who were expressly against the resolution, or who was unlawfully deprived of voting.[364]

The directors owe fiduciary duties to the company. Spain does not provide for a precise position whether the directors should adhere to either the stakeholder's or shareholder's approaches.[365] The case law, however, upheld the shareholder's approach but does not provide clear explanations on the concerned issue.[366] Shareholders, who hold one percent of the share capital, are able to file **a derivative suit**, in case of breach of the fiduciary duties by the directors, that is what Spanish called "corporate liability action"[367]. Also, it is possible to bring an **individual suit**, in case of the breach a duty owed to the shareholder, that is "individual action for liability."[368]

In addition, **the majority shareholders are under fiduciary duties to the minority**. It is notable that the damage to the interests of the company is also caused when the shareholders' decisions are adopted in an abusive manner by the majority *(abuso de minoría),* i.e., in the interests of the majority shareholders and to the unjustifiable detriment of the other shareholders.[369] The minority, who holds at least 5% of the share capital, are entitled to file an action.[370] However, Spanish courts and lawmakers have not determined the content and scope of the controlling shareholders' duties of loyalty.[371] That is to say, that the boundaries of the directors' duties as well as the majority shareholders to the minority are not precisely set by law and explained by the court.

The shareholders are also entitled to exit rights namely, to **squeeze-out** and to **sell-out right**, if the majority shareholder in the listed-company holds 90% of the share capital.[372]

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[362] Ibid., Art. 197.
[363] Ibid., Art. 204, 240, 251.
[364] Paul Davies et al., *supra* note 269; 607-610.
[365] Beate Sjåfjell and Benjamin J. Richardson, *Company Law and Sustainability*, Cambridge University Press, (Cambridge: Cambridge University Press, 2015), 100.
[366] "Supreme Court Judgments (Sentencias del Tribunal Supremo – STS) of 5 July 1986, 19 February 1991, 4 March 2000" **cited in** Paul Davies et al., *supra* note 269; 557.
[367] Art. 238-240 *supra* note 346.
[368] Art. 241 *supra* note 346. Paul Davies et al., *supra* note 269 ; 609.
[369] "Study on Minority Shareholders Protection, Final report" *supra* note 250; 363-367.
[370] Art. 239, 539 *supra* note 346.
[371] "Spain Supreme Court Rulings of 01-07-1961, 04-03-2000, 12-07-2002, 29-11-2002, 20-02-2003, 07-03-2006 and 29-03-200"; **cited in** Maria Isabel Sáez and Damaso Riaño *supra* note 308.
[372] "Study on Minority Shareholders Protection, Final report" *supra* note 250.

In this subchapter, the rights of the preference shareholders under the Spanish law were introduced and investigate. Spain has a bit different approach to the regulation of the status of the preference shareholder in comparison with France, Germany, the U.S.A., and the U.K. Namely, Spanish law provides for the privileged shares - voting preferred shares, alongside, separately regulates the non-voting preferred stock. The voting preference shareholders might enjoy the same rights as the ordinary shareholders in addition to the priority granted. Moreover, the company is obligate to declare the dividends to the preference shareholders if there is a sufficient profit. The non-voting stock encompasses the consent-voting and the pre-emptive rights. However, the events entitled to the consent-voting and the procedure of the subscription should be indicated in the by-laws.

2.2.4. Status of the Preference Shareholders in Ukraine

Ukraine is defined as a civil law country. The development of the Ukrainian modern civil law started in 1991, after the Soviet Union collapsed.[373] In the modern Ukrainian law might be tracked the influence of western states. In Soviet times there was not a freedom of contract, and it is regarded as "a necessary form of freedom of capitalist exploitation and capitalist competition." This principle has a long history of development, which is associated primarily with the development of market relations[374]. Nowadays, the freedom of contract is one of the general and fundamental principles of civil law.[375]

The preferred shares *(привілейована акція)* appeared in modern Ukraine almost simultaneously with the first joint-stock companies in 1991.[376] The Ukrainian securities market is currently under development. And, the legislation on the regulation of the companies and the

[373] Н. С. Батурин-Бока, "Поняття "корпоративне право" та "корпоративні права" у законодавстві України" (N. S. Bytrun-Boka, "The concept of "corporate law" and "corporate rights" in Ukrainian legislation"). Accessed May 09, 2020, http://nbuv.gov.ua/j-pdf/Nvkhdu_jur_2015_3%281%29__22.pdf.

