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Freeze-outs: Transcontinental Analysis and Reform Proposals

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FREEZE-OUTS: TRANSCONTINENTAL ANALYSIS AND REFORM PROPOSALS

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I. INTRODUCTION

One of the most crucial, but systematically neglected, comparative differences between corporate law systems in Europe and in the United States, as crucial as often neglected, concerns the regulations governing freeze-out transactions in listed corporations. Freeze-outs can be defined as transactions in which the controlling shareholder exercises a legal right to buy out the shares of the minority, and consequently delists the corporation and brings it private.[1] Beyond this essential definition, the systems diverge profoundly.

This gap exists despite the fact that minority freeze-outs are one of the most debated issues in corporate law, in the public media,[2] in a vast body of scholarly work and in case

[1] "Freeze-out" is neither a well-defined term of art nor has a precise statutory or case-law definition. It is commonly used to describe several different situations in which majority shareholders force minority shareholders to sell their shares either through a statutory provision or simply by creating *de facto* – and sometimes abusive – strong incentives to sell the shares. This article focuses on transactions in which a controlling shareholder has a legal right to buy out the shares of the minority in a listed corporation, with the goal of delisting it. Delisting is usually a consequence of a minority buy out, but the conditions for delisting vary in different legal systems and, in some instances, it is possible to delist a corporation even if there are still minority shareholders. This article will not focus on delisting; for a discussion of the delisting phenomenon and its underlying economic determinants *see* Jonathan Macey et al., *Down and Out in the Stock Market: The Law and Economics of the Delisting Process*, 51 J. L. & ECON. 683 (2008). The terms "freeze-out" and "squeeze-out" are occasionally used interchangeably, even if the latter should refer to techniques used by controlling shareholders and/or managers to extract benefits from the corporation and minimize the gains of minority shareholders while they remain members of the business organization. These techniques, whether legal or not, are mainly used in closely-held corporations: a typical example might be to pay high salaries only to the controlling shareholder who is also an employee of the corporation, while refusing to distribute dividends to all the shareholders.

[2] *See* David Wessel, *Closing the Door: Going Private Offers Rewards*, WALL ST. J. May 17, 2007, at A2; Robin Sidel, *Takeover Targets Force Up Offers in 'Minority Freeze-out' Deals*, WALL ST. J. May 10, 2002, at C3.

law in the United States[3] and, to a lesser degree, in Europe.[4] In light of the relevance of the subject and the extensive and growing number of cross-Atlantic mergers in which the acquiring and the target corporations are subject to different legal regimes,[5] it is startling

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[3] Among the most recent contributions to freeze-outs in the United States, with specific reference to Delaware law, *see* Mary Siegel, *Going Private: Three Doctrines Gone Ashtray*, 4 N.Y.U. J. L. & BUS. 399 (2008); Clark W. Furlow, *Back to Basics: Harmonizing Delaware Law Governing Going Private Transactions*, 40 AKRON L. REV. 85 (2007); Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775 (2007); Peter V. Letsou, Steven M. Haas, *The Dilemma that Should Never Have Been: Minority Freeze Outs in Delaware*, 61 BUS. LAW. 25 (2005); Michael J. McGuinness, Timo Rehbock, *Going-Private Transactions: A Practitioner's Guide*, 30 DELAWARE J. CORP. L. 437 (2005); Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005); Bradley R. Aronstam et al., *Revisiting Delaware's Going-Private Dilemma Post-Pure Resources*, 59 BUS. LAW. 1459 (2004); Ely R. Levy, *Freeze-Out Transactions the Pure Way: Reconciling Judicial Asymmetry Between Tender Offers and Negotiated Mergers*, 106 W. VA. L. REV. 305 (2004); Charles W. Murdock, *Freeze-outs, Freeze-Outs, and Discounts: Why is Illinois in the Minority in Protecting Shareholders' Interests?*, 35 LOY. U. CHI. L.J. 737 (2004); A. C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L. J. 83 (2004); Bradley R. Aronstam et al., *Delaware's Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of Siliconix and Unocal Exploration*, 58 BUS. LAW. 519, 520 (2003); Kimble Charles Cannon, *Augmenting the Duties of Directors To Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors To Express a Valuation Opinion in Unilateral Tender Offers After Siliconix, Aquila, and Pure Resources*, 2003 COLUM. BUS. L. REV. 191 (2003); Ronald J. Gilson, Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003); Brian M. Resnick, Note, *Recent Delaware Decisions May Prove To Be "Entirely Unfair" to Minority Shareholders in Parent Merger with Partially Owned Subsidiary*, 2003 COLUM. BUS. L. REV. 253 (2003); William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, (2001); Leo Herzel, Dale E. Colling, *Establishing Procedural Fairness in Freeze-out Mergers after Weinberger*, 39 BUS. LAW. 1525 (1984); Elliott J. Weiss, *Balancing Interests in Cash-Out Mergers: The Promises of Weinberger v. UOP*, 8 DEL. J. CORP. L. 1 (1983).

[4] For a discussion of freeze-out rights under Article 15 of the Takeover Directive (Council Directive 2004/25, 2001 O.J. (L 142) 12 (EC), also called "Thirteenth Directive") and the price at which minorities can be liquidated, *see* Christoph Van der Elst & Lientje Van der Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights*, forthcoming in ___ EUR. COMPANY & FIN. L. REV. ___ (2009), on file with the author; Timo Kaisanlahti, *When Is a Tender Price Fair in a Freeze-out?*, 8 EUR. BUS. ORG. L. REV. 497 (2007); on the economic effects of price mechanisms in the freeze-out context pursuant to the Thriteeneth Directive *see* also Mike Burkart, Fausto Panunzi, *Mandatory Bids, Freeze-out, Sell-out and the Dynamics of the Tender Offer Process* (ECGI Law Working Paper No.10, 2003), *available* at www.ssrn.com. A brief description of the implementation of the European Takeover Directive and its Article 15, concerning freeze-out rights in several European countries is offered by DIRK VAN GERVEN, COMMON LEGAL FRAMEWORK FOR TAKEOVER BIDS IN EUROPE (Cambridge University Press 2008); SILJA MAUL, DANIÈLE MUFFAT-JEANDET, JOËLLE SIMON, TAKEOVER BIDS IN EUROPE. THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES (Memento Verlag 2008). On specific European jurisdictions *see* Olivier Douvreleur, *Un noveau cas de retrait obligatoire: Le Retrait Obligatoire dans la Foulée d'une Offre*, 3 RTDF 58 (2006); Hubert Segain, *Les Opération de Public to Private en France: Bilan et Perspectives*, 5 BULLETIN JOLY BOURSE 536 (2005) (both contributions on France); Mathias Habersack, *Beendigung der Börsenzulassung*, in MATHIAS HABERSACK, PETER O. MÜLBERT, MICHAEL SCHLITT, UNTERNEHMENS-FINANZIERUNG AM KAPITALMARKT (Verlag Otto Schmidt 2008) (on Germany); Juan A. Aguayo, *Ofertas Públicas de Adquisición de Sociedades Cotizadas y Exclusión de Negociación. Public to Private*, _____ (on Spain); Alessandro Pomelli, *"Delisting" di Società Quotata tra Interesse dell'Azionista di Controllo e Tutela degli Azionisti di Minoranza*, ___ RIVISTA DELLE SOCIETÀ ___ (2009) (on Italy).

[5] Data on the volume of cross-border mergers and acquisitions from 1987 to 2005 have been published by the United Nations Conference on Trade and Development, *World Investment Report* 2006, *available* at

how little research has focused on a comparison between the European and the American approaches in this area.[6] The This Article fills this gap by offering a first comparative discussion of freeze-out regulations in the U.S. and in Europe, by proposing some explanations for the causes and consequences of the differences between the two regulatory regimes, and by advancing reform proposals for the development of financial markets both in Europe and in the U.S.

Freeze-outs are relevant from both a theoretical and a practical perspective. From a theoretical point of view, freeze-outs of minorities lie on the contended frontier that separates the powers (and duties) of controlling shareholders and directors from the rights of minority shareholders. It is a boundary drawn along the elusive and politically charged lines of efficiency on the one hand, and fairness and equity on the other hand. A comparative scrutiny of the American and European attitudes toward freeze-outs allows identifying some of the most meaningful and defining features of different corporate law regimes, such as the kind of property interest that minorities are deemed to have in the corporation, the role of litigation in shaping corporate rules, and the propensity toward monetary damages versus other types of reliefs to protect minorities.

From a more practical perspective, the possibility to go private, its costs and timing affect not only the success and prosperity of single corporations at the micro level, but also, at the macro level, the strength and health of the financial system in which they operate. It may be questioned whether going-private transactions are value-maximizing, and how the possible efficiency gains are split among different stakeholders. The empirical evidence is, as it is often the case, not conclusive. It is, however, unquestionable that, under specific circumstances, powerful financial, strategic, legal and tax considerations suggest buying out minority's equity interests and delisting the corporation. In many instances going private would be in the best interest of all the parties involved: majority and minority shareholders, investors, creditors, employees and other stakeholders.[7]

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www.unctad.org, at 13 ff., showing in particular a peak of the cross-border activity in 2000, when the total value of international deals exceeded 860 billion dollars. In 2003, 2004, and 2005, the total value of cross-border M&As has been on the rise again, going approximately from 141 billion dollars to 200 billion dollars, to 454 billion dollars. Additional data on cross-border mergers and specific examples of important international acquisitions in the last decade are offered by Oliver Budzinski, *Toward an International Governance of Transborder Mergers? Competition Networks and Institutions Between Centralism and Decentralism*, 36 N.Y.U. J. INT'L L. & POL. 1, at 2 (2003).

[6] One obvious reason for the gap is the difficulty implied by such an endeavor, which requires analyzing profoundly different systems and rules. But this complexity is precisely what makes the topic so worthy of study, and the lack of scholarly attention even more puzzling.

[7] Henry DeAngelo, Linda DeAngelo, E. Rice, *Going Private: Minority Freezeouts and Stockholder Wealth*, 27 J. L. & ECON. 367 (1984). Even if this work is quite dated, it still retains its validity in indicating both the theoretical reasons why minority shareholders can appropriate part of the gains connected with a going private transaction, and in offering, with respect to the American market, empirical evidence of this this hypothesis. As a matter of fact, considering that the protections for minority shareholders have been increased by the cases decided since the 1980s that will be discussed in this Article, one might argue that the net gains of public shareholders in a freeze-out context is probably greater today than at the time of the study. More recently, further empirical research has convincingly demonstrated that minority shareholders can obtain a significant increase of wealth in a freeze-out transaction: *see* Thomas W. Bates et al., *Shareholder Wealth Effects and Bid Negotiation in Freeze-Out Deals: Are Minority Shareholders Left Out in the Cold?*, *available* at www.ssrn.com, at 29, observing that "on average, minority claimants in freeze-

Going private can be particularly desirable in times of financial crisis like the one that the world has experienced since 2008. The credit crunch adversely affects the availability of liquidity necessary to finance large leveraged acquisitions. However, buying out minorities when market prices are low, as it is the case following the recent financial turmoil, can be an attractive option for controlling shareholders and other specialized investors, such as private equity firms and hedge funds.[8] If the consideration paid was fair and included a premium over market prices, the transaction may also be welcomed by minorities, who can liquidate their investment at better conditions than the ones offered by the market. Finally, delisting may be desirable in the wake of a financial crisis in the light of increased regulatory burdens introduced by policy makers, or simply *vis-à-vis* uncertainty concerning future regulatory reforms and developments.

More generally, in a developed legal system, going public should not be a one-way street. Provided that adequate protections for minorities are in place, the decision to withdraw from the stock exchange and to liquidate the interests of minority shareholders, a decision that affects the financial structure of the corporation, should not be banned or rendered so difficult that it is not a viable alternative for controlling shareholders and corporate executives. The degree to which different legal systems allow these transactions also reflects on the propensity of closely-held corporations to go public in the first place, and therefore affects the role of stock exchanges as a source of capital.

Here lay the policy implications of the analysis that will follow. Current European regulation is more restrictive of freeze-outs that its U.S. counterpart. This distinction reflects different philosophies concerning shareholders' rights and minority protection. The European model is based on the idea that every shareholder enjoys a substantially untouchable property right in her shares. The American model, on other hand, shows greater flexibility as a consequence of regulatory competition among states and the common law case-based approach, but it lacks certainty and can lead to partially contradictory outcomes. This Article, after a critical discussion of freeze-out rules in the U.S. and in Europe, builds on the comparative analysis to propose some reforms that would increase shareholders' protection in the U.S., and foster more uniform rules in Europe, facilitating, under certain conditions, going private transactions.

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out bids actually receive approximately 11% more than their pro-rata share of deal surplus generated at the bid announcement, an excess distribution of roughly $6.1 million. These results are inconsistent with the notion that controlling shareholders systematically undertake freeze-out transactions at the expense of the minority claimants of the target firm." On the possible effect of freeze-outs on corporate constituencies different from shareholders, *see* Kent Greenfield, *The Impact of "Going Private" on Corporate Stakeoholders*, 3 BROOK. J. CORP. FIN. & COM. L. 75 (2008), noting that "there is little reason to be particularly skeptical of private companies, as compared to public companies, in their treatment of stakeholder interests" and suggesting that going private appear to be at least neutral in terms of effects on corporate stakeholders.

[8] For an interesting analysis of market prices drop in the U.S. during the 2008 crisis, and the possible relationship between the bearish market and corporate governance, *see* R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock market Meltdown? The Case of the S&P 500*, (ECGI Law Working Paper No. 124, 2009), *available* at www.ssrn.com. The author, at page 11, underlines how "At the close of trading on December 31, 2008, the Dow Jones Industrial Average was 8,776, a drop of 33.8% over the year, and the S&P 500 average was 903, representing a 38.5% annual decline. 2008 was the worst year for the S&P 500 since 1937 and the worst for the Dow Jones since 1931."

The Article is organized as follows. Part I briefly discusses the economic reasons for going private. Part II analyzes U.S. rules concerning freeze-outs and going private transactions, focusing in particular on Delaware law. Part III discusses the corresponding European rules. While every single European country has its own rules, freeze-outs enjoy a certain degree of harmonization. Even though the level of harmonization is partial and insufficient, European Union's directives on mergers and on takeovers provide for a general uniform framework. Specific details on a selected number of countries will also be offered, but the goal of this work is more to capture the fundamental traits of the European approach, rather than to dig in the technicalities of single jurisdictions. Part IV sums up the major differences between the two systems and offers an explanatory theory of the different developments of the law in Europe and in the U.S. Finally, Part V is dedicated to the normative implications of the analysis.

II. RATIONALES FOR GOING PRIVATE

Several sound financial, regulatory and organizational reasons can support a going private decision. Needless to say, these reasons are intertwined and mutually interactive so that it would be difficult and probably incorrect to consider them as separate and distinguished factors. Generally speaking and with some degree of simplification, the same cost-benefit analysis that motivates going public might suggest windrowing from public markets when the net effect of being listed or publicly held is perceived to be negative.[9]

The first rationale to go private may be linked to the fact that market prices of publicly traded securities do not fully reflect the real value of the issuer. This underestimation can be due to several causes, either firm-specific (such as lack of analysts coverage, poor communication strategies, and so on), or generally affect the market. In those circumstances, not only the costs of staying public might be inadequately compensated by a reduction of the cost of capital, but buying out minorities might be a desirable option both for controlling shareholders and managers, who are able to unlock the hidden value of the firm, and for minority shareholders, which could liquidate their investment at a price higher than what the market would recognize them. A real or perceived systematic under pricing of the shares of a listed corporation can erode most of the possible advantages of being public, including the possibility to use stock options and other similar forms of compensation to attract and retain top executives.

Another reason to go private is to reduce the cost of compliance with securities laws and regulations. In connection with this, in legal systems that rely heavily on private

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[9] A list of the most important possible reasons to go private can be read in Joshua M. Koening, *A Brief Roadmap to Going Private*, 2004 COLUM. BUS. L. REV. 505, at 509 (2004); *see* also Sreedhar T. Bharath & Amy K. Dittmar, *Why Do Firms Use Private Equity to Opt Out of Public Markets?*, Working Paper (2007), *available* at http://www.ns.umich.edu/htdocs/releases/story.php?id=6018; Sreedhar T. Bharath & Amy K. Dittmar, *To Be or not to Be (Public)*, *available* at www.ssrn.com. According to Hamid Mehran & Stavros Peristiani, *Financial Visibility and the Decision to Go Private*, *available* at www.ssrn.com, one of the major drivers of the going private decision between 1990 and 2007 was the failure to attract sufficient investors' interest.

litigation as a policing tool, going private curbs the risk of disruptive legal disputes, even if, as will be discussed further on, the decision to go private itself can prompt shareholders' suits.[10] The time that managers devote to regulatory issues and litigation-related concerns, rather than business issues, might be substantial and become a driver behind a going-private decision. A recent example of how increased regulatory burdens might affect the propensity of firms to go private can be found in the enactment of the Sarbanes-Oxley Act of 2002, which according to several scholars induced smaller issuers to exit the market.[11]

From an organizational and financial point of view, the reduced separation between ownership and control that characterizes a closely-held versus a publicly-held corporation may diminish agency costs[12] and, under specific circumstances, improve the debt to equity ratio of the firm, with possible beneficial fiscal effects.[13] Because most going private transactions imply a substitution of equity with debt, and interest payments are deductible while dividends are not, tax considerations might also drive the decision to go private, especially when a high leverage is used.[14] As recently pointed out, "Private-equity investors can increase firm value (by reducing taxes) solely by using the firm's assets as collateral to borrow money to buy out existing shareholders and to replace their

[10] The role of potential litigation associated with publicly-held status in going private transaction as a motivation for going private has been recently investigated by Eric L. Talley, *Public Ownership, Firm Governance, and Litigation Risk*, 76 U. CHI. L. REV. 335 (2009) observing that the effect of governance changes aimed at reducing the risk of lawsuits in a public corporation seem to be negligible.

[11] Ehud Kamar at al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, 25 J. L. ECON. & ORG. 107 (2009). Consistently with the hypothesis that the enactment of the Sarbanes-Oxley Act, increasing the costs and risks of being public, positively affected going private decisions, especially for smaller issuers, *see* Robert P. Bartlett III, *Going Private But Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going-Private Decisions*, 76 U. CHI. L. REV. 7 (2009) (starting from the observation that going private transactions might require issuing of high-yield debt instruments, with the consequence of maintaining the corporation subject to some provisions of the Sarbanes-Oxley Act also after it becomes private, the author questions the effect of SOX in increasing going private transactions. More specifically, he tests whether going private transactions after 2002 were structured without issuing of high-yield securities and therefore avoiding further application of SOX, finding a diminishing number of similar deals in the case of smaller issuers, consistently with the hypothesis that SOX affected going private decisions for smaller, rather than larger, issuers); Carl R. Chen, Nancy Mohan, *The Impact of the Sarbanes-Oxley Act on Firms Going Private*, 19 RESEARCH IN ACCOUNTING REGULATION ____ (2006) (confirming the impact of SOX on going private decisions of smaller issuers); Ellen Engel , Rachel M. Hayes, Xue Wang, *The Sarbanes-Oxley Act and Firms' Going-Private Decisions*, ____ J. ACCOUNTING & ECONOMICS (JAE) ___ (finding that SOX affected going private decisions); but *see* Christian Leuz, *Was the Sarbanes-Oxley Act of 2002 Really this Costly? A Discussion of Evidence from Event Returns and Going-Private Decisions*, 44 J. ACCOUNTING & ECONOMICS (JAE) ____ (2007) (doubting the positive correlation between enactment of SOX and increase in going private transactions).

[12] *See* James Spindler, *How Private is Private Equity, and at What Cost?*, 76 U. CHI. L. REV. 311 (2009).

[13] K. Lehn, A. Poulsen, *Free Cash Flow and Stockholder Gains in Going Private Transactions*, 44 J. FINANCE 771 (1989).

[14] S. N. Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217 (1989); S. N. Kaplan, *Management Buyouts: Evidence on Taxes as a Source of Value*, 44 J. FIN. 611 (1989); S. N. Kaplan, *The Staying Power of Leveraged Buyouts*, 29 J. FIN. 287 (1991).

equity interest with debt."[15] Clearly, the increased leverage resulting from these transactions exposes the corporation to a higher risk of insolvency, and the decision to withdraw from public markets must take into account the pros and cons of a similar change in the financial structure of the firm.[16]

In addition to the above mentioned "classical" rationales for going private, a new and insightful explanation focusing on risk monitoring and the use of derivative instruments has been offered recently by Professors Masulis and Thomas for the wave of leverage-buy outs (LBOs) in the 2003-2007 period.[17] According to these authors, boards of publicly-held firms with widespread ownership and low management shareholdings are ill equipped to control complex trading in derivative instruments. Private-equity might represent a specific response to this particular type of agency problem because financially sophisticated controlling shareholders can exercise better monitoring on management derivatives trading in a closely-held corporation.[18] This can be considered a particular case of agency-costs-reduction rationale, but it seems particularly relevant in the current economic scenario *vis-à-vis* the exponential increase in the use of financial derivatives.

Even this short list of reasons for going private suggests how, under certain circumstances, opting out of public markets can be a value-maximizing transaction. Controlling shareholders and managers are usually in the best position to evaluate when these conditions occur. Therefore the information asymmetries and collective action problems affecting the behavior of minority shareholders support the idea that the legislature should grant and regulate the right of the former to freeze-out the latter.

In regulating this issue, the most delicate problem is how the potential benefits of going private are split between controlling shareholders, managers and acquiring subjects on the one hand, and minority shareholders and investors on the other. The regulation of freeze-outs can largely be seen as the way in which policy makers address these efficiency and distributive justice conundrums.

