

Freeze-Outs: Transcontinental Analysis and Reform Proposals

MARCO VENTORUZZO*

Introduction.....	842
I. Rationales for Going Private	847
II. Freeze-Out Transactions in the United States	851
A. A Roadmap.....	851
B. Shareholders' Remedies Vis-à-Vis Cash-Out Mergers ...	853
C. Appraisal Rights and Their Limits	855
1. Scope of Application	856
2. Procedural Requirements.....	856
3. Valuation Techniques	857
4. Litigation-Related Problems.....	858
D. Challenging Cash-Out Mergers: How Litigation Shaped Freeze-Out Techniques	859
E. Delaware Case Law on Challenges to Long-Form Cash-Out Mergers from <i>Weinberger</i> to <i>Getty Oil</i>	860
F. Tender Offers Followed by Short-Form Mergers from <i>Pathe</i> to <i>Pure</i>	865
G. An Unnecessary Quandary	871
III. Freeze-Out Transactions in the European Union	877
A. Unavailability of Cash-Out Mergers in Europe.....	877

* Professor of Law, Bocconi University Law School, Milan, Italy, and Pennsylvania State University, Dickinson School of Law; Vice-Director, Paolo Baffi Research Center; Research Associate, ECGI, Brussels, Belgium. For comments and suggestions, I wish to thank David Cabrelli, Ray Campbell, Paul L. Davies, José A. Engrácia Antunes, Heribert A. Hirte, Richard Mendales, Geoffrey P. Miller, Sebastian Mock, Peter O. Mülbart, Catherine A. Rogers, Stephen F. Ross, and Miguel Trias Sagnier. Excellent research assistance was provided by Yun Lee and Jana Victoria Nysten. This Article is dedicated to the memory of my uncle, Mario Ventoruzzo, who seized the rhino by the tail and the marlin by the sword.

B.	Shareholders' Remedies in Case of Delisting Through Merger: Challenging the Transaction.....	879
C.	Appraisal Rights in the Merger Context.....	883
D.	Statutory Freeze-Out in Europe: Takeover Directive, Article 15.....	886
E.	Freeze-Out Consideration and Fair Price Presumptions .	891
F.	Implementation of Freeze-Out Rights in Some European Member States.....	894
G.	Alternative Ways to Freeze Out Minority Shareholders in Some European Jurisdictions	900
IV.	An Explanation for the Differences in the Regulation of Freeze-Out Transactions.....	902
A.	Comparative Differences in Context.....	902
B.	Causes and Consequences of the Diverging Approaches.....	908
V.	Prescriptive Analysis and Policy Implications.....	912
A.	What the United States Can Learn from Europe	912
B.	What Europe Can Learn from the United States	914
	Conclusion.....	916

INTRODUCTION

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

1. The acquisition of all the outstanding shares of a corporation by one of its shareholders can obviously occur also in a nonlisted corporation, and some legal systems allow majority shareholders of closely-held corporations to compel minority shareholders to transfer their shares. "Freeze-out," in fact, is neither a well-defined term of art, nor does it have 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—incentives to sell the shares. This Article focuses on transactions in which a controlling shareholder in a listed corporation has a legal right to buy out the shares of the minority and does so 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 sys-

Few studies have undertaken to examine the differences between the European and U.S. approaches to minority freeze-outs, despite the fact that they are among the most debated issues in corporate law,² the public media,³ a vast body of scholarly work, and case law in the United States⁴ and Europe.⁵ In light of the relevance of the subject and the ex-

tems and, in some instances, it is possible to delist a corporation even if there are still minority shareholders. 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 though the latter should refer specifically 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 of a “squeeze-out” technique 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. For some of the most important cases that will be discussed in this Article, see *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001); *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421 (Del. Ch. 2002).

3. See Robin Sidel, *Takeover Targets Force Up Offers In ‘Minority Squeeze-Out’ Deals*, WALL ST. J., May 10, 2002, at C3 (discussing factors that have encouraged squeeze-out deals); David Wessel, *Closing the Door: Going Private Offers Rewards*, WALL ST. J., May 17, 2007, at A2 (proposing reasons why public companies may be eager to go private).

4. For the most recent contributions to freeze-outs in the United States, with specific reference to Delaware law, see William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001); 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 (2003); Bradley R. Aronstam et al., *Revisiting Delaware’s Going-Private Dilemma Post-Pure Resources*, 59 BUS. LAW. 1459 (2004); 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); Clark W. Furlow, *Back to Basics: Harmonizing Delaware’s Law Governing Going Private Transactions*, 40 AKRON L. REV. 85 (2007); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003); Leo Herzel & Dale E. Colling, *Establishing Procedural Fairness in Squeeze-Out Mergers After Weinberger v. UOP*, 39 BUS. LAW. 1525 (1984); Peter V. Letsou & Steven M. Haas, *The Dilemma that Should Never Have Been: Minority Freeze Outs in Delaware*, 61 BUS. LAW. 25 (2005); 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); Michael J. McGuinness & Timo Rehbock, *Going-Private Transactions: A Practitioner’s Guide*, 30 DEL. J. CORP. L. 437 (2005); Charles W. Murdock, *Squeeze-Outs, Freeze-Outs, and Discounts: Why is Illinois in the Minority in Protecting Shareholder 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); Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U. J. L. & BUS. 399 (2008); Faith Stevelman, *Going Private at the Intersection of the Market and the Law*, 62 BUS. LAW. 775 (2007); Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2 (2005); Elliott J. Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 1 (1983); Brian M. Resnick, Note, *Recent Delaware Decisions May Prove to Be “Entirely Unfair” to Minority Shareholders in Parent Merger with*

tensive and growing number of transatlantic mergers in which the acquiring corporations and target corporations are subject to different legal regimes,⁶ the dearth of research focused on comparing the European and American approaches to minority freeze-outs is startling.⁷ This Article fills the gap by offering, first, a comparative discussion of freeze-out regulations in the United States and in Europe; second, an explanation for the causes and consequences of the differences between the two regulatory regimes; and, third, a reform proposal for the development of financial markets in both Europe and the United States.

Partially Owned Subsidiary, 2003 COLUM. BUS. L. REV. 253.

5. 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 known as the “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*, 6 EUR. COMPANY & FIN. L. REV. 391 (2009), and 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 Thirteenth Directive, see Mike Burkart & Fausto Panunzi, *Mandatory Bids, Squeeze-out, Sell-out and the Dynamics of the Tender Offer Process* (Eur. Corporate Governance Inst., Law Working Paper No. 10, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=420940. 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 1 DIRK VAN GERVEN, COMMON LEGAL FRAMEWORK FOR TAKEOVER BIDS IN EUROPE (2008), and SILJA MAUL, DANIELE MUFFAT-JEANDET, & JOËLLE SIMON, TAKEOVER BIDS IN EUROPE: THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES (Silja Maul et al. eds., 2008). On specific European jurisdictions, see Olivier Douvreur, *Un nouveau cas de retrait obligatoire: Le Retrait Obligatoire dans la Foulée d'une Offre*, 3 REVUE TRIMESTRIELLE DE DROIT FINANCIER 58 (2006); Hubert Segain, *Les Opérations de Public to Private en France: Bilan et Perspectives*, 5 BULL. 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 (2008) (on Germany). See generally Alessandro Pomelli, “Delisting” di società quotata tra interesse dell’azionista di controllo e tutela degli azionisti di minoranza, 54 RIVISTA DELLE SOCIETÀ 407 (2009) (on Italy).

6. 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. See U.N. CONFERENCE ON TRADE & DEV., WORLD INVESTMENT REPORT 2006, FDI FROM DEVELOPING AND TRANSITION ECONOMIES: IMPLICATIONS FOR DEVELOPMENT, at 13–14, U.N. Sales No. E.06.II.D.11 (2006), available at http://www.unctad.org/en/docs/wir2006_en.pdf (showing a peak in cross-border activity in 2000, when the total value of international deals exceeded 860 billion dollars). During 2003, 2004, and 2005, the total value of cross-border mergers and acquisitions was on the rise again, going from approximately \$141 billion to \$200 billion to \$454 billion. 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, 2 (2003).

7. 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.

Much can be gained from a study of minority freeze-outs, from both a theoretical and practical perspective. From a theoretical point of view, freeze-outs of minorities lie on the contested frontier separating 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 line of efficiency and fairness. Comparative scrutiny of the American and European attitudes toward freeze-outs allows for identification of some of the most defining features of different corporate law regimes, such as the kind of property interest that minorities are deemed to maintain in the corporation, the role of litigation in shaping corporate rules, and the propensity toward monetary damages versus other types of relief for the protection of minorities.