[374] "Свобода договора и ее ограничения в законодательстве Украины", zakon.kz. Accessed April 19, 2020, https://www.zakon.kz/110494-svoboda-dogovora-i-ee-ogranichenija-v.html .
Волос А.А., "Свобода договора в прав е зарубежных государств: некоторые аспекты, Актуальные проблемы юридической науки и практики" (Volos A.A., "Contract freedom in the right of the foreign states: some aspects"), (October 3, 2014): 70-73.

[375] Ibid.

[376] О.В. Варга, В.В. Забровський, "Привілейовані акції та їх нормативне регулювання" (O.V. Varga, V.V. Zabrovskyi "Preferred shares and their normative regulation"). Accessed May 09, 2020, https://dspace.uzhnu.edu.ua/jspui/bitstream/lib/20231/1/%D0%97%D0%B0%D0%B1%D0%BE%D1%80%D0%BE%D0%B2%D1%81%D1%8C%D0%BA%D0%B8%D0%B9%20%D0%9F%D1%80%D0%B8%D0%B2%D1%96%D0%BB%D0%B5%D0%B9%D0%BE%D0%B2%D0%B0%D0%BD%D1%96%20%D0%B0%D0%BA%D1%86%D1%96%D1%97%20%D1%82%D0%B0%20%D1%97%D1%85%20%D0%BD%D0%BE%D1%80%D0%BC%D0%B0%D1%82%D0%B8%D0%B2%D0%BD%D0%B5%20%D1%80%D0%B5%D0%B3%D1%83%D0%BB%D1%8E%D0%B2%D0%B0%D0%BD%D0%BD%D1%8F.pdf.

preference shares has undergone a lot of changes. However, the preference shares are not popular among the Ukrainian investors.[377]

The Ukrainian preferred shares are regulated by the Commercial Code of Ukraine[378], the Law on the Joint Stock Companies[379], the Law on Securities and Stock Market[380], the Law on Business Associations[381].

According to the Law on Securities and Stock Market, the preferred shares entitle their holders to the priority in receiving the dividends and the liquidation proceeds in the event of the liquidation, as well as grant the right to participate in the management of the company in cases defined by the articles and the law.[382] So, the Ukrainian preferred stock has two obligatory features: priority in payment of dividend as well as in receiving the reimbursement in case of liquidation. The preference stock cannot represent more than 25 % of the capital of the company[383].

Generally, the status of the preference shareholders is defined in the articles, however, the law provides on inclusion of comprehensive provisions on the amount and regularity of the dividends, liquidation proceeds, list of the events of the conversion of the preference shares, access to the information.[384]

Also, the law provides the preference shareholders for **the consent-voting**, but not limited the following events: 1) liquidation, mergers, demergers; 2) amendments of the articles which limit the rights of the preference shareholders; 3) issuance of the preference stock which may affect the existed priority of the former shareholders or change their rights; 4) reduction of the statute capital. One preference share bears one vote.[385] The articles might define other events for the consent-voting. A majority of three-quarters of the votes is required for the approval. The procedure should be indicated in the articles, there is no obligatory requirement for a class-voting.[386] However, by taking into consideration that the preference shares may constitute no more than 25% of the share capital, class voting would protect the interests of shareholders better, because in case of share

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[377] В. Боднар "Переважні права в акціонерному товаристві та способи їх захисту" (V. Bondar "Preferential rights in a joint-stock company and methods of their protection"). Accessed May 09, 2020, http://www.irbis-nbuv.gov.ua/cgi-bin/irbis_nbuv/cgiirbis_64.exe?C21COM=2&I21DBN=UJRN&P21DBN=UJRN&IMAGE_FILE_DOWNLOAD=1&Image_file_name=PDF/VKNU_Yur_2011_89_26.pdf.