From the point of view of minority shareholders, going private can turn their investment into a "lemon".[19] As the old saying goes, "If life gives you lemons, make lemonade". But in the context of corporate transactions, turning something sour into something sweet might not be as easy as squeezing citruses. When minority shareholders are squeezed-out, the controlling shareholder is largely in control of the amount of sugar that the investors receive. The remaining of this article addresses how different legal rules affect the sugar-to-lemon ratio in a freeze-out.

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[15] M. Todd Henderson & Richard A. Epstein, *The Going-Private Phenomenon: Causes and Implications*, 76 U. CHI. L. REV. 1, 3 (2009).

[16] Henderson & Epstein, *supra* note 15, at 2 f.

[17] Ronald W. Masulis & Randall S. Thomas, *Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives in Corporate Governance*, 76 U. CHI. L. REV. 219 (2009).

[18] Masulis & Thomas, *supra* note 17, at 258 f.

[19] Reference to a possible "lemon effect" in going private transactions has been made by Lucian Arye Bebchuk & Marcel Kahan, *The "Lemons Effect" in Corporate Freeze-outs*, NBER Working Paper 6938, 1999, *available* at www.ssrn.com.

III. FREEZE-OUT TRANSACTIONS IN THE UNITED STATES

1. A Roadmap

In theory there are numerous combinations of transactions that can lead controlling shareholders to appropriate the equity interests of minority shareholders. In the United States, the different techniques can be traced to four major families: assets sales, reverse stock splits, (cash-out) mergers, and tender offers.

In an asset sale, all or substantially all the assets of the corporation are sold to another corporation owned or controlled by the same subject that controls the selling corporation, for a consideration either in cash or securities. Consequently, the selling corporation is either liquidated or remains in existence but without control of its former assets. Sales of all or substantially all the assets require shareholders' consent, but a controlling shareholder can have sufficient votes to unilaterally decide the transaction, leaving minorities only with the choice of challenging the deal or exercising their dissenters' rights when available.[20]

As the name suggests, a reverse stock split is the converse of a stock split. The corporation adopts a resolution according to which a certain number of outstanding shares is exchanged for one share of greater value: for example, for every 100 shares of $2 of par value each, one single share of $200 par value is issued. If the exchange ratio is high enough, only the largest shareholders are entitled to obtain at least one share, and therefore maintain their participation in the company, while minority shareholders would receive a cash equivalent to the value of the fraction of a share that they would be theoretically be entitled to. Especially in a listed corporation with a widespread ownership structure a reverse stock split is difficult to realize and might raise several grounds for litigation.[21]

In the U.S., assets sales and reverse stock splits are not widely used to cash out minorities. The two most common techniques are mergers and tender offers.[22] More specifically, under Delaware law, two approaches developed in the last few years: the long-form, cash-out merger, and the tender-offer followed by a short-form merger.[23] In the first case, controlling shareholders simply approve a merger in which the consideration offered to minority shareholders is not represented by shares of the surviving entity, but rather cash or other non-equity securities. The second road to buy out minorities, which emerged more recently, encompasses two steps: a voluntary tender offer on all the outstanding shares launched by the parent corporation, generally aimed at

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[20] On sale of assets *see*, generally, JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS (Aspen, 2003), at 594 ff.; FRANKLIN A. GEVURTZ, CORPORATION LAW 661 West (2000); more recent developments in Delaware case law are discussed by ROD J. Howard, *Recent Case Law Developments Addressing Sales of 'All or Substantially All' the Assets*, 1459 PLI/Corp 243 (2005).

[21] For a general discussion of reverse stock splits *see* Elliot M. Kaplan & David B. Young, *Corporate 'Eminent Domain': Stock Redemptions and Reverse Stock Splits*, 57 UMKC L. Rev. 67 (1988).

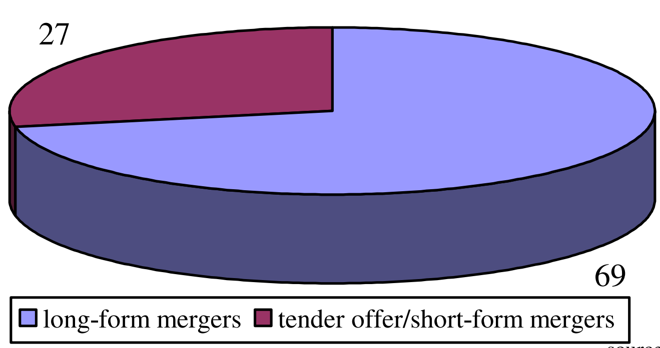
[22] *See* Stevelman, *supra* note 3, at 779; Furlow, *supra* note 3, at 85; McGuinnes & Rehbock, *supra* note 3, at 437 f.

[23] McGuinness & Rehbock, *supra* note 3, at 437; Furlow, *supra* note 3, at 85.

acquiring at least 90% of the outstanding shares, followed by a short-form, cash-out merger. In the second step, under Delaware law as well as in most other jurisdictions, because the controlling parent into which the subsidiary will be merged holds more than 90% of the shares, different from a long-form merger, the decision simply requires the approval of the board of directors of the controlling corporation, with no need for a vote of the shareholders of either corporation or of the directors of the subsidiary. The first type of freeze-out can be defined "long-form merger" or "one-step freeze-out", and the second type "tender offer/short-form merger" or "two-step freeze-out".

In the following pages, these two forms of freeze-outs will be analytically examined. The number of transactions in which they are used is substantial. According to a recent statistical analysis, in the period between June 19, 2001 (the announcement of *Siliconix*, an important Delaware decision that facilitated two-step freeze-out[24]) and December 31, 2003, 96 freeze-outs of minority shareholders of listed Delaware corporations were announced in which the controlling shareholder held, before the acquisition, between 35% and 90% of the voting shares. This means an average of over 38 transactions a year.[25] As the following Figure 1 illustrates, of this sample, 27 deals involved a two-step freeze-out, and 69 a one-step freeze-out (in two of these 69 cases, however, minorities were forced out through a reverse stock split rather than through a cash-out merger).

Figure 1 - Squeeze-out Transactions in Delaware
(June 2001 - December 2003)



Even if in the aftermath of *Siliconix* two-steps freeze-outs seemed more convenient from the point of view of the controlling shareholder, leading on average to lower payments to minorities, the more traditional and better tested long-form merger remained the most commonly used going private technique. This might partially be explained by path dependency and lesser experience of legal consultants in the new road opened by *Siliconix*.[26]

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[24] In re Siliconix Inc. Shareholders Litigation, 2001 WL 716787 (Del. Ch. 2001).

[25] Guhan Subramanian, *Post-Siliconix Freeze-Outs: Theory and Evidence*, 36 J. LEGAL STUD. 1, 8 (2007).

[26] *See* Subramanian, *supra* note 25, at 10.

2. Shareholders' Remedies vis-à-vis Cash-out Mergers

As it is often the case in a legal system like the U.S., in which the complex interaction between statutory and case law is amplified by the federal structure, the development of the rules governing going-private transactions followed paths that can better be understood, retrospectively, when put in their historical perspective. This task can, however, be significantly simplified by concentrating on Delaware, by far the most important jurisdiction for the regulation of freeze-out transactions both quantitatively and qualitatively.[27]

Traditionally, in the U.S. as in most jurisdictions, minority shareholders could not be forcefully cashed out. This common law approach, rooted in the contractual nature of the corporate charter, erected several walls to protect the property interests of minority equity investors from the will of the directors or the majority stockholders. First of all, unanimity was required to approve any major amendment to the corporate contract, including mergers and other business combinations, therefore granting each single shareholder a veritable veto power.[28] Legislatures and courts soon realized that, in the modern business environment, the costs and dangers of minority's dictatorship could outweigh the risk of abuse of the majority, and started permitting amendments to the economic and legal structure of the corporation approved by a (sometimes qualified) majority of the outstanding shares.[29] Dissenting minority shareholders could be more efficiently protected through appraisal rights, which would allow them to have their shares liquidated at a court-determined fair price. Statutory appraisal rights were introduced in due course.[30] This evolution was the first step toward an entirely new vision of corporate law, in which emphasis is put on the financial nature of the minority investors' equity interests.

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[27] Not only, as it is well-known, Delaware is the dominant state of incorporation for listed corporations (for a recent study *see* Robert Daines, *The Incorporation Choices of IPO Firms*, in 77 N.Y.U. L. REV. 1559, according to which 77% of companies engaged in an IPO are incorporated in the state), but also the vast majority of merger agreements choice-of-law and forum clauses opt for Delaware: Cain and Davidoff found that, in a sample of over one thousand merger agreements announced between 2004 and 2008, in roughly two thirds of the contracts the parties chose Delaware law, and in 60% of the cases opted for Delaware as forum, even in situations where either the buyer or the target were not incorporated in Delaware (Mattew Cain & Steven M. Davidoff, *Delaware Competitive Reach: An Empirical Analysis of Public Company Merger Agreements*, 2009, available on *www.ssrn.com*). According to the same study, Delaware faces some competition from New York, but it is not substantial (just 13% of the contracts opted for New York law to apply, and 10.8% for New York as a forum).

[28] For a comprehensive overview of the development of cash-out statutes in the U.S. *see* Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981), at 632 ff. An account of the distinct but related issue of the earlier rules concerning shareholders' voting rights, and in particular the evolution from a one-vote-per-shareholder to a one-share, one-vote system, is offered Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347 (2006).

[29] Weiss, *supra* note 28, at 626.

[30] Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1 (1995-1996), at 15 (showing how in most states appraisal statutes followed with some delay the introduction of statutory rules authorizing mergers approved by less than a unanimous vote).

The majority rule did not automatically imply that minority shareholders could be cashed out rather than be given shares of the surviving entity. This was only made possible through a second legislative step that allowed mergers in which the consideration offered to minority shareholders was not stock of the incorporating company, but cash. The first state to allow cash-out mergers was Florida in 1925, soon to be followed by a growing number of jurisdictions.[31]

Minority shareholders dissenting from a cash-out merger, as in other business combination situations, can chose among an array of judicial remedies, appraisal rights being only one of them. In brief, on the one hand there are remedies based on allegation of some form of illegality: lack of authority or abuse of power, self-dealing, failure to comply with state or federal statutory requirements, and so on. These violations can sustain actions at law or suits in equity, and can also lead to remedies as diverse as injunctions, rescission, damages based on wrongdoing of the controlling shareholder or the directors, claims under the securities laws for disclosure violations under SEC Rule 10b-5 or Rule 14a-9 of the Exchange Act.[32] On the other hand, another type of remedy is the previously mentioned right of appraisal based on corporate statutes, which allows dissenting shareholders to seek the payment of the fair value of their shares through a judicial procedure regulated by the legislature, without need to prove any specific violation of the law.

It should be noted that some of the most relevant judge-made rules shaping going private transactions in the U.S. were established in cases based on the first type of remedies, and that appraisal rights are less often litigated in the context of cash-out mergers. Before proceeding further, it is necessary to understand why this is the case, briefly considering the inadequacy, from the standpoint of minority shareholders, of the appraisal rights in a cash-out merger context.

3. Appraisal Rights and Their Limits

As pointed out by Robert Thompson in his seminal contribution on the subject, the use of appraisal rights as a check against conflicted transactions such as freeze-outs is a relatively recent development that departs from the historical function of this institute.[33] Appraisal rights were introduced by the legislatures, between the end of the Nineteenth century and the 1950s to balance the shift from shareholders' unanimous consent to simple or qualified majority as a condition to approve fundamental corporate changes.[34] At the dawn of their appearance on the corporate stage, appraisal rights were usually triggered by mergers between independent firms, often in the absence of an active market

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[31] Weiss, *supra* note 3, at 7; Alexander Khutorsky, Note, *Coming in From the Cold: Reforming Shareholders' Appraisal Rights in Freeze-Out Transactions*, 1997 COLUMBIA BUS. L. REV. 133, 139 (1997); *see also*, generally, Weiss, *supra* note 28.

[32] For a synthetic but complete discussion of the major remedies available to minority shareholders dissenting from a merger or other business combinations, besides the appraisal right, *see* COX & HAZEN, *supra* note 20 at 617.

[33] Thompson, *supra* note 30.

[34] *Id.*, at 15.

for the shares, and invoked by shareholders that substantively dissented from the economic desirability of the business combination pursued by the majority. Coherently with this specific goal, legislatures drafted appraisal statutes that served primarily what Professor Thompson describes as a "liquidity purpose": to ensure that minority shareholder would not be imprisoned in the corporation resulting from the transaction. With this specific goal in mind, legislatures balanced minority's protection with efficiency consideration, trying to prevent a disgruntled small investor to veto the consummation of a value-maximizing deal. In light of this historical origin, dissenters' rights were and still are ill-suited to protect unaffiliated shareholders from a conflicted transaction imposed on the minority, such as a cash-out merger decided by the controlling shareholder.[35]

More specifically, from the point of view of the cashed-out shareholder, the unattractiveness of appraisal rights can be attributed to four reasons: (a) scope of application of the statutory relief, (b) procedural requirements, (c) accepted valuation techniques of the dissenters' shares, and (d) other litigation-related problems.[36]

Limiting the discussion to the most relevant aspects for analyzing freeze-outs, in terms of scope of application states following the Model Business Corporation Act (MBCA) and Delaware provide for a "market exemption" to appraisal rights when the shares of the corporation are either listed or widely held.[37] The rational for the exception is that shareholders that can easily sell the share on the market at a presumably fair price assuming efficient markets[38], and therefore are not entitled to initiate a lengthy and

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[35] More generally, appraisal rights did not always achieved the goal of adequately protecting dissenting minorities also in the light of their scope of application. Similar business combinations can often be achieved trough different procedure, mergers being only one of them. For example, corporation A might purchase all the assets of corporation B paying them with shares of A. Subsequently, B can dissolve and liquidate the stocks of its shareholders distributing the shares of A received as consideration for the sale. The substantive result is the same as a merger of B with and into A, but the formal procedure is not a merger. In jurisdictions, like Delaware, where no statutory dissenters' rights are triggered by the sale of assets, minority shareholders can not invoke this particular remedy. In this situation, under Delaware case law, appraisal rights can not even be applied arguing that the sale of assets is a *de facto merger*, because Delaware's jurisprudence follows the "independent statutory significance" doctrine, according to which appraisal is not available when the statutory regulation of the particular transaction at hand does not explicitly provides them (the leading Delaware case adopting this view, and ruling that appraisal rights are not available in a sale of asset is Hariton v. Arco Electronics, Inc., 40 Del. Ch. 326 (1962); a famous earlier example of a jurisdiction embracing the de facto merger doctrine is the Pennsylvania case Farris v. Glen Alden Corp., 143 A.2d 25 (Pa. 1958). In reaction to this decision, however, the Pennsylvania legislature explicitly revoked the doctrine thus making appraisal rights unavailable in a sale of assets, even if the effect of the transaction is substantially equivalent to a cash-out merger: 15 PA. CONS. STAT. §§ 1105, 1904).

[36] On the problems of the appraisal remedy, in addition to the previously cited work by Thompson, *supra* at note 33, *see* Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613 (1998); Joel Seligman, *Reapprising the Apprisal Remedy*, 52 GEO. WASH. L. REV. 829 (1984)

[37] *See*, for example, MODEL BUS. CORP. ACT §13.02(b)(1) (2002).

[38] According to the Efficient Capital Market Hypothesis, and for its legal relevance *see* Basic v. Levinson, 485 U.S. 224 (1988); for a description of the concept of efficient markets and its regulatory implications *see* Christopher Paul Saari, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 STAN. L. REV. 1031 (1977); more recently *see* William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551 (2003).

expensive procedure to assess in court a value that can be readily monetized on the market. This exception clearly reflects the liquidity purpose of early appraisal statutes, but is not apt to cope with conflicted transactions where minority shareholders are cashed out against their will. In this context, not only the fair value of the shares can be significantly higher than the cash consideration offered, but also the market price might not reflect the fair value because it discounts the possibility of the majority to freeze out minority shareholders. For this reason, even if Delaware adopts the market exemption, cash-out mergers and mergers where minorities receive illiquid shares are carved out, and shareholders can still have their appraisal day in court. Many other states, however, do not provide for such an "exception to the exception", thus ruling out altogether the possibility to invoke dissenters' rights when a listed corporation is brought private.[39]

A second and straightforward reason why appraisal remedies are not often used by minority shareholders is procedural. Most appraisal rights statutes, including Delaware's, provide for a rather complicated procedure that dissenting shareholders must follow in order to access the remedy. Shareholders seeking appraisal must, among other things, notify the corporation of their intention to dissent *before* the shareholders' meeting that triggers the right. In addition, they must explicitly dissent (or at least abstain) at the meeting, and comply with further notification requirements following the meeting. These steps impose meaningful burdens on the minority. It is often difficult for investors to "anticipate" their dissent before the meeting, and compliance with the procedure raises transaction costs for good-faith minority shareholders who are being unfairly cashed-out.

Additionally, the valuation of dissenters' shares can be unattractive especially in the context of a self-dealing cash-out merger. Traditional appraisal statutes provided that dissenting shareholders could obtain the fair value of their shares *without* considering the potential positive effects of the merger, the so-called "post-acquisition gains".[40] Once again, this approach makes perfect sense when a fully informed minority, having the option to obtain shares of the surviving corporation, freely decides to have its investment liquidated through the appraisal remedy. When minority shareholders are not given this option, and are forced out at a price unilaterally determined by the controlling shareholder or directors, to ignore post-acquisition gains seems unfair. In fact, several states have abandoned rigid valuation formulas and allow for these elements to be considered in a take out merger. The Delaware Supreme Court followed this course of action in 1983 in *Weinberger v. UOP*,[41] and in the early 1980s, New York amended its statute to permit considering post-acquisition gains in a merger context.[42] The 1984 version of the MBCA provided that post-acquisition gains should be excluded except when it would be inequitable, but the current version of the Act simply states that for appraisal purposes "fair value" should be determined "immediately before the effectuation of the corporation action to which shareholders object".[43] Notwithstanding

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[39] Thompson, *supra* note 30, at 10 and 29, indicates that about half of the states do not grant appraisal rights when a market for the corporation's shares exist.

[40] *Id.*, at 35.

[41] Weinbergerer v. UOP, INC., 457 A.2d 701 (Del. Supr. 1983), at 713.

[42] Thompson, *supra* note 30, at 36

[43] *See* MODEL BUS. CORP. ACT §13.01(4)(i) (2002).

these qualifications, it is clear that the minority faces at least the possibility that, in an appraisal procedure, the benefits of the very transaction from which they have been kept out, would not be fully taken into account in evaluating their shares. A second drawback in terms of valuation, that might discourage the use of the appraisal remedy in the context of conflicted transaction, is that it is doubtful, not to say unlikely, whether appraisal valuations might include recovery for damages caused by abuse of power or breach of fiduciary duties.[44]

The inadequacy of the appraisal remedy in terms of value of the shares is even more striking when compared with the possible outcome of a challenge to the cash-out merger based on breach of fiduciary duties or other illegalities – an alternative remedy available to minority shareholders. As a leading hornbook puts it:

> "[f]or breach of fiduciary duties, the Chancery Court might order a "rescissory" measure of damages – in other words, instead of measuring damages based upon the difference between what the minority shareholders received in the merger, and the value of the minority's stock at the time of the merger, the court might award damages based upon the difference between what the minority shareholders received, and the value of the stock at the time of the damage award. If the provable value of the minority's interest increases after the majority forces out the minority, this rescissory measure gives a larger award than would an appraisal."[45]

Finally, appraisal procedures can be lengthy and expensive, with most of the costs of the procedure, including attorneys' and expert fees, can fall on the individual defendant.[46] In this regard, it should also be noted that, differently from an appraisal procedure, a suit for breach of fiduciary duty can be brought as a class action, both because the potential measure of damages is often larger than the appraisal value (and therefore it is appealing to lawyers operating on a contingency fee basis), and because in the former procedure only dissenting shareholders who formally exercise their appraisal rights are entitled to the relief.[47]

4. Challenging Cash-out Mergers: How Litigation Shaped Freeze-out Techniques

The Delphic ambiguity[48] surrounding the potential outcome of an appraisal procedure, coupled with rules not tailored to the specific features of self-dealing transactions, render appraisal rights a not very effective protection for cashed-out minority shareholders. Therefore minority shareholders often challenge the merger on

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[44] Rapid-American Corp. v. Harris, 603 A.2d 796 (Del. 1992); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137 (Del. 1989).

[45] *See supra* GEVURTZ, note 20, at 737 (West 2000).

[46] MODEL BUS. CORP. ACT §13.31.

[47] In Delaware, class appraisal procedures are not authorized by the statute: *see* DEL. GEN. CORP. LAW § 262(a); *see* also Gilson & Gordon, *supra* note 3, at 799.

[48] The expression is borrowed from Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79 (1995), at 93.

the basis of some form of illegality, and in particular for breach of directors' fiduciary duties or disclosure violations of the Federal securities laws.[49] The bulk of cases that contributed to shape the law applicable to going-private transactions in the United States dealt, in fact, with this type of allegations.

Before discussing the most recent Delaware case law, one should observe that, in some jurisdictions, the preliminary bastion to protect minority shareholders from being unfairly cashed out is the so-called "business purpose requirement." Under this standard, a cash-out merger is permissible only when the combination presents a valuable economic purpose besides getting rid of minority equity investors. Several states still retain this rule, including important corporate jurisdictions such as New York,[50] but in Delaware, it has been abandoned since *Weinberger*. [51]

In cash-out cases, Delaware courts are therefore usually confronted with minority shareholders' claims of breach of fiduciary duties, or other illegalities, in connection with the transaction. In deciding these disputes, courts have attempted to draw a fine and winding line between the power of the directors and the majority on the one hand, and the protection of the minorities on the other hand. Too much of the latter, then efficient, value-maximizing transactions would be prevented; too much of the former, then justice would not be served. The balance was found in procedural protections, as it is often the case in corporate law, given the reluctance of courts to interfere with business decisions, and their hesitation to grapple with elusive substantive fairness standards.