From a more practical perspective, the opportunity to go private, its costs, and its timing affect not only the prosperity of single corporations at the micro level, but also the health of the financial system in which they operate at the macro level. One may question whether going-private transactions are value-maximizing, and how efficiency gains, if any, are split among different stakeholders. As is often the case, the empirical evidence is not conclusive. It is, however, unquestionable that under specific circumstances, powerful financial, strategic, legal, and tax considerations incentivize the majority shareholders to buy out the minority's equity interests and delist the corporation. In many instances, going private is in the best interest of all parties involved: majority and minority shareholders, investors, creditors, employees, and other stakeholders.⁸

8. Henry DeAngelo, Linda DeAngelo & Edward Rice, *Going Private: Minority Freezeouts and Stockholder Wealth*, 27 J.L. & ECON. 367 (1984). Even if this work is quite dated, it still explains well the theoretical reasons why minority shareholders can appropriate part of the gains connected with a going-private transaction and presents empirical evidence from the American market in support of this hypothesis. Considering that the protections for minority shareholders have been increased by several cases decided since the 1980s, which will be discussed later in this Article, one might argue that the net gains of public shareholders in a freeze-out context are probably greater today than at the time of the study. More recently, 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?*, 81 J. FIN. ECON. 681 (2006). The article observes that:

[O]n average, minority claimants in freeze-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.

Id. at 707. On the possible effect of freeze-outs on corporate constituencies different from shareholders, see Kent Greenfield, *The Impact of "Going Private" on Corporate Stakeholders*, 3

Going private is particularly desirable in times of financial crisis. A credit crunch adversely affects the availability of liquidity necessary to finance large leveraged acquisitions. Buying out minorities when market prices are low, however, is an attractive option for controlling shareholders and other specialized investors, such as private equity firms and hedge funds.⁹ Delisting may also be desirable in light of increased regulatory burdens, which often follow in the wake of financial crises. Finally, delisting may be attractive simply to avoid uncertainty concerning future regulatory reforms and developments.

But going private is not a one-way street. If the consideration paid is fair and includes 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. Thus, 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 should not be banned nor rendered so difficult that the U.S. approach is not an available alternative for controlling shareholders and corporate executives. The degree to which different legal systems allow freeze-out transactions also affects 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.

This Article proceeds on the general assumption that European regulation is more restrictive of freeze-outs than its U.S. counterpart. This disparity 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.¹⁰ Conversely, the American model allows greater flexibility

BROOK. J. CORP. FIN. & COM. L. 75 (2008). Professor Greenfield notes that "there is little reason to be particularly skeptical of private companies, as compared to public companies, in their treatment of stakeholder interests," and suggests that going private appears to be at least neutral in terms of effects on corporate stakeholders. *Id.* at 75.

9. For an interesting analysis of the drop in market prices in the United States during the 2008 crisis and the possible relationship between the bearish market and corporate governance, see Brian R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500* (Eur. Corporate Governance Inst., Law Working Paper No. 124, 2009), available at <http://ssrn.com/abstract=1396126>. Cheffins mentions that:

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.

Id. at 11.

10. The reference to "property right" in this Article is made for the sake of simplicity, and not in a strictly technical sense. As correctly pointed out to me by Peter O. Mülbert, a better expres-

as a consequence of regulatory competition among states and the common law case-based approach. At the same time, this model lacks certainty and leads to partially contradictory outcomes. This Article, after a critical discussion of freeze-out rules in the United States and Europe, builds a comparative analysis to propose reforms that would increase shareholder protection in the United States and foster more uniform rules in Europe that would facilitate, under certain conditions, going-private transactions.

The Article begins in Part I with a discussion of 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 that, while not uniform among states, nevertheless enjoy a certain degree of harmonization due to the European Union's directives on mergers and takeovers. Specific details on a selected number of countries will be offered, though the goal of this work is more to capture the fundamental traits of the European approach, rather than to unearth the technicalities of individual 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 United States. Finally, Part V is dedicated to the normative implications of the analysis.

I. RATIONALES FOR GOING PRIVATE

Several sound financial, regulatory, and organizational reasons support going private in certain circumstances. These reasons are intertwined and mutually interactive, making it difficult and probably incorrect to consider them as separate and distinguished factors. Generally speaking, the same cost-benefit analysis that motivates going public also suggests withdrawing from the public market when the net costs of being listed or publicly held outweigh the benefits.¹¹

sion would make reference to the German concept of *Mitgliedschaft*—the idea that the shareholder has a contractual relationship with the other shareholders and the corporation, which cannot be resolved without his consent. Email from Peter O. Mülbart, Professor, Johannes Gutenberg-Universität Mainz, to author (Nov. 29, 2009) (on file with author).

11. A list of the most important reasons to go private can be found in Joshua M. Koenig, *A Brief Roadmap to Going Private*, 2004 COLUM. BUS. L. REV. 505, 509 (2004). See also Sreedhar T. Bharath & Amy K. Dittmar, *To Be or Not to Be (Public)* (Dec. 2006) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=951710; Sreedhar T. Bharath & Amy K. Dittmar, *Why Do Firms Use Private Equity to Opt Out of Public Markets?* (Mar. 2007) (unpublished manuscript), available at <http://webuser.bus.umich.edu/adittmar/publicprivatepapermar132007.pdf>. A Federal Reserve Bank report suggests that one of the major

The first rationale for going private is that sometimes market prices of publicly traded securities fail to reflect the real value to the issuer. Underestimation can be due to several causes, firm-specific (such as lack of analysts' coverage or poor communication strategies), or general (such as a bearish market caused by exogenous macroeconomic variables—for example a sudden increase of interest rates on treasury bonds—that adversely affects most listed corporations). In either circumstance, the costs of staying public are inadequately compensated. Systematic underpricing (real or perceived) of publicly-held shares erodes many of the advantages of going public, including the possibility of using stock options and other similar forms of compensation to attract and retain top executives. Thus, buying out minorities can be a desirable option for controlling shareholders and managers, who are then able to unlock the hidden value of the firm, but also for minority shareholders, who can then liquidate their shares at a higher price than what the market currently reflects.

Another reason to go private is to reduce the cost of compliance with securities laws and regulations. In legal systems that rely heavily on private litigation as a policing tool, going private curbs the risk of disruptive legal disputes, even if, as will be discussed, the decision to go private itself prompts shareholders' suits.¹² If the time that managers devote to regulatory issues and litigation-related concerns significantly exceeds the time that managers devote to business issues, the option to go private becomes more attractive. A recent example of increased regulatory burdens affecting the propensity of firms to go private is the Sarbanes-Oxley Act of 2002, which several scholars argue has induced smaller issuers to exit the market.¹³

drivers of companies' decisions to go private between 1990 and 2007 was the failure to attract sufficient investor interest. HAMID MEHRAN & STAVROS PERISTIANI, FED. RESERVE BANK OF N.Y., FINANCIAL VISIBILITY AND THE DECISION TO GO PRIVATE (2009), available at http://www.newyorkfed.org/research/staff_reports/sr376.pdf.

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

13. See, e.g., Ehud Kamar et al., *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, 25 J. L. ECON. & ORG. 107 (2009). For an article supporting the hypothesis that the enactment of the Sarbanes-Oxley Act (SOX) increased the costs and risks of remaining public and 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). Professor Bartlett's article starts from the observation that going-private transactions might require issuing high-yield debt

Additionally, from an organizational and financial standpoint, the reduced separation between ownership and control that characterizes a closely-held corporation (versus a publicly-held corporation) may diminish agency costs¹⁴ and, under specific circumstances, improve the debt-to-equity ratio of the firm.¹⁵ Because most going-private transactions imply a substitution of equity for debt, and because interest payments are deductible while dividends are not, tax considerations also drive the decision to go private, especially when high leverage is used.¹⁶ As argued by Henderson and Epstein, “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 equity interests with debt.”¹⁷ Clearly, however, the increased leverage resulting from these transactions exposes the corporation to a higher risk of insolvency, and, thus, the decision to withdraw from public markets must take into account the pros and cons of such a dramatic change to the financial structure of the firm.¹⁸

In addition to the above mentioned “classical” rationales for going private, Professors Masulis and Thomas offer a new and insightful explanation focused on risk monitoring and the use of derivative instru-

instruments, with the consequence of maintaining the corporation subject to some provisions of SOX even after it becomes private. Bartlett questions the effect of SOX on the number of going-private transactions. More specifically, he tests whether going-private transactions after 2002 were structured without the issuance of high-yield securities and thereby avoided further application of SOX. Bartlett found that there were a diminishing number of similar deals in the case of smaller issuers, consistent with the hypothesis that SOX affected going-private decisions for smaller, rather than larger, issuers. *See also* Carl R. Chen & Nancy Mohan, *The Impact of the Sarbanes-Oxley Act on Firms Going Private*, 19 RES. ACCT. REG. 119 (2007) (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*, 44 J. ACCT. & ECON. 116 (2007) (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. ACCT. & ECON. 146 (2007) (doubting the positive correlation between the enactment of SOX and an increase in going-private transactions).

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

15. Kenneth Lehn & Annette Poulsen, *Free Cash Flow and Stockholder Gains in Going Private Transactions*, 44 J. FIN. 771 (1989).

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

17. M. Todd Henderson & Richard A. Epstein, *The Going-Private Phenomenon: Causes and Implications*, 76 U. CHI. L. REV. 1, 2 (2009).

