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The preclusion of minority shareholders – a legal comparison of the protection of minority shareholders under the laws of Germany, the United Kingdom and the United States

Abstract

Der Beitrag untersucht die unterschiedlichen Regelungen zum Ausschluss von Minderheitsaktionären nach dem Recht von Deutschland, Großbritannien und den Vereinigten Staaten von Amerika. Im Fokus der Untersuchungen steht dabei einerseits die Praktikabilität und Effizienz des Mechanismus für den Ausschluss von Minderheitsaktionären gegen eine Abfindung in Geld als Gegenwert für ihre Aktien, den sogenannten „Squeeze-out", in den untersuchten Rechtsordnungen. Andrerseits untersucht der Beitrag das Schutzniveau, das für die Minderheitsaktionäre bei einem solchen Vorgehen gewährleistet wird. Dabei zeigt sich, dass der europäische Gesetzgeber mit einer auf der englischen Konzeption des Squeeze-out beruhenden Richtlinie (2004/25/EG) den europäischen Rechtsordnungen ein modernes und effizientes Regelungsregime verpasst hat. Dieses erweist sich insbesondere gegenüber dem Recht der USA als vorzugswürdig.

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I. Introduction

In a squeeze-out situation there are usually two groups of shareholders which have opposing interests. On the one hand, a majority shareholder may like to exclude the other shareholders and there might be good reasons to let him proceed and to permit such an exclusion. On the other hand, the minority shareholder usually wants to keep his shares in the company as a part of his ownership position.[1] This conflict of interests has to be solved in order to achieve a balance between the opposing interests of both parties. The way in which the legislators and the courts try to achieve such a balance differs however significantly throughout the world's jurisdictions. This is to say that not only the degree of how detailed this issue is regulated differs, but also the concepts of how the preclusion of minority shareholders can be achieved. Accordingly the three important jurisdictions of the United States, the United Kingdom and Germany are to be examined as they each offer a particular model to deal with the issue of the preclusion of minority shareholders and with regard to the protection of minority shareholders in the squeeze-out process. As a last step, the three sets of rules are to be compared and evaluated in order to identify the benefits and disadvantages each of them has to offer.

II. The significance of rules for the preclusion of minority shareholders

As a basic principle, protection of minority shareholders in a jurisdiction is an important indicator for the shape of the entire economic system and has significant influence on the propensity to invest as well as on the role of the shareholding in the respective economy.[2]

The preclusion of minority shareholders may be in some cases regarded as the counterpart to the issuance of new shares when a company wants to delist from the stock market, a process which is known as ‚going private'. Such an action may be considered by a company if the disadvantages of listing at the stock market outweigh the

1 Squeeze-out rules also raise questions of constitutional law and whether the preclusion of minority shareholders is compatible with the respective ownership right. These questions are not dealt with in the following article. However it is important to bear in mind that constitutional law may limit the legislator to a certain extent in making rules on the squeeze-out procedure. For an overview on the evaluation of the squeeze-out rules with regard to constitutional law see Silke Schöpper, *Ausschluss von Minderheitsaktionären in Deutschland und den USA* (Duncker & Humblot, Berlin 2007) for the German rules on p. 48 *et seqq.* and the United States rules on p. 160 *et seqq.*

2 *John Coffee*, ‚Privatization and Corporate Governance: The Lessons from Securities Market Failure' [1999] Iowa Journal of Corporation Law, 1, 2; *Bernard Black*, ‚The legal and institutional preconditions for strong securities markets, [2001] University of California Law Review, 781; *Holger Fleischer*, ‚Das neue Recht des Squeeze out' [2002] Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR), 757, 763; Schöpper, *supra* n 1, p. 47.

advantages associated therewith.[3] However ‚going private' is not the only reason why a majority shareholder may wish to preclude minorities holding shares in the same company.

The possibility by law to permit a majority shareholder, which fulfills the preconditions of the squeeze-out rules to exclude the other shareholders, can be understood as a weighting of the legislator in favour of the entrepreneurial initiative and against the ownership position of individuals.[4] The disposal of minority shareholders makes it significantly easier for a majority shareholder to put into effect his corporate conception. The decision making process is accelerated and the threat of potential actions of voidance, which are sometimes even conducted professionally to blackmail the corporation with the blocking of decisions, no longer has to be feared by the majority shareholder.[5] Also the costs to run the business decrease as the formal requirements for companies with only one shareholder decrease significantly.[6]

III. The squeeze-out of minority shareholders under the laws of the United States

Under the laws of the United States[7] there are no particular rules which control the preclusion of minority shareholders. From a number of different transacti-

3 The discontinuation of the need for external capital, planned investments which cause dislike on the side of the shareholders, the prevention of hostile takeovers or the delisting of a company that has been taken over may serve as examples for reasons why a company may wish to delist from the stock market; *Volker Land/ Kai Hasselbach*, ‚"Going Private" und „Squezze-out" nach deutschem Aktien-, Börsen- und Übernahmerecht' [2000] Der Betrieb (DB), 557.

4 Hüffer, *Aktiengesetz* (C. H. Beck, 8th Edition, Munich 2008), § 327a, Rn. [para] 1 *AktG*.

5 *Matthias Horbach/ Stefan Koch*, ‚How to manage squeeze-outs in Germany' [2005] International Financial Law Review, 34, 34; *Klaus Rüdiger Veit*, ‚Die Prüfung des Squeeze-outs' [2005] Der Betrieb (DB), 1697, 1697.