Notwithstanding its complexity, the resulting legal framework can be illustrated through just seven leading cases, each of which added a piece to the mosaic of the regulation of going-private transactions. These cases are: *Weinberger v. UOP*,[52] *Rosenblatt v. Getty Oil*,[53] *Kahn v. Lynch*,[54] *Solomon v. Pathe*,[55] *In re Siliconix*,[56] *Glassman v. Unocal*,[57] and finally *In re Pure Resources*.[58] The first three cases dealt with long-form mergers, the last four with short-form mergers.

5. *Delaware Case Law on Challenges to Long-form Cash-out Mergers: from* Weinberger *to* Getty Oil

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[49] For a brief description of Rule 13e-3, promulgated by the Stock Exchange Commission in 1979 to impose specific disclosure obligations in a going-private transaction *see* Koening, *supra* note 9, at 524.

[50] Alpert v. 28 Williams St. Corp., 473 N.E.2d 19 (1984); for the relevance of New York in terms of choice-of-law and forum clauses in merger agreements, *see supra* note 27.

[51] Weinberger v. UOP, INC., 457 A.2d 701 (Del. Supr. 1983).

[52] *Id.*

[53] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. Supr. 1985).

[54] Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994).

[55] Solomon v. Pathe Communications Corp., 672 A.2d 35 (Del. 1996).

[56] In re Siliconix Inc. Shareholders Litigation, 2001 WL 716787 (Del. Ch. 2001).

[57] Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2007).

[58] In re Pure Resources, Inc., Shareholders Litigation, 808 A.2d 421 (Del. Ch. 2002).

In *Weinberger*, decided by the Delaware Supreme Court in 1983, UOP, a subsidiary of Signal Companies ("Signal", holding 50.5% of the outstanding voting shares), was merged into the parent corporation through a long-form, cash-out merger. Minority shareholders who did not exchange their shares for the cash offered brought a class action against both the subsidiary and the parent, some of the directors of the two companies and the investment bank Lehman Brothers, challenging the fairness of the transaction and seeking to set the merger aside or, alternatively, monetary damages.

Some of the key factual issues leading to obtain the approval of the merger should be briefly recounted. At the beginning of the '80s, Signal was looking for investment opportunities. After considering different alternatives, the company's board of directors came to the conclusion that the best option was to acquire the totality of the shares of its subsidiary, UOP, through a cash-out merger. The executive committee of Signal informed the president and CEO of UOP, James V. Crawford, a long-time employee and executive of the Signal group, of this intention and mentioned a price per share between $20 and $21. At trial the evidence showed that, during the discussion, Crawford stated that the price was fair, but preferred to concentrate on the consequences of the acquisition on the personnel. In due course, Signal's board of directors approved a merger proposal offering $21 per share to minority shareholders. This figure was significantly above market prices that fluctuated around $15. The proposal provided that the merger would have been completed only if it satisfied a double condition: the totality of the votes casted in favor of the merger would not be lower than two-thirds of the entire voting capital, and a majority of the 49.5% minority must vote in favor.

The UOP board approved these terms and recommended the merger. In making this decision, the board relied, among other things, on a fairness opinion issued by Lehman Brothers, which the court however considered hastily prepared. The trial revealed, in addition, that two directors of UOP, which were also employees of the acquiring corporation Signal, had prepared a report, according to which a price up to $24 would have been a "good investment" for Signal. The court observed that this higher price would have had minor consequences on the financial structure of the deal for Signal, but would have represented a substantial additional benefit for UOP's shareholders. The report was never disclosed to outside directors of UOP, and was only shared with Signal's board.

The Chancery Court found for the defendants and considered the merger fair. On appeal, the Supreme Court of Delaware reversed the lower court's ruling and took the occasion to discuss, and partially resolve, several different issues, including shares evaluation techniques.[59]

[59] On the different important contributions of this decision, among the first comments, *see* Weiss, *supra* note 3; William Prickett & Michael Hanrahan, *Weinberger v. UOP, Inc.: Delaware's Effort to Preserve a Level Playing Field for Cash-Out Mergers*, 8 DEL. J. CORP. L. 59 (1983); Robert K. Payson & Michael A. Inskip, *Weinberger v. UOP, Inc.: Its Practical Significance in the Planning and Defense of Cash-Out Mergers*, 8 DEL. J. CORP. L. 83 (1983); Carol B. Haigt, Note, *The Standard Care Requirement of an Investment Banker to Minority Shareholders in a Cash-Out Merger: Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 98 (1983).

For the purposes of this work, the starting point is that under Delaware law, as in other U.S. jurisdictions, freeze-out transactions conducted by a controlling shareholder amount to self-dealing. Not being negotiated at arm's length, these transactions are subject to the entire fairness standard of judicial review. The decision explored the concept of entire fairness in the merger context, arguing that it encompasses both "fair dealing" and "fair price". The former is a procedural element, concerning the way in which the acquisition is negotiated; the latter is a substantive element, consisting in the intrinsic economic rationale of the deal.[60]

The most relevant part of the decision for the current analysis, however, was a dicta somehow buried in a footnote, where the Delaware Supreme Court suggested the way in which the entire fairness requirement could have been met: The corporation should have appointed a special committee of independent directors, entrusted with the task of negotiating the merger at arm's length.

The laconic and almost casual observation of the court stirred a theoretical debate among supporters of the ability of outside directors to ensure a truly independent decision in the best interest of all the shareholders, and critics that doubt the efficacy of a special committee with veto powers.[61] At a more practical level, however, the path pointed out by *Weinberger* was soon followed by many corporations and litigation erupted on the precise consequences of the committee's approval.

Two answers were possible, and the judges of the Delaware Chancery Court split. According to one approach, the decision of the committee would be entitled to the protection offered by the business judgment rule, and the deal would not be subject to entire fairness review. The resolution of the independent directors would, in other words, be presumed to be taken on an informed basis, in good faith, and in the honest belief that the action was in the best interest of the corporation.[62] According to the second approach, approval by the special committee would simply shift the burden to prove the absence of entire fairness to the plaintiff.[63] The second school of thought would be more favorable to plaintiffs challenging the transaction. To allege that a transaction is not entirely fair, either for lack of fair dealing or of fair price, is clearly less cumbersome than overcoming the highly deferential business judgment standard.

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[60] Weinberger v. UOP, INC., 457 A.2d 701 (Del. Supr. 1983), at 711: "The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."

[61] Among the authors arguing that the members of the special committee entrusted with the task of negotiating the merger can hardly be independent from the controlling shareholder, *see* William T. Allen et al., *Functio over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001), at 1308.

[62] Trans World Airlines, Inc. Shareholders Litigation, 1988 WL 111271 (Del. Ch. 1988); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. 1995);

[63] Citron v. E. I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990); Rabkin v. Olin Corp., 1990 WL 47648 (Del. Ch. 1990).

The Delaware Supreme Court addressed the issue left open in *Weinberger* in two following pivotal cases: *Rosenblatt v. Getty Oil*[64] and *Kahn v. Lynch*.[65] In both decisions, even if under different circumstances, the court embraced the view that compliance with two specific procedural protections for minorities, approval by a majority of minority shareholders or by independent directors, would not dispense with the entire fairness test but rather transfer the burden of proving it from the defendant to the plaintiff.

The first case decided settled the question concerning the effects of a majority of the minority's shareholders' approval of a merger. In the 1960s, Getty Oil, the oil behemoth created by Jean Paul Getty, became a majority stockholder of Skelly, another big player in the industry, owning directly 7.42% of the outstanding voting shares, and indirectly, through its controlled subsidiary Mission, an additional 72.6%. Jean Paul Getty did not favor any further integration between the two related companies, believing that a certain degree of competition between them was beneficial to their own strength and profitable for the shareholders.[66] Soon after the passing away of the strong-willed founder – actually, just six days after his death in June 1976 – Getty Oil's executive vice-president, Harold E. Berg, called James H. Hara, president of Skelly, to discuss a combination of Getty Oil, Skelly and Mission.

The directors of Skelly and Getty Oil engaged in an extensive and at traits very tough bargaining process to determine the proper exchange ratio. From the discussion of the factual issues in the case, it appears that Skelly's representatives were very determined to obtain the best possible conditions for their shareholders, focusing extensively on the application of the Delaware Block Method.[67] Eventually the boards agreed on an exchange ratio of 0.5875 Getty Oil's shares for every Skelly share. With the unanimous approval of the boards, the deal was submitted to the shareholders of the corporations involved, and conditioned to the approval of the majority of the minority of the stockholders. Almost 90% of the minority shares present at the meeting, representing 58% of all the outstanding minority shares, voted in favor of the integration, which was completed on January 1977. The merger was however challenged by some of Skelly's shareholders who brought a class action based on the unfairness of the exchange ratio. After a lengthy and complicated trial, the Chancery Court found the deal entirely fair and entered judgment for the defendants. On appeal, the Supreme Court affirmed the decision of the lower court.

The opinion, applying *Weinberger*, evaluates the issues of both fair dealing and fair price. The decision offers an insightful discussion of the Delaware Block Method and proper disclosure of all material facts in a proxy statement. For current purposes, the crucial issue was however simply stated and resolved by Justice Moore:

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[64] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. Supr. 1985).

[65] Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994).

[66] Quite in line with the Darwinian view embedded in one of his oft-quoted lines: "The meek shall inherit the earth, but not the mineral rights" (Euan Ferguson, *Big Money Given With Good Grace*, SCOTLAND ON SUNDAY, Aug. 14, 1994).

[67] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. Supr. 1985), at 936.

> "Clearly, Getty, as a majority shareholder of Skelly, stood on both sides of this transaction and bore the initial burden of establishing its entire fairness. […] However, approval of a merger, as here, by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs".[68]

To follow this procedural protection simply shifted the burden of proving the fairness of the transaction. It did not alter the standard of review to the business judgment rule, which is more deferential to managers and is less favorable to minority shareholders.

Nine years later, in 1993, *Kahn v. Lynch Communication System* reached a consistent conclusion in a situation where the procedural protection adopted and invoked by the defendants was the approval of the merger by a committee of independent directors.

In this case, Alcatel, holding almost 44% of Lynch, pursued a freeze-out merger with the latter. The board of directors of Lynch instituted a special committee to negotiate the terms of the acquisition. To make a long story short, Alcatel proposed a cash price for minorities of $14 per share, Lynch representatives requested $17. Finally the board endorsed a price of $15.5 per share. This price was accepted after the directors were informed that Alcatel was considering reaching out directly to minority shareholders through a hostile tender offer for a lower price.

The Chancery Court held that the negotiation between the acquiring corporation and the special committee was, in fact, conducted at arm's length, and consequently that the burden of proving unfairness of the $15.5 price was on the plaintiffs. The Court concluded, however, that this burden had not been met. On appeal, the Supreme Court reversed but, in doing so, endorsed the doctrine that approval by an independent committee would only shift the onus of proving unfairness to the plaintiff. But, having subscribed to this view, the Court also considered that the threat of a hostile acquisition affects the ability of the directors' to negotiate independently. In other words, the very capitulation of the directors when confronted with a possible tender offer demonstrated, according to the *Lynch* decision, their inability to be truly independent and to adequately protect the interests of minority shareholders. The case was therefore remanded to the lower court with the burden of proving entire fairness shouldered back to the defendant.[69]

In the Mid-Nineties, after *Lynch*, Delaware case law on long-form, freeze-out mergers was relatively well settled. As in any arm's length transaction, in a merger conducted by a controlling shareholder courts would review the transaction against the strict entire fairness test, articulated in two prongs: fair dealing and fair price (*Weinberger*). Normally, the defendants shouldered the burden of proving fairness. However, if certain procedural protection for minorities were followed, such as approval by a truly

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[68] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. Supr. 1985), at 937.

[69] Doubts on the relevance of the alleged threat of Alcatel have been raised by Subramanian, *supra* note 3, at 15.

independent special committee (*Lynch*), or approval by the majority of the minority stockholders (*Getty*), the proof of unfairness had to come from the challenging plaintiff.[70]

This doctrinal framework has been applied extensively and quite consistently, even if some more recent decisions added further specifications and, mainly in the form of dictum, even suggested possible reforms.[71]

6. Tender Offers Followed by Short-Form Mergers: from Pathe *to* Pure

The second technique used to achieve a freeze-out of minority shareholders, the tender-offer followed by a short-form merger, was somehow anticipated by the alleged "threat" of Alcatel, in *Kahn v. Lynch*, to launch a tender offer directly to the shareholders, bypassing the board of directors.

The crucial question for using a tender offer followed by a short-form merger as a going-private vehicle was a very straightforward one: When a majority shareholder launches a public bid to purchase the outstanding minority shares of a controlled corporation, is the offer subject to the entire fairness standard?

In 1996, the Delaware judiciary answered in the negative.[72] *Salomon v. Pathe Communication* involved a complex financial transaction with ramifications from the U.S. to the Netherlands and Italy. Pathe financed its acquisition of the movie company MGM/UA with loans from the Dutch bank Credit Lyonnaise Banque Nederland N.V. ("CLBN"). The loans were guaranteed by security interests in 89% of Pathe's shares and 98% of MGM/UA shares, and CLBN also obtained control over 89.5% of Pathe's shares through voting trusts. Not long after the acquisition, CLBN voted to remove four directors of Pathe, among which CEO Giancarlo Parretti. An Italian court found the removal of Parretti improper: while the legal grounds and possible consequences of this order of the Italian judge in the U.S. were unclear, CLBT decided to foreclose its security. Pathe and CLBN reached an agreement according to which the former would not delay the foreclosure, and the latter would extend an offer to buy the publicly held shares of Pathe for $1.5 per share. The agreement was approved by a committee of independent directors of the target, supported by financial and legal advisors. The likely motivation for Pathe's directors to require the launch of a tender offer on all the shares was to reduce potential liabilities toward shareholders.

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[70] Subramanian, *supra* note 3, at 16, criticizes the fact that combining *both* approval by a special committee of independent directors and a majority of the minority provision does not lightens the position of the acquiring corporation. *See infra* note 71, observing how this sketched reform proposal has been given consideration in a recent Delaware decision by Vice Chancellor Strine.

[71] *See*, in particular, In re Cysive, Inc. Shareholders Litigation, 836 A.2d 531 (Del. Ch. 2003), and In re Cox Communications, Inc. Shareholders Litigation, 879 A.2d 604 (Del Ch. 2005). In *In re Cox*'s decision, Vice Chancellor Strine observed that "each *Lynch* case has a settlement value, not necessarily because of its merits but because it cannot be dismissed". In fact, the standard of review of entire fairness exposes defendants to the costs and loss of time of discovery. Strine's proposal, therefore, is that when both approval by disinterested directors and shareholders (majority of the minority) are present, the standard of review of the deal should be shifted to the business judgment rule, and the plaintiff would need to plead with particularity the facts supporting a breach of fiduciary duties.

[72] Salomon v. Pathe Communications, 672 A.2d 35 (Del. 1996).

Nonetheless, Salomon, representing the class of Pathe's shareholders that tendered the shares, brought suit alleging that the directors breached their duty of care in not resisting the foreclosure and not negotiating effectively the price of the tender offer. This second failure, according to the plaintiff, also represented a breach of the directors' duty of fair dealing.

The Delaware Supreme Court, confirming the Chancery Court's decision, rejected the plaintiff's theory that:

> "In the case of totally voluntary tender offers, as here, courts do not impose any right of the shareholders to receive a particular price. Delaware law recognizes that, as to allegedly voluntary tender offers (in contrast to cash-out mergers), the determinative factor as to voluntariness is whether coercion is present, or whether there is "materially false or misleading disclosures made to shareholders in connection with the offer.""[73]

The decision was somehow surprising to the legal community because the common understanding was that a tender offer launched by a controlling shareholder presented a conflict of interest and was, therefore, subject to the entire fairness requirement. This point of view emphasizes the role of the board of directors of the subsidiary negotiating the terms of the bid with their parent corporation. The Justices reasoned, however, that the two parties of the deal are the bidder on the one hand, and the minority shareholders on the other. They are unrelated parties and, in the absence of coercion and disclosure violations, the single investors are free to accept or refuse the proposed price.[74]

Notwithstanding the very specific facts of *Salomon*, transactional lawyers and their clients start to look at tender offers as a less treacherous pathway to eliminate minorities than long-form cash-out mergers. The remaining doubts were eliminated with the decision of *In re Siliconix Inc. Shareholders Litigation* and *Glassman v. Unocal Exploration*, both decided in 2001.

In *Siliconix*, vice-chancellor Noble decided that a bidder voluntarily launching a tender offer followed by a short-form merger is not obliged to offer a fair price. Siliconix was a company active in the semiconductors industry listed on the NASDAQ. Its controlling shareholder, with an 80.4% equity interest, was Vishay, listed on the NYSE. In 2000, the market price of Siliconix's shares was subject to significant volatility, hitting a low in December of that year. Between 2000 and 2001, some of its fundamentals were looking grim: sales and profits were decreasing at an alarming rate.

In February, Vishay announced a proposed cash tender offer on Siliconix for $28.82 a share, which included a premium over the then market price of roughly 10%. Vishay also announced that if it would have reached a 90% interest, it would have then proceeded to merge Siliconix into one of its subsidiaries through a short-form, cash-out merger at the same $28.82 price. The board of Siliconix appointed a two-members

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[73] *Id.*, at 39, citing Eisenberg v. Chicago Milwaukee Corp., Del.Ch., 537 A.2d 1051, at 1056 (1987)

[74] In re Siliconix Inc. Shareholders Litigation, 2001 WL 716787 (Del. Ch. 2001), at 6, where the Court states that "as long as the tender offer is pursued properly, the free choice of the minority shareholders to reject the tender offer provides sufficient protection."

special committee to evaluate the offer. Although questions were raised on the actual independence of its members because of their relationships with the controlling stockholder, the committee expressed the view that the price offered was not adequate. At that point, the market price of the shares had rose above the $28.82 figure, and Vishay started considering a stock-for-stock offer, which is less financially burdensome than one with a cash consideration.

The stock-for-stock offer was announced in May 2001, without giving the special committee the opportunity to evaluate the fairness of the transaction. The exchange ratio was calculated simply by dividing the price of Siliconix and Vishay share on 22 February 2001, and was fixed at 1.5 shares of Vishay for every share of Siliconix. No premium above the market price was considered.

It is important to point out what the parties disclosed in the documents destined to the public concerning the acquisition. Vishay, in its offer to exchange prospectus, included a majority of the minority non-waivable condition, stating that the offer would be finalized only if a majority of the non-affiliated investors would tender their securities. In addition, Vishay also informed the public that, following the offer, it might proceed to a cash-out short-form merger for the same consideration offered in the bid, but specifying that it would have followed through only if certain conditions were met. Siliconix, on the other hand, stated in its Schedule 14D-9 form that the special committee was neutral with respect to the offer, not issuing any recommendation. It also declared that no fairness opinion had been provided by any outside financial advisor.

Raymond L. Fitzgerald, a qualified minority shareholder holding above 6% of Siliconix, filed suit asserting individual claims both on behalf of himself and the class of Siliconix's minority shareholders, and a derivative action on behalf of the corporation, seeking, in particular, to enjoin the transaction.

To recount all the reasons why the Court denied the plaintiff's motion, relying also on *Salomon*, would be beside the point here. What is relevant here is that the Court distinguished the merger context, where the boards of the corporations involved are primary negotiators with extensive powers to structure and bring forward the deal, from the tender offer context, in which the counterpart of the bidder are minority shareholders that can decline the proposal if they find it inadequate. In other words, this second type of transactions does not entail the conflict of interest of directors and officers elected by the controlling acquiring corporation that might taint a merger. On this basis, the tender offer – and the behavior of Siliconix's directors – was deemed not subject to the entire fairness test, and the bidder was not considered obliged to offer any specific price. Consequently, not finding any disclosure violation and not considering the offer coercive[75], the court denied the relief sought by Fitzgerald.

[75] This finding of the court is somehow troubling. In fact, Vishay announced that Siliconix could be delisted if the short-form merger would have not been completed, a circumstance that the court dismisses simply as "not threatening or coercive but, instead, […]the disclosure of a potential (and undeniably adverse) consequence to those shareholders who do not tender, if the tender is successful." (*In re Siliconix*, at 16). It is undeniable that a similar possibility, and its announcement, puts a significant pressure to tender on the individual minority shareholder.

Siliconix focused on the front-end of the new freeze-out technique, the tender offer. *Glassman v. Unocal* addressed the back-end, the subsequent short-form, cash-out merger; in fact, in *Glassman* no tender offer ever took place. When the short-merger of Unocal's subsidiary, UXC, took place, the parent company already owned 96% of its outstanding shares and could proceed directly to a short-form merger pursuant to Section 253 of the Delaware General Corporation Law. A minority class action was brought alleging the unfairness of the exchange ratio.

The crucial point here is that the court considered the statutory procedure set forth by Section 253 of DGCL for a short-form merger inherently incompatible with an equity relief based on entire fairness review. In a short-form merger, the board of directors and the shareholders of the merged subsidiary have no voice at all, are not involved in the decision, and do not even receive advance notice of the transaction. This exceptionally truncated process, which allows the board of directors of the parent to unilaterally decide the transaction, is based on a clear policy rationale. The relative small dimension of the interest of the minority does not justify the lengthy and more costly procedure required in a long-form merger, where efficient and value-maximizing integrations might be blocked by minority shareholders. In the Court's own words:

> "The equitable claim plainly conflicts with the statute. If a corporate fiduciary follows the truncated process authorized by § 253, it will not be able to establish the fair dealing prong of entire fairness. If, instead, the corporate fiduciary sets up negotiating committees, hires independent financial and legal experts, etc., then it will have lost the very benefit provided by the statute – a simple, fast and inexpensive process for accomplishing a merger. We resolve this conflict by giving effect the intent of the General Assembly. In order to serve its purpose, § 253 must be construed to obviate the requirement to establish entire fairness."[76]

Applying its own precedents, the Court reasoned that, in the specific context of a short-form merger, minorities are sufficiently protected by the appraisal remedy, available to "dissenting" shareholders even if technically they do not vote and, therefore, can not "dissent" in the general sense. Equitable relief through an entire fairness claim is, however, not available in the context of short-form mergers.[77]

The combined effect of *Siliconix* and *Glassman* was to clear the way of take out transactions through a tender offer followed by a short-form merger: neither of the two ends of the transaction would be subject to the demanding standard of entire fairness.