18. *Id.* at 2–3.

ments.¹⁹ 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 represents a specific response to this particular type of agency problem because financially sophisticated controlling shareholders can better monitor management derivatives by trading as a closely-held corporation.²⁰ This could be considered a particular case of the agency-costs-reduction rationale discussed in the preceding paragraph, 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 is a value-maximizing transaction. Controlling shareholders and managers are usually in the best position to evaluate when such circumstances occur. By the same token, information asymmetries and collective action problems affecting the behavior of minority shareholders support the proposition that legislatures 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. Freeze-out regulation is the way in which policy makers address the efficiency and distributive justice conundrums that arise when a publicly held company goes private.

From the point of view of minority shareholders, going private can turn their investment into a “lemon.”²¹ 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 citrus fruits. When minority shareholders are squeezed out, the controlling shareholder is largely in control of the amount of sugar that the investors receive. The remainder of this Article addresses how different legal rules affect the sugar-to-lemon ratio in a freeze-out transaction.

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

20. *Id.* at 257–58.

21. Professors Lucian Arye Bebchuk and Marcel Kahan have made reference to a possible “lemons effect” in going-private transactions. See Lucian Arye Bebchuk & Marcel Kahan, *The “Lemons Effect” in Corporate Freeze-Outs* (Nat’l Bureau of Econ. Research, Working Paper No. 6938, 1999), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=226397.

II. FREEZE-OUT TRANSACTIONS IN THE UNITED STATES

A. *A Roadmap*

There are numerous combinations of transactions that allow controlling shareholders to appropriate the equity interests of minority shareholders. In the United States, the different techniques are distilled into four major categories: asset sales, reverse stock splits, (cash-out) mergers, and tender offers.

In an asset sale, all or substantially all of the assets of the corporation are sold to another corporation owned or controlled by the same subject that controls the selling corporation, for consideration either in cash or securities. Consequently, the selling corporation is either liquidated or allowed to remain in existence but without control of its former assets. An asset sale requires shareholders' consent, but a controlling shareholder may have sufficient votes to unilaterally determine the transaction. Such a scenario leaves minority shareholders with the limited choice of either challenging the deal or exercising dissenters' rights, when available.²²

As the name suggests, a reverse stock split is the converse of a stock split. The corporation adopts a resolution whereby a certain number of outstanding shares is exchanged for one share of greater value. For example, for every hundred shares at \$2 par value each, the corporation issues one single share at \$200 par value. 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; meanwhile, the minority shareholders receive a cash equivalent to the value of the fraction of a share to which they are entitled. Especially in the case of a listed corporation with a widespread ownership structure, a reverse stock split is difficult to achieve and raises several grounds for litigation.²³

In the United States, asset sales and reverse stock splits are rarely used to cash out minority shareholders. The two more common tech-

22. See generally JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 594 (2d ed. 2003) (discussing the sale of a corporation's assets); FRANKLIN A. GEVURTZ, CORPORATION LAW 661 (2000); Rod J. Howard, *Recent Case Law Developments Addressing Sales of 'All or Substantially All' Assets*, in DRAFTING CORPORATE AGREEMENTS 2004, at 243 (2004) (discussing more recent developments in Delaware case law).

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

niques are mergers and tender offers.²⁴ More specifically, under Delaware law, two approaches have become increasingly popular: the “long-form merger,” (or “one-step freeze-out”) and the “tender-offer/short-form merger” (or “two-step freeze-out”).²⁵ In the long-form merger, controlling shareholders simply approve a merger in which the consideration offered to minority shareholders is cash or other nonequity securities, rather than shares of the surviving entity. The tender offer/short-form merger, a more recent development, consists of two steps: a voluntary tender offer on all the outstanding shares launched by the parent corporation, generally aimed at acquiring at least 90% of the outstanding shares, followed by a short-form, cash-out merger. Under Delaware law (as well as that of most other jurisdictions), because the controlling parent into which the subsidiary will be merged holds more than 90% of the shares following the tender offer, the decision to cash out remaining shareholders requires simply the approval of the board of directors of the controlling corporation, thus obviating the vote of shareholders of either corporation or of the directors of the subsidiary corporation.²⁶

The following pages will analyze these two forms of freeze outs. The number of transactions in which one or the other is employed is substantial. Between June 19, 2001 (when the Delaware Court of Chancery decided *In re Siliconix Inc. Shareholders Litigation*,²⁷ an important decision approving the two-step freeze-out) and December 31, 2003, ninety-six listed Delaware corporations initiated freeze-out transactions where, prior to the acquisition, controlling shareholders held between 35% and 90% of the voting shares—an average of thirty-eight transactions per year.²⁸ Of this sample, twenty-seven deals involved a two-step freeze-out, and sixty-nine involved a one-step freeze-out.²⁹

Interestingly, even in the aftermath of *Siliconix*, traditional one-step freeze-outs outpaced two-step freeze-outs at a rate of nearly two-to-one, despite the fact that, on average, two-step freeze-outs precipitate lower payments to minority shareholders. This result might be explained by

24. See Furlow, *supra* note 4, at 85; McGuinness & Rehbock, *supra* note 4, at 437–38; Stevelman, *supra* note 4, at 779.

25. Furlow, *supra* note 4, at 85; McGuinness & Rehbock, *supra* note 4, at 437–38.

26. COX & HAZEN, *supra* note 22, at 601.

27. No. CV-A-18700, 2001 WL 716787 (Del. Ch. June 19, 2001).

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

29. Note that in two of these sixty-nine cases, minorities were forced out through a reverse stock split rather than a cash-out merger.

path dependency and legal consultants' lack of familiarity with the new path forged by *Siliconix*.³⁰

B. *Shareholders' Remedies Vis-à-Vis Cash-Out Mergers*

The development of rules governing going-private transactions in the United States is best understood when put in historical perspective. This task is significantly simplified by concentrating on the evolution of these rules in the state of Delaware, by far the most important jurisdiction for the regulation of freeze-out transactions both quantitatively and qualitatively.³¹

Traditionally, in the United States and most jurisdictions outside the United States, controlling shareholders could not forcefully cash out minority shareholders. This common law rule, 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 directors and majority stockholders. First, unanimity was required to approve any major amendment to the corporate contract, including mergers and other business combinations, thus granting each shareholder a veritable veto.³² Legislatures and courts gradually realized, however, that in the modern business environment, the costs and dangers of minority dictatorship outweighed the risk of majority abuse, and they started amending the economic and legal structure of publicly held corporations.³³ Dissenting minority shareholders would be adequately (and more effi-

30. See *id.* at 10–11.

31. Delaware is not only the dominant state of incorporation for listed corporations, but also the state whose law governs the choice-of-law and forum clauses of the vast majority of merger agreements. See Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1571 (2002) (finding that 77% of companies engaged in IPOs are incorporated under Delaware law). Another study found that, in a sample of over one thousand merger agreements announced between 2004 and 2008, roughly two thirds of agreements chose Delaware for their governing law and 60% opted for Delaware as their choice of forum—even in situations where either the buyer or the target was not incorporated in Delaware. Matthew Cain & Steven M. Davidoff, *Delaware's Competitive Reach: An Empirical Analysis of Public Company Merger Agreements* 1 (August 18, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1431625>. According to the same study, Delaware faces some competition from New York, but it is not substantial (just 13% of the contracts opted to apply New York law, and 10.8% opted for New York as a forum). *Id.* at 4.

32. For a comprehensive overview of the development of cash-out statutes in the United States, see Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624 (1981). 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 in Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347 (2006).

33. See Weiss, *supra* note 32, at 626.

ciently) protected through appraisal rights, which allowed minority shares to be liquidated at a court-determined fair price. Statutory appraisal rights were introduced in due course,³⁴ thus marking the first step toward an entirely new vision of corporate law, emphasizing the financial nature of minority investors' equity interests.

It would take one more step, however, before minority shareholders could be cashed out rather than given shares of the surviving entity: Florida was the first state to allow straight cash-out mergers (in 1925), soon to be followed by the vast majority of jurisdictions.³⁵

Legislatures did not, however, leave minority shareholders without recourse. Minority shareholders dissenting from a cash-out merger could choose among an array of judicial remedies. A shareholder could seek relief by alleging some form of illegality: lack of authority or abuse of power, self dealing, failure to comply with state or federal statutory requirements, etc. Such violations sustained actions at law or suits in equity and led to remedies as diverse as injunctions, rescission, damages, and claims under the securities laws for disclosure violations under SEC Rule 10b-5 or Rule 14a-9 of the Exchange Act.³⁶ Alternatively, as previously mentioned, minority shareholders could invoke the right of appraisal based on corporate statutes, which allowed dissenting shareholders to receive payment of their shares' fair value through a judicial procedure regulated by the legislature, without requiring proof of any specific legal violation.

It is worth noting that some of the most relevant judge-made rules shaping going-private transactions in the United States were established in cases where shareholders sought legal or equitable relief, and that appraisal rights are less often litigated in the cash-out merger context. Before proceeding further, it is necessary to understand why this is the case.

34. See Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1, 15 (1995) (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).