[378] "Господарський Кодекс України", (the Commercial Code of Ukraine). Accessed April 30,2020, https://zakon.rada.gov.ua/laws/show/en/436-15.

[379] "Закон України Про акціонерні товариства", (the Law on the Joint Stock Companies). Accessed April 30,2020, https://zakon.rada.gov.ua/laws/show/en/514-17/.

[380] "Закон України Про цінні папери та фондовий ринок", (the Law on Securities and Stock Market). Accessed April 30,2020, https://zakon.rada.gov.ua/laws/show/3480-15?lang=en.

[381] "Закон України Про господарські товариства", (the Law on Business Associations). Accessed April 30,2020, https://zakon.rada.gov.ua/laws/show/1576-12?lang=en.

[382] Art. 6 *supra* note 379.

[383] Art. 20 *supra* note 378.

[384] Art. 13, 26 *supra* note 379.

[385] Ibid., Art. 26.

[386] Art. 26 *supra* note 379.

voting the ordinary shareholders may amend the status of the preference shareholders without their consent.

The law grants the preference shareholders with the **pre-emptive right** unless the amount of the shareholders of the company is less than 100 or it is established so be the articles if the general meeting does not decide otherwise. The procedure should be indicated in the articles.[387]

If there is no profit or it is insufficient, **dividends are to be paid from reserves**.[388] However, the general meeting, who is authorized to decide on the distribution of dividends, is not obliged to declare dividends. So, by taking into consideration these two provisions jointly, the issues arise: 1) whether the preference shareholders should be paid regularly, and then: this serves as protection for the shareholders, makes the status of the preference shareholder more similar to debtholder; on the other, however, this deprives the preference share of its attractive features, because the dividends and interests should be paid irrespective of the profit; or 2) the preference shareholders might be paid from the reserves, but the general meeting is obliged to declare the dividends for preference shareholders.

Preference shareholders, along with the ordinary, may **attend the general meeting** if they are included in the list of shareholders who authorized to be present at such a meeting[389]. However, the selection criteria for those authorized are not defined by the law; in addition, there is no provision on the regularity of the shareholders' attendance. Thus, the preference shareholders who own no more than 25% of the capital and usually are not entitled to vote may never attend the meeting. Thought, the Law provides the possibility for each shareholder to propose issues on the agenda.[390] So, there is a gap, that should be fixed.

The preference shareholders are authorized to **challenge the resolutions of the general meeting** if the resolution violates the law or the articles, and thus harm the interests of the shareholder. However, the shareholders should initially ask for the redemption of their shares, and in case if there is either no answer or refuse the shareholders may challenge.[391] So, the violation of the law might be regarded as a method of influence on the shareholders to redeem their stakes. Moreover, the law does not provide the opportunity to challenge the resolutions of the general meeting, if such resolutions, even comply with the law, harm the shareholders' interests. Furthermore, the law does not provide for a possibility to the shareholders to challenge the decision of the board: neither derivative nor individual action.

[387] Ibid., Art. 7, 26.
[388] Ibid., Art. 30.
[389] Ibid., Art. 34.
[390] Ibid., Art. 38.
[391] Ibid., Art. 50.