6 Under German law the requirements in sect. 121–128 of the German Public Companies Act (*Aktiengesetz)* which provide several formal requirements for the conduct of the general meeting according to sect. 121 para. 6 of the German Public Companies Act (*Aktiengesetz)* become obsolete; Schöpper, *supra* n 1, p. 19; Hüffer, *supra* n 4, § 327a, Rn. [para] 1 *AktG*; *Dirk Eisolt*, ‚Die Squeeze-out Prüfung nach § 327c Abs. 2 AktG' [2002] Deutsches Steuerrecht (DStR), 1145, 1145; See for the situation in the US, *Peter V. Letsou/Steven M. Haas*, ‚The Dilemma That Should Never Have Been: Minority Freeze Outs in Delaware' [2005] Bussines Lawyer, 25, 30.

7 The Constitution of the United States grants the states and the federal government separate legislative powers. The laws concerning companies overlap with both competences. Pursuant to the Commerce Clause in Article I, sect. 8, clause 3 of the Constitution of the United States, the federal government has authority to regulate the commerce between the states and hence to control the stock market and the trade with shares. However, the states have the competence to regulate the legal relationships of corporations which are incorporated within the respective state, as the X. Amendment reserves to the states any constitutional powers which are neither expressively transferred to the federal government nor prohibited from being exercised by the states; Mario Weiss, *Der Ausschluss von Minderheitsaktionären, Eine*

ons[8] a preclusion of minority shareholders is achieved mostly by conducting various merger transactions.[9] The following analysis compares these merger transactions feasible under the laws of the United States.

1. Different merger transactions to preclude minority shareholders

a) Statutory merger

The simplest form of such a merger is the ‚statutory merger'. Here, either one company merges into another company or the two merging companies merge into a new third company.[10] The new company assumes the rights and liabilities of the terminated companies[11] and, accordingly, has to compensate the shareholders for the loss of their shares in the terminated company. Traditionally, these shareholders were compensated by offering them shares in the new post-merger corporation. Yet, under the laws of most of the states and under the Model Business Corporation Act 2002 (MBCA) it is currently possible to compensate them in cash.[12] This is how the basic mechanism of the preclusion of minority shareholders works under the laws of the United States. In a statutory merger the two boards of directors negotiate a merger agreement which has then to be approved by the shareholders' meeting of the company which is to be acquired and of the acquiring company.[13] The MBCA therefore requires a simple majority.[14]

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rechtsvergleichende Untersuchung nach US-amerikanischem und deutschem Recht (Dissertation, Universität Konstanz, 2003), p. 15 *et seq.* In the following it is therefore referred either to the Revised Model Business Corporation Act of 2002 as a model set of rules used by 38 states (2002) in the US or to the state law of Delaware, New York and California as the most prominent states with regard to corporate law.

8 Other techniques to preclude minority shareholders are the dissolution, the sale of assets and the stock split by which minority shareholders can be squeezed out. These solutions have however the disadvantage, that the conditions under which they can be used for the sole purpose to preclude minority shareholders are not entirely clear. This is why they have become less popular in the past and have been largely replaced by merger constellations; Weiss, *supra* n 7, p. 19 *et seqq.*

9 Philipp Baums, *Ausschluss von Minderheitsaktionären* (Lang, Frankfurt am Main 2001), p. 175; Schöpper, *supra* n 1, p. 151.

10 § 11.02(a) of the MBCA; Del. GCL § 251(a).

11 § 11.06 of the MBCA; Del. GCL § 251(c).

12 § 11.02(c)(3) of the MBCA; Del. GCL § 251(b); § 902(a)(3) of the New York Code; § 1101(d) of the California Code; *Elliott Weiss*, ‚The law of take out mergers: a historical perspective' [1981] New York University Law Review, 624; Weiss, *supra* n 7, p. 31 *et seqq.;* This is significant because contrary to German law, the shareholders of the extinct company must be compensated with shares of the post-merger company to guarantee the continuity of their membership, sect. 2 of the Transformation Act (*Umwandlungsgesetz)*; Arndt Stengel, *Umwandlungsgesetz mit Spruchverfahrensgesetz* (C. H. Beck, 2nd Edition, München 2007), § 2, Rn. [para] 40 *et seqq.*

13 § 11.04(b) of the MBCA; Del. GCL § 251(c).

14 § 11.04(e) of the MBCA.

b) Triangular merger

The statutory merger automatically brings along a change of the legal status of the companies which are involved.[15] If this consequence is not desired, the laws of the United States allow for another form of merger in which the two companies remain separate. This is known as a triangular merger and involves three companies rather than two.[16] The buyer company sets up a subsidiary company whose only purpose is to serve as a shell company for the subsequent merger. This company is entirely owned by its mother, the buyer company, which equips it with assets. The subsidiary company then merges[17] with the target company whereby all the minority shareholders of the target company are compensated with either shares in the buyer company or with the assets of the subsidiary company.[18] After the merger the buyer company still holds all the shares in the subsidiary company. However, this subsidiary company is in fact the target company. The subsidiary company was only a shell to absorb the target company. The crucial difference here is that there are no more minority shareholders in the target company because they have been compensated in the merger either with cash or shares of the buyer company.

Similar to the statutory merger, the boards of directors in a triangular merger must approve a merger agreement. The fact that the board of the buyer company does not decide on this is unproblematic as the subsidiary company is fully controlled by the buyer company. The only hurdle to clear is a majority approval of the shareholders of the target company.[19]

c) Short-form merger

This is where the third merger type comes in. A short-form merger is principally a statutory merger where the only difference is that the buyer company already holds 90 % of the shares in the target company. If this is the case an exception is granted on the basic principle that the shareholders of the target company have to approve the merger.[20] Such an approval is dispensable in a short-form merger as this requirement would be a mere formality since the majority shareholder has 90 % of the votes in the

15 As has been stated above the acquiring company assumes not only all rights but also all liabilities of the company which is to be acquired. The triangular merger offers however the advantage to gain full control over another company without having to assume all liabilities of this company; *T.D.P.*, ‚Three-party mergers: the fourth form of corporate acquisition' [1971] Virginia Law Review, 1242, 1244.