35. Weiss, *supra* note 4, at 8; Alexander Khutorsky, Note, *Coming in From the Cold: Reforming Shareholders' Appraisal Rights in Freeze-out Transactions*, 1997 COLUM. BUS. L. REV. 133, 139 n.32. See generally Weiss, *supra* note 32.

36. For a synthetic but complete discussion of the major remedies, other than the appraisal right, available to minority shareholders dissenting from a merger or other business combinations, see COX & HAZEN, *supra* note 22, at 617.

C. *Appraisal Rights and Their Limits*

Professor Robert Thompson points out that the use of appraisal rights as a check against conflicted transactions (including freeze outs) is a relatively recent development.³⁷ As originally designed, appraisal rights sought to counterbalance the shift from shareholders' unanimous consent as a precondition to fundamental corporate changes, to a simple or qualified majority consent.³⁸ They offered protection to dissenting minority shareholders, particularly in the situation of a merger between independent firms and in the absence of an active market for the shares. Given this specific goal, legislatures drafted appraisal statutes to serve what Professor Thompson describes as a "liquidity purpose"³⁹—to ensure that minority shareholders were not imprisoned in the new corporation that resulted from the transaction. In other words, legislatures balanced minority protection with efficiency considerations in an attempt to prevent one disgruntled shareholder from vetoing a value-maximizing deal.

In light of this historical origin, appraisal rights were, and still are, ill-suited for the protection of minority shareholders faced with a cash-out.⁴⁰ More specifically, from the minority shareholder's point of view, appraisal rights are unattractive for four reasons: (1) scope of application of statutory relief, (2) procedural requirements, (3) accepted valua-

37. Thompson, *supra* note 34, at 16.

38. *Id.*

39. *Id.* at 29.

40. More generally, appraisal rights did not always achieve the goal of adequately protecting dissenting minorities in the light of their scope of application. Similar business combinations can often be achieved through different procedures, mergers being only one of them. For example, Corporation A might purchase all the assets of Corporation B in exchange for shares of A. Subsequently, B can dissolve and liquidate the stock 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 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 cannot invoke this particular remedy. In this situation, courts applying Delaware law would not interpret this as a *de facto* merger because Delaware's jurisprudence follows the "independent statutory significance" doctrine, in which appraisal is not available when the statute governing the particular transaction at hand does not explicitly provide for appraisal. The leading Delaware case adopting this view and ruling that appraisal rights are not available in a sale of assets is *Hariton v. Arco Elecs., Inc.*, 182 A.2d 22 (Del. Ch. 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. See 15 PA. CONS. STAT. §§ 1105, 1904 (2009).

tion techniques of dissenters' shares, and (4) other litigation-related problems.⁴¹ I address each reason in turn.

1. *Scope of Application*

Generally, the right of appraisal is not uniformly applicable to all mergers. Delaware provides for a "market exemption" from appraisal rights when the shares of the corporation are listed or widely dispersed.⁴² The rationale for the exemption is that, presumptively, shareholders can easily sell their shares on the market at a fair price⁴³ and therefore are not entitled to initiate lengthy and expensive procedures in court to assess an already-monetized value. This exception clearly reflects the liquidity goal of early appraisal statutes, but it fails to provide relief to dissenting minority shareholders facing cash-out as a result of conflicted transactions. In such a context, the fair value of the shares might be significantly higher than the cash consideration offered by controlling shareholders. Alternatively, the market price might not reflect the shares' fair value because it has discounted for the possibility of a majority freeze-out. For these very reasons, Delaware adopts an "exception to the exemption," where cash-out mergers are carved out for special treatment, and minority shareholders are afforded their appraisal day in court.⁴⁴ Many other states, however, do not provide for such an "exception to the exemption," thus ruling out altogether the possibility of invoking dissenters' rights when a listed corporation is taken private.⁴⁵

2. *Procedural Requirements*

Complicated procedural requirements are another reason why appraisal remedies are rarely invoked by minority shareholders. Dela-

41. On the problems of the appraisal remedy, in addition to the previously cited work by Thompson, *supra* note 34, at 28–52, see Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829 (1984), and Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L.J. 613 (1998).

42. See, e.g., MODEL BUS. CORP. ACT § 13.02(b)(1) (2002).

43. For its legal relevance, see *Basic, Inc. 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). For more recent commentary, see William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551 (2003).

44. Thompson, *supra* note 34, at 30. Thompson indicates that about half of the states do not grant appraisal rights when a market for the corporation's shares exists. *Id.* at 10, 29.

45. *Id.* at 30.

ware's appraisal rights statutes provide that dissenting shareholders must, among other things, notify the corporation of their intention to dissent *before* the shareholders' meeting that triggers the right, 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. Often it is difficult for investors to "anticipate" their dissent before the meeting, and procedural compliance raises transaction costs for good-faith minority shareholders that are being unfairly cashed out.⁴⁶

3. Valuation Techniques

Additionally, dissenters' shares might be intentionally undervalued, particularly in the context of a self-dealing cash-out merger. Traditional appraisal statutes provide that dissenting shareholders can be cashed out *without* considering the merger's potential positive effects on shares' value, the so-called "post-acquisition gains."⁴⁷ Once again, this approach makes sense when a fully informed minority, having had the option to obtain shares of the surviving corporation, freely decides to liquidate its investment through appraisal. But when minority shareholder-shareholders are not given this option, and are instead forced out at a price unilaterally determined by the controlling shareholders or directors, it is unfair to ignore post-acquisition gains. In fact, several states have abandoned rigid valuation formulas and allow for these elements to be considered in a take-out merger. The Supreme Court of Delaware followed this course of action in 1983 in *Weinberger v. UOP, Inc.*,⁴⁸ and in the early 1980s, New York amended its statute to permit considering post-acquisition gains in a merger context.⁴⁹ The 1984 version of the Model Business Corporation Act (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 corporate action to which the shareholder objects."⁵⁰ Notwithstanding these qualifications, minority shareholders face at least the possibility that, in an appraisal procedure, the benefits of the very

46. DEL. CODE ANN. tit. 8, § 262 (2010).

47. *Id.* at 35–36.

48. 457 A.2d 701, 713 (Del. 1983).

49. Thompson, *supra* note 34, at 36.

50. MODEL BUS. CORP. ACT § 13.01(4)(i) (2002).

transaction from which they are locked out will not be accounted for when their shares are valued.

A second drawback in terms of valuation is that it is doubtful whether appraisal valuations include recovery for damages caused by abuse of power or breach of fiduciary duties.⁵¹

But the inadequacy of the appraisal remedy in terms of share valuation 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:

[I]n case of breach of fiduciary duty, 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.⁵²

4. *Litigation-Related Problems*

Finally, appraisal procedures can be lengthy and expensive, with individual plaintiffs bearing most of the costs, including attorney and expert fees.⁵³ By way of contrast, it is worth noting that a suit for breach of fiduciary duty can be brought as a class action, whereby the potential measure of damages is larger than the appraisal value (and therefore appealing to lawyers operating on a contingency basis), and even dissenting shareholders that fail to formally exercise their rights are entitled to the relief.⁵⁴

51. See *Rapid-Am. Corp. v. Harris*, 603 A.2d 796, 805 (Del. 1992) (“[A] court cannot assign value to any ‘speculative’ events arising out of the merger or consolidation.”). *But see Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989) (holding that a corporate opportunity claim could be asserted in appraisal proceedings).

52. GEVURTZ, *supra* note 22, at 737.

53. MODEL BUS. CORP. ACT § 13.31(b).

54. In Delaware, class appraisal procedures are not authorized by statute. See DEL. CODE ANN. tit. 8, § 262(a) (2010); see also *Gilson & Gordon*, *supra* note 4, at 799.

D. Challenging Cash-Out Mergers: How Litigation Shaped Freeze-Out Techniques

The Delphic ambiguity⁵⁵ surrounding the potential outcome of an appraisal procedure, coupled with rules that are not tailored to the specific features of self-dealing transactions, render appraisal rights an ineffective protection for minority shareholders facing cash-out. Therefore, minority shareholders often challenge a merger on the basis of some illegality, in particular for breach of directors' fiduciary duties or disclosure violations of federal securities laws.⁵⁶ The bulk of cases that shape the law of going-private transactions in the United States deal with these types of allegations.

Before discussing the most recent Delaware case law, it is worth noting that in many jurisdictions the "business purpose requirement" serves as the preliminary protection for minority shareholders against unfair cash-out.⁵⁷ Under this standard, a cash-out merger is permissible only when the merger presents a valuable economic purpose (other than the elimination of minority equity investors). Delaware, however, abandoned the business purpose requirement in *Weinberger*.⁵⁸

Lacking the business purpose requirement, Delaware courts frequently adjudicate minority shareholders' claims of breach of fiduciary duties, or other illegalities, in connection with cash-out transactions. In deciding these disputes, Delaware courts have attempted to balance the power of the directors and the majority shareholders on one hand with the protection of minority shareholders on the other. Too much of the latter prevents efficient, value-maximizing transactions, whereas too much of the former leads to injustice. Courts are frequently reluctant to grapple with elusive standards of substantive fairness, particularly because the legislature has already attempted to strike the balance through procedural protections. Notwithstanding the complexity of the issue, courts have weighed in, and the resulting legal framework is illustrated

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

56. For a brief description of Rule 13e-3, promulgated by the Securities and Exchange Commission in 1979 to impose specific disclosure obligations in a going-private transaction, see Koenig, *supra* note 11, at 524.