By taking into consideration the judicial practice, it is notable that the court's position on **whether shareholders might challenge the board's resolutions is different**. Concerning the challenging of the decisions on the ground of the non-compliance with the procedure issues: the court held that such decisions might be challenged according to the procedure determined either in the articles or by the analogy of the law with the law on the challenging the shareholders' resolutions,[392] however, this position is not stable. The resolution of the Plenum of the Supreme Commercial Code of Ukraine from February 25, 2016 No. 4 "On some issues of practice of resolving disputes arising from corporate legal relations" (Постанова Пленуму ВГСУ від 25 лютого 2016 року № 4 "Про деякі питання практики вирішення спорів, що виникають з корпоративних правовідносин") stated that the analogy of the law cannot be applied.[393] In order to avoid the ambiguity, the procedure should be indicated in the articles.

Also, the questions arise: whether the shareholders may bring individual action or derivative suit against the directors who breached their fiduciary duty; and, moreover, whether the directors are under the fiduciary duty towards the company or shareholders. First, the institution of fiduciary duties is not developed in Ukraine.[394] The fiduciary duty is one of the fundamental in the Code of Professional Conduct of Corporate Directors, however, this Code does not have the binding power. According to the Resolution of the Supreme Court within the Board of Judges of the Court of Cassation of 29 May 2018 in Case No. 920/432/17 (Постанова Верховного Суду у складі колегії суддів Касаційного господарського суду від 29 травня 2018 року у справі № 920/432/17) shareholders are entitled to challenge the board's decisions. However, the Court did not indicate the grounds for such suits.[395]

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[392] "При вирішенні спорів, пов'язаних з порядком скликання і роботи наглядової ради товариства, визначенням правомочності її засідання, необхідно застосовувати положення установчих документів товариства. У випадку їх неврегульованості в установчих документах застосовується аналогія закону в частині норм, що регулюють відповідні питання скликання та проведення загальних зборів товариства (обов'язковість повідомлення усіх членів наглядової ради про проведення засідання, надання інформації з питань порядку денного, правомочність, порядок прийняття рішення)." Постанова ВГСУ від 25 квітня 2012 року у справі № 15/5025/1283/11. (Resolution of the High Commercial Court of 25 April 2012 in Case No. 15/5025/1283/11. Accessed April 28, 2020, http://arbitr.gov.ua/docs/28_3673696.html.

[393] Постанова Пленуму ВГСУ від 25 лютого 2016 року № 4 "Про деякі питання практики вирішення спорів, що виникають з корпоративних правовідносин". (The resolution of the Plenum of the Supreme Commercial Code of Ukraine from February 25, 2016 No. 4 "On some issues of practice of resolving disputes arising from corporate legal relations"). Accessed April 28, 2020, https://zakon.rada.gov.ua/laws/show/v0004600-16?lang=en.

[394] Игорь Реутов, "Обязать по-английски" (Igor Reutov, "Oblige in English manner") Vol.23 (754), parvo.ua. Accessed May 09, 2020, https://pravo.ua/articles/objazat-po-anglijski/.

[395] Олександр Окунєв, "Огляд судової практики щодо визнання недійсними рішень наглядової ради", (Oleksandr Okunev, "Review of the case law on the nullification of the resolutions of the Supervisory Board") Corporate Governance Professional Association, Accessed April 28 ,2020, https://cgpa.com.ua/ru/novini/oglyad-sudovoyi-praktyky-shhodo-vyznannya-nedijsnymy-rishen-naglyadovoyi-rady-vid-oleksandra-okunyeva-golovy-pravlinnya-paku/; Дайджест судової практики Верховного Суду у справах, що виникають із корпоративних відносин 2018 рік – 15 липня 2019 року (Digest of Supreme Court case law on corporate matters 2018 - July 15, 2019). Accessed April 28, 2020, https://supreme.court.gov.ua/userfiles/media/Dajest_korporat_vidnosunu_1.pdf.

So, considering that Ukraine is a Civil law country, and, thus, judges may only explain the law provisions and not crate them, and the fact, that there is no single provision on such issues: there is a need to make changes to the law because due to the gaps in the regulation, the shareholders are vulnerable.