The resulting doctrinal picture was subject to criticism, especially by academics arguing that two types of transaction aimed at the same substantive result of eliminating minority shareholders, the long-form merger and the tender-offer followed by a short-form merger, were held to radically different standards of review. In the first case, the standard would be entire fairness, more protective of minority investors. In the second case, absent coercion and disclosure violations, the standard would be the more pro-manager business judgment rule.

[76] Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2007), at 247.

[77] *See* Stevelman, *supra* note 3, at 799: "in its Glassman decision, the Delaware Supreme Court held that fiduciary fair dealing criteria are inapplicable to short-form mergers".

In 2002, in deciding *In re Pure Resources*, vice-chancellor Strine tried to reconcile these differences by establishing further protections for minorities in tender offers followed by short-term mergers. In *Pure*, Unocal, controlling shareholder of the corporation that gives its name to the case, launched a stock-for-stock tender offer on the common stock of its subsidiary. The exchange offer, as in *Siliconix*, was conditioned on the tendering of a majority of the minority non-affiliated shareholders, and was subject to the (waivable) condition that Unocal would receive enough shares to own 90% of Pure to consummate a short-form merger under Section 253 of the DGCL. Unocal also stated that it would proceed to the merger as soon as possible after completion of the tender offer, at the same exchange ratio of the front-end offer.

The special committee instituted by Pure to evaluate the transaction, after several uncertainties about the best course of action (among other alternatives, the issuing of a shareholder rights plan was considered), prepared a 14D-9 communication recommending *not* to tender the shares. A class action followed, and the plaintiff asked the court to enjoin the transaction. The arguments for the injunction, according to the plaintiff, were the usual ones in similar cases: the offer did not meet the entire fairness standard, to which it was held; it was coercive; and material information had not been properly disclosed.

Once again, it would be beyond the scope of our analysis to dissect all the reasons that led the court to enjoin the offer. What is relevant here is that vice-chancellor Strine distinguished clearly between long-form, negotiated merger, subject to the entire fairness standard established in *Getty* and *Lynch*, and tender offer/short-form merger, not held to the same standard in the light of the greater freedom of minority shareholders to accept the front-end offer.

Strine was not, however, oblivious to the circumstance that the front-end offer could expose minority investors to a prisoner's dilemma, and force them to accept a less-than-optimal price. As the opinion acknowledged, the coercion of the minority would be, in this case, more subtle than in the case of a cash-out merger, but still present.[78] In order to level the playing field, therefore, *Pure* established three conditions that, only when met, would exclude entire fairness review: (a) the offer must be subject to a non-waivable condition of approval (expressed through tendering) by the majority of the minority; (b) the bidder must guarantee to promptly consummate a short-form merger at the same conditions of the tender offer in terms of price and/or exchange ratio; (c) the bidder should make no retributive threats in dealing with the target's directors.

7. The Quandary That Does Not Need To Be: Two Incoherent Standards?

[78] In addition, in a brilliant part of his remarkable opinion, Strine underlines the parallel existing between directors' powers (and duties) in the context of a hostile takeover – or, generally, an offer launched by a non-controlling subject –, and of a tender offer in which the bidder is a controlling shareholder. If in the former situation directors should have enough latitude – but also specific duties – to defend shareholders' interests from offers they believe to be inadequate, it would be contradictory to hold that a tender offer launched by the controlling shareholder would fall in a no-men's land in which directors of the target corporation have no fiduciary duties. *In re Pure Resources*, 808 A.2d 421, at 439-441.

To sum up the discussion so forth, Delaware law provides two major ways in which a controlling shareholder can freeze-out minorities. The first one is a long-term, cash-out merger. In this case the transaction is subject to the entire fairness standard of review, and the burden to prove fairness is, in the absence of procedural protections, on the defendants. The burden can, however, be shifted to the plaintiff if a truly independent special committee of the controlled corporation was instituted to negotiate the deal, or if a majority of the minority, unaffiliated shareholders of the acquired corporation approve the merger. The second technique to freeze-out minorities is represented by a tender offer followed by a short-form merger. In this case, entire fairness review applies only if the three conditions set forth in Pure are not respected. Table 1 synthesizes the existing doctrinal framework.

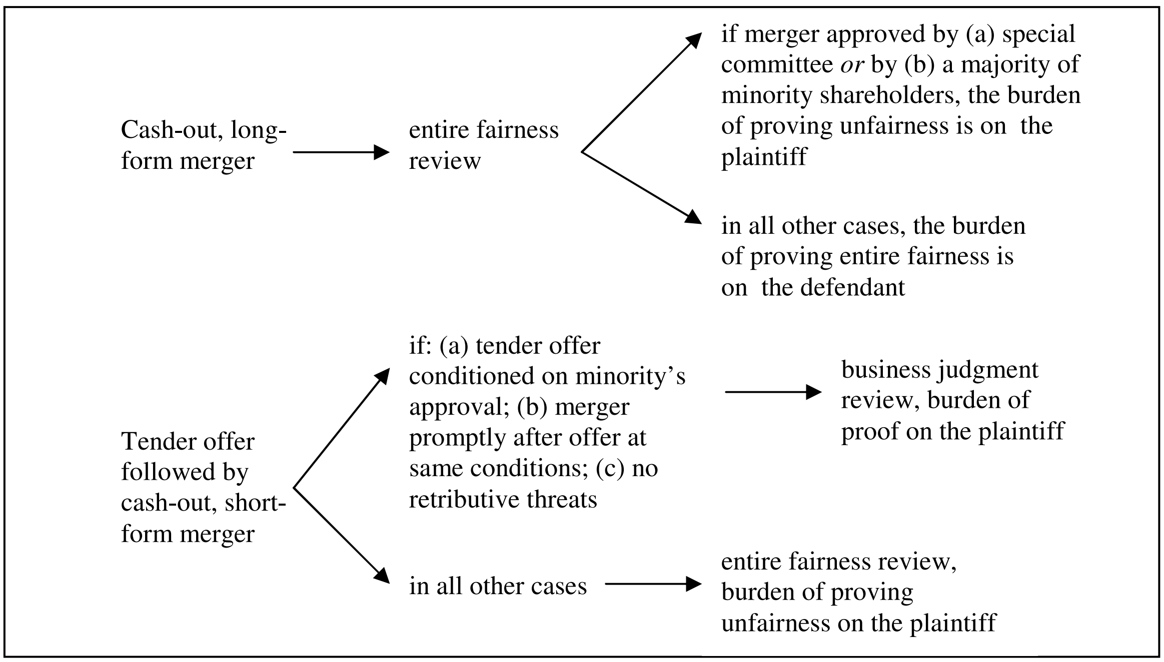

Table 1 – Standards of Review for Freeze-outs under Delaware law

As we have already mentioned, this doctrinal outcome has been widely discussed, and often criticized, by legal scholars and commentators. As concisely observed in one of the most comprehensive recent studies on the subject,[79] the different positions expressed can be divided in three major groups: (a) authors that object to what they consider different standards of review for transactions leading to the same result, and therefore argue for convergence toward either entire fairness review or the business judgment rule ("convergence up" or "convergence down", to use Subramanin's expression[80]) in both situations;[81] (b) authors that approve the current status of Delaware's case-law[82]; and (c)

[79] Subramanian, *supra* note 3, at 22 ff.

[80] *Id.*, at 23.

[81] Convergence "up", toward some form of entire fairness review for a two-step freeze-out, has been advocated by Cannon, *supra* note 3; Levy, *supra* note 3; Resnick, *supra* note 3.

authors that suggest "mixed" approaches.[83] In a nutshell, critics of the *status quo* emphasize that both transactions reach the same result (cashing out minorities), and that applying different standards of review results in unfair treatment of shareholders. The majority of the writers seems to agree, more specifically, that shareholders are under-protected in the case of a tender offer followed by a short-form merger, and advocate for additional procedural protections in that particular instance.[84]

It is not the purpose of this Article to engage in a detailed discussion of the different positions expressed. This paragraph will rather explain why the general legal framework drawn by the Delaware's judiciary is a very sensible one and, even if it is not perfect and still subject to possible fine-tuning, a substantial departure from the current approach is not necessary. The final section of this Article will illustrate how the comparative perspective supports and confirms the rationales of current Delaware case law, and also suggests some partial but important adjustments of the existing doctrines.

The first general point that should be made is that empirical contributions on the subject are not conclusive on the hypothesis that minority shareholders are under-protected and receive lower payments in two-steps freeze-out transactions. According to a recent analysis, for example:

> "[O]ur evidence suggests that wealth effects and negotiation associated with freeze-out bids are statistically equivalent in pre- and post-*Siliconix* sub-periods. This evidence contrasts with the conventional wisdom that tender offers present an optimal transaction for controlling shareholders seeking to consummate a freeze-out following the *Siliconix* decision. We infer instead that freezeout tender offers (like tender offers generally) provide a relatively poor method for extracting deal value from atomistic target shareholders, as they require the distribution of premium to all minority shareholders sufficient to meet the reservation price of the marginal informed shareholder. Given these results, we question the economic basis underlying recent calls for a strengthening of the

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[82] *See* Jon E. Abramczyk et al., *Going-Private Dilemma? Not in Delaware*, 58 BUS. LAW. 1351 (2003); Pritchard, *supra* note 3; Thomas M. McElroy, II, Note, *In re Pure Resources: Providing Certainty to Attorney Structuring Going-Private Transactions, or Not?*, 39 WAKE FOREST L. REV. 539 (2004). The holding in *Pure* is considered correct also by Siegel, *supra* note 3, who however criticizes the reasoning through which the court has reached its conclusion.

[83] *See* Gilson & Gordon, *supra* note 3; Aronstam et al., *supra* note 3.

[84] Gilson & Gordon, *supra* note 3, at 821, observing that "there is a sharp disconnect between Siliconix's characterization of the target board's role in responding to a freeze-out tender offer by a controlling shareholder and the Delaware Supreme Court's characterization of the target board's role in responding to a third-party tender offer". In the same line, *see* Stevelman, *supra* note 3, at 806. Even if our focus is on Delaware, it should also be observed that other states have developed different doctrines or statutory approaches to these transactions. A very interesting case is, for example, offered by Sections 1101 and 1101.1 of the California Corporation Code, which prevent a cash-out merger when the controlling shareholder owns less than 90% of the outstanding shares. In all other situations, a cash merger is allowed only if a regulatory authority approves the fairness of the transaction (*see* GEVURTZ, *supra* note 20, at 732).

current review standards applied to freeze-out transactions by the Delaware judiciary."[85]

Second, from a more doctrinal point of view, a powerful response to the arguments suggesting that judicial treatment of one-step and two-steps freeze-outs should be harmonized and subject to the same rules is that the two transactions are, in fact, *different*. The fact that they tend to accomplish a similar result is certainly not surprising: it is often the case, in transactional law, that one specific factual outcome can be reached through different roads. This is not, in itself, sufficient to advocate the need of absolutely identical rules. It is important to observe that, in a two-step freeze-out, minority shareholders tend to receive a lower price than in long-form mergers, as the empirical evidence seems to indicate.[86] It is also fairly easy to identify the causes of this difference in the veto power of the special negotiating committee in long-form mergers, and in the existence of collective action problems and information asymmetries in the tender offer context. From this perspective, it seems legitimate to wonder whether minority shareholders are sufficiently protected in a two-step cash-out merger. None of these arguments is however sufficient, in my opinion, to convincingly claim that two techniques should be subject to the same judicial standard of review.

In a two-step freeze-out, minorities are confronted with a tender offer that they can accept or refuse, the offeror and the offeree are on the opposite sides of the transaction, and they do not suffer the same conflict of interest as the managers of the merged corporation in a long-form merger. Investors are exposed to a certain pressure to tender, and one might discuss if *Pure* goes far enough in mitigating that pressure. But the conceptual framework used by the Delaware Chancery Court, according to which this basic difference in the structure of the two types of deals calls for differentiated standards of review, is absolutely correct and acceptable. If equal protection of investors means to treat investors in the same situation in a given deal equally, it does not also mean that independently from the type of transactions investors should always receive the same treatment. The law does not require exactly the same kind of protection in all situations.

"Convergence up", in particular, stretched to its extreme but somehow coherent consequence, would lead to the paradoxical result that in a private transaction in which shareholder A negotiates with shareholder B the purchase of the shares of the latter, should be conducted by a special committee of independent directors. It is likely, after all, that if B is a smaller and less sophisticated investor than A, she might receive a lower price than the one she might obtain in a long-form, cash-out merger negotiated by an *ad hoc* committee with veto power.

One particular argument against the current regulatory scenario deserves special consideration. The *Pure* rule creates an inconsistent dichotomy between the duties of directors in a hostile takeover context and in a friendly tender offer one. In the hostile acquisition context, the argument runs, directors and managers have specific fiduciary duties aimed at preventing waste of corporate resources to fend off value-maximizing

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[85] Bates et al., *supra* note 7, at 29 f. Contrasting empirical evidence is offered by Subramanian, *supra* note 25.

[86] Subramanian, *supra* note 3, at 25.

offers, which are welcomed by minority shareholders but undesirable for corporate insiders and controlling shareholders. These substantial duties are said to be at odds with the fact that no specific duty is imposed on directors in the case of a tender offer launched by the controlling shareholder as a way to, or a predicate for, cashing out minorities.[87]

In a similar fashion, it is also argued that in a hostile acquisition context, the market plays a policing role because, if the price offered is too low, additional bidder can "auction" for the shares, maximizing minority shareholders' wealth.[88]

Once again, however, the differences between the two situations justify different treatments. In the hostile takeover context, fiduciary duties are imposed to curb the incentives of directors to adopt defenses in conflict of interest, or – according to the *Revlon* rule – to ensure that once a change in control is inevitable, and an auction among different suitors is occurring, they put shareholders' interests ahead of their personal ones.[89] In the freeze-out context, requiring specific procedural steps to be taken by the directors in order to negotiate the best possible price for minority shareholders in the front-end tender offer, would impose on the directors an active duty to step in a transaction between independent parties, and use the corporate assets to favor one of them. The difference is substantial, and the circumstance that in the friendly acquisition context the directors would generally be helping the weaker party to obtain a greater gain does not seem enough to impose such a duty.

Also the argument concerning the protection offered by potential competitor bidders in the hostile acquisition context does not appear conclusive. First of all, it does not seem the duty of the courts to recreate, in every acquisition process, the same conditions that can be found in a contested takeover. But even assuming that shareholders are entitled to benefit from a competition among different buyers, the freezing-out shareholder is in a usually in a controlling position because, at one point in the history of the corporation, he or she acquired control through a potentially contested takeover, in which all the protection offered by the market were available to minority shareholders. The remaining shareholders either decided not to sell their shares in that occasion, or bought the shares of a corporation that *already* had a controlling shareholder that could freeze them out. It is reasonable to assume that the market discounted this possibility, and to recreate artificially the conditions of an auction for the shares would over-protect the investors.[90]

It should be further considered that equitable relief through entire fairness review is hardly compatible with the very structure of the short-form merger, a simplified process sustained by a clear policy choice of the legislature. The argument has been emphasized by the Delaware judiciary in more than one occasion:

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[87] Gilson & Gordon, *supra* note 3, at 820; Stevelman, *supra* note 3, at 806.

[88] *Id.*

[89] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986), for a discussion of the Revlon doctrine *see* Clark W. Furlow, *Reflections on the Delaware Doctrine*, 11 U. PA. J. BUS. L. 519 (2009); Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691 (2003).

[90] A somehow similar argument is offered by ROBERT CHARLES CLARK, CORPORATE LAW, 506 (Aspen, 1986); and Pritchard, *supra* note 3, at 103.

> "§ 253 authorizes a summary procedure that is inconsistent with any reasonable notion of fair dealing. In a short-form merger, there is no agreement of merger negotiated by two companies; there is only a unilateral act-a decision by the parent company that its 90% owned subsidiary shall no longer exist as a separate entity. The minority stockholders receive no advance notice of the merger; their directors do not consider or approve it; and there is no vote."[91]

It follows that if the back-end short-form merger in a two-step freeze-out would be subject to entire fairness review, the corporation would find itself in a sort of Catch-22 situation. It would either have to always bear the burden of the proof, or shift the burden of the proof by setting procedural protections similar to the ones regulated by *Pure* and its progeny (special committee of independent directors, or majority of the minority approval) in place. These protections, however, are hardly compatible with the short-form merger process. Rather than going through the expenses and complications of a tender offer followed by a merger without any of the advantages of the short-form merger, the acquiring company might, at this point, just opt for the long-form cash-out merger. To argue for entire fairness review to also apply in a two-step freeze-out means, in other words, the demise of the short-form merger.

In connection with this last issue, a final argument in favor of the existing Delaware case law is its consistency with the well-established doctrine of "equal dignity". As mentioned above,[92] according to this principle, different transactions with distinct statutory regulations should be treated differently, and not leveled and equated simply because they might be used to reach similar results. Applying this approach, for example, Delaware courts declined to recognize the de-facto merger doctrine, and grant appraisal rights to dissenting shareholders in the context of sales of assets. The arguments that might be made to support or criticize the "equal dignity" rule might also partially be applied to the current debate over freeze-outs. But to the extent that consistency and predictability are concerned, the different treatment of long-form, cash-out mergers and short-form mergers preceded by a non-coercive tender offer on all the outstanding shares must also take this rule into account.

Last but not least, Part VI of this Article will consider how the comparative analysis supports the overall rationale followed by the Delaware judiciary, and suggest some fine-tunings that would improve the protection of minority shareholders in the context of a two-step freeze-out.

IV. Freeze-out Transactions in the European Union

1. Unavailability of Cash-out Mergers in Europe

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[91] Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2007), at 247.

[92] *See supra*, note 35.

Cash-out mergers are generally not permitted in Europe.[93] Articles 3 and 4 of the Third Company Law Directive on Mergers of Public Limited Liability Companies (hereinafter, the "Merger Directive" or the "Third Directive")[94] provide that both in a "merger by acquisition" and in a "merger by the formation of a new company", shareholders of the constituent corporations must receive shares of the surviving corporation according to an exchange ratio agreed upon by the boards of directors and approved by the shareholders' meetings. They can also receive a cash payment, but "not exceeding 10% of the nominal value of the shares […] issued or, where they have no nominal value, of their accounting par value."[95]

Thus shareholders of the corporation extinguished by the merger are entitled to receive at least some shares of the surviving company, and cannot simply be cashed out. In other words, under European law, a merger with an entirely cash consideration to some shareholders is not acceptable. This rule is the expression of a more general principle, still reflected in the national laws of most Member States, which – with very limited exceptions – a shareholder's participation right can not be taken from her without consent.[96]

Sure enough, in theory, the exchange ratio could be set so high that minority shareholders of the acquired corporation might not, as a matter of fact, obtain shares of the acquiring corporation, not differently from what can happen in a reverse stock split, or share consolidation. Consider, for instance, a situation where the controlling shareholder owns 51,000 shares, and no other shareholder matches this equity interest. If the exchange ratio is set at one share of the surviving corporation for every 51,000 shares of the merged corporation, only the majority shareholder would be able to obtain equity of the surviving entity.

The exchange ratio cannot be set arbitrarily, but must express a fair relationship between the value of the two constituent corporations and their shares. According to the directive, in all Member States, before the draft terms of merger are presented to the shareholders, a judicially-appointed independent expert must examine the exchange ratio, and issue an opinion on its intrinsic fairness.[97] This provision embodies in many respects

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[93] A caveat is that, in some European jurisdictions, specific freeze-out rules that seem to mimic the effect of a cash-out merger are available. However, not only these provisions are limited to some countries and are not a common, harmonized trait of the European corporate law scenario, but they are also significantly different, and more cumbersome and uncertain for the controlling shareholder, than the American cash-out merger. For examples on Germany and the U.K. *see infra*, Paragraph IV.7.

[94] Third Council Directive 78/855/EEC concerning mergers of public limited liability companies, 1978, O.J. (L295), 26.

[95] Directive 78/855/EEC, art. 4(1) *supra* note 94.

[96] For example, this principle is stated very clearly by a leading French scholar: "L'actionnaire est *member de la societé*; il ne peut pas être privé de cette qualité parce qu'il y aurait une véritable expropriation. C'est seulment avec son consentment que son droit peut disparaître" ["The shareholder is *member of the corporation*; this quality can not be taken away from him because that would constitute a true expropriation. Only with his consent this right can be disposed of".], Michel Germain, TRAITÉ DE DROIT COMMERCIAL RIPERT/ROBLOT 376 (18th ed., 2002).

[97] Directive 78/855/EEC, art. 10, *supra* note 94. The expert's opinion can be considered binging because, in the absence of a positive assessment of the fairness of the transaction, minority shareholders can challenge

one of the fundamental differences between European, and in particular civil-law based systems, and U.S. law. The former rely more on *ex ante* procedural protections regulated by the legislature, the latter is a litigation-based system where directors enjoy greater freedom in structuring the deal, but are subject to potential extensive review through *ex post* lawsuits.[98] Interestingly enough, in the U.S. the outcome of litigation often backfires on the process, suggesting procedural protections for minorities that can avoid or reduce the risk of a class action.

According to European rules, a listed corporation will virtually never be able to pursue a merger with an exchange ratio so high to freeze-out minority shareholders. It is possible that some small investors do not have enough shares to obtain even one single share of the resulting corporation, and in this case, the constituent corporations will offer to buy the shares. But the vast majority of minority shareholders will be entitled to maintain their status in the new corporation. The limitation on the cash payment ensures this result.