57. See *Alpert v. 28 Williams St. Corp.*, 473 N.E.2d 19, 28 (1984) (holding that freeze-out mergers are only acceptable when in advancement of general corporate interest). For the relevance of New York in terms of choice-of-law and forum clauses in merger agreements, see Daines, *supra* note 31, at 1571.

58. *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

through seven leading cases, each of which adds to the mosaic of regulation governing going-private transactions. These cases are: *Weinberger v. UOP, Inc.*,⁵⁹ *Rosenblatt v. Getty Oil Co.*,⁶⁰ *Kahn v. Lynch Communication Systems, Inc.*,⁶¹ *Solomon v. Pathe Communications Corp.*,⁶² *In re Siliconix Inc. Shareholders Litigation*,⁶³ *Glassman v. Unocal Exploration Corp.*,⁶⁴ and *In re Pure Resources, Inc., Shareholders Litigation*.⁶⁵ The first three cases dealt with long-form mergers; the last four addressed short-form mergers.

E. Delaware Case Law on Challenges to Long-Form Cash-Out Mergers from Weinberger to Getty Oil

In *Weinberger*, 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. Dissenting minority shareholders refused cash consideration and brought a class action suit against the subsidiary and the parent, directors of the two companies, and the investment bank Lehman Brothers, challenging the fairness of the transaction and seeking injunctive relief or, alternatively, monetary damages.

The key factual issues leading to approval of the merger are worth recounting. In the early 1980s, Signal sought investment opportunities. After considering different alternatives, the company's board of directors concluded that the best option was to acquire the totality of shares of its subsidiary, UOP, through a cash-out merger. Signal's executive committee informed James V. Crawford, UOP's president, CEO, and long-time Signal group executive, of this intention and quoted a price per share between \$20 and \$21. Evidence at trial showed that, during the discussion, Crawford agreed that the price was fair but concentrated his attention on the consequences of the acquisition for personnel. Following this conversation, Signal's board of directors approved a merger proposal offering \$21 per share to minority shareholders, a figure significantly above market price, which fluctuated around \$15. The proposal provided that the merger would be completed only if it satisfied a double condition: the totality of the votes cast in favor of the merger

59. *Id.*

60. 493 A.2d 929 (Del. 1985).

61. 638 A.2d 1110 (Del. 1994).

62. 672 A.2d 35 (Del. 1996).

63. No. CV-A-18700, 2001 WL 716787 (Del. Ch. June 19, 2001).

64. 777 A.2d 242 (Del. 2001).

65. 808 A.2d 421 (Del. Ch. 2002).

would be greater than or equal to two-thirds of the entire voting capital, and a majority of the minority shareholders (constituting 49.5% of all shares) would vote in favor.

The UOP board approved these terms and recommended the merger. In making its decision, the board relied upon, among other things, a fairness opinion issued by Lehman Brothers, which, at trial, the court determined to have been hastily prepared. The trial also revealed that two UOP directors (who were also employees of the acquiring corporation Signal), had prepared a report quoting a price of up to \$24 as a “good investment” for Signal. This higher price would have had minor consequences on the financial structure of the deal for Signal, but would have created substantial additional benefit for UOP’s shareholders. The report was never disclosed to UOP’s outside directors and was only shared with Signal’s board.

Notwithstanding the revelation of the \$24 per share recommendation, the Chancery Court considered the merger fair and found for the defendants. On appeal, however, the Supreme Court of Delaware reversed the lower court’s ruling and took the occasion to discuss, and partially resolve, several different issues, including share evaluation techniques.⁶⁶

Weinberger held that under Delaware law, as in other U.S. jurisdictions, freeze-out transactions conducted by controlling shareholders amount to self-dealing. Thus, freeze-out transactions are subject to “entire fairness” 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, concerned with the way in which the acquisition is negotiated; the latter is a substantive element, taking into account the economic rationale behind the deal.⁶⁷

66. On the different important contributions of this decision, among the first comments, see Weiss, *supra* note 4; Robert K. Payson & Gregory 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); 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); Carol B. Hagt, Note, *The Standard of Care Required of an Investment Banker to Minority Shareholders in a Cash-Out Merger: Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 98 (1983).

67. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) (“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.”).

The most relevant part of the decision for the current analysis, however, is dicta buried in a footnote, where the Supreme Court of Delaware proscribed the means by which the entire fairness requirement would be met: the corporation considering a cash-out merger should appoint a special committee of independent directors, entrusted with the task of negotiating the merger at arm's length.⁶⁸

The court's laconic observation stirred a theoretical debate. Supporters of outside directors' ability to ensure truly independent decisions in the best interest of all shareholders clashed with critics that doubted the efficacy of a special committee with veto powers.⁶⁹ At a more practical level, however, many corporations soon followed the path pointed out by *Weinberger*, 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. By one approach, the committee's decision would be measured by the "business judgment rule." In other words, the resolution of the independent directors would be presumed to have been made on an informed basis, in good faith, and in the honest belief that the action was in the best interest of the corporation.⁷⁰ Alternatively, the special committee's decision would simply shift the burden to the plaintiff to prove the absence of entire fairness.⁷¹ This school of thought was more favorable to plaintiffs because to prove that a transaction is not entirely fair, either for lack of fair dealing or fair price, is less cumbersome than overcoming the highly deferential business judgment rule.

The Delaware Supreme Court addressed the issue left open in *Weinberger* in two pivotal cases: *Rosenblatt v. Getty Oil*⁷² and *Kahn v. Lynch*.⁷³ In both decisions, and under different circumstances, the court embraced the view that if merging companies complied with specific procedural safeguards intended to protect minority shareholders, review

68. *Id.* at 709.

69. 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 is former Delaware Chancellor William T. Allen. See William T. Allen et al., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1308 (2001).

70. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995); *In re Trans World Airlines, Inc. S'holders Litig.*, No. 9844, 1988 WL 111271 (Del. Ch. 1988).

71. *Citron v. E.I. Du Pont de Nemours & Co.*, 584 A.2d 490 (Del. Ch. 1990); *Rabkin v. Olin Corp.*, No. 164, 1990 WL 47648 (Del. Ch. 1990).

72. 493 A.2d 929 (Del. 1985).

73. 638 A.2d 1110 (Del. 1994).

would be limited to the entire fairness test, with the burden of proof transferred from the defendant to the plaintiff.

Getty Oil settled the question concerning the effect of a majority of the minority shareholders' approval of a merger. In the 1960s, Getty Oil, an 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 opposed any further integration between the two companies, believing that a certain degree of competition between them was beneficial to their own strength and profitable for the shareholders.⁷⁴ Soon after his death, however, Getty Oil's executive vice-president, Harold E. Berg, contacted Skelly President James H. Hara to discuss combining Getty Oil, Skelly, and Mission.

The directors of Skelly and Getty Oil engaged in an extensive hard-bargaining process to determine the proper exchange ratio for outstanding stock. 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.⁷⁵ Eventually, the boards agreed on an exchange ratio of 0.5875 Getty Oil shares for every Skelly share. With the boards' unanimous approval, the deal was submitted to the shareholders of the corporations involved and conditioned on the approval of the majority of the minority stockholders. Almost 90% of the minority shares present at the meeting, representing 58% of all the outstanding minority shares, voted in favor of integration, which was subsequently completed. The merger was, however, challenged by disgruntled Skelly shareholders, who brought a class action suit claiming the exchange ratio was unfair. After a lengthy and complicated trial, the Chancery Court found the deal entirely fair and entered judgment for the defendants. On appeal, the Delaware Supreme Court affirmed.

Applying *Weinberger*, the Delaware Supreme Court evaluated issues of both fair dealing and fair price. Its decision offers an insightful discussion of the Delaware Block Method and proper disclosure of all material facts in a proxy statement. For current purposes, however, it resolved what significance should be attributed to the minority shareholders' vote:

74. This is quite in line with the Darwinian view embedded in one of Getty's oft-quoted lines: "The meek shall inherit the earth, but not its mineral rights." Euan Ferguson, *Big Money Given With Good Grace*, SCOT. ON SUNDAY, Aug. 14, 1994, at 4.

75. *Rosenblatt*, 493 A.2d at 936.

Clearly, Getty, as 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.⁷⁶

Utilizing 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, with its more deferential treatment of managers and its less favorable disposition towards minority shareholders.