In addition, after the amendments of the 2017 to the law, that is an attempt to adjust the Ukrainian legislation to the legislation of the EU Member States. The **exit rights** are granted to the shareholders of the listed companies.[396] First, the shareholder who holds 50% or 75% should propose to purchase the shares of the minority shareholders at the fair price.[397] Also the sell-out, squeeze-out rights provided if the majority shareholder holds 95%.[398]

In this subchapter, the status of the preference shareholder in Ukraine is introduced and analysed. Generally, the company and the shareholders are free to structure their relationship and set up the rights of the preference shareholders in the articles. The preference shareholders also enjoy the consent-voting rights in case of detailed events established by the law, this list also might be extended in the articles.

However, the preference shareholders are lack of protection while challenging the resolutions of the general meeting as well as the decisions of the management board. The existing regulation rather forces the preference shareholders to redeem their shares, than protect the rights.

Thus, the newly amended law should be changed. Namely, the clear procedures on the challenging of the directors' and shareholders' resolutions should be established and clarified, these procedures should exclude the initial applying for the redemption. Also, the director's duties to the company and to the shareholders should be clarified. In addition, concerning the payment of preferred dividends, the sources of payment, as well as the events of non-payment, should be established by the law.

2.2.5. Summary

The investigation of the legislation on the regulation of the preferred shares in the developed states reveals that they all, in general, have a similar approach. Namely, the company and the preference shareholders enjoy the freedom to structure their relationship and, on the other hand, they enjoy the protection of their investments as well as of their position in the company. So, the status of the preference shareholder under civil law is similar to those under common law. However, the civil law imposes some restrictions intending to protect the preference shareholders

[396] "The law № 2210-VIII of 16.11.2017." Accessed May 04, 2020, https://zakon.rada.gov.ua/laws/show/en/2210-19#n1093.
[397] Art. 65^1 *supra* note 379.
[398] Ibid., Art. 65^3.

as well as to benefit the equality of the shareholders, for instance, the prohibition of the fixed dividends under the French law, or the obligatory dividends under the Spanish law. While, the common law states mostly concerned on the regularity of the payments to the preference shareholders, namely, the presumption of the cumulative dividends. Considering the civil law state with a transition economy, namely, Ukraine, it becomes apparent that Ukraine is, also, try to follow the freedom approach, however, it does not provide decent protection to the investors. So, the changes should take place.

2.3 "Protected" Preference Shareholder

The unifying feature of the above-mentioned approaches on to the regulation of the preference shares in different states is the freedom granted. The preference shareholders and the company enjoy the freedom, in the frameworks established by the law, in structuring the contract between them. The restrictions on the freedom granted vary from jurisdiction to jurisdiction, from state to state. Some states provide more freedom, for instance, the UK, the U.S.A., than others, for instance, Spain.

The companies usually resort to the issuance of the preferred stock if they are interested in the attraction of new investments without the dilution of the ownership control because the preference shareholders usually do not have voting powers. However, in the U.S.A., the preference shareholders of the start-up companies are frequently entitled to the voting rights, as well as to the priorities in the distribution, and even more, in such a case, they often might constitute the majority.[399] It is notable that under these conditions the interests of the preference shareholders are protected and hardly harmed.

However, the voting preference shareholders do not represent a common pattern. So, the contract or/and the law should provide additional protection for the non-voting preference shareholders to balance their position in the company. Yes, the contract itself is incomplete, and it is impossible to create a contract that would encompass all the issues might arise.[400] Nevertheless, it is probable to create a contract that would meet the "basic" and current interests of the company and the preference shareholders and provide the pattern on the regulation of the future issues as well as to contemplate the legislation on the preference shares. As a template, for the preference shareholders to be protected, the MBCA and the Spanish law might be referred and followed.