For example, consider a merger in which the par value of the shares of both corporations is €1, the real value for one share of P (the acquiring corporation) is €2, and of one share of S (the target) is €1.1. The exchange ratio would be 0.55 (1.1/2), which means that for every share of S you would be entitled to 0.55 shares of P. This would result in many shareholders of S being entitled only to a fraction of P's shares, with obvious complications in the merger process. European law allows reducing the exchange ratio by offering a consideration partially in cash. The cash consideration cannot, however, exceed 10% of the par value of the shares of P. In this example it would be possible to provide that for every share of S, one would be entitled to €0.1 in cash (10% of the €1 par vale) on top of the exchange ratio, and consequently set the exchange ratio at 0.5 (2/1), a more manageable figure.[99]

These adjustments, however, are very limited and, as a practical matter, can be simply used to round up the exchange ratio, not to cash out minorities. In this respect, the European approach resembles the one prevalent in the United States before the mid 1930s, when corporate statutes were just beginning to allow cash-out mergers.[100]

2. Shareholders' Remedies in Case of Delisting through a Merger: Challenging the Transaction

The fact that cash-out mergers are not generally possible in Europe does not exclude the use of mergers in a public-to-private transaction in which a listed corporation is

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the resolution approving the merger in court and have it set aside. In addition, completing a merger that the court's expert has not declared fair can determine directors' liability toward minority shareholders, notwithstanding the approval of the controlling shareholder.

[98] *See e.g.* Gerard Hertig, Hideki Kanda, *Related Party Transactions* in REINER KRAAKMAN ET AL. (eds.) THE ANATOMY OF CORPORATE LAW 101, (2004) at 117.

[99] LUIGI A. BIANCHI, IL GIUDIZIO DI 'CONGRUITÀ' DEL RAPPORTO DI CAMBIO NELLA FUSIONE (il Sole 24 Ore, 2002), at ____ .

[100] *See supra* Paragraph III.2.

merged into a non-listed one. Minority shareholders will participate in the resulting corporation, which might not be ideal from the point of view of the acquirer, but delisting would still ensure a lower regulatory burden and, in many respects, an increased flexibility for the controlling shareholder and the directors.

It is, therefore, useful to have a brief discussion of two other comparative differences in this specific context, and specifically the availability, in Europe, of short-form mergers, and remedies for dissenting shareholders, focusing in particular on appraisal rights.

European law provides for simplified procedures designed to facilitate merging a subsidiary with and into a parent corporation that owns a substantive participation. The two most important provisions in this respect are Articles 24 and 27 of the Third directive on mergers. Article 27 bears notable resemblances, but also important differences, with the American short-form merger. It applies to mergers in which the surviving corporation holds more than 90% (and less than 100%) of the voting shares and securities of the merging corporation. In this situation, the business combination does not require the approval of the shareholders *of the acquiring corporation*.[101]

There are at least four major differences distinguishing this "European short-form merger" from its American counterpart. First, in the former transaction both the board and the shareholders' meeting of the target corporation have an inalienable right to vote on the merger, while according to Section 253 of the DGCL and Section 11.04 of the MBCA, a fundamental trait of the short-form merger is that it only needs to receive a green light from the directors of the acquiring corporation. Second, under European law, specific and extensive information must be provided to the non-voting shareholders of the parent corporation in advance of the shareholders' meeting of the acquired corporation. As in the case of a long-form merger, the merger agreement approved by the boards of directors, the financial statements of three preceding years of both corporations, a current financial statement, and the above-mentioned fairness opinion of the court-appointed appraiser must be deposited with the corporation's secretary and made available for inspection to all shareholders at least one month before the date of the shareholders' meeting.[102] This inspection right gives shareholders information to have a say in the consummation of the merger. In addition – and this is the third important difference – a qualified minority of the acquiring corporation's shareholders, representing not more than 5% (Member States can require a lower threshold), can request the merger to be submitted also to the shareholders' meeting, and therefore reinstate the regular approval process.[103]

A fourth difference concerns the conditions upon which the procedure can be further simplified. In both short-form mergers and long-form mergers, substantive documentation must be prepared and made available to shareholders: the merger agreement, financial statements, and the expert's fairness opinion. It is possible not to comply with these requirements, as long as minority shareholders of the controlled

[101] Directive 78/855/EEC, *supra* note 94, art. 27.

[102] Directive 78/855/EEC, *supra* note 94, art. 27.

[103] *Id.*, art. 27(c) jo. 8(c).

corporation are given the option to receive the fair value of their shares in cash, provided that in case of disagreement on the value of the shares, a judicial appraisal process is available.[104] This is not a forced cash-out of minorities, since it is simply an additional choice offered to minorities, who can always obtain shares of the surviving corporation according to the exchange ratio.

An even more streamlined procedure is available when the acquiring corporation is the sole shareholder of the target. According to Article 24 of the Third directive, in this case, it is not necessary to obtain approval from the parent company's shareholders meeting. In addition, determining an exchange ratio is not necessary either, since there are no minority shareholders that need to receive any consideration. Once again, however, directors must publish the relevant documents and a qualified minority of the surviving corporation's shareholders may require the holding of a general meeting.[105]

In brief, when a subsidiary is merged into a parent corporation holding 90% or more of the voting securities, the same rationale that inspires short-form mergers in the United States commands a simplified merger process under European law. In Europe, however, shareholders retain stronger information rights, enjoying the benefit of a pre-merger fairness opinion by an independent financial expert appointed by a judge, and can even stop the simplified procedure and obtain a shareholders' vote.

Turning to dissenters' rights, the analysis becomes more complicated and murky. In fact, this specific issue is not comprehensively regulated and harmonized at the European level: the directive only sets forth minimal standards, and each jurisdiction provides for different rules. Rather than a detailed discussion of the technical differences among different states, it is possible to look at the overall general framework and consider a few country-specific examples.

First of all, the mergers directive requires Member States to regulate civil liability of directors, managers and independent experts for misconducts in the merger process.[106] Shareholders can sue for breach of fiduciary duties, and seek monetary damages if the exchange ratio is unfairly prejudicial. In addition, at least in theory, acquisition of a subsidiary by a parent can be considered a transaction not at arm's length, in which directors, managers, and in some cases even controlling shareholders have a conflict of interest, with the consequence that the rules dealing with conflicted transactions would apply.[107] Comparative research that does not need to be revisited here has convincingly demonstrated that one of the fundamental differences between European and U.S. corporate law systems lays in the degree of reliance on shareholder-driven litigation as a tool to enforce fiduciary duties of directors and controlling shareholders: limited in the

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[104] Directive 78/855/EEC, *supra* note 94, art. 28.

[105] *Id.* art. 24.

[106] Directive 78/855/EEC, *supra* note 94, art. 20.

[107] For an overview on the different approaches to directors' conflicts of interests and duty of loyalty *see* Luca Enriques, *The Law on Company Directors' Self-Dealing: A Comparative Analysis*, 2 INT'L & COMP. CORP. L.J. 297 (2000); on the regulation of conflict of interest of controlling shareholder in some European countries *see* Pierre-Henri Conac et al., *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany and Italy*, 4 EUR. COMP. FIN. L. REV.491 (2007).

former, extensive in the latter.[108] Complex and multifaceted factors explain this divergence, not limited to substantive legal rules. Procedural obstacles to derivative suits and class actions play a major role, as well as the very fact that the concentrated ownership structure that prevails in Europe makes it less likely for the development of extensive *ex post* litigation lead by minority shareholders.[109]

It should be noted that none of these different underlying philosophies – U.S. reliance on *ex post* civil litigation and European reliance on ex ante statutory procedural protections and shareholders' voting – is in itself superior. For the purpose of comparing going private transactions across the Atlantic, it is sufficient here to point out how lawsuits based on a breach of fiduciary duty of controlling shareholders or directors are not nearly as common and relevant to protect minorities in Europe as in the U.S.

In addition to or in connection with seeking damages for a breach of a fiduciary duty, a merger can also be challenged for lack of authority or other illegalities in the procedure, seeking rescission.[110] The same reluctance showed by American judges in granting rescission of a completed merger[111] is reflected in the Third directive and in European corporate statutes and codes. In most jurisdiction, in line with the provisions of Article 22 of the Directive, a merger can not be declared "void" after the publication (filing with the competent public office) of the merger deed or a short period thereafter. Form this moment on, only monetary damages can be granted.[112] The same reasons that discourage shareholders' litigation for breach of the duty of care or of loyalty mentioned above also deter recourse to these types of causes of action.

3. Appraisal Rights in the Merger Context

Shareholders of a listed corporation dissenting from a merger in which the surviving corporation is not listed might enjoy dissenters' rights similar to U.S. appraisal rights. Once again, on this subject there is no harmonized European law, and Member States'

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[108] In this respect, it has been observed that "U.S. jurisdictions have a more developed duty of loyalty than other jurisdictions. One reason is that U.S. courts are more willing to review managerial transactions, as we discussed above. A second reason is that U.S. law encourages shareholder lawsuits. Not only are the procedural thresholds for shareholder suits relatively low in the U.S., but a combination of discovery mechanism and generous attorney's fees is also available to support a specialized plaintiff's bar", Hertig & Kanda, *supra* note 98, at. 116.

[109] For a comparative analysis of shareholders' derivative suits in the U.S., England, Germany, France and Italy, showing how continental European systems do not have the preconditions for the widespread use of these types of actions that exist in common law countries, *see* ALESSANDRO DE NICOLA, SHAREHOLDER SUITS. THE ROLES AND MOTIVATIONS OF MINORITY SHAREHOLDERS AND DIRECTORS IN DERIVATIVE SUITS (Aspatore 2006).

[110] For example, for a brief description of Spanish law in this respect, *see* Agustín Madrid Parra, *Transformación, fusion, escisión de las sociedades mercantiles*, in DERECHO MERCANTIL 669 (2006).

[111] *See* the Alabama decision reported by COX & HAZEN, *supra* note 20, at 618, in which the court clarifies that "It would be a painful travesty upon justice if a court of equity, in order to conserve the rights of a few stockholders in one of the parent companies, should destroy the property rights of innocent stockholders in the new company" (Alabama Fidelity Mortgage & Bond Co. v. Dubberly, 73 So. 911, 915 (Ala 1916)).

[112] Again as an example, *see* C.C. §2504-*quater* (It.).

rules present significant differences. Some interesting common traits can, however, be extrapolated from specific examples.

Consider, for instance, appraisal rights under Italian law, where a recent reform innovated profoundly from the former approach and introduced a fairly modern set of rules.[113] In the Italian system, mergers are not necessarily a ground for invoking the appraisal remedy. Appraisal right is conditioned on the approval by the majority of the shareholders of specific amendments of the corporate charter and other relevant corporate events, among which mergers are not included. A merger can, indirectly, represent a ground for the appraisal remedy, but only when it triggers one of the fundamental changes specifically listed in the Italian Civil Code.[114] The list includes, among others: a conversion of a joint stock corporation in a different business association, the adoption of a different corporate purpose (in several European systems, corporate purposes should be defined more narrowly than in the U.S.), the transfer of the legal seat abroad (because it might lead to the application of the corporate laws of a different state), modification of shareholders' voting and economic rights, and others.[115] A merger can indirectly cause one of these changes and therefore allow dissenting shareholders to liquidate their investment. But a merger in itself does not trigger an appraisal remedy. In addition, when considering transactions resulting in the delisting of a listed corporation, Italian law also provides appraisal rights for shareholders not approving going private.[116] While there is some ambiguity concerning the precise scope of this provision, it can be argued that merging a listed corporation in a closely held one is a ground for appraisal.

Spanish law is no different in restricting charter's amendments that trigger appraisal rights, or withdrawal rights, as they are occasionally referred to in Europe, and the list does not include mergers as a general rule.[117] Mergers and spin-offs are also not an independent ground to trigger appraisal rights in France and Germany.[118] A first

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[113] Marco Ventoruzzo, *Cross-border Mergers, Change of Applicable Corporate Laws and Protection of Dissenting Shareholders: Withdrawal Rights Under Italian Law*, 4 EUR. COMP. FIN. L. REV. 47 (2007).

[114] C.C. §2437 (It.); *see* Ventoruzzo, *supra* note 113, at 62 ff.

[115] *Id.*, at 62.

[116] C.C. §2437-*quinquies* (It.), *see Id.*, at 62.

[117] According to Spanish corporate law, shareholders have an appraisal – or "withdrawal" – rights, called "*derecho de separción*", in limited circumstances. As a leading treatise puts it, pursuant to the Ley des sociedades anonymas (LSA), shareholders' rights include the "derecho de separción en los supuestos de sustitución del objecto – art. 147 –, de transformacion de sociedad anonima en sociedad colectiva o comanditaria – art. 225 –, de transferencia del domicilio social al extranjero – art. 149.2 –, de traslado del domicilio de una SE a otro Estado miembro del la UE – art. 315 –, de fusion que implica la constitucion de una SE en otro Estado miembro – art. 320 –, y de constitucion de una SE *holding*." [appraisal right in case of change of the corporate purpose, conversion of a corporation into a general or limited partnership, transfer of the corporate seat to a foreign jurisdiction, transfer of the corporate seat of a SE to another UE member State, merger that implies the creation of a SE in another member State, and of establishment of a holding SE]. Important for our purposes, also, shareholders' have a right to maintain their participation in case of merger pursuant to Articles 229 and 247 LSA. *See* Ignacio Lojendio Osborne, *La Accion. Los Derechos del Socio* 300, in DERECHO MERCANTIL (2006).

[118] Shortly before the enactment of the Takeover Directive, a comparative analysis underlined how, with respect to appraisal rights, differently from the U.S. "neither Germany nor France had any comparable ex

observation, therefore, is that appraisal rights are available in Europe, but the grounds for exercising these rights are somehow narrowly defined and that a merger, in itself, does not always triggers dissenters' rights.

A second observation concerns valuation rules for dissenters' shares. In some systems, different rules are provided for listed and non listed corporations. For the latter, criteria inspired by the same rationale of the Delaware Block Method, but with some flexibility (like in Delaware after *Weinberger*), are provided for.[119] More important for our purposes are, however, listed corporations. General market exemptions, *i.e.* rules limiting appraisal rights to unlisted securities, are generally not provided, but the list of withdrawal grounds in listed corporation is often more narrow than for shares not traded on an exchange. For appraisal purposes, the valuation of shares listed on an exchange is usually based on market prices, usually on an average of prices in a set period preceding the event triggering the appraisal rights.

Once again, the Italian regulation offers an illustrative example. According to Article 2437-*quarter* of the Italian Civil Code, while non listed shares are evaluated applying a statutory formula that resembles the Delaware Block Method, the evaluation of listed shares for appraisal purposes is defined by the Civil Code as the arithmetic (*i.e.*, not weighted) average of the closing prices of every negotiation day in the six months preceding the publication of the shareholders' meeting's call.[120]

Similar formulas are provided for in the corporate statutes of other European jurisdictions, or in jurisdictions that present a similar approach to corporate governance issues. For example, in Spain, the appraisal value of listed shares for shareholders dissenting from a change of the corporate purpose is established, according to Article 147.2 *Ley de Sociedades Anónimas* (LSA), the average market price of the last three months.[121]

This criterion often does not capture the fair current value of the shares, especially when, as it might be the case in a freeze-out transaction, prices have been depressed, and the very fact that prices do not reflect the real value of the shares is what motivates the controlling shareholder to go private. In addition, as Professor Gevurtz warns, reliance on market – and especially on a long historical series of prices – might be particularly

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ante exit protection in the case of a merger.", *see* Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791 (2002).

[119] For example, according to Article 2437-*ter* of the Italian Civil Code, the evaluation of the non-listed shares of a dissenting shareholder requires to take into account three elements: the value of the assets of the corporation, the net present value of future earnings, and the market price, if available. *See* Ventoruzzo, *supra* note 113, at 65 f.

[120] *See* Ventoruzzo, *supra* note 113, at 66, and *Id.*, *I criteri di valutazione delle azioni in caso di recesso del socio*, ___ RIVISTA DELLE SOCIETÀ 333, 393 (2005). A delicate interpretative problem is how to proceed when there are not data on the market prices for six months, for instance because the negotiation of the shares has been suspended for a few weeks or months by the Italian Stock Exchange. In similar cases it should be possible – when necessary – to integrate the legal criteria provided for listed shares with the above-mentioned rules applicable to the evaluation of non-listed shares.

[121] Juan Manuel Gomez Porrua, *La Modification de los Estatutos Sociales. Aumeno y Reduccion del Capital Social* 401, in DERECHO MERCANTIL (2006).

problematic in a freeze-out, exactly for the reason that "the market price should reflect the risk that the majority will freeze out the minority".[122] The foundation of this concern has also been demonstrated by Bebchuk and Kahan, showing how the very possibility of being cashed out may push down market prices.[123]

Summing up, cash-out mergers, in Europe, are not really available to conduct a going private transaction. Minority shareholders are generally protected through specific *ex ante* devices, and one of the most important is the binding fairness opinion on the exchange rate issued by a court-appointed expert before the shareholders' meeting called to vote on the merger. Coherent with this limitation, dissenters' rights play a more limited role in protecting minority shareholders, both in terms of the scope of application, and in terms of the determination of the fair value of the shares.

4. Statutory Freeze-out in Europe: Article 15 of the Takeover Directive

The fact that cash-out mergers are not the way in which you can bring a European corporation private through freezing out minority shareholders does not mean that freeze-outs are not possible in Europe. This goal can, in fact, be accomplished through a different legal technique, explicitly regulated by Article 15 of the Thirteenth directive on takeovers (hereinafter, the "Takeover Directive" or also the "Thirteenth Directive").[124]

In short, Article 15, under certain conditions, grants any shareholder acquiring 90% (or more, depending on the Member State) of the voting shares of a listed corporation through a tender offer, the right to cash out minorities at a fair price. In these general terms, the overall structure of the provision recalls a U.S.-style short-form merger. At a closer analysis, however, important and profound differences emerge. First of all, pursuant to Article 15, minorities are cashed out without merging the target into the parent corporation. After the majority shareholder exercises the freeze-out right, the delisted target can maintain its corporate identity, as a totally-owned subsidiary of the parent (and, of course, at that point can also easily be merged into the parent).

To understand this rule and appreciate its nuances, a few words on the general framework of E.U. takeover regulation are necessary. European law, largely inspired by the U.K. experience, provides for an institute largely unknown to U.S. corporate law (although some state anti-takeover statutes might resemble this approach): the Mandatory Bid. According to this rule, set forth in Article 5 of the Takeover Directive, anyone who acquires control of a listed corporation must launch a tender offer on all the outstanding voting shares, including shares with limited voting rights. The price of the offer cannot be lower than the highest price paid by the bidder for the securities in a period, determined by Member States, between six to twelve months preceding the triggering

[122] GEVURTZ, *supra* note 20, at 763.

[123] Bebchuk & Kahan, *supra* note 19.

[124] Directive 2004/25/EC of the European Parliament and of the Council on takeover bids, 2004, O.J. (L 142) 12, art. 15.

event of the acquisition of control.[125] During the offer, an all holders/best price rule similar to the one set forth in SEC Rule 14d-10 applies.[126]

The rationale for the mandatory bid is twofold: distributing the control premium to all shareholders, and granting a fair way out to minority investors. While the rule can be advantageous for minority shareholders in case of a friendly acquisition, in which the selling controlling shareholder might reap all the capital gains of her investment, serious doubts have been cast on its overall effect on the market for corporate control. A mandatory bid can render acquisitions, especially hostile ones, particularly expensive and hinder an efficient market for corporate control.[127]

Voluntary tender offers on a percentage or on all the outstanding shares are also possible under the Takeover Directive. In this case, the price can be freely set by the bidder. An important exception to the mandatory bid is that if an investor acquires control through a voluntary tender offer on all the outstanding shares, he is not required to follow up the voluntary offer with an additional mandatory bid.[128] The rationale is that the offeror has already granted to all shareholders the possibility to sell their shares, and the very success of the bid – the fact that a controlling stake was obtained – indicates that the price offered was adequate. On the other side of the coin, there are situations where technically a subject has not acquired control, but a compulsory offer is still mandated. For instance, if someone who already owns de-facto control but less than absolute majority of the voting shares creeps up toward 50% plus one share at a quick pace (depending on the jurisdiction, for example 3% within one year)[129], the acquisition triggers an obligation to launch a mandatory bid under the assumption that a control premium is being paid.

With this sketched background in mind, freeze-out rights set forth in Article 15 of the Takeover Directive can be understood. This provision requires Member States to provide for freeze-out rights when, following a voluntary or mandatory tender offer on all the outstanding shares ("triggering tender offer"), certain conditions are met. More specifically, there are two scenarios that trigger the freeze-out right.

The first scenario occurs when the shares tendered in the triggering offer raise the ownership of the offeror above 90% of the voting capital, *and* the shares tendered represent at least 90% of the ones included in the offer.[130] The second condition can be described as a (super)majority of the minority approval, no different, notwithstanding its very high threshold, from the requirements articulated by Delaware jurisprudence in both

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[125] Directive 2004/25/EC, *supra* note 124, art. 5(4).

[126] The rule provides that all shareholders should be offered the same consideration for their shares, and that if a higher consideration is offered to any shareholder, it should be extended to all the investors. For an analysis of SEC Rule 14d-10 *see* Rusty A. Fleming, *A Case of "When" rather than "What": Tender Offers Under the Williams Act and the All Holders and Best Price Rules*, 27 S. ILL. U. L.J. 263 (2003).

[127] Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe*, 11 U. PENN. J. BUS. L. 135, 140 (2008).

[128] Directive 2004/25/EC, *supra* note 124, art. 5(2).

[129] This is for example the case in Italy, pursuant to Article 106 of the T.U.F.

[130] Directive 2004/25/EC, *supra* note 124, art. 15(2)a.

Getty and – more on point – *Pure*. One may call this first freeze-out right the "majority of the minority" freeze-out.