In *Kahn v. Lynch*, decided nine years after *Getty Oil*, the Delaware Supreme Court reached a consistent conclusion where the procedural protection afforded minority shareholders was approval of the merger by a committee of independent directors.⁷⁷

In *Kahn*, Alcatel, holding almost 44% of Lynch, pursued a freeze-out merger with Lynch, whose board of directors instituted a special committee to negotiate the terms of the acquisition. Alcatel proposed a cash price for minorities of \$14 per share; Lynch representatives countered at \$17. Finally, the board endorsed a price of \$15.50 per share, but only after Alcatel executives informed the committee that they were considering a hostile tender offer directly to minority shareholders at a lower price.

The Chancery Court ruled that the negotiation between the acquiring corporation and the special committee was, in fact, conducted at arm's length, and that the burden of proving unfairness of the \$15.50 price therefore shifted to the plaintiffs. Moreover, the court concluded that the plaintiffs had not satisfied their burden. On appeal, the Delaware Supreme Court reversed but, in doing so, endorsed the general rule that approval by an independent committee shifted the onus of proving unfairness to the plaintiff. Having subscribed to this view, the court nonetheless considered what effect the threat of a hostile tender offer had on the directors' ability to negotiate independently and determined that the plaintiffs had made a prima facie showing of unfairness. Simply put, the directors' capitulation in the face of a possible hostile tender offer belied their ability to operate independently and to adequately protect the interests of minority shareholders. The case was therefore remanded to

76. *Id.* at 937 (citation omitted).

77. 638 A.2d 1110, 1121 (Del. 1994).

the lower court, with the burden of proving entire fairness shifted back to the defendant.⁷⁸

Thus, by the mid-nineties, Delaware case law on long-form, freeze-out mergers was well settled. As in any arm's-length transaction, courts would review a merger conducted by controlling shareholders against the two-pronged entire fairness test (*Weinberger*). Under normal entire fairness review, the defendants shoulder the burden of proving fairness. However, in the context of a freeze-out where certain procedural protections are afforded to minority shareholders—for example, when there is approval by a truly independent special committee (*Lynch*), or approval by the majority of the minority stockholders (*Getty*)—the burden of proving unfairness shifts to the plaintiff.⁷⁹

This doctrinal framework has been applied extensively and consistently, even if more recent decisions have added further specifications and, in some cases, suggested possible reforms.⁸⁰

F. *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 anticipated by Alcatel's alleged threat in *Kahn v. Lynch* to launch a tender offer directly to the shareholders, bypassing the board of directors. The essential question for a court to consider in such a situation is straightforward: 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 Supreme Court answered in the negative.⁸¹ *Solomon v. Pathe Communications Corp.* involved a complex financial

78. Doubts on the relevance of the alleged threat by Alcatel have been raised by Professor Subramanian. See Subramanian, *supra* note 4, at 15.

79. Professor Subramanian criticizes the fact that combining *both* approval by a special committee of independent directors and a majority of the minority provision does not lighten the position of the acquiring corporation. *Id.* at 16; see also *infra* note 80 (observing how this reform proposal has been given consideration in a recent Delaware decision by Vice Chancellor Strine).

80. See, e.g., *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604 (Del. Ch. 2005); *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del. Ch. 2003). In *In re Cox*, Vice Chancellor Strine observed that "each *Lynch* case has settlement value, not necessarily because of its merits but because it cannot be dismissed." 879 A.2d at 605. In fact, the standard of review of entire fairness exposes defendants to the time and expense of discovery. Strine's proposal, therefore, is that when approval by both disinterested directors and shareholders (a majority of the minority) is present, the standard of review should shift to the business judgment rule, and the plaintiff should have to plead with particularity the facts supporting a breach of fiduciary duties.

transaction with global ramifications.⁸² 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. CLBN also obtained control over 89.5% of Pathe's shares through voting trusts. Not long after the acquisition, CLBN voted to remove four Pathe directors, among them CEO Giancarlo Parretti. An Italian court found Parretti's removal improper, and while the legal grounds and possible consequences of the ruling in the United States were unclear, CLBN nonetheless decided to foreclose its security. Pathe and CLBN reached an agreement pursuant 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 \$1.50 per share. A committee of independent directors approved the merger, supported by financial and legal advisors.

The likely motivation for Pathe's directors to launch a tender offer on all the shares was to reduce potential liabilities toward shareholders. Nonetheless, Solomon, representing the class of Pathe's shareholders that tendered the shares, brought suit alleging that the directors breached their duty of care in failing to resist 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 confirmed the Chancery Court's decision, rejecting the plaintiff's theory:

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 [sic] "materially false or misleading disclosures made to shareholders in connection with the offer."⁸³

The decision came as a surprise to the legal community. Prior to *Solomon*, the common understanding was that a tender offer launched by a controlling shareholder presented a conflict of interest and was, there-

81. See *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35 (Del. 1996).

82. *Id.*

83. *Id.* at 39 (citations omitted) (citing *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1056 (Del. Ch. 1987)).

fore, subject to the entire fairness requirement.⁸⁴ This point of view emphasized the role of the board of directors of the subsidiary in negotiating the terms of the bid with the parent corporation. The court 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, single investors are free to accept or refuse the proposed price.⁸⁵

Notwithstanding the very specific facts of *Solomon*, transactional lawyers and their clients started to consider tender offers a less treacherous pathway for the elimination of minorities than the traditional long-form cash-out merger. Any remaining doubts were eliminated by the Delaware Supreme Court's holdings in *In re Siliconix Inc. Shareholders Litigation*⁸⁶ and *Glassman v. Unocal Exploration Corp.*,⁸⁷ both decided in 2001.

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

In February 2001, Vishay proposed a cash tender offer on Siliconix for \$28.82 per share. The quoted price included a 10% premium over the market price. Vishay also announced that if it reached a 90% controlling stake, it would proceed to merge Siliconix into one of its subsidiaries through a short-form, cash-out merger at the same \$28.82 price. Siliconix's board appointed a two-member special committee to evaluate the offer. Although questions were raised on the actual independence of the committee's members because of their relationships with the controlling stockholder, the committee found that the price offered was inadequate. By then, Siliconix's shares had risen above \$28.82.

When the committee rejected the initial offer, Vishay started considering a less financially burdensome stock-for-stock offer which was

84. Subramanian, *supra* note 4, at 9.

85. *In re Siliconix Inc. S'holders Litig.*, No. CV-A-18700, 2001 WL 716787, at *6 (Del. Ch. June 19, 2001) (“[A]s long as the tender offer is pursued properly, the free choice of the minority shareholders to reject the tender offer provides sufficient protection.”).

86. 2001 WL 716787.

87. 777 A.2d 242 (Del. 2001).

announced in May 2001, with no opportunity provided for the special committee to evaluate the fairness of the transaction. The exchange ratio was calculated simply by dividing the price of Siliconix and Vishay shares on February 22, 2001, and was fixed at 1.5 Vishay shares for each Siliconix share. No premium above the market price was considered.

In the public disclosure documents concerning the acquisition, Vishay included a majority of the minority nonwaivable condition, stating that the offer would be finalized only if a majority of the nonaffiliated investors tendered their securities. In addition, Vishay 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 specified that it would follow 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 having issued a recommendation. It also declared that no fairness opinion had been provided by an outside financial advisor.

Raymond L. Fitzgerald, a qualified minority shareholder holding 6% of Siliconix's outstanding shares, sued asserting individual claims both on his own behalf and on behalf of a class of Siliconix's minority shareholders. He also filed a derivative action on behalf of the corporation seeking, in particular, to enjoin the transaction.

Relying on *Solomon*, the court denied Fitzgerald's petitions. For the purpose of this Article, however, it is sufficient to note that the court distinguished mergers (where corporate boards are the primary negotiators, with extensive power to structure and bring forward the deal) from tender offers (where the counterpart to the bidder consists of minority shareholders with power to decline the proposal if inadequate). In other words, the tender offer does not entail the conflicts of interest that arise when directors and officers elected by the controlling acquiring corporation promulgate a merger. On this basis, the court determined that a tender offer is not subject to entire fairness review.⁸⁸

Siliconix focused on the front-end of the new freeze-out technique, the tender offer. In contrast, *Glassman v. Unocal Exploration Corp.* ad-

88. This finding of the court is somehow troubling. In fact, Vishay announced that Siliconix could be de-listed if the short-form merger was not 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." *Siliconix*, 2001 WL 716787, at *16. It is undeniable that a similar possibility, and its announcement, puts significant pressure to tender on the individual minority shareholder.

ressed the back-end, the subsequent short-form, cash-out merger.⁸⁹ In fact, no tender offer ever took place in *Glassman*. When Unocal initiated the short-form merger of its subsidiary UXC, it already owned 96% of UXC's outstanding shares and proceeded directly to the short-form merger pursuant to Section 253 of the Delaware General Corporation Law (DGCL).⁹⁰ Dissenting minority shareholders brought a class action suit alleging an unfair exchange ratio.

Crucially, the court considered the statutory procedure for a short-form merger set forth by Section 253 inherently incompatible with equitable 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, are not involved in the decision, and do not even receive advance notice of the transaction. This exceptionally truncated process, which allows the parent company's board of directors to unilaterally determine the transaction, is based on a clear policy rationale: the relatively small dimension of minority interests fails to justify a lengthy and more costly procedure, such as that required in a long-form merger. 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.⁹¹

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, cannot “dissent” in the general sense. Equitable relief through an entire fairness claim is therefore not available in the context of short-form mergers.⁹²

89. 777 A.2d 242 (Del. 2001).