[399] Charles R. Korsmo *supra* note 3, 1173.
[400] Oliver Hart, "Incomplete Contracts and Control". Accessed May 05, 2020, https://www.nobelprize.org/uploads/2018/06/hart-lecture.pdf.

To start with, it is necessary to examine the legal national and international practice and to summarize the common cases where the interests of the preference shareholders are harmed. The issues arise due to the lack of the voting power of the preference shareholders. Their interests might be harmed by the intentional non-declaration of the dividends by the company as well as by the amending the articles or the certificates in part that change the status of the preference shareholders. Taking into consideration, the wide range of cases, that arose because the rights of the preference shareholders are not defined precisely in the articles, the basic protective rights should be provided by the law.

First, following the Spanish example, the legislation should oblige **to declare the dividends**, unless the profit of the company is insufficient[401]. Besides, as in the U.S.A., the law should establish the presumption on the **cumulative dividend** of the preference shareholders, to accumulate the arrears due that appear when the company does not have sufficient profit.[402] As in the U.S.A., the preference shareholders also should be entitled to the **consent-voting right** in case of, but not limited to the amendments of the articles that change the rights and obligations of the preference shareholders, the issuance of the new stock of shares that enjoy the same priority or the higher priority as the concerned class, etc.[403] If the law does not provide these protective measures the articles should provide so.

In addition, following the MBCA, the preference shareholders should be entitled to the "basic rights" such as the **information rights** and the **right to attend the meetings,** without the requirement for the preference shareholder to hold a certain percentage of the share capital**.** In particular, the preference shareholders should be entitled to attend the meetings and ask the questions. Also, the preference shareholders should the possibility access to the wide range of information, if the shareholder shows the purpose in the acquiring of the data "that is reasonably relevant to the demanding shareholder's interest as a shareholder."[404]

In addition, as above-mentioned the U.S.A. law provides, the preference shareholders who constitute a minority should enjoy the fiduciary protection of the majority shareholders. As well as the preference shareholders should be able to challenge the directors' decisions in case of the breach of their fiduciary duties,[405]

These are the most frequent "protective" rights that the preference shareholders should enjoy to protect their investments. Nevertheless, the preference shares, also, might be redeemable

[401] Art. 96, 99, *supra* note 346.
[402] "Whabarton v. John Wanamaker, Philadelphia, 329 PA. 5, 196 ATL. 506 5 (1938)", **cited in** Hugo Kerbib *supra* note 188, 20.
[403] 10.04 *supra* note 187.
[404] Ibid., 16.02.
[405] Ibid., 7.40.

and convertible or entitle their holders to the subscription or pre-emption right. In the common law states, the tag-along, or drag-along rights, as well as the right to acquire additional information, is also regularly included in the contracts.

To sum up, this subchapter proposed the template on the basic protective set of rights that the law should provide on a par with granting freedom to regulate other issues to protect the preference shareholders.

CONCLUSIONS

After the analysis of the status of the preference shareholder in the U.S.A., the UK, France, Germany, Spain, and Ukraine, as well as of the hybrid nature of the preference share itself, the following conclusions could be done.

1. The preference share resembles the ordinary shares in a part of the entitling to the ownership of the company, and, thus, in providing the shareholders with the rights and protection granted by the corporate law. Namely, for instance, in the U.S.A,, Germany, France, etc, the preference shareholders are entitled to information rights and to attend the general meetings along with the ordinary shareholders; the preference shareholders that constitute the minority also enjoy the protection against the abuse of the majority shareholders; the preference shareholders also might exercise a right to file a derivative suit on behalf of the company, etc.

2. The usual lack of voting powers of the preference shares along with the right to acquire the dividends in priority over the ordinary shareholders makes the preference share a bit similar to the debenture. However, the company is obliged to pay the interest rates to the creditors, while, generally, there is no obligation to pay the dividends to the shareholders (for instance, only Spain from analysed states provides for the obligation to declare the dividends, if the company has sufficient profit).