16 *T.D.P.*, *supra* n 15, 1242; 1244; Schöpper, *supra* n 1, p. 157.

17 There are two forms of a triangular merger: In a ‚forward triangular merger' the target company merges into the subsidiary company, which is the „surviving" company after the merger. In the ‚reverse triangular merger' both companies merge as well with the only difference that here the target company is the „surviving" company. The result of both forms of merger is the same. However, a ‚reverse triangular merger' may be preferred in cases where the target company shall be carried on under the same name; Weiss, *supra* n 7, p. 30.

18 Weiss, *supra* n 7, p. 29.

19 Weiss, *supra* n 7, p. 29 *et seq.*

20 Baums, *supra* n 9, p. 177.

shareholders meeting.[21] This rule has been included in the past few years under the law of Delaware in an ‚all or nothing strategy' which includes two steps: As a first step, the buyer company makes a tender offer on the condition that it will acquire at least 90 % of the shares.[22] If this condition has been met, the majority shareholder can preclude the minority shareholders by conducting a ‚short form merger' as a second step. The significance of this course of action is that in the case in which the tender offer has been successful, neither the board, nor the shareholders of the target company must approve the transaction.[23] However, if the first condition has not been met and the threshold of 90 % has not been reached, the majority shareholder simply abandons the squeeze-out transaction.

2. The protection of minority shareholders in the squeeze-out mergers

It has been demonstrated that the preclusion of minority shareholders may be conducted unproblematically and that a squeeze-out under certain circumstances is feasible as soon as the majority shareholder holds a simple majority in the shareholders' meeting. Accordingly, this raises the question of how minority shareholders are protected in this process. Their protection takes place on different levels.

a) Approval by the board of directors

As previously stated, a merger transaction must be approved by both boards of directors. In their decision, the directors are bound by their fiduciary duties which include a primary protection for the minority shareholders. The directors of a corporation have the duty of care, which means that they must act for the good of the corporation.[24] The counterpart of the duty of care is the business judgment rule, which is a rebuttable presumption that the directors have acted within their duties.[25] Additionally, the laws of the United States impose a significant duty on the directors in a squeeze-out process to inform the shareholders adequately about the facts that are relevant for their decision.[26]

b) Approval by the shareholders

After the boards of directors have approved the merger transaction, the shareholders of the two corporations have to approve the merger as a basic principle.[27] It is, however, strongly questionable whether a protection of minority shareholders can effectively take place on this level as such an approval by the shareholders usually requires

21 Del. GCL § 253; MBCA § 11.05.
22 *Letsou/Haas*, *supra* n 6, 25, 26.
23 *Letsou/Haas*, *supra* n 6, 25, 26.
24 *Melvin Eisenberg*, ‚The duty of care of corporate directors and officers' [1990] University of Pittsburgh Law Review, 945; Schöpper, *supra* n 1, p. 164.
25 Schöpper, *supra* n 1, p. 166.
26 Security Exchange Act (SEC) Rule 10b-5.
27 MBCA § 11.04(b); Del. GCL § 251(c).

a bare majority.[28] Furthermore, as has been pointed out above, the approval of the shareholders of the target company may even be dispensable in case of a short-form merger.

c) Appraisal right of the shareholders

The shareholders of the company which is to be taken over also have an appraisal right if they object to the merger.[29] The appraisal right is an exit strategy for those shareholders who disapprove of a structural transaction of the company.[30] If the minority shareholder wants to exercise his appraisal right he is usually obliged to vote against the merger transaction in the shareholders' meeting[31] and can subsequently file with the courts for a determination of the consideration after having transferred his shares back to the company.[32] By exercising the appraisal right, the shareholder not only ceases to earn dividends, but may even have to bear the costs of legal advice and his procedural costs.[33] With regard to the assessment of the payment which is awarded to the minority shareholder there are several different methods to determine a fair price, which is a rather complex matter.[34]

3. Interim result

Under United States law minority shareholders are precluded by conducting merger transactions. The minority shareholders are protected by the fiduciary duties of the directors, their right of approval and the appraisal right.

IV. The squeeze-out under the laws of the United Kingdom

In the United Kingdom the need for squeeze-out rules has been recognized for a long time. Consequently, it was the first European country to introduce such rules in 1929.[35] It is therefore not surprising that the elaborated rules in sect. 428–430 F of the Companies Act 1985 have served as a model for the European legislator in the

28 MBCA § 7.25(c), 11.04(e); Del. GCL § 251(c).
29 MBCA § 13.02(a)(1); Del. GCL § 262.
30 Arthur Pinto/Douglas Branson, *Understanding Corporate Law* (Matthew Bender, New York 1999), § 6.06, p. 127.
31 Del. GCL § 262(d)(1).
32 Del. GCL § 262(e); Schöpper, *supra* n 1, p. 201.
33 Cf. Del. GCL § 262(j); Pinto/ Branson, *supra* n 30, § 6.06, p. 128; However, under the MBCA the rules are more favorable for the minority shareholder exercising his appraisal right as there he will not have to bear the procedural costs and does not have to wait for payment until the court has reached a decision; Schöpper, *supra* n 1, p. 202.
34 Examples of such methods are the ‚Delaware block method' and the newer ‚discounted cash flow method'; Schöpper, *supra* n 1, p. 203 *et seqq.*
35 Joanna Warchol, *Squeeze-out in Deutschland, Polen und übrigen Europa* (Nomos, Baden-Baden 2008), p. 355.

working process for the Takeover Directive 2004/25/EC[36] on takeover bids adopted in April 2004.[37] This Takeover Directive seeks to provide adequate protection for the shareholders in Europe, to set unified standards for companies with regard to takeovers and to diminish potential restraints for takeovers.[38] Consequently, the transformation of the European Takeover Directive and the enacting of the Companies Act 2006 only brought minor changes to the traditional rules on the preclusion of minority shareholders for the laws of the United Kingdom. Today, the relevant rules for the squeeze-out of minority shareholders are to be found in sect. 974 to 991 of the Companies Act 2006, which provide the offeror with the right to buy out the minority shareholders under the conditions stated therein.