90. Codified at DEL. CODE ANN. tit. 8, § 253.

91. *Glassman*, 777 A.2d at 247–48.

92. See Stevelman, *supra* note 4, at 799 (“[I]n its *Glassman* decision, the Delaware Supreme Court held that fiduciary fair dealings criteria are inapplicable to short-form mergers.”).

Siliconix and *Glassman* combined to clear the way for going-private transactions through a tender offer followed by a short-form merger: neither of the two components of the transaction would be subject to the demanding standard of entire fairness.

The resulting doctrinal picture was subject to criticism, particularly by academics. Two types of transactions 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. One-step mergers (i.e., long-form mergers) were subject to the entire fairness standard, more protective of minority investors. Two-step mergers (i.e., tender offers/short-form mergers), however, were subject to the pro-manager business judgment rule absent proof of coercion and disclosure violations.

In 2002, with *In re Pure Resources*, the Chancery Court attempted to reconcile these differences by establishing further protections for minority shareholders in two-step mergers.⁹³ In *Pure*, Unocal, the 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 majority of the minority nonaffiliated shareholders tendering their shares and was also subject to the waivable condition that Unocal secure at least 90% of all Pure shares before it initiated a short-form merger pursuant to DGCL Section 253. Unocal also stated that it would proceed with the merger as soon as possible after completion of the tender offer, at the same exchange ratio as the front-end offer.

The special committee instituted by Pure to evaluate the transaction prepared a 14D-9 communication recommending that minority shareholders *not* tender their shares. A class action followed, with dissenting minority shareholders seeking to enjoin the transaction. The plaintiffs proffered the usual argument: The offer did not meet the entire fairness standard because it was coercive and material information was not properly disclosed.

The court ruled in favor of the plaintiffs, enjoining the offer. For the purpose of this Article, it is relevant that the court, for the first time, distinguished clearly between the one-step merger (subject to the entire fairness standard) and the two-step merger (subject to the business judgment rule in light of the greater freedom of minority shareholders to accept the front-end offer). The court was not, however, oblivious to the risk that a two-step merger might sometimes confront minority investors

93. 808 A.2d 421 (Del. Ch. 2002).

with a prisoner's dilemma, forcing them to accept less-than-optimal consideration for their shares. Coercion of the minority would be more subtle in a two-step merger than in a one-step merger, but still present.⁹⁴ Therefore, to level the playing field, *Pure* established three conditions that must be met in order to exclude the transaction from entire fairness review: (1) the offer must be subject to a nonwaivable condition of approval (expressed through tendering) by the majority of the minority; (2) 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; and (3) the bidder can make no retributive threats in dealing with the target's directors.⁹⁵

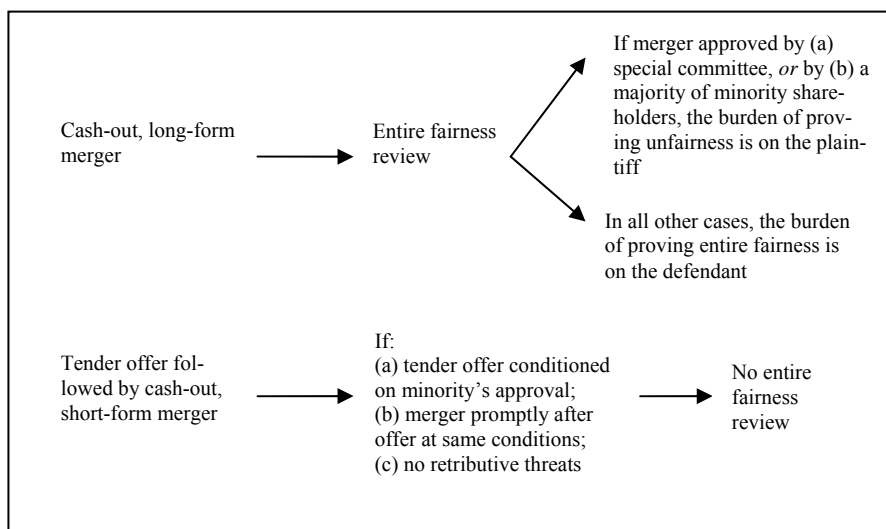
G. *An Unnecessary Quandary*

To sum up the discussion thus far, Delaware law provides two primary modes by which controlling shareholders can freeze-out minorities. The first is the one-step, long-term, cash-out merger, subject to the entire fairness standard of review. Absent certain procedures to protect minority shareholders, the burden to prove fairness is on the defendants. The burden is shifted to the plaintiffs, however, if a truly independent special committee of the controlled corporation is instituted to negotiate the deal, or if a majority of the minority unaffiliated shareholders of the acquired corporation approve the merger. Alternatively, controlling shareholders can employ a two-step tender offer followed by a short-form merger, where entire fairness review applies only if the three *Pure* conditions are not satisfied. Table 1 synthesizes the existing doctrinal framework.

94. In addition, in a brilliant part of his remarkable opinion, Vice Chancellor Strine underlines the parallel existing between directors' powers (and duties) in the context of a hostile takeover—or, generally, an offer launched by a noncontrolling entity—and those in the context 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-man's land in which directors of the target corporation have no fiduciary duties. *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 439–41 (Del. Ch. 2002).

95. *Id.* at 445.

TABLE 1: STANDARDS OF REVIEW FOR FREEZE-OUTS UNDER DELAWARE LAW



As mentioned above, this doctrinal outcome has been widely criticized by legal scholars and commentators. As concisely noted in one of the most comprehensive recent studies on the subject,⁹⁶ the different positions expressed can be divided into three major groups: (1) authors who object to what they consider to be different standards of review for transactions leading to the same result, and who therefore argue for convergence toward either entire fairness review or the business judgment rule (“convergence up” or “convergence down,” to use Subramanian’s expression⁹⁷) in both situations;⁹⁸ (2) authors who approve the current status of Delaware case law;⁹⁹ and (3) authors who suggest “mixed” approaches.¹⁰⁰ In a nutshell, critics of the *status quo* emphasize that both transactions reach the same result (cashing out minorities), and

96. See Subramanian, *supra* note 4, at 22–30.

97. *Id.* at 23.

98. “Convergence up” toward some form of entire fairness review for a two-step freeze-out has been advocated by Cannon, *supra* note 4; Levy, *supra* note 4; and Resnick, *supra* note 4.

99. See Jon E. Abramczyk et al., *Going-Private “Dilemma”?—Not in Delaware*, 58 BUS. LAW. 1351 (2003); Pritchard, *supra* note 4; Thomas M. McElroy, II, Note, *In re Pure Resources: Providing Certainty to Attorneys Structuring Going-Private Transactions, or Not?*, 39 WAKE FOREST L. REV. 539 (2004). Although Siegel also considers the holding in *Pure* correct, he criticizes the court’s reasoning. Siegel, *supra* note 4.

100. See Aronstam et al., *supra* note 4; Gilson & Gordon, *supra* note 4.

that applying different standards of review results in unfair treatment of shareholders. The majority of the writers seem to agree, more specifically, that shareholders are under-protected in the case of a two-step merger and advocate for additional procedural protections in such transactions.¹⁰¹

It is beyond the scope of this Article to engage in a detailed discussion of the different positions expressed. Rather, this Section will explain why the general legal framework drawn by Delaware's judiciary is sensible (if perhaps imperfect and subject to possible fine-tuning), and why a substantial departure from the current approach is unnecessary. The final Section of this Article illustrates how comparative analysis supports the rationales behind current Delaware case law and suggests some partial, but important, adjustments to the existing doctrine.

First, there are empirical studies on two-step mergers that seem to indicate that minority shareholders are not under-protected in the event of a freeze-out, and that they do not receive lower payments than in the case of a one-step merger. For example, a recent analysis stated:

[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 freeze-out 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 current review standards applied to freeze-out transac-

101. See Gilson & Gordon, *supra* note 4, 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”); see also Stevelman, *supra* note 4, 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 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 22, at 732.

tions by the Delaware judiciary.¹⁰²

Second, there is an even more compelling argument that calls into question the thesis, based on a comparison between prices paid in one-step and two-step freeze-outs, according to which tender offers followed by short-form mergers should be subject to stricter scrutiny. The argument runs like this: Even if one can prove that in the long-form merger scenario shareholders receive systematically higher premiums over the market price of the shares than in a tender offer context, this does not automatically imply that shareholders are unfairly undercompensated in the second situation. It might as well be inferred that shareholders are overcompensated in the case of a long-form merger. The special committee of independent directors, in other words, might “over shoot,” potentially motivated by concerns of lawsuits and possibly seeking to gain a reputation as champions of investors. The simple fact that premiums over market prices are larger in one case than in the other does not imply that the regulation of either one is intrinsically superior, unless it is possible to compare the actual prices paid with some reliable indication of the fair value of the shares. If, on the other hand, we assume that markets are efficient and that market prices correctly reflect publicly available information, including a discount for the possibility of being cashed out, a higher premium on market prices might even be considered more, rather than less, problematic.