3. The preference shareholders enjoy the contractual protection on a par with the corporate. The contractual protection represents the rights attached to the preference shares by the articles or the certificate. So, as long as the preference shares are of dual nature, the corporate law, that establishes the general framework for the adjustment of the relationship between the company and its investors, is of the same importance as the contract, that represents an instrument for the determination and regulation of the status of the preference shareholder. The preference shareholders do not enjoy the additional fiduciary protection as a class.

4. In contrast to the ordinary shareholders, as above-mentioned, the preference shareholders usually do not enjoy such leverage of the control of the company as the voting power. And, this, however, does not serve as the violation of such fundamental standards as the presumption of the equality and “one share, one vote” principle. If, also, consider the financial preferences granted to the preference shareholders that serves as compensation for the lack of control rights. This rather represents the adaptation of the principles to the modern legal area. Nevertheless, the preference shareholders might be entitled to vote on the issues that might adversely change their position in the company.

5. The analysed states of both common and civil law legal systems provide freedom to the company and investors to structure and set up the rules of their legal relationships. The law authorises the issuing of the preference shares and establishes the framework of regulation of the preference shares by setting the rules on the status of the shareholder as the owner of the stake in a company.

6. Generally, the preference shareholders enjoy the same rights as the ordinary shareholders except for voting and the priority in the payments. However, the preference shareholders might be entitled to vote in case of the amendments of their status. In particular, some countries, namely, Germany, Spain, Ukraine, the UK, and some states of the U.S.A., that follow the MBCA , provide for the consent-voting right for the preference shareholders to approve the changes that might adversely affect their position. The consent-voting right allows the preference shareholders to protect their status and their investments.

7. The states of civil law jurisdictions usually provide some limitations in comparison with the common law. First, the issuance of the share is often limited to some proportion of the share capital. While, there are no such restrictions under the examined common law states, namely the UK and the U.S.A. Also, in France, for instance, the fixed dividends are prohibited. In addition, the company under the Spanish law is obliged to pay the dividends, unless the company is lack of the profit or it is insufficient.

In conclusion, taking into consideration the above-mentioned, the defended statement has been affirmed.

RECOMMENDATIONS

1. As the analysis reveals, not all the jurisdictions provide the precise list of the events that allow for the consent-voting as well as not all the articles provide so, by leaving it at the discretion of the company. So, the preference shareholders might undergo the amendments of their status without their consent. Moreover, there are jurisdictions where the obligatory consent-voting is not provided, for instance, Delaware. So, it is **recommended** to provide in the legislation such a list which will include, but not limited to the amendments of the articles that change the rights and obligations of the preference shareholders, the issuance of the new stock of shares that enjoy the same priority or the higher priority as the concerned class, the mergers or demergers; as well as to provide the obligatory consent-voting and the events allow so in the legislation of jurisdictions where the consent-voting is not provided. This would allow for the preference shareholders to approve the amendments of their status, and, thus, to protect their investments.

2. The preference shareholders also might experience the problems while exercising the pre-emptive right and applying for the redeemability or convertibility where the procedures on the exercising of those rights are not defined. So, it is **recommended** for legislators to impose an obligation to include such procedures in the articles or the certificates if these rights are provided.

3. As far as, the institution of the fiduciary duties of the directors owned to the company and the shareholders as well as the fiduciary duties of the shareholders owed towards each other is developing now. And, in general, the boundaries of the directors' and the shareholders' duties are not accurately set and explained by the law. It is **recommended** for the courts to summarize the legal practice on fiduciary duties and to formulate the unified position on the main issues concerned in national as well as in international language, for instance, in English, for example, in some resolutions or other documents, according to the national legislation of each state. And, as far as, this institution is under development, such summarization should be held periodically.