Pursuant to Article 15 of the Takeover Directive, Member State can opt for an alternative scenario. Freeze-out rights can be triggered when, as a consequence of the tender offer, the bidder holds securities representing not less than 90% of the voting capital and 90% of the voting rights,[131] *independently* from the rate of acceptance of the tender offer. In this instance, minorities can be cashed out even if a majority of the shares of the non-affiliated investors have *not* been tendered, as long as after the offer, the bidder reached the 90% threshold.[132] This might be the case when someone who is holding little less than the triggering threshold, or already holding more than 90%, launches a tender offer that receives few acceptances. This can be referred to as the "single threshold" freeze-out.

As mentioned above, Member States can choose to adopt either the single threshold or the majority of the minority freeze-out procedure. This optional regime represents another compromise among the different positions of the Member States, together with other optional provisions that characterize the Takeover Directive.[133] Historically, the single threshold approach was adopted in several continental European countries; while the majority of the minority approach was followed in the United Kingdom.[134] In most situations, the single threshold approach facilitates squeeze-out of minorities, because no (super)majority of the minority requirement shall be met. Coherently with this feature, according to Article 15(2) of the directive, Member States that choose to implement the single threshold freeze-out can provide for a threshold higher than 90% and lower than 95%.[135]

It should also be noted that if the target corporation has issued multiple classes of voting shares, Member States implementing the directive can adopt a "disjoint" freeze-out, providing that the majority shareholder can exercise his or her buy-out right by class, only on the shares of the class in which the relevant threshold is reached.[136]

For example, consider a corporation that has issued 10,000,000 common stock and 10,000,000 preferred stocks carrying limited voting rights only on fundamental charter

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[131] There might be a difference in those two percentages in the case that voting rights are attached to non-equity securities or notes.

[132] Directive 2004/25/EC, *supra* note 124, art. 15(2)b.

[133] For a critical analysis of the extensive scope of optional rules in the Takeover Directive *see* Vanessa Edwards, *The Directive on Takeover Bids – Not Worth the Paper it's Written on?* 1 EUR. COMP. FIN. L. REV. 416 (2004).

[134] Silja Maul & Danièle Muffat-Jeandet, Takeover Directive, Silja Maul et al. (editors), TAKEOVER BIDS IN EUROPE. THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES, Memento Verlag (2008), at 57.

[135] Directive 2004/25/EC, *supra* note 124, art. 15(2), last sentence.

[136] *Id.*, art. 15(3), par. 2.

amendments and business combination, a practice relatively frequent in Europe.[137] Both categories of shares are listed on a national stock exchange, and the controlling shareholder holds 85% of the common stock and 65% of the preferred shares. Given that the Member State, whose laws are applicable, has introduced the "single threshold" freeze-out, setting the triggering threshold at 95%. The controlling shareholder launches a voluntary offer on all the outstanding common and preferred shares, with the intention of going private. The offers on the common and on the preferred shares are issued at different prices, reflecting the different values of the securities. At the end of the offering period, the bidder reaches 98% of the common shares, but only 89% of the preferred stock. The majority shareholder owns 93.5% of the entire voting capital (9,800,000 common stock, plus 89,000,000 preferred stock, over 20,000,000 outstanding shares), but still less than 90% of the preferred shares. If the Member State has not opted for the "disjoint" freeze-out, the offeror will be able to cash out *all* the minority shareholders, independently from the type of shares they own. If, on the other hand, the jurisdiction has opted into the rule set forth in Article 15(3) of the Takeover Directive, then she could only cash out common stockholders.

The effect of squeeze out by class is difficult to assess. On the one hand, it increases the flexibility of the rule and facilitates the reshaping of the equity structure of the corporation without imposing to buy substantively all the shares of different classes. On the other hand, it might make cash-outs aimed at eliminating all minority shareholders more financially burdensome because it requires reaching the relevant threshold for every single class of shares. Some countries have opted for this greater flexibility, for example, Italy and the U.K.; while others, such as France, do not allow freeze-outs limited to one class of shares.[138]

5. Freeze-out Consideration and Fair Price Presumptions

At what price should the freeze-out right be exercised? As a general, and relatively empty, principle, the first part of Article 15(5) of the directive provides that the price must be "fair".[139] More specifically, two rules govern the determination of the fair price: one concerning the type of consideration, the other concerning the amount of consideration offered.

Regarding the first rule, the directive provides that the consideration for squeezing out minorities shall have the same form of the consideration offered in the preceding triggering tender offer. If the preceding offer is for cash, minority shareholders must be squeezed out in cash. If the 90% threshold is reached through a stock-for-stock offer, the

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[137] For a discussion and some empirical evidence on the widespread use of limited voting shares in Europe *see* Deminor, *Application of the One-share, One-vote Principle in Europe*, Commissioned by the Association of British Insurers (2005), on file with author.

[138] Joëlle Simon, *France*, in Silja Maul, Danièle Muffat-Jeandet, Joëlle Simon (editors), TAKEOVER BIDS IN EUROPE. THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES 255 (Memento Verlag 2008); *see also* Commission Staff Working Document Report on the Implementation of the Directive on Takeover Bids, SEC (2007) 268 (February 21, 2007).

[139] Directive 2004/25/EEC, *supra* note 124, art. 15(5).

consideration for the freeze-out can be represented by the same type of securities, but cash is a viable alternative. If a non-cash or non-entirely-cash consideration is offered, Member States can also mandate the bidder that wants to freeze-out minorities to also offer an all-cash alternative.[140]

In terms of fair price, the directive provides for two different presumptions of fairness, depending on the type of tender offer that led to the relevant threshold. In case of a mandatory tender offer, triggered by acquisition of control, the minimum price is not freely determined by the bidder. Article 5(4) of the directive provides that the offer shall be launched at a price not lower than the highest price paid by the bidder in a period, set by the single Member States, between 6 to 12 months preceding the acquisition of control. When freeze-out rights are exercised after a mandatory tender offer, the price of the front-end offer, floored by this general rule, is deemed to be fair for cashing out minorities.

On the other hand, when the freeze-out threshold is reached through a voluntary bid, there is no minimum statutory price required by the directive, and therefore, no guarantee on the fairness of the front-end offering price. In this circumstance, according to Article 15(5) of the directive the price of the voluntary offer is presumed fair only if the shares tendered are more than 90% of the ones comprised in the bid.[141] A majority of the minority test is therefore applied to determine the fairness of the triggering tender offer. It should be noted that this rule applies both to the "majority of the minority" freeze-out, and to the "single threshold" freeze-out, when they follow a voluntary tender offer. In the case of a "majority of the minority" freeze-out, the presumption of fairness of the tender offer's price is met by definition, while this might not be the case in a "single threshold" freeze-out.[142]

There might be situations in which the offeror meets the requirements for squeezing out minority shareholders, but no presumption of fair price applies. For example, in a country providing for the single threshold freeze-out, the controlling shareholder holding 70% of the shares might launch a voluntary bid and obtain a little bit more than two thirds of the outstanding shares. This would grant her more than 90%, and therefore the right to take out minorities, but no fair price presumption would apply because her offer did not reach 90% of the shares included in the offer. In these situations, Member States should set up specific rules to determine fair price. Several Member States use some

[140] *Id.*, art. 15(5): "Member States shall ensure that a fair price is guaranteed. That price shall take the same form as the consideration offered in the bid or shall be in cash. Member States may provide that cash shall be offered at least as an alternative."

[141] It should be noted that shares acquired during the offer's acceptance period, but outside the mechanism of the tender offer (i.e., blocks of shares acquired directly from qualified minority shareholders), do not count toward the 90% threshold.

[142] In fact, even if the shareholder exercising the freeze-out would own no shares before the launching of the triggering tender offer, under the majority of the minority approach she necessarily has to acquire at least 90% of the share included in the offer to freeze-out the minority and, therefore, at least 90% of all the outstanding shares. Obviously, if – as it is normally the case – the acquiring shareholder already owns a substantive participation, if she obtains more than 90% of the shares included in the tender offer, she also obtains more than 90% of the totality of the outstanding shares.

form of appraisal by a regulatory agency, an independent expert, or on a court proceeding, and based on statutory-defined elements.[143]

The directive does not further clarify an element that might be extraordinarily important for litigation purposes: whether the fairness presumption regarding the price of the triggering tender offer is a rebuttable one. Some authors, in particular German commentators such as Krause and Austmann and Mennicke, have argued that the presumption is not rebuttable.[144] While it is difficult to offer a general answer, one can observe that even if the fair price presumption would be considered rebuttable, it is highly improbable, especially in civil law countries, that a price deemed presumably adequate by the legislature would be subject to extensive judicial review in the light of specific factual circumstances.

One final observation on the fair price presumption set forth by the directive. Setting the freeze-out price at the same level of the preceding mandatory or voluntary tender offer – somehow similar to what Vice-chancellor Strine decided in *Pure* – serves two conflicting goals. The first is to protect minorities from the pressure to tender in a front-end loaded two-steps acquisition. The second goal is to avoid strategic behaviors by minority shareholders. If they are expecting a higher price in the freeze-out, they would be tempted not to tender the shares in the front-end offer even if the price is fair, hoping to raise their gains by waiting. This strategy, rational at the individual level, might turn out to be a market failure because of collective action and coordination problems. If many shareholders follow this reasoning, the front-end tender offer may not reach the required thresholds, therefore making it impossible to trigger freeze-out rights. This outcome can be damaging not only to the controlling shareholder, but possibly also to the corporation and to minority shareholders. In light of this dichotomy, to provide for an identical price in the front-end and in the back-end acquisition seems a sensible regulatory approach. What might be missing, however, is the present value of the consideration received. The freeze-out consideration is paid *after* the one paid to shareholders that spontaneously tender their shares. The time lag is not dramatic but, depending on the specific legal system and the deal, it might go from a few weeks to some months. Usually no interest or other additional compensation for the delay is granted to shareholders that are forced out, and this element, in itself, might pressure them to tender in the front-end offer. After all, no rational investors would opt for receiving $100 in a month from now, when she could obtain the same amount today.[145]

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[143] *See* Commission Staff Working Document Report on the Implementation of the Directive on Takeover Bids, *supra* note 138.

[144] *See* H. Krause, *Die EU-Übernahmerichtiline – Anpassungsbedarf im Wertpapiererwerbs- und Übernahmegesetz*, DER BETRIEBS-BERATER 113, 118 (2004); A. Austmann and P. Mennicke, *Übernahmerechlicher Freeze-out und Sell-out*, NEUE ZEITSCHRIFT FÜR GESELLCSHAFTRECHT 846, 851 (2004). *Contra* Peter O. Mülbert, *Umsetzungsfragen der Übernahmerechlichtlinie – erheblicher Änderungsbedarf bei den heutigen Vorschiften des WpÜG*, NEUE ZEITSCHRIFT FÜR GESELLSHAFTRECHT 633, 634 (2004).

[145] European regulation provides for an additional, important rule that represents the other side of the coin of the freeze-out right. According to Article 16 of the Takeover Directive, in the same circumstances in which the controlling shareholder might exercise her buyout rights following a tender offer, every single minority shareholder has a sell-out right. Pursuant to this rule, a shareholder can force the controlling

Table 2 synthesizes the structure of Article 15 of the Takeover Directive.

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shareholder that has not exercised her freeze-out right to buy his shares at the same price and conditions regulated by Article 15. While the freeze-out right must be exercised on *all* the outstanding shares, the sell-out right *can* be exercised, within a three months window from the closing of the triggering tender offer, also solely by some minority shareholders, with the result that the controlling shareholder will not become the single owner of the corporation. This provision is designed to empower minority shareholders, and is relevant from at least two related points of view. On the one hand, if the minimum freeze-out price seems to be particularly convenient for minority shareholders, the controlling shareholder can not unilaterally refuse to buy the remaining outstanding shares. On the other hand, the provision might reduce the pressure to tender in the front-end offer, because the decision to acquire the non-tendered securities is shared between the controlling shareholder and every single minority shareholder. As the former has the power to unilaterally buy the shares, the latter has the power to have his shares bought at a fair price. For an analysis of the economics of sell-out rights *see* Mike Burkart & Fausto Panunzi, *Mandatory Bids, Freeze-out, Sell-out and the Dynamics of the Tender Offer Process*, ECGI Law Working Paper No. 10, 2003, *available* at www.ssrn.com. This right represents an important difference between the American and the European systems.

<table>
<tr><th>type of freeze-out rights that Member States can implement</th><th>statutory ground</th><th>triggering offer</th><th>minimum thresholds</th><th>consideration</th><th>fair price</th></tr>
<tr><td>“single threshold”</td><td>Article 15(2)(a)</td><td rowspan="2">voluntary or mandatory offer on all voting securities</td><td>from 90 to 95% (determined by the Member State) of the voting capital and voting rights in the target</td><td rowspan="2">same as in the triggering offer or cash. If a non-cash consideration is offered in the triggering offer, Member States can mandate a cash alternative</td><td rowspan="2">if triggering offer is mandatory, offer’s price is presumed fair

if triggering offer is voluntary, and 90% of the shares comprised in the offer have been tendered, offer’s price is presumed fair

all other cases are not regulated by the directive, different solutions are adopted in different Member States</td></tr>
<tr><td>“majority of the minority”</td><td>Article 15(2)(b)</td><td>90% of the voting capital and 90% of the shares comprised in the offer</td></tr>
</table>

Table 2 – Freeze-out pursuant to Article 15 of the E.U. Takeover Directive

6. Implementation of Freeze-out Rights in Some European Member States

After discussing the overall framework of the Takeover Directive, it should now be examined how some Member States have implemented the directive’s provisions in light of the different regulatory options left open by the European legislature.

First of all, one can distinguish jurisdictions that opted for Article 15(2)(a) of the Takeover Directive, the “single threshold” freeze-out, and for Article 15(2)(b) of the Takeover Directive, the “majority of the minority” freeze-out. In the first case, it is further possible to distinguish countries that have conditioned the exercise of freeze-out rights upon the acquisition of the 90% or the 95% thresholds of shares and voting rights.

Figure 1 shows that the vast majority of continental European countries have adopted the “single-threshold” option. Most of them applied this or a similar approach even before the adoption of the Takeover Directive.[146] The only two European states that have adopted the "pure" form of the "majority of the minority" freeze-out are the United Kingdom[147] and Ireland,[148] where the right to buy out minorities is conditioned to acquiring at least 90% of the shares included in the triggering tender offer. Even in this case, the solution adopted is coherent with path dependency, as it confirms the pre-directive approach.

A different solution is provided in Portugal and Spain. In these two jurisdictions, the conditions set forth in Article 15.2(a) and 15.2(b) of the Takeover Directive have been combined, and both requisites – achieving a number of shares corresponding to 90% of the voting rights, and acquiring a number of shares equal to 90% of the voting rights included in the bid – are required to allow squeezing out minorities.[149]

[146] For example, in Germany *see* Aktiengesetz (AktG) (Stock Corporation Act) September 6, 1965, Bundesgesetzbuch (BGBI) I, 189, as amended, §327a ff (Ger.) (which requires a single threshold of 95% and has entered into force already back on January 1, 2002). In Italy *see* Testo Unico della Finanza, T.U.F., §111, Dec. Leg. n. 59 February 24 1998 (It.).

[147] Companies Act 2006, sec. 979 ff. (UK).

[148] Companies Act 1963 (consolidated), sec. 204 (Irl.).

[149] *See* Commission Staff Working Document Report on the Implementation of the Directive on Takeover Bids, *supra* note 138, at 18.

Figure 1 – Implementation of Freeze-out Rights in Some E.U. Member States

The following Figure 2 shows the Member States that, having opted for the "single threshold" freeze-out, have chosen the highest possible threshold of 95%. States that have adopted the "majority of the minority" freeze-out right did not have any choice in terms of threshold, which is fixed by the directive at 90% of the shares included in the triggering tender offer.

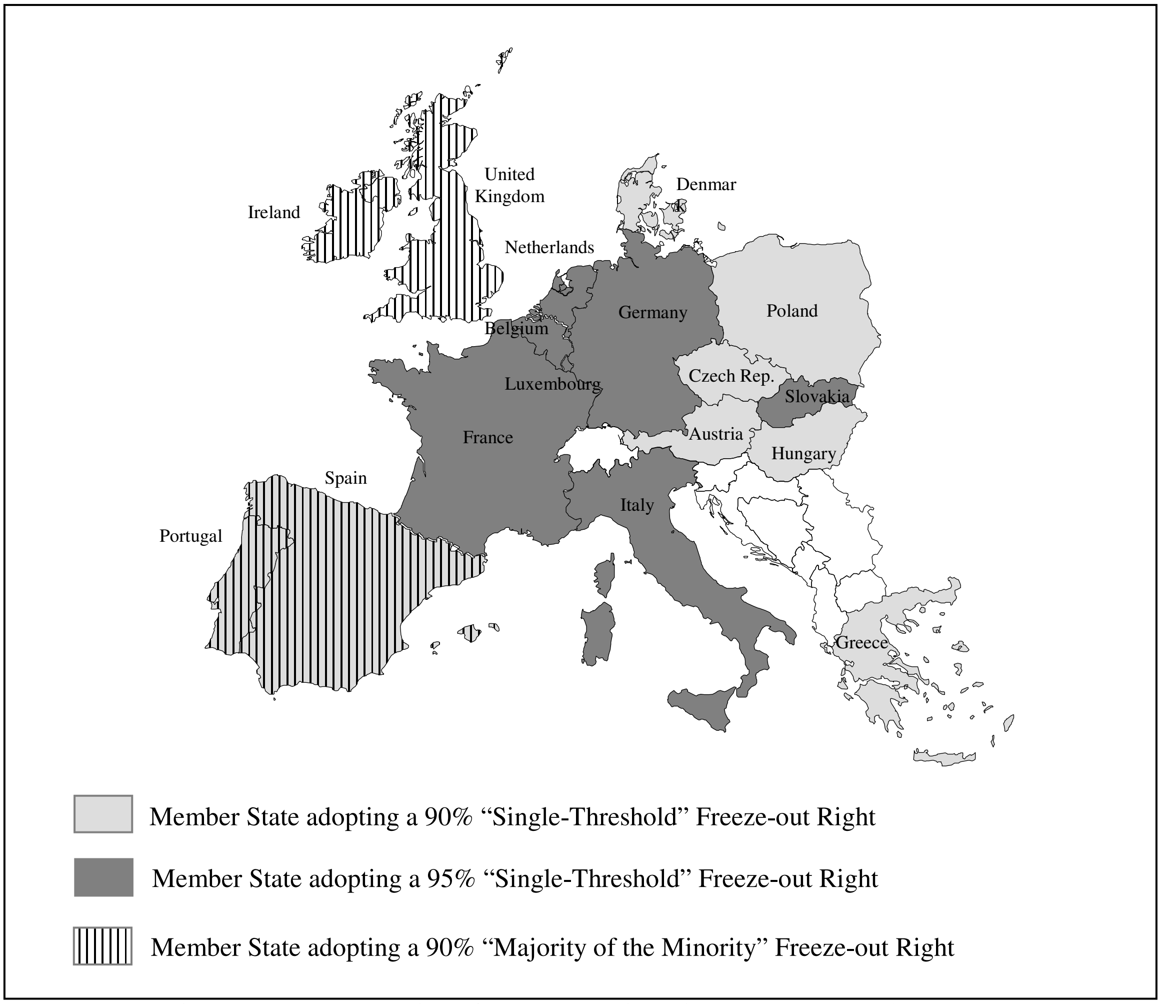

Figure 2 – Implementation of Freeze-out Rights in Some E.U. Member States

The map shows not only that most continental European systems adopted the single-threshold approach, but also that, in the largest economies, the threshold triggering the freeze-out right is set at the highest possible level, 95%. This option clearly affects the possibility of conducting a public-to-private transaction.

A second important comparative difference among European countries that regulate freeze-outs pursuant to Article 15 of the Takeover Directive concerns the type of consideration offered to minority shareholders, and the fair price presumption. As we mentioned above, the directive provides relatively straightforward rules. The consideration shall be the same with the one offered in the triggering offer, but it can also always be in cash. Member states can ever provide that, when a non-cash consideration is offered, cash must be offered as an alternative. As for the fairness of the price, the directive distinguishes between freeze-outs triggered by mandatory and voluntary offers. In the first case, the price of the mandatory offer (the highest paid by the offeror in a period between six to twelve months preceding the offer determined by the Member State) is presumed fair.[150] In the second case, the price of a voluntary offer is considered

[150] Directive 2004/25/EEC, *supra* note 124, art. 5(4).

fair if the bid obtained at least 90% of the shares included in the offer.[151] The directive does not clarify whether these presumptions are absolute or can be rebutted; and leaves to Member States to regulate how fair price should be determined when none of these presumptions apply.

Within this general framework, different Member States have introduced specific variations concerning the minimum fair price and its determination. On the one hand, there are countries that have plainly adopted the directive's approach set forth in Article 15(5), and therefore always deem the price of a triggering mandatory offer fair, and the price of a voluntary offer that reached a 90% rate of acceptance. This approach is followed, for instance, in Italy and in the Slovak Republic.[152]

Another large group of countries provides for more articulated rules. Numerous local variations exist, but the jurisdictions departing from the basic rule try to accomplish a higher level of protection for minority shareholders. While Member States can not lower the minimum price provisions set forth in Article 15 of the directive, the enactment of more rigorous rules is compatible with European law.

In countries that require "something more" than the directive, the legislative techniques through which freeze-out prices are regulated can be ascribed to two families: (a) provisions that directly regulate the price establishing presumptions of fairness that are stricter than the ones provided for by the directive; and (b) provisions that require or facilitate the appraisal of the shares by a third party expert or by a court, either automatically or upon demand of minority shareholders.