1. Mechanism to preclude minority shareholders

The squeeze-out law of the United Kingdom is tailored to takeover situations, which is expressed by the requirement of a precedential takeover offer.[39] With regard to this takeover offer two requirements must be fulfilled: First, the offer must relate to either all the shares of a company or to all the shares of one class of shares if applicable.[40] Second, the offer must be the same in relation to all the shares.[41] The right to preclude the minority shareholders originates only where the bidder acquires 90 % in value of the shares to which the offer was related and in case that the shares to which the offer relates are voting shares, at least 90 % of the voting rights.[42] Accordingly, the squeeze-out right is linked to the success of the public takeover bid and not to a certain percentage of shares held by the bidder.[43] If the threshold of 90 % has

36 Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, OJ L 142/12.

37 *Philipp Rühland*, ‚Der übernahmerechtliche Squeeze-out im Regierungsentwurf des Übernahmerichtlinie-Umsetzungsgesetzes – Ökonomisch sinnvoll, aber nicht vollständig mit höherrangigem Recht vereinbar' [2006] Neue Zeitschrift für Gesellschaftsrecht (NZG), 401, 402.

38 *Hans Diekmann*, ‚Änderungen im Wertpapiererwerbs- und Übernahmegesetz anlässlich der Umsetzung der EU-Übernahmerichtlinie in das deutsche Recht' [2007] Neue Juristische Wochenschrift (NJW), 17, 17; *Peter Kindler/ Hendrik Horstmann*, ‚Die EU-Übernahmerichtlinie – Ein „europäischer" Kompromiss' [2004] Deutsches Steuerrecht (DStR), 866; *Barbara Dauner-Lieb*, ‚Das Tauziehen um die Übernahmerichtlinie – eine Momentaufnahme' [2003] Deutsches Steuerrecht (DStR), 555.

39 Stephen Mayson/ Derek French/ Christopher Ryan, *Company Law* (Oxford University Press, 24th Edition, Oxford 2007), p. 224; for a specification what exactly an offer constitutes, see Paul Davies, *Principles of Modern Company Law* (Thomson Sweet & Maxwell, London 2008), p. 1048.

40 Sect. 974 (2) of the Companies Act 2006.

41 Sect. 974 (3) of the Companies Act 2006; sect. 976 (1) and (2) state permissible exceptions to this principle.

42 The threshold with regard to 90 % of the voting rights is new under the Companies Act 2006, Brian Cain, ‚Companies Act 2006: Takeovers' [2007] Company's Secretary Review, 201.

43 Cf. Appendix 1.

been met, the majority shareholder can exercise his squeeze-out right within three months[44] by giving notice to the shareholders which did not accept his offer, stating that he wishes to acquire their shares.[45]

2. Protection of minority shareholders

a) Sell-out right

A significant feature of the squeeze-out rules in the United Kingdom is that aside from the offeror's right to buy out the minority shareholders, they on their part have the right to be bought out by the offeror which is referred to as a ‚sell-out'.[46] The justification for this right is the equal treatment of the shareholders: In the United Kingdom, shareholding is typically a matter of free float. Without the sell-out right the buyer would tender as many shares as he needs to gain control over the target company and the other shareholders would not obtain the opportunity to offer their shares to the same price as well.[47] Similarly, the precondition of the sell-out right is also that the offeror has achieved 90 % in value of the shares in the company, and if the shares are voting shares he must also have 90 % of the voting rights. However, this threshold is different from the one for the squeeze-out right as in this case shares which were held by the offeror by the time of the offer are also included.[48]

b) The consideration

The crucial issue in case of an exit of the minority shareholders from the shareholding is the consideration they get in return for their shares. For this case, the Companies Act 2006 provides the rule that both the squeeze-out and the sell-out take place on the terms of the offer which was made by the buyer.[49] The appropriateness of the consideration is hereby indicated by the number of shareholders which accept the offer of the buyer.[50] This is to say that an offer which is accepted by 90 % of the shareholders is deemed to be appropriate.[51] To ensure that the buyer makes an offer which has a good chance to be accepted by the shareholders instead of ap-

44 Sect. 980 (2) of the Companies Act 2006.

45 Sect. 979 (4) of the Companies Act 2006.

46 Sect. 983 *et seqq.* of the Companies Act 2006.

47 In countries where it is more typical to have shareholders of different distribution in the sense that there are shareholders with only few shares and some with rather large participations, the buyer usually deals only with those shareholders which hold big packages of shares; Till Böhmer, *Der Schutz der Minderheitsaktionäre bei Übernahmen börsennotierter Gesellschaften in Europa* (C. H. Beck, München 2004), p. 35–37.

48 Sir Francis Beaufort Palmer/ Goeffrey Morse, *Palmer's Company Law: Annotated Guide to the Companies Act 2006* (Thomson/ Sweet & Maxwell, London 2007), p. 724.