Third, from a doctrinal point of view, it is worth pointing out that one-step and two-step freeze-out transactions are *different*, notwithstanding the observation that they tend to accomplish similar results. Similar results, however, are not, of themselves, sufficient to advocate a need for absolutely identical rules. In fact, it is often the case in transactional law that one specific factual outcome can be reached through different roads. While it is true that, in a two-step freeze-out, minority shareholders tend to receive a lower price than in a one-step freeze-out,¹⁰³ and that this difference is caused by the veto power of the special negotiating committee in the one-step merger and by the existence of collective action problems and information asymmetries in the two-step context, none of these considerations are sufficient to prove that the two techniques should be subject to the same judicial standard.

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 opposite sides of the transaction, and they do not suffer the same conflict of

102. Bates et al., *supra* note 8, at 29–30. *But see* Subramanian, *supra* note 28.

103. Subramanian, *supra* note 4, at 25.

interest as managers of merged corporations in a one-step freeze-out. Admittedly, minority shareholders are exposed to certain pressure to tender, and one might debate whether *Pure* goes far enough to mitigate that pressure, but the conceptual framework used by the Delaware Chancery Court remains sound. Equal protection of investors means treating all similarly-situated investors in a given deal equally; it does not mean that investors should receive the same treatment regardless of the type of transaction. That is, the law does not require the same kind of protection in all situations.

The argument that the *Pure* rule creates an inconsistent dichotomy between the duties of directors in a hostile takeover and those of directors in the context of a friendly tender offer deserves particular consideration. Briefly, the argument proceeds that in the hostile acquisition context, directors and managers have specific fiduciary duties to fend off some value-maximizing offers which, while welcomed by minority shareholders, are nonetheless undesirable for corporate insiders and controlling shareholders because they waste corporate resources. It is argued that these duties are at odds with the fact that no corollary duty exists to require directors to protect the interests of minority shareholders when a controlling shareholder launches a two-step freeze-out.¹⁰⁴ By way of contrast, proponents of this argument point out that in the traditional hostile acquisition context, the market itself affords an additional line of protection to minority shareholders because if the consideration tendered for their shares is too low, additional bidders can “auction” for the shares, thereby maximizing the potential value of minority shareholders’ shares.¹⁰⁵

Once again, however, the differences between these 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, directors put shareholders’ interests ahead of their personal interests.¹⁰⁶ But to require specific procedural steps whereby directors would negotiate the best possible price for minority shareholders in the front-end tender offer of a two-step minority freeze-out would

104. See Gilson & Gordon, *supra* note 4, at 820; Stevelman, *supra* note 4, at 806.

105. Stevelman, *supra* note 4, at 806.

106. See *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 Revlon 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).

be to impose on directors an active duty to intervene in a transaction between independent parties and to employ corporate assets to favor one party over the other. The contextual difference is substantial, and comparisons to the friendly acquisition context where directors generally help the weaker party obtain greater gains are insufficient to impose such a duty.

Also, the argument concerning the protection offered to minority shareholders by the potential for competitive bidding in the hostile acquisition context is inconclusive. First of all, it is not the duty of the courts to recreate, in every acquisition process, the same conditions found in a contested takeover. But even assuming that shareholders are entitled to benefit from competition among different buyers, the controlling shareholder initiating a minority freeze-out is generally in her position of control precisely because at a prior point in the history of the corporation, she acquired control through a contested takeover, wherein all market protections were available to minority shareholders. Thus, it can be said of any remaining minority shareholders that either: (1) at the time the controlling shareholder wrested control, they decided not to sell their shares; or (2) they bought their shares subsequent to the controlling shareholder's power play and were aware that she could, potentially, freeze them out at a later date. In the latter case, it is reasonable to assume that the market discounted the shares' price for this possibility. In either case, to artificially recreate the conditions of an auction for the shares would be to overprotect the investors.¹⁰⁷

Finally, applying the entire fairness review to the two-step freeze-out is incompatible with the very structure of the short-form merger, a vehicle designed by the Delaware legislature to simplify the process of going private. The argument has been emphasized by the Delaware judiciary on more than one occasion:

[Section] 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;

107. See also ROBERT CHARLES CLARK, CORPORATE LAW 506 (1986); Pritchard, *supra* note 4, at 103.

and there is no vote.¹⁰⁸

If the back-end of the two-step freeze-out were subject to entire fairness review, the corporation would find itself in a Catch-22 situation. It must either bear the burden of proving fairness or shift the burden of proof to the plaintiff by establishing procedural protections similar to those required by *Pure* and its progeny. But, if he is forced to do this, the controlling shareholder loses the advantage of the short-form merger and might instead just opt for the long-form cash-out merger. In other words, to require entire fairness review for the two-step freeze-out would mean the end of the short-form merger.

Part V of this Article lays the foundation for a comparative analysis, the implication of which supports the overall rationale followed by the Delaware judiciary, and suggests some fine-tuning that would improve the protection of minority shareholders in the context of a two-step freeze-out.

III. FREEZE-OUT TRANSACTIONS IN THE EUROPEAN UNION

A. *Unavailability of Cash-Out Mergers in Europe*

Cash-out mergers are generally not permitted in Europe.¹⁰⁹ Articles 3 and 4 of the Third Council Directive Concerning Mergers of Public Limited Liability Companies (Third Directive)¹¹⁰ provide that 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. 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.”¹¹¹

Thus, shareholders of the corporation extinguished by the merger are entitled to receive at least some shares of the surviving company and

108. *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 247 (Del. 2001).

109. 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 are these provisions 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 from Germany and the United Kingdom, see *infra* Part III.G.

110. Third Council Directive 78/855/EEC, 1978 O.J. (L 295) 36.

111. *Id.* art. 4(1).

cannot simply be cashed out. In other words, under European law, a merger with an entirely cash consideration for some shareholders is unacceptable. This rule is the expression of a more general principle, still reflected in the national laws of most Member States, that a shareholder's participation right cannot be taken without her consent.¹¹²

To be sure, the exchange ratio could theoretically be set so high that minority shareholders of the acquired corporation will not, as a matter of fact, obtain shares of the acquiring corporation, similar to 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 is 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 Third Directive, in all Member States, before the draft terms of a merger are presented to the shareholders, a judicially-appointed independent expert must examine the exchange ratio and issue an opinion on its intrinsic fairness.¹¹³ This provision embodies in many respects 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 potentially extensive review through *ex post* lawsuits.¹¹⁴ Interestingly, in the United States, the outcome of litigation often backfires on the process, suggesting procedural

112. For example, this principle is stated very clearly by a leading French scholar: "the shareholder is a *member of the corporation*; this quality cannot be taken away from him because that would constitute a true expropriation. Only with his consent can this right be disposed of." ("L'actionnaire est *member de la société*; il ne peut pas être privé de cette qualité parce qu'il y aurait là une véritable expropriation. C'est seulement avec son consentement que son droit peut disparaître.") (author's translation). MICHEL GERMAIN, *TRAITE DE DROIT COMMERCIAL* 376 (Georges Ripert & René Roblot eds., 18th ed. 2002).

113. Third Council Directive, *supra* note 110, art. 10. The expert's opinion can be considered binding because, in the absence of a positive assessment of the fairness of the transaction, minority shareholders can challenge 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.

114. See, e.g., Gerard Hertig & Hideki Kanda, *Related Party Transactions*, in *THE ANATOMY OF CORPORATE LAW* 101, 117 (Reiner Kraakman et al. eds., 2004).

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 allowed to pursue a merger with an exchange ratio so high as to freeze out minority shareholders. It is possible that some small investors may have insufficient shares to obtain even a single share of the resulting corporation, and in this case, the constituent corporations offer to buy the shares. The vast majority of minority shareholders, however, are entitled to maintain their status in the new corporation. The limitation on cash consideration ensures this result.

Consider, for example a merger in which the par value of the shares of both corporations is €1, the real value for one share of P (the parent/acquiring corporation) is €2, and the real value of one share of S (the subsidiary/target) is €1.10. The exchange ratio would be 0.55 (1.10/2), meaning that for each share of S, an investor is entitled to 0.55 shares of P. This will result in many shareholders of S being entitled only to a fraction of P's shares, with obvious complications for the merger process. European law allows reducing the exchange ratio by offering consideration *partially* in cash. The cash consideration cannot, however, exceed 10% of the par value of P's shares. In this example, it would be possible to provide that for each S share, an investor is entitled to €0.10 cash (10% of the €1 par value) on top of the exchange ratio, consequently setting the exchange ratio at 0.5 (2/1), a more manageable figure.¹¹⁵

These adjustments, however, are very limited and, as a practical matter, are 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.¹¹⁶

B. Shareholders' Remedies in Case of Delisting Through Merger: Challenging the Transaction

The fact that cash-out mergers are not generally possible in Europe does not preclude the