In some jurisdictions, for instance, not only the price of a voluntary tender offer, but also the one of a mandatory offer is considered fair for freeze-out purposes only if 90% of the shares included in the offer have been tendered: Spain and the U.K. follow this approach. This represents an additional requirement when compared with the default rule in Article 15(5) of the Takeover Directive, according to which the price of a mandatory tender offer is always considered fair, independently from the level of acceptance of the offer.[153]

Another interesting, and somehow more complicated example of this approach can be found in Germany. First of all, implementing the directive, the German legislature decided to allow a freeze-out following a tender offer *only* when the relevant freeze-out threshold 95% is reached through a mandatory tender offer, or a voluntary offer launched

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[151] *Id.*, art. 15(5).

[152] On Italy, *see* Articles 111(2) and 108(3) of the Testo Unico della Finanza and Lucia Picardi, *Italy*, in Silja Maul, Danièle Muffat-Jeandet, Joëlle Simon (editors), TAKEOVER BIDS IN EUROPE. THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES 416 (Memento Verlag 2008); on the Slovak Republic, *see* Branislav Hazucha, Michaela Jurková, *Slovak Republic*, in Dirk Van Gerven (editor), COMMON LEGAL FRAMEWORK FOR TAKEOVER BIDS IN EUROPE 375 (Cambridge University Press 2008). One important difference between the two countries is that in the former, if the voluntary bid does not reach the required threshold, the freeze-out price is determined by the Stock Exchange Commission (Consob), taking into account the market prices of the last six months and the offer's price; while in the latter the price must be equal to the one that would have been required in the case of a mandatory offer.

[153] Clearly enough, in Member States that have adopted the majority of the minority freeze-out rule, this condition is always met, otherwise it would not be possible to exercise the freeze-out right in the first place.

to obtain control.[154] Under the relevant statute, the Wertpapiererwerbs- und Übernahmegesetz (WpÜG), freeze-out rights are not available to a subject already controlling the corporation (for instance, a shareholder holding 60% of the voting shares) who can simply launch a voluntary tender offer on the remaining shares. Even if the directive allows the price of a voluntary tender offer to be freely determined by the offeror, in Germany, the price of the voluntary offer launched to gain control, which might lead to the exercise of freeze-out rights, cannot be lower than the price of a hypothetical mandatory tender offer. This latter price is the highest price paid by the offeror in the six months preceding the bid.[155] This price is presumed fair for freeze-out purposes only if the bidder has acquired more than 90% of the securities included in the triggering offer, independently from its mandatory or voluntary nature.[156]

Apart from the specific technicalities of the German model, what should be pointed out is how some Member States have provided for particularly strict rules, when compared to other European jurisdictions, rules that might limit the ability of the controlling shareholder to freeze-out minorities, or make it generally more financially burdensome, *ceteris paribus*, than in other jurisdictions.

In other systems, further protections for minorities in case of freeze-out are established through recourse to a greater involvement of an external appraiser, either *ex ante* or *ex post.* The appraiser can be an independent expert, the court, or a national supervisory authority. A good example of this approach is from France, where the Autorité des Marchés Financieres (AMF) must be notified *ex ante* of the intention to carry on a freeze-out following a tender offer. The AMF shall decide whether the conditions required by the law for squeezing-out minorities are met, and examine an evaluation of the shares submitted by the offeror weighting different elements: the value of the corporate assets, past earnings, market value and business prospects.[157]

In the absence of meaningful empirical evidence, it is virtually impossible to say whether this approach leads, in general, to higher or lower freeze-out prices. It should be noted, however, that this approach provides for another variation on the theme, and the need to comply with this procedure might affect the smoothness of the freeze-out.

To sum up, the last two paragraphs have demonstrated that Member States have adopted a great variety of different solutions to implement the freeze-out provisions of the Takeover Directive. Differences exist in the conditions that trigger the freeze-out right, in the applicable fair-price presumptions, and even in the regulatory strategies

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[154] Wertpapiererwerbs- und Übernahmegesetz (WpÜG) Bundesgesetzblatt (BGBI) I 3822, as amended, §31(3).

[155] Wertpapiererwerbs- und Übernahmegesetz (WpÜG) Bundesgesetzblatt (BGBI) I 3822, as amended, §31(3).

[156] The German legislature did not expressly regulated what happens when the 90% threshold is not reached, and the fair price presumption does not apply. A court procedure to determine the fairness of the consideration offered will follow, but it is not clear how the burden of proving fairness will be divided between the offeror and the (contesting) minority shareholders.

[157] Simon, *supra* note 138, at 256.

followed, depending on whether the legislature relied more on "rules" or on "standards" that require implementation by courts, regulatory authorities or independent experts.

This kaleidoscopic mosaic not only symbolizes the compromise underlying the numerous options contained in the Takeover Directive, but also represents, in itself, a possible obstacle to the creation of a truly integrated market for corporate control and to cross-border acquisitions in the European Union, as will be argued argue more extensively in paragraph V.2.

7. *Alternative Ways to Freeze-out Minority Shareholders in Some European Jurisdictions*

Before turning the page and providing a critical comparison of the different systems, a few more words are necessary on freeze-outs in European countries. In some jurisdictions freeze-out rights based on Article 15 of the Takeover Directive are not the only way by which controlling shareholders can cash out minorities without their consent.

Two of the most meaningful examples of these additional procedures are the use of a "scheme of arrangement" in the U.K., and Articles 327a ff. of the German AktG. As for the former, pursuant to British law:

> "A '*scheme of arrangement*' or '*reconstruction*' under CA 2006, Part 26 and Part 27 (additional requirements for public companies) enables a company to effect mergers and amalgamations, and also to alter the rights of its members or *its creditors*, with the sanction of the court. The provisions are sufficiently wide to accommodate schemes having a considerable diversity of objectives and range of complexity, which may involve more than one company. [*omissis*] Unless the court orders otherwise, the members or creditors who dissent are nevertheless bound to accept the terms of the scheme."[158]

A "scheme of arrangement" is a very flexible procedure that can be used to reach a broad variety of outcomes with the approval of a court. This technique can, in theory, be used to cash out minorities, but the existing case law is limited on this subject, and therefore raises doubts on this possibility and suggests that from the point of view of the controlling shareholder, the procedure would not be as streamlined as a short-form merger in the U.S. In *In Re Hellenic & General Trust Ltd*[159], Hambros Ltd. intended to buy all of the outstanding shares of Hellenic. The transaction was approved by the general shareholders' meeting with a large majority of 80% of the votes, but opposed by some minority shareholders (in particular, the National Greek Bank, holding 14% of the share), which was fearful of the negative tax consequences of the acquisition. The court did not sanction the scheme, but required a positive vote of the majority of the (non-affiliated) minority as a "separate class". In addition, the case suggests reluctance to

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[158] LEN SEALY & SARAH WORTHINGTON, CASES AND MATERIALS IN COMPANY LAW 605 (Oxford University Press, 8th ed., 2008). I wish to thank David Cabrelli and Paul Davies for discussing with me over email the issue of scheme of arrangements as a possible way to cash out minorities in the U.K. (email on file with the author). Obviously, mistakes on this issue are solely mine.

[159] Re Hellenic & General Trust Ltd. [1976] 1 WLR 123, [1975] 3 All ER 382 (Chancery Division), *see again* SELEY & WORTHINGTON, *supra* note 158, at 610.

allow the use of a scheme of arrangement for freeze-out purposes, when shareholder could be cashed out pursuant to Articles 974 ff. of the Companies Act 2006, implementing Article 15 of the Takeover Directive.

The British "scheme of arrangement" therefore does not appear equivalent to the U.S. cash-out merger, and can be considered a much more uncertain, lengthy and potentially expensive cash-out technique, if it is one at all.

Articles 327a ff. of the German AktG also provide a way to freeze-out minorities outside the scope of Article 15 of the Takeover Directive, while granting meaningful protections for minority shareholders. This procedure is available when a shareholder holds 95% of the shares.[160] In short, the controlling shareholder can convene a meeting of all the shareholders to approve the cash-out procedure.[161] Because the squeeze out is not preceded by any tender offer, the fairness of the cash-out price must be determined differently than through presumptions based on the price of the triggering offer.[162] In this case, a court-appointed expert must evaluate the fairness of the proposed price. A positive opinion of the expert limits the possibility to challenge the transaction in court.[163]

While this particular procedure clearly broadens the possibility to squeeze out minorities, and is quite flexible, it is still significantly stricter than American rules. The controlling shareholder, in fact, must own a very high percentage of shares, close to 100%, in order to exercise the freeze-out right.

In conclusion, Article 15 of the Takeover Directive is not the *exclusive* freeze-out provision in all European jurisdictions. To the extent that other rules exist in some Member States, however, they are significantly less liberal than in the U.S. This is coherent with the above-mentioned principle that minority shareholders' enjoy a quasi-absolute right to remain members of the corporation in which they have invested. In addition, these rules only exist in a handful of Member States, and lack any harmonization. For these reasons, additional provisions do not undermine the reform proposals that will be advanced in the final Part of this Article, which calls for a more harmonized and flexible regime, based on a more modern view of minority shareholders property rights.

V. AN EXPLANATION OF THE DIFFERENCES IN THE REGULATION OF FREEZE-OUT TRANSACTIONS

1. Comparative Differences in Context

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[160] AktG, *supra* note 146, §327a; *see* VOLKER EMMERICH & MATHIAS HABERSACK, AKTIEN- UND GMBH-KONZERNRECHT (2008), at §327a Rn 1-31.

[161] *Id.*

[162] AktG, *supra* note 146, §327b; *see* VOLKER EMMERICH & MATHIAS HABERSACK, *supra* note 160, at §327a Rn 3-9.

[163] AktG, *supra* note 146, §327b; *see* VOLKER EMMERICH & MATHIAS HABERSACK, *supra* note 160, at §327a Rn 1-15.

In the preceding analysis, we have considered some of the most important differences concerning freeze-out transactions in the United States (focusing in particular on Delaware law) and in Europe. Before discussing the causes and consequences of these differences, a brief recapitulation is necessary.

In the United States, freezing out minorities independently from their consent and going private is, generally speaking, easier than in Europe. Two major techniques are available and usually followed: the long-form, cash-out merger and the tender offer followed by a short-form merger. In both cases, the emphasis in terms of protection of minorities is not based on an absolute right for minorities to remain shareholder, but rather on ensuring that the cashed-out investors obtain the fair value of their shares.

Dissenting minority shareholders can either exercise their appraisal right and have their shares evaluated in a court proceeding, or challenge the merger on several possible grounds, and in particular alleging a breach of directors' and/or controlling shareholders' fiduciary duties. The former remedy, for the reasons discussed above, is not particularly effective from the standpoint of the minorities. The latter one is the most widely used and extensive case law exists on the subject.

When challenged in court, a merger with a controlling corporation is considered a self-dealing transaction and therefore is subject to the entire fairness standard of judicial review, a standard significantly less deferential to directors then the business judgment rule. Normally, the defendants would have to positively prove entire fairness. If, however, certain specific procedural protections are adopted in approving the deal, the burden of proving (un)fairness is then shifted to the plaintiffs. These procedural protections are either: (a) approval of the deal by a special committee of independent directors, entrusted with the responsibility of negotiating the deal with veto power; or (b) approval of the deal by a majority of the minority shareholders non-affiliated with the controlling acquiring corporation.

As for the second freeze-out technique, the tender offer followed by a short-form merger, the front-end offer is not subject to any particular standard of review, and the bidder is free to offer the price he or she deems adequate. The transaction is, in fact, not considered in conflict of interest because the bidder and the minority shareholders are not related parties. The second step of the deal, the short-form merger approved solely by the directors of the acquiring corporation, is only subject to the business judgment rule standard if three conditions, designed not to make the front-end offer coercive, are met: (a) the tender offer is subject to a non-waivable majority of the minority condition; (b) the bidder assumes the obligation to effectuate the short-form merger, if she reaches the necessary threshold, promptly after the conclusion of the bid and at the same price and conditions in which the offer was launched; (c) the buyer does not engage in any retributive threat capable of manipulating the decision making process of the shareholders with respect to accepting or rejecting the offer.

The European scenario presents significant differences but also some interesting similarities. Generally speaking, there are fewer situations in which a controlling shareholder can unilaterally decide to cash-out minorities. Cash-out mergers are not available in the vast majority of the Member States of the E.U. Even if, at least in theory, in some jurisdictions, transactions leading to similar results are not utterly impossible, for several different reasons they are not really used, and in any case they present significant differences, and lesser flexibility, than the American cash-out merger.[164]

Mergers can be used to go private and delist, and create pressure on minority shareholders to sell their shares. In general terms, however, the consideration for all the shareholders of a corporation that will be extinguished as a consequence of a merger must be, at least in part, shares of the surviving entity.

In Europe, the principal way to go private, harmonized by the Thirteenth directive, is a statutory freeze-out right following a mandatory or voluntary tender offer on all the outstanding shares. In the triggering offer, the bidder shall obtain either a threshold between 90 and 95% of all the outstanding shares and voting rights ("single-threshold freeze-out", more common on the continent), or 90% of the shares included in the offer ("majority of the minority freeze-out", consistent with the British tradition). At this point, the controlling shareholder can force the minority shareholder out by purchasing their share at a fair price. The price of the triggering offer is generally considered fair if it is at least equal to the price of the mandatory offer or – more relevant for our purposes – to the one of the voluntary offer when a minimum of 90% of the securities involved have been tendered. Different local variations of this rule exist in Member States.

Looking at the overall structure of this rule, and how it has been implemented in most Member States, we can point out differences and similarities with the Delaware two-step freeze-out.

First of all, also in Europe, the unilateral acquisition follows a tender offer. However, the European system is somehow more flexible to the extent that the second step of the freeze-out does not need to be a merger in which the target corporation is merged with and into the parent. Following the exercise of the freeze-out right, the subsidiary can survive as a corporation with one single shareholder.

With respect to the percentage of shares that needs to be reached to cash-out the minorities, however, European law is more rigid than its American counterpart. In fact, while in the U.S., under Delaware law, a short-form cash-out merger can unilaterally be decided if the controlling shareholder reaches 90% of the capital, in Europe, the threshold is higher. The majority of the countries that have adopted the single-threshold freeze-out have opted for a 95% threshold. The few countries that follow the majority of the minority freeze-out option set forth in Article 15(1) of the Takeover Directive, on the other hand, require that the bidder receives at least 90% of the shares included in the offer on all the outstanding shares. Practically this means that he or she needs to obtain more than 90% of all the outstanding shares, because freeze-outs are rarely pursued by a

[164] Consider, for example, the possibility to use a scheme of arrangement under British law, or Section 327a of the German Corporation Statute, both mentioned *supra*, par. IV.7. It should be noted, in addition, that even a U.K. scheme of arrangement would require approval of the majority of the minority to be permissible. Even when compared with the unique British approach, American law is, in this respect, significantly more flexible. In the U.S., a cash-out merger, in fact, can always be unilaterally approved by the majority shareholders: approval by a majority of the minorities simply has the effect of shifting the burden of proving entire fairness if the merger is challenged in court, but is not a condition for the consummation of the deal.

subject that launches an offer without already owning a substantial participation in the target corporation.

A very simple example can clarify this point. A controlling shareholder holds 60% in common stocks of a corporation that has only issued one class of equity securities. If he wants to freeze-out minorities, in the U.S., he or she can opt for a cash-out long-form merger, or launch a tender offer followed by a short-form merger. In this second case, he or she would have to acquire an additional 30% of the outstanding common stocks. In Germany, a country adopting the single-threshold freeze-out, on the contrary, the bidder would have to buy at least 35% of the remaining shares. In the United Kingdom, according to the majority of the minority freeze-out, he would have to acquire 90% of the remaining 40%, equal to 36% of the outstanding shares in absolute terms. Other things being equal, to achieve the position in which one can actually cash out minorities is more expensive, at least in terms of quantity of shares that it is necessary to buy, in Europe.

Another crucial issue is the determination of the fair price of the freeze-out. Also in this case European law appears less favorable to going private transactions. Let's focus on an hypothetical that allows for an immediate comparison between the U.S. and Europe rules: a controlling shareholder already holds the absolute majority of the shares – for example, 82% – and launches a voluntary tender offer in order to acquire the relevant threshold to force minorities out.

Both Article 15(5) of the Takeover Directive, and Delaware jurisprudence, follow a surprisingly similar rationale in regulating this matter. To begin with, both systems require that the majority of the minority accepts the tender offer, in order to presume the fairness of the price offered in the front-end bid. Since *Pure*, however, in the U.S. a simple majority is sufficient (50% of the shares involved in the bid). European law, on the contrary, sets forth the stricter condition that the acceptance rate should be at least 90%.

If our controlling shareholder starts her acquisition owning 82% of the shares, for the presumption of fairness to apply, Delaware law requires the tendering of a minimum of 9% (plus one share) of the remaining 18% of the capital. The bidder will thus reach 91% and be able to approve a short-form merger. According to the presumption of fairness in Article 15(5) of the Takeover Directive, the same bidder would need to obtain at least 16.2% of the shares from the minority, reaching an ownership stake as high as 98.2% of the shares. Only in this case, the price of the front-end tender offer would be considered fair for freeze-out purposes.

This rule, as it has been insightfully argued, implies that "more weight is given to the securities that belong to those rejecting the bid".[165] A minority as small as 10.1% of the owners of the shares included in the offer (less than 2% of the entire capital!), by rejecting the offer, can rebut the fairness presumption, notwithstanding the fact that the bid has been accepted by almost 9 shareholders over 10 (more precisely, with 9 shares over 10). When compared to U.S. law, this approach puts an emphasis on the opinion of the minority of the minority, rather than of the majority of the minority.[166]

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[165] Kaisanlahti, *supra* note 4, at 507.

[166] *Id.*, at 507.

In Europe, the freeze-out can also follow a mandatory tender offer pursuant to Article 5 of the Takeover Directive. This scenario is not directly comparable with any similar situation in the U.S., and in Delaware in particular, because the mandatory tender offer does not exist in these jurisdictions.[167] It should be noted, however, that in this case, the freeze-out price will likely need to be even higher than the one resulting from a triggering voluntary tender offer, because the minimum price of the mandatory tender offer is the price paid by the bidder to acquire control. It is, therefore, a price that often includes a substantial premium for control.

In addition to that, as mentioned above, when the freeze-out is triggered by a voluntary tender offer, some countries impose further protections for minorities in determining the minimum freeze-out price. In Germany, for example, even the voluntary tender offer must be launched at the same price as a mandatory offer. In other jurisdictions, like France, additional measures require following an administrative or court *ex ante* procedure. Those and similar rules contribute to raise the costs and length of a freeze-out.

A second condition provided both by Delaware freeze-out doctrines and E.U. law in order to presume the fairness of the deal concerns the fact that the second step of the acquisition (the short-form merger in the U.S., the statutory buyout in Europe) must be completed in a set timeframe after the acquisition, through the tender offer, of the relevant threshold. The purpose of this rule is clear: the later the second step is completed, at the same conditions of the front-end offer, the higher the pressure to tender is imposed on minorities. When the controlling shareholder launches the triggering tender offer, in other words, the message sent is: you can walk away with so many dollars today, or the same amount but a couple of months later. The present value of the consideration paid in the second step of the freeze-out is clearly lower in the absence of corrective mechanisms such as the payment of interest rates.

In *Pure* and its progeny, Delaware courts did not specifically clarify the exact meaning of the condition that the short-form merger should be consummated "promptly" after the tender offer. Apart from this rather generic and elastic requirement, a precise timeline has not been established. On the other hand, in Europe, the three months period after the conclusion of the tender offer granted by the Takeover Directive to exercise the freeze-out rights seems quite long and appears to be potentially longer than the corresponding American concept of "prompt" freeze-out. This provision might put a higher pressure to tender on minority shareholders in Europe than in the U.S.

A final distinction concerns the third requirement set forth in *Pure* in order to presume the fairness of a two-step freeze-out: the fact that the acquiring corporation does not pose any retributive threat to minority shareholders. As elusive and difficult to apply this requirement might be, it is an important bastion for avoiding coercion of minorities. The Takeover Directive does not address this issue, which would largely be regulated by

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[167] *See* Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEXAS INT'L L. J. 171, 189 (2006); it should be pointed out, however, that some anti-takeover devices allowed in some U.S. jurisdictions relay on mechanisms similar to the mandatory bid in the fact that require to a raider to acquire all the outstanding shares: *see* Peter V. Letsou, *Are Dead Hand (and No Hand) Poison Pills Really Dead?*, 68 U. CIN. L. REV. 1101, 1105 (2006).

the national laws of the single jurisdictions. To the extent that it is possible to generalize, in some systems similar conducts might theoretically be considered in breach of controlling shareholders' fiduciary duties. It is however fair to say that, in the absence of specific statutory or case law limitations, even assuming that a duty to restrain from retributive threats could be established, it would be very difficult to enforce it. In addition, in terms of regulatory technique, this requirement is a typical example of a "standard", as opposed to a "rule".[168] As such, it would probably be less easily and effectively applied in continental civil law systems rather than in common law systems, where the accumulation of precedents contributes to specify the content of the requirement.

In sum, in the framework of E.U. law, squeezing out shareholders appear to be more difficult than in the U.S. Not only one of the two most important techniques used in America, the one-step, long-form cash-out merger, is generally not available in Europe, but also the statutory freeze-out right provided for by Article 15 of the Takeover Directive, notwithstanding its important similarities with the American two-step freeze-out (tender offer followed by short-form merger), is less accessible to controlling shareholders for at least a couple of reasons. First, the triggering threshold that must be reached to unilaterally buy out the minorities is, on average and notwithstanding local variations, higher in Europe. Second, the presumption that the price paid in the front-end tender offer is the fair freeze-out price which requires approval by a substantially larger majority of the minority.