49 See sect. 981 (2) of the Companies Act 2006 for the squeeze-out; sect. 985 (2) of the Companies Act 2006 for the sell-out.

50 Warchol, *supra* n 35, p. 288.

51 Re Hoare and Company Ltd., [1933] 150 LT 374.

proaching the target several times, rule 35.1 of the City Code introduces a blocking period of 12 months for the bidder which assures that the first offer is made on reasonable terms.[52]

c) Appeal to the court

There is also the possibility for the dissenting shareholder to appeal the court to review the squeeze-out under two aspects: either the shareholder can argue that the offeror is not entitled to acquire the shares[53] or he can request that the terms of the acquisition shall be amended „as the court thinks fit."[54] If the dissenting shareholder can show that the 90 % threshold has not been met this will certainly be a reason for the court not to let the majority shareholder proceed. Yet, one has to take into consideration that the passing of the 90 % threshold is *prima-facie* very strong evidence that the offer is fair, and the British courts therefore tend to exercise their discretion to let the squeeze-out proceed.[55] As a basic principle, the British courts tend to refrain from fixing the prices in squeeze-out transactions.[56]

3. Interim result

The law of the United Kingdom assumes that if a takeover offer was accepted by 90 % of the shareholders, this is a sufficient reason to permit the preclusion of the other shareholders at the same price. If these conditions have been met, the chances for the minority shareholder to challenge the squeeze-out are not very high as the acceptance of 90 % of the shareholders is deemed to be a sufficient reason to permit a squeeze-out and it also serves as the basis for determining the consideration.

V. The preclusion of minority shareholders under the laws of Germany

Under the laws of Germany, the possibility to preclude minority shareholders was not codified until the beginning of 2002. Since then some special provisions have been introduced in the German Public Companies Act (*Aktiengesetz, AktG*) in sect. 327a *et seqq.* which provide a procedure for the squeeze-out of minority shareholders. Besides these rules, the German legislator has also implemented the Takeover Directive into German law which found its way into sect. 39a–c of the Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahme-*

52 Davies, *supra* n 39, p. 1045.
53 Sect. 986 (1) (a) of the Companies Act 2006.
54 Sect. 986 (1) (b) of the Companies Act 2006.
55 Davies, *supra* n 39, p. 1053; *Jürgen Sieger/ Kai Hasselbach*, ‚Ausschluss von Minderheitsaktionären (Squeeze-out) im ausländischen Recht' [2001] Neue Zeitschrift für Gesellschaftsrecht (NZG), 926, 927.
56 Re Grierson, Oldham & Adams Ltd. [1967] 1 All ER 192.

gesetz, WpÜG).[57] Accordingly, there are two different ways to preclude minority shareholders under German law and in some cases the majority shareholder even might have the choice which one of them he will envisage.

1. Squeeze-out according to sect. 39a-c *WpÜG*

a) Mechanism to preclude minority shareholders

The rules in sect. 39a-c *WpÜG* originate from the aforementioned Takeover Directive and therefore bear close resemblance to the English system regarding the squeeze-out of minority shareholders. Sect. 39a *WpÜG* para. 1 gives the right to an offeror to demand the preclusion of the minority shareholders if he has reached the threshold of 95 % of the voting shares of the target company as a result of a public takeover offer. If this threshold is met, the remaining shares held by the minority shareholders are transferred to the majority shareholder by order of the court.

b) Protection of minority shareholders

According to sect. 39a para. 3 *WpÜG*, the majority shareholder has to offer an adequate consideration in return for the preclusion, whose character has to equal the consideration of the public takeover offer. In any case a consideration in cash must be offered alternatively according to sect. 39 para. 3 sentence 2 *WpÜG*. To determine the appropriateness of such consideration the same mechanism is used as in the United Kingdom, which is to rely on the price of the public takeover offer. This means that if the offeror has acquired at least 90 % of the shares by reason of the public takeover offer, sect. 39a para. 3 sentence 3 *WpÜG* deems such price to be adequate for the consideration of the remaining shareholders. Whereas it has been seen that the courts in the United Kingdom are very reluctant to deviate from the corresponding rule in the Companies Act 2006,[58] the recent practice in Germany has shown that German courts are not. Not only have there been several judgments in the short period since the rules in sect. 39a-c *WpÜG* have come into force, but the judgments are also contradictory and therefore have raised a considerable debate whether the presumption of sect. 39a para. 3 sentence 3 *WpÜG* can be rebutted.[59] Following a judgment of the *Landgericht (District Court)* in Frankfurt which held that this presumption could be

57 For the interrelationship of both sets of rules see *Christoph van der Elst*, ‚Squeezing and Selling-out – a Patchwork of Rules in Five European Member States' [2007] European Company Law, 19, 21.

58 In more than 75 years of jurisprudence in the United Kingdom there have been only very few judgements dealing with this matter at all; *Rühland, supra* n 37, 401, 402.

59 See examplary *Roland Steinmeyer/ Matthias Santelmann*, ‚Zur Widerleglichkeit der Angemessenheitsvermutung beim übernahmerechtlichen Squeeze-out, [2009] Betriebs-Berater (BB), 674–678; *Hans-Ulrich Wilsing/ Markus Ogorek*, ‚Die Angemessenheitsvermutung beim übernahmerechtlichen Squeeze Out' [2009] Zeitschrift Gesellschafts- und Wirtschaftsrecht (GWR), 211 *et seqq.*; *Rainer Süßmann*, ‚Die Unwiderleglichkeit der Abfindungshöhe beim übernahmerechtlichen Squeeze-out' [2009] Neue Zeitschrift für Gesellschaftsrecht (NZG), 980–982.

jeopardised,[60] the *Oberlandesgericht (OLG)* Frankfurt overruled this judgment stating that the presumption of sect. 39a para. 3 sentence 3 *WpÜG* could only be deviated from in very exceptional circumstances, where the market powers have not taken effect.[61] However, the *Oberlandesgericht (OLG)* Stuttgart held on the contrary that even under such circumstances, the presumption of the appropriateness of the consideration must prevail.[62]

c) Interim result

Through the implementation of the Takeover Directive, Germany has obtained an almost identical regime for the preclusion of minority shareholders as the original model of the United Kingdom. However in Germany the mechanism to determine the consideration by relying fully on the market forces is perceived with much more scepticism by academia and the courts.

2. Squeeze-out according to sect. 327a *et seqq. AktG*

Besides the provisions in sect. 39a-c *WpÜG*, which originate from European law, the German legislator had created rules for the preclusion of minority shareholder before the Takeover Directive came into force. Subject to the preconditions of the two regimes, there might eventually be two options for a majority shareholder as a course of action for the preclusion of minority shareholders.

a) Mechanism to preclude minority shareholders

According to sect. 327a *et seqq. AktG*, a majority shareholder can force the minority shareholders through a decision of the shareholders' meeting to sell him their shares for an adequate price even if it is against their will.[63] The only requirement which must be fulfilled is that the majority shareholder holds shares corresponding to 95 % of the entire share capital.[64] If the threshold of 95 % is reached, the majority shareholder can request that the shareholders' meeting is convened, which is the appropriate institution to carry out the demand of the majority shareholder. There, the squeeze-out decision may be made with a simple majority.[65] However it is up to the

60 LG Frankfurt a. M., Beschluss 5.8.2008 – 3-5 O 15/08, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2008, 665, 668.

61 LG Frankfurt a. M., Beschluss vom 9.12.2008 – WpÜG 2/08, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2009, 74, 78.

62 OLG Stuttgart, Beschluss vom 5.5.2009 – 20 W 13/08, Neue Zeitschrift für Gesellschaftsrecht (NZG) 2009, 950, 950.

63 *Karlheinz Küting*, ‚Der Ausschluss von Minderheiten nach altem und neuem Recht – unter besonderer Berücksichtigung des „Squeeze-out", [2003] Deutsches Steuerrecht (DStR), 838, 842.

64 Sect. 327a (1) AktG.

65 Sect. 133 (1) AktG; This illustrates that the threshold of 95 % relates to the amount of share capital the majority shareholder holds and not to the voting rights he can exercise. The falling apart of these two figures may be explained by the fact that in German law there are two

majority shareholder to determine an adequate price for the consideration, which must equate to the conditions of the company by the time of the decision of the shareholders' meeting.[66] As German law does not provide any possibility for the minority shareholders to influence whether there will be a squeeze-out or not according to these rules, it is consistent that there must be adequate means of protection for the minority shareholders in such a situation.

b) The protection of minority shareholders

aa) Determination of the appropriateness of the consideration

As there is usually no way to stop a squeeze-out if the conditions for its completion are fulfilled, the appropriateness of the consideration becomes the crucial issue. The determination of the consideration takes place in a two-step process. First, the majority shareholder must submit a report to the shareholders' meeting which states the conditions under which consideration is granted and he must substantiate the appropriateness of the consideration.[67] A further step is a review of the squeeze-out by one or more auditors[68] which are proposed by the majority shareholder for appointment by the shareholders' meeting.[69] The subject matter of the review is the appropriateness of the consideration which was proposed by the majority shareholder.[70] In the review the auditors must rely on information and evaluations of the company which have been made by other independent auditors.[71] This process of reporting and reviewing the consideration offered by the majority shareholder seeks to achieve a balance between the interests of the parties in the squeeze-out process. A squeeze-out according to the sect. 327a *et seqq. AktG* accordingly requires in every case the review of the consideration by a third party which is deemed to be a means of protection by German law.[72]

bb) Review by the courts

As a measure of protection, minority shareholders also have the possibility to appeal to the court to challenge such a squeeze-out decision. Potential reasons to challenge

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types of shares: The *Stammaktie* (voting share) and the *Vorzugsaktie* (preferred share). The latter one gives the shareholder no voting rights; Mathias Habersack in: Emmerich/ Habersack, *Aktien- und GmbH-Konzernrecht* (5th Edition, Munich 2008), § 327a, Rn. [para.] 24.

66 Sect. 327b (1) AktG.

67 Sect. 327c (2) AktG; The report must enable the minority shareholder to make on themselves an evaluation whether or not the consideration is appropriate; *Veit, supra* n 5, 1697, 1698.

68 According to sect. 327c (2) sentence 2, sect. 293d (1) *AktG* and sect. 319 (1) of the German Commercial Code (*Handelsgesetzbuch, HGB)* only certified accountants (*Wirtschaftsprüfer*) may be auditors. From these rules common standards like neutrality, qualification and the responsibility can be derived; *Eisolt, supra* n 6, 1145, 1148.

69 Sect. 327c (2) sentence 2 and 3 *AktG*.

70 *Eisolt, supra* n 6, 1145, 1147; *Veit, supra* n 5, 1697, 1698.

71 *Eisolt, supra* n 6, 1145, 1147.

72 The only exception hereof is that all shareholders waive such a review by means of notarization; *Veit, supra* n 5, 1697, 1698.

the decision might be either of procedural or substantive nature.[73] As a basic principle the pendency of such an appeal has the consequence that the decision of the shareholders' meeting cannot be registered with the commercial register, which is an indispensable requirement for the transfer of the shares.[74] However, the German legislator expressively excluded disputes about the appropriateness of the consideration explicitly from this consequence by submitting such disputes to another procedure *(Spruchverfahren)*, which does not block the commercial register in order to prevent the case that a squeeze-out cannot be conducted merely because the appropriateness of the consideration is at issue.[75]

3. Interim result

In a squeeze-out according to the sect. 327a *et seqq. AktG* the German legislator has made an assessment that as a basic principle, a shareholder who owns shares corresponding to 95 % of the entire share capital is allowed to preclude the minority shareholders. The crucial issue under such rather general permission is to guarantee the appropriateness of the consideration. This is regularly – and not exceptionally like under the rules originating from the Takeover Directive – a matter of third parties who are involved in the squeeze-out process.

VI. Comparison of the different national rules

As has been shown, there are various ways to arrange the preclusion of minority shareholders in the examined jurisdictions. Accordingly, the protection of minority shareholders differs as well. In the following, the different regimes are compared with regard to the benefits they offer and to their potential disadvantages.

1. Scope of the squeeze-out rules

A first significant difference concerning the preclusion of minority shareholders in the three jurisdictions is that they differ in scope. The model used by the Takeover Directive is strictly related to takeover situations and therefore has the narrowest scope, as a squeeze-out can only take place within three months after a takeover bid. Under the traditional German squeeze-out rules (sect. 327a *et seqq. AktG)* it is insignificant by what time the majority shareholder has acquired his shares.[76] A preclu-

73 The three main reasons to challenge a squeeze-out decision are a wrong calculation of the threshold of 95 %, insufficient information to the shareholders and a breach of the fiduciary duties among the shareholders; *Barbara Grunewald*, ‚Die neue Squeeze-out-Regelung' [2002] Zeitschrift für Wirtschaftsrecht (ZIP), 18, 20.

74 Hüffer, *supra* n 4, § 327e AktG, Rn. 3.

75 Sect. 327 f. *AktG*; *Eisolt*, *supra* n 6, 1145, 1147; Hüffer, *supra* n 4, § 327e AktG, Rn. 1.

76 *Andreas Austmann/ Petra Mennicke*, ‚Übernahmerechtlicher Squeeze-out und Sell-out' [2004] Neue Zeitschrift für Gesellschaftsrecht (NZG), 846, 846.

sion of minority shareholders can take place at any time if the conditions for a squeeze-out are fulfilled. Similarly, the examined laws of the United States' do not state any requirements with regard to a certain time period, within which a squeeze-out can take place as merger transactions can be conducted at any time. However, something that both the United States model and the model of the Takeover Directive have in common is that they usually go along with changes in the balance of power within the company. The traditional German rules offer here a set of rather neutral rules which can be exercised at any time.

2. Parties that are involved in the squeeze-out

There are significant differences in the three jurisdictions with regard to the role that the concerned parties play. In the United States, the directors of the companies have a great impact both on whether the squeeze-out can take place and also on the protection of the minority shareholders through their fiduciary duties. The decision of a squeeze-out therefore strongly depends on third parties. Under traditional German law, the minority shareholders have no potential to influence whether there will be a squeeze-out or not. As soon as the majority shareholder has reached the threshold of 95 % of shares, he can unilaterally initiate a squeeze-out. According to these rules, it is the shareholders' meeting which deals with a squeeze-out as well as external auditors which are supposed to guarantee that in such a case the rights of the minority shareholders are respected. Hence, third parties are involved in a squeeze-out process on a regular basis as well. By contrast in the Takeover Directive model the protection of minority shareholders is left to themselves as it is the decision of the collectivity of minority shareholders which decides whether a squeeze-out can take place or not.

3. Determination of the consideration

With regard to the determination of the consideration, the Takeover Directive model offers a very simple mercantile rule which relies on the market forces to produce a fair price for the consideration. The price of the consideration will only in exceptional cases be subject to review by the courts and therefore comes about through the exclusive decision of the parties whose interests are at stake. By contrast, the traditional German rules seem to be very complex requiring in every case, even if the large majority of shareholders considers the consideration as appropriate, the assessment of third parties in reports that have to be submitted. In this respect, the traditional German law rules trust rather in third independent parties, which are deemed to be specialists in this area, than in market forces. The United States model takes an approach which lies in between these two extremes. Here, it is up to the parties to determine the consideration, and third parties may be involved in this issue only in cases of appraisal by the court.

VII. Statement

By comparison, the model of the Takeover Directive on the squeeze-out of minority shareholders is the most favorable one, based on three main arguments.

1. Takeover Directive model efficiently protects the interests of minority shareholders in the squeeze-out decision

It may seem that the model of the Takeover Directive has a limited scope as it requires a precedent takeover offer contrary to the traditional rules in Germany and the model of the United States, where the majority shareholder does not have to make a takeover offer. Yet, this argument is flawed. The fact that even a shareholder who already owns more than 90 % of the shares must make such a „takeover offer" shows that the attachment of the squeeze-out procedure to a takeover bid is not a limitation in scope.[77] It is rather the arrangement of a key principle by which the two essential questions with regard to a squeeze-out can be answered: First, it decides whether or not a squeeze-out can take place at all by making conditional the number of at least 90 % of the shareholders who accept the takeover bid. This is subsequently also used as an indication for the appropriateness of the consideration. Such an approach brings several advantages. At the first stage it gives all shareholders an equal chance to either vote for the proposed squeeze-out by accepting it, or to prevent it as a collectivity. The majority shareholder must obtain the approval of his offer by the majority of this collectivity in order to be able to proceed with a squeeze-out. This ensures, on the one hand, that a squeeze-out cannot take place without the consent of at least a large majority of the remaining shareholders. On the other hand, it ensures that all remaining shareholders before a squeeze-out are treated equally, regardless of whether they „sell" in the course of the public takeover bid or by way of the squeeze-out decision. Contrary to the squeeze-out mergers in the United States and the traditional rules in Germany there is a reasonable chance for the minority shareholders to prevent a squeeze-out in advance. Germany and the United States offer the minority shareholders protection only after the decision for or against a squeeze-out has been made during the process of determination of the consideration in Germany and the appraisal right in the United States, respectively. The possibility of being able to influence whether they can keep their participation in the company is different from the mere question what the consideration will be after a squeeze-out. The crucial difference here to the traditional rules in Germany is that the majority shareholder cannot acquire the shares step by step in order to reach the threshold, but that the decision of the collectivity of the minority shareholders is required which strengthens their position opposite the majority shareholder.

77 Cf. Appendix 1.

2. The involvement of third parties in the squeeze-out decision is susceptible for manipulation

Contrary to the models of the traditional German rules and the United States, the approach of the Takeover Directive only allows for the majority shareholder and minority shareholders to be involved in the squeeze-out process, as a conflict of interests exists among these two groups. Under the United States approach, the directors play an important role in the squeeze-out. Similarly, under the traditional German rules, it is the auditors who control the decision of the shareholders' meeting. The involvement of third parties however includes the risk that they do not entirely represent the interests of those they are supposed to.[78] The fact that the issue of self-dealing plays a significant role[79] in squeeze-outs in the United States points out this structural difficulty. If there is one major shareholder in the United States, the directors of a company are influenced by this shareholder at least to a certain extent. It is hard to see how a director who is elected and wants to be reelected by the majority of shareholders can protect the interests of the minority shareholders in a squeeze-out transaction at the same time. The traditional German rules solve this problem by involving independent auditors to review the squeeze-out. In this case, the judgment of a third party still leaves space for manipulation and constrains the minority shareholders to rely on a third party to protect their interests. The criticism of the traditional German rules must however be limited to cases where they are used for a squeeze-out in companies which are listed at the stock market because here sect. 39a-c *WpÜG* could be used alternatively. As the traditional German rules apply also to companies which are not listed at the stock market and in which case the determination of the consideration cannot be determined by the share price at the stock market, the involvement of third parties is much more justifiable and offers here a fair procedure. In these cases sect. 39a-c *WpÜG* are not available for a squeeze-out as they apply only to companies which are listed at the stock market. However, the rules in sect. 39a-c *WpÜG* remain the more advantageous set of rules for the majority of cases as they permit the exclusion of third parties from the squeeze-out process which reduces the risk of manipulation to a minimum.[80]

3. The Takeover Directive model is simple and effective

The real strength of the model of the Takeover Directive lies in its effectiveness and simplicity. The United States lack special rules for squeeze-out situations alltogether. This results in different merger constellations which usually go along with structural changes of the affected company. This is rather complicated and unpredictable for the parties. Also the costs for the merger transaction and legal advice increase the costs of the transaction compared to a squeeze-out process according to the Takeover

78 Schöpper, *supra* n 1, p. 162.

79 Schöpper, *supra* n 1, p. 174.

80 *PhilippRühland*, ‚Der squeezeout nach dem RefE zum Wertpapiererwerbs- und Übernahmegesetz vom 12.3.2001' [2001] Neue Zeitschrift für Gesellschaftsrecht (NZG), 448, 551.

Directive. Subject to the qualification made above and only with regard to companies which are listed on the stock exchange, the traditional German rules are rather costly and complicated. The shareholders' meeting has to consider several reports before a decision can be made which increase also the costs of the transaction. By linking the approval of the majority of the shareholders to the success of a squeeze-out transaction, the Takeover Directive rules also decrease the risk of appeals to the courts to a minimum as the squeeze-out has been approved by a large majority of the remaining shareholders. This encourages a fast and foreseeable squeeze-out procedure for both parties of the squeeze-out. Thereby the economic system benefits as a whole since potential restraints for takeovers are diminished and the entrepreneurial initiative is strengthened. Finally, it must be pointed out that experiences from the United Kingdom show that the consideration of the shareholders through its mercantile rule is in any case not below what the shareholders can expect in other countries.[81]

VIII. Conclusion

The legal comparison of the rules for the preclusion of minority shareholders reveals that it is beneficial for both the majority shareholders and the protection of the minority shareholders to solve the conflict of interests between them through special rules for a squeeze-out situation. Here, the rules in Germany and the United Kingdom resulting from the Takeover Directive have an advantage compared to the rules in the United States. Since it is commonly acknowledged that under certain circumstances a squeeze-out must be possible, the issue of crucial importance is the determination of the consideration of the minority shareholders. In this respect, the Takeover Directive model offers the better solution compared to the traditional German rules as it is simple, effective, less prone to manipulation and predictable.

81 *Rühland*, stating that the situation for German shareholders is significantly worse than for those in the United Kingdom or the United States which get 15–30 % more than the stock market price; *Rühland*, *supra* n 80, 448, 450.

Appendix 1:

Application of the squeeze-out right under the Companies Act 2006 with different initial amounts of shares

1. Initial amount of shares before the takeover offer	2. Shares to which the takeover relates	3. Approval of 90 % of the shareholders	4. Maximum amount of shares which may be squeezed-out (in % of the total share capital)
0	100	90	10
10	90	81	9
20	80	72	8
30	70	63	7
40	60	54	6
50	50	45	5
60	40	36	4
70	30	27	3
80	20	18	2
90	10	9	1
95	5	4,5	0,5
97	3	2,7	0,3

[Source: Joanna Warchol, *Squeeze-out in Deutschland, Polen und übrigen Europa* (Nomos, Baden-Baden 2008), p. 285]