4. Separately, it is **recommended** for Ukraine to develop the institution of the fiduciary duties. In particular, the courts should recognise the directors' fiduciary duties owed to the companies and determine the scope of such a duty. The same applies to the fiduciary duty of the majority of shareholders owned to minority shareholders. In addition, it is recommended to add the provision in the Law on the Joint-Stock companies, which would authorize for the shareholders to challenge the board resolution. Also, article 50 of the concerned law should exclude the comprehensive initial requirement for the redemption to challenge the resolutions of the general meeting. And, it is recommended to establish by the law the right to file a derivative suit on behalf of a company and an individual suit in case of breach of the duties by the directors. Also, the article

30 on the payment of the dividends of the Law on the Joint-Stock companies should be changed. In particular, the payment of the dividends from the reserves should be substituted by the obligation on the comprehensive declaration of the dividends, if the company has sufficient profit.

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ABSTRACT

Yarko O. Types of Preference Shares and Rights of Their Owners: Legal Regulation and Practice in Selected Jurisdictions, master thesis. Supervisor Prof. Dr. Virginijus Bitė. — Vilnius: Mykolas Romeris University, School of Law, 2020.

This paper is dedicated to the investigation of the nature of the preference share and the regulation of the status of the preference shareholder. It reveals the meaning of the hybrid nature of the preference share. As well as, the status of the preference shareholder is depicted by referring to the rights provided by the contract as well as corporate law. Also, the non-voting stock in the framework of the general standards such as equality of shareholders, "one share, one vote", homogeneity of interest is explored.

The survey is based on the regulation and the legal practice of civil law and common law states, in particular, the UK, the U.S.A., France, Germany, Spain, as the representatives with the developed economy and Ukraine, as the representative with a transition economy. The work is predicated on the introduction and comparing the approaches of the above-mentioned states to the regulation of the status of the preference shareholder. Also, the "basic" protective measures that should be provided to the preference shareholders are summarised.

Key words: share, shareholder, preference shares, dual-class stock, hybrid security.

SUMMARY

This master thesis “Types of preference shares and rights of their owners: legal regulation and practice in selected jurisdictions” reveals the concept of the preference share as well as investigates the regulation of the status of the preference shareholder by disclosure of the rights provided by the contract and corporate law. The approaches on the regulation of the status of the preference shareholder of the common law and civil law states is explored. Also, the set of “basic” protective rights is suggested.

The main purpose of the master thesis is to define the status of the preference shareholders in selected jurisdictions and to suggest possible solutions for their protection. The main objectives are defined as follows: 1) to determine the peculiarities of the hybrid nature of the preference share; to investigate the preference shareholder’s position in the company, namely through the rights that might be granted by the contract and by corporate law; 2) to determine and to compare the status of the preference shareholder in selected jurisdictions; to suggest the “protective set of rights” the preference shareholders should bear.

The Master Thesis is structured into two part. The first chapter introduces the concept of the preference shares and the rights provided to their owners by the corporate law and contact. In particular, the emphasise is set on the hybrid nature of the preference share. The second chapter reveals and compares the approaches on the regulation of the preference shares of the civil and common law states, namely the UK, the U.S.A., France, Germany, Spain, and Ukraine.

The research showed that the preference shareholders usually are lack voting rights that are considered to be one of the cores in the set of shareholders' rights. The voting power provides a possibility to influence the company’s decisions, it serves as a protection of the shareholders and their investments. As far as the preference shareholders are not entitled to the voting, they might seem vulnerable, and the question arises, what the protection the preference shareholders enjoy. The preference shareholders, in general, are entitled to enjoy the same rights as the ordinary shareholder, except for voting. Besides, they enjoy the priority in payment of dividends that compensates for the absence of voting. Also, the preference shareholders benefit from the rights provided by the articles or the certificates. And, generally, states grant the freedom, in established by the law framework, to the company and the preference shareholders to structure their relationships.

HONESTY DECLARATION

20/04/202

Vilnius

I, _Olena Yarko_, student of Mykolas Romeris University (hereinafter referred to University),
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