Needless to say, numerous and complicated factors, and not only legal ones, interact to determine whether freeze-outs are really more difficult and costly for controlling shareholders in Europe, a question that should also be declined somehow differently with respect to different corporate law jurisdictions. However, the general picture described in the previous pages and the conclusion that stems from it appear to be confirmed by empirical evidence.[169]

2. Causes and Consequences of the Diverging Approaches

Different overlapping elements concur in explaining the different approaches to freeze-outs in the U.S. and in Europe. The interactions among these elements are complicated and nuanced, and this section has not the ambition to capture all the causes of the divergence, but the more modest one of spelling out some of the most crucial ones.[170] Four explanations for the comparative differences can be identified: (a) the

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[168] For the distinction between these regulatory techniques, *see* Henry Hansmann & Reiner Kraakman, *Agency Problems and Legal Strategies*, in THE ANATOMY OF CORPORATE LAW. A COMPARATIVE AND FUNCTIONAL APPROACH (Reiner Kraakman et al. ed. Oxford University Press 2004), at 23.

[169] Toby Stuart & Soojin Yin, *Board Interlocks and the Propensity to be Targeted in Private Equity Transactions*, NBER Working Paper No. 14189, 2008, *available* at www.ssrn.com.

[170] An additional cautionary note is that, as in most comparative analysis, causes and consequences might be difficult to tell apart. The very fact that a given freeze-out regime is adopted, affects the development of the legal system from which it stems. For example, a rule designed for working in systems that do not typically rely, or rely less, on judicial intervention, is likely to be less well-suited for being enforced in court, thus further limiting recourse to lawsuits.

federal structure of the American corporate law system and the related chartering competition among states; (b) the risks and costs of litigation associated with the status of listed corporation; (c) the potential role of freeze-out rules or their absence thereof as a springboard for hostile corporate acquisitions or a protection for entrenched shareholders; and (d) a path-dependency phenomenon linked to how the legal system and local culture traditionally envisioned the property rights of shareholders.

The first reason that explains the existence of a more flexible freeze-out regime in the United States can be found in that ubiquitous feature of American corporate law that is regulatory competition among states and the existence of a market for corporate charters.[171] The scholarly debate has largely explained the different dynamics of regulatory competition in the U.S. and Europe, to the extent that corporate mobility exists in Europe.[172] There is little doubt that a regime that facilitates going private can be appealing for decision-makers when selecting the jurisdiction of incorporation. This conclusion holds both because freeze-out rules can be an important driver for regulatory competition, and because corporate jurisdiction generally characterized by a more permissible approach are likely to offer more flexible rules concerning freeze-outs. The limited role of the market for corporate charters in Europe, especially with respect to public corporations or corporation considering going public, that could potentially be more interested in going private in the future, supports the conclusion that legislatures and policy makers had few incentives to facilitate these types of transactions.[173]

The second, and connected, explanation concerns the risk of litigation. It is clear that in systems that rely highly on litigation, like the U.S. in comparison to Europe – especially continental Europe –, going private can be particularly relevant. In the U.S.

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[171] *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (AEI Press, 1993). The literature on regulatory competition in corporate law is extensive. Limiting to some of the "classical" contributions, among the supporters of the idea that the incorporation principle leads to a "race to the top", in addition to Romano, *see* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 290 (1977); Ralph K. Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg,* 89 COLUM. L. REV. 1526, 1528 (1989); FRANK H. EASTERBROOK & DANIEL R. FISHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212-227 (1991). More critical of the beneficial effects of regulatory competition are William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1486-88 (1992); Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999); Lucian A. Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1820 (2002). A general discussion of regulatory competition can be found in Joel P. Trachtman, *International Regulatory Competition, Externationalization, and Jurisdiction*, 34 HARV. INT'L L.J. 47, 59-81 (1993). The issue of regulatory competition in securities regulation is examined by Frederick Tung, *Lost in Translation: From U.S. Charters Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525 (2005); Merrit B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investment Empowerment,* 85 VA. L. REV. 1335 (1999); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

[172] For a discussion of how the recent jurisprudence of the European Court of Justice might have affected corporate mobility in Europe, *see* Marco Becht et al., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241 (2008).

[173] Marco Ventoruzzo, *"Cost-based" and "Rule-based" Regulatory Competition: Markets for Corporate Charters in the U.S. and in the E.U.*, 3 N.Y.U. J. L. & BUS. 92 (2006).

more than in Europe, buying out minority shareholders eliminates the risk of future derivative suits and class actions, and its value is directly correlated with the potential costs associated to these events for the corporation, its controlling shareholders, directors and managers. It is true that going private itself is often a catalyst for litigation. Nonetheless, corporate insiders might prefer to face a "controlled" risk of litigation for one specific transaction, minimizing it by complying with the now well-established Delaware case-law, rather than remaining exposed to potential lawsuits as a listed corporation.

Vis-à-vis the higher potential relevance of litigation associated with publicly-held status, it is therefore not surprising that freeze-out rules emerged as a pivotal issue in the U.S. before and more forcefully then in Europe. For American legislatures and judges it became crucial, especially in the light of regulatory competition among states, to facilitate going private transactions while protecting the value of the investment of minority shareholders.

This last motivation for the different development of freeze-out rules opens the door to a more general, and probably more cynical, remark from a public choice perspective. The idea that in most civil law systems private benefits of control are higher than in the U.S. is coherent with the observation that legislatures face less pressure from controlling shareholders, managers and their lobbies to facilitate going private transactions. A lower level of minority protection reduces the risks and costs associated with the status of publicly-held corporation. In other words and more bluntly: in Europe, controlling shareholders and directors might be less eager to buy out minority shareholders, because the likelihood to be brought to court and succumb are low, and the possibility of exploiting the private benefits of control are more significant than in the U.S.[174]

But there is even more. Barriers to going private transactions might have a protective effect for incumbent controlling shareholders against hostile acquisitions. It can be a sort of implied antitakeover measure, which has not really been examined by scholars and policy makers. It is intuitive that many hostile acquisitions in the form of LBOs or MBOs can be sustained financially only bringing the corporation private and cashing our minorities. This might be the case for different reasons, for instance in light of the tax benefits of substituting equity with debt, or because the debt incurred to take over the corporation can be serviced only cutting compliance expenses, or because the corporation needs an organizational turnaround that cannot be effectively and efficiently accomplished in the presence of minority shareholders.

When potential buyers know that to achieve a position in which they can unilaterally cash out minorities is difficult, especially with the opposition of the existing controlling shareholder, the risk of not being able to obtain 100% of the outstanding shares might discourage hostile acquisitions. It can therefore be argued that, in states with a concentrated ownership structure that do not favor the proliferation of hostile acquisitions, stricter rules concerning freeze-outs might also serve as an indirect, but

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[174] *See* Rafel La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

relatively effective, deterrent of some takeovers, to the advantage of existing controlling shareholders.[175]

A fourth and final explanation for the different approaches to freeze-outs in the U.S. and Europe can be found in a cultural relic concerning the legal qualification of the interests of minority shareholders in the corporation. Most continental European systems emphasize the property rights of the single shareholder over the shares she owns, and consider most forced acquisitions an infringement of the right to own property.[176] In some Member States, freeze-out statutory rights have even raised constitutional law issues, because they might be considered a taking based on a private, rather than a public, interests and, therefore, prohibited by their constitutions.[177]

Allowing controlling shareholders to unilaterally buy out minorities is at odds with this view. In Europe it is still dominant the concept that cashing-out minorities should be possible only in extreme circumstances. This approach assumes that the best protection of minority shareholders consists in allowing them to hold on to their shares.

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[175] The fact that equity buyouts activity in Europe is as relevant as in the U.S., if not more, (as pointed out by Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 39 (2006)), does not contradict this point because the distinction drawn in the text concerns hostile acquisitions, which appear significantly less common in continental Europe than in common law systems (*see* John Armour & David Skeel, *Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L. J. 171, ___ (2007); Marina Martynova & Luc Renneboog, *Mergers and Acquisitions in Europe*, ECGI Finance Working Paper No. 114/2006, *available* at www.ssrn.com, at 42; Ventoruzzo, *supra* note 127, at 170.

[176] Germain, *supra* note 96.

[177] For example, the Constitutional Court of the Czech Republic had to address this issue in 2008, when it denied the unconstitutionality of the freeze-out right implemented pursuant to Article 15 of the Takeover Directive, but it also observed that the rule might raise some questions of compatibility with the constitutional protection of property rights. *See* Decision Pl. ÚS 56/05 of March 27, 2008, available in English at http://angl.concourt.cz/angl_verze/doc/pl-56-05.php, which reads that "we must state that the legal regulation of a forced buy-out of securities is not, and not only in terms of the process of introducing it into the Commercial Code and amending it, an example of a legal regulation that does not raise a number of questions of a constitutional nature. These objections can be overcome through a constitutional interpretation." Likewise, the German Bundesverfassungsgericht confirmed the constitutionality of freeze-outs; see e.g. Bundesverfassungsgericht (BVerfG) (Federal Constitutional Court), Sept. 19, 2007, 1 BvR 2984/06. (it has been constantly held that §327a is not in conflict with the constitutional right to property, as in §14 GG.). The issue of the constitutionality of freeze-out rights of controlling shareholders has also been discussed in Italy. In a lawsuit brought by a minority shareholder of the listed corporation Cartiere Burgo, it was raised the question whether freeze-out rights are compatible with the Italian Constitution. In this legal system, the local judge can decide if there are sufficient grounds to submit the question to the Constitutional Court. For three times, both at the preliminary injunction stage and in the following decision on the merits, the local court dismissed the constitutionality issue (*see* Tribunale di Milano, 26 March 2001, SOCIETÀ 1235 (2001); Tribunale di Milano, 8 June 2001, BANCA BORSA TITOLI DI CREDITO II 162 (2002); Tribunale di Milano, 13 March 2003, SOCIETÀ 87 (2004)). In the decision on the merits, the Milanese court observed that freeze-out rights are compatible with Article 42 of the Italian Constitution, the rule that states that private property can be taken only for general interest motives, because it balances the mandatory bid provision and composes a set of rules that protects general interests. Even if these constitutionality challenges have been dismissed, the very fact that they have been raised suggests the existence of a less favorable approach to freeze-out rules than in the U.S.

In the United States, on the other hand, the prevailing perspective is that minority shareholders are primarily investors with a financial interest in the corporation. Coherent with this idea, the accent in terms of protection for minorities is put on the fair value of the investment. Additional flexibility for controlling shareholders and managers in designing the financial structure of the corporation, including the option to exit the equity market, is not considered incompatible with the interests of the minority, as long as the latter are liquidated at fair value and are not coerced or mislead to sell their shares. With the cash or securities received, minority shareholders should be able to find alternative investments with similar characteristics in a robust and efficient market.

VI. Prescriptive Analysis and Policy Implications

1. What the U.S. Can Learn from Europe

The comparison between the European and the U.S. approaches to freeze-outs shows a combination of striking similarities and profound differences. The similarities concern the general rationale underlying both the tender offer/short-form merger in Delaware and in the other jurisdictions that follow a similar approach, and the statutory freeze-out pursuant to Article 15 of the European Takeover Directive. The first lesson the comparison teaches stems from these similarities: the very fact that very different systems, moving from distinct perspectives and characterized by dissimilar law-making processes have converged toward a common framework is not only an interesting theoretical observation, but offers some support to the soundness of Delaware jurisprudence in *Pure* and its progeny.

Both systems favor freeze-out rights that follow a voluntary tender offer. The fact that in the front-end tender offer, the two sides (the controlling shareholder and the minority shareholders) deal at arm's length is taken into account and leads to lower procedural protections for minorities than in the case of a simple merger between the controlling and the controlled corporations. In Europe, the different treatment of one-step and two-steps freeze-outs is so profound that, as mentioned before, long-form cash-out mergers are usually not even possible; while in the U.S. they are possible, but subject to a the higher standard of entire fairness review if the conditions spelled out in *Weinberger* and its progeny are not followed.

The European legislative framework, however, confirms the approach followed by the Delaware Chancery Court in *Pure*, and sustains the rationale underlying the provision for different regulatory approaches to one-step and two-steps freeze-outs, stricter for the former, more lax for the latter. Obviously, the comparative argument merely has persuasive authority, but it is important to notice that different policy makers regulating some of the most sophisticated financial markets and corporate systems in the world, moving from different perspective, reached a somehow similar general framework. This observation provides one additional argument in favor of Delaware case law.

A second contribution offered by the comparative analysis is a new possible way to improve Delaware law in this area. The interesting thing about this potential minireform is that it does not call for an overhauling of the existing doctrinal framework, as other scholarly proposals do, but can rather be considered a fine-tuning of the rules set forth in *Pure*. The idea is to adjust the threshold of the majority of the minority approval requirement.

As discussed earliers, Article 15 of the Takeover Directive provides for a very high threshold. On the one hand, in order to exercise its freeze-out right, the controlling shareholder must either reach 90% or more of the voting capital, or acquire 90% of the shares included in the tender offer. In addition, the price of the front-end voluntary tender offer is considered fair for freeze-out purposes only if 90% of the shares included in the offer have been tendered. It is intuitive that the higher this second threshold is set, the more the price and conditions of the front-end bid must attract a greater number of minority shareholders. In other words, requiring a higher majority of the minority approval tends to impose to the controlling shareholders to offer better conditions both in the front-end offer and in the following freeze-out procedure.[178]

One of the criticisms of the current Delaware approach, also in light of the empirical evidence, is that shareholders could receive less in two-steps freeze-outs than in one-step freeze-outs.[179] As it has been discussed above, the empirical foundations of this critique are questionable,[180] but in any case an easy way to improve, on average, the conditions offered to minority shareholders and gap the bridge between the two types of deals (to the extent that the gap needs to be bridged), could be to slightly adjust the majority of the minority requirement in *Pure* from simple majority to a higher threshold. If, as will be argued in the next paragraph, the 90% rule in European law is not advisable because is too demanding and can prevent value-maximizing deals, a middle ground could be found, also on the basis of empirical evidence, requiring approval by two thirds of the minority. This would be an easy and flexible way to increase minority protection in the *Pure* context, reducing the difference with the treatment that shareholders receive in a one-step freeze-out, without contradicting or restructuring the underlying philosophy of Delaware law.

V.2. What Europe Can Learn from the U.S.

In the particular area of the law considered here, there are probably more lessons that Europe can learn from Delaware and the U.S. generally, than the other way around.

The first reform that the analysis of the European scenario suggests is a more substantive harmonization of the numerous national variations of freeze-out rules. The need for broader harmonization does not only flow from the general goal of achieving a more integrated European financial market and equal treatment of shareholders throughout the Union, but also from the more specific need to create a leveled-playing field in the market for corporate control. As mentioned above, the possibility to freeze-out minority shareholders is an important consideration in virtually every acquisition

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[178] *See supra*, Paragraph V.1.

[179] Subramanian, *supra* note 3 at 7.

[180] Bates et al., *supra* note 7, at 29 f.

plan, especially in case of a hostile takeover.[181] Excessive burdens and diverging local rules can hinder mergers and acquisitions and, in some circumstances, represent a relevant, even if indirect and hidden, protection of entrenched controlling shareholders.[182] In this perspective, it is surprising that in the debate over the Takeover Directive, the link between corporate acquisitions and freeze-out rules has received so little attention from both policy makers and legal scholars.

The harmonization should proceed in two directions, concerning both the regulation of mergers and the statutory freeze-out provisions set forth in Article 15 of the Takeover Directive.

As for the former issue, European legislatures should further liberalize cash-out mergers. A similar move requires a policy shift that corresponds to a more modern vision of financial markets, according to which minority shareholders are not primarily or exclusively protected by an absolute right to remain shareholders, but rather – given the financial nature of their investment – by the right to receive the fair value of their shares. Empirical evidence suggests that value-maximizing cash-out mergers can unlock hidden value that is at least partially captured by minority shareholders, leading to Pareto-efficient outcomes.[183] Historically, European mergers regulation followed a trajectory similar to the one that can be observed in the U.S., moving from requiring shareholders' unanimity to approve a merger, to a majority rule, introducing simplified merger procedures applicable when the controlling shareholder holds more than 90% of the capital of the merging corporation; and more recently, providing for statutory freeze-out rights.[184] But the European evolution stopped short of a somehow consequential step, which would be to allow, under specific circumstances and with adequate protections for minorities, a cash-out merger. Path dependency and the desirability of a smooth transaction might suggest requiring supermajority approval of a cash-out merger, for example setting the voting threshold at two thirds of the outstanding voting capital. However, banning these types of transactions altogether can pay mere lip-service to shareholders' protection, while putting European markets at a disadvantage when compared to their American counterparts.

In legal systems that rely less on litigation, the fairness of the cash-out price could be ensured with different techniques than fostering the possibility of challenging mergers in court, as it happens in the U.S. Also, the typical procedural protections devised by Delaware jurisprudence, approval by a committee of independent directors or by the majority of the minority, might prove inadequate in countries characterized by very concentrated ownership structures dominated by strong controlling shareholders, and by extensive cross-ownership connections among listed corporations. These features may

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[181] *Supra* Paragraph V.1.

[182] As we discussed above, in systems characterized by lower protection of minority investors, controlling shareholders are less interested in effective freeze-out provisions because, unfettered from litigation concerns, enjoy a greater ability to extract private benefits from the corporation notwithstanding the presence of minority shareholders.

[183] *See* the works cited *supra* in note 7.

[184] In order to foster the protection of minority shareholders, European legislatures might also explicitly recognize a general appraisal right in any merger case.

cast doubts on the actual independence of "outside directors" and impair the ability to discern truly non-affiliated minority shareholders.[185] Alternative legal instruments can however ensure adequate protection of minorities. In this respect, the cornerstone of minority protection in the merger context in Europe is the fairness opinion on the exchange ratio rendered before the shareholders' meeting by an independent, court-appointed expert. The opinion does not exclude the possibility of challenging the merger in court, but the burden of proving the unfairness of the transaction notwithstanding a positive independent evaluation is on the plaintiff. This device could be easily applied, also to control *ex ante* the cash-out price.

The second direction of the harmonizing reform should address freeze-out rights set forth in Article 15 of the Takeover Directive and more specifically both the conditions triggering the right and the fair price presumption. As for the former, of the two approaches allowed by the directive, the single-threshold freeze-out and the majority-of-the-minority freeze-out, the first one seems more desirable. The second rule, adopted in the U.K. and Ireland, might make it difficult to cash-out minorities even in situations where it would appear reasonable. Consider the hypothetical of a controlling shareholder holding 89% of the outstanding shares. Pursuant to the British approach, the bidder triggers the freeze-out right only acquiring, in a voluntary offer, almost 10% of the remaining shares, reaching the very high 98.9% threshold. It is likely that some minority shareholders holding a little more than 1.1% might not sell the shares for reasons totally unrelated to the fairness of the price, for example, because they do not even know or remember to own the shares or, worse, because they intend to exploit their position greenmailing the corporation. Convergence toward the single-threshold freeze-out, adopted by the vast majority of the Member States, seems, therefore, a desirable and not impossible goal.

The last reform proposal concerns the fair price presumption. When the freeze-out is triggered by a voluntary bid, the presumption that the price of the front-end bid is fair only if it is accepted by offerees holding 90% of the shares included in the offer is too strict. If Delaware law should require a higher threshold than the current simple majority of the minority in a two-step freeze-out, then European law should lower a threshold so high that might determine a true dictatorship of the minority. The current threshold grants excessive relevance to the position of (a small) minority of the minority.[186] Once again, a balanced solution might be found in a threshold between 50% and 90%, for example the fair price presumption could be conditioned upon the tendering of two thirds of the shares included in the offer.

Finally, the *Pure* requirement that the controlling shareholders do not pose any retributive threat to minority shareholders in order to coerce acceptance of the front-end offer is a sensible one, and could easily be extended to the European framework. Even if such a requirement would probably be more difficult to apply and rarely invoked in jurisdictions where corporate litigation is less used and courts might be less equipped for a similar analysis, the absence of retributive threats is a rule that "closes the system" and that should also be explicitly and uniformly provided for in the European Union.

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[185] *See Der Aufsichtsrat in der Rolle des Vorstandsberaters*, 124 F.A.Z., May 30, 2009, at 19.

[186] Kaisanlahti, *supra* note 4, at 507.

V.3. A Very Brief Conclusion

Profound and meaningful differences exist among different legal systems concerning freeze-out rights, but also striking similarities. No system is free from flaws, and can be inherently considered superior. The last two paragraphs have advocated, however, that both the U.S. and the European approaches to this crucial area of the law could improve by learning from each other's experience.

The specific reforms proposed would be more profound and complicated in Europe, and more simple in the U.S. In neither case they are, however, overhauling structural modification of the existing legal framework, and can largely be regarded as either a natural evolution along an already existing trajectory – such as the introduction of cash-out, long-form mergers in Europe –, or as fine tuning of an overall sound approach – such as raising the majority of the minority threshold required in *Pure* in Delaware. By observing each other, the two systems might also move toward a greater trans-continental harmonization.

Legal harmonization does not have a positive value in itself. Legal transplants are often the cause of dangerous rejections, and similar rules applied in different legal, economic and social environments can generate monsters or betray their own original purposes.[187] The recent financial crisis, which had its epicenter in the U.S., may suggest not looking at the U.S. system of corporate law and financial markets as a possible example. In these times, stronger convergence might seem to conflict with the protectionist winds that blow both in Europe and in the U.S. However, if superficial slogans are to be abandoned for a more serious discussion, both systems show some of the most advanced regulations of freeze-outs in the world, and valuable lessons and ideas can be derived from studying them in parallel. The cross-Atlantic corporate governance dialogue should not only facilitate mutual understanding of the comparative differences, but also be able to advance reform proposals inspired by this deeper comprehension. In the light of the very interdependence of financial markets demonstrated by the financial crisis, greater convergence towards rules that strike a correct balance between efficiency and investors' protection is more desirable than ever. Freeze-out rules are a small, but important, piece of this dialogue.

[187] As I have argued, with respect to the mandatory bid in the Takeover Directive, transplanted from the U.K. to continental Europe, in systems with a more concentrated ownership structure. *See* Ventoruzzo, *supra* note 127, at 140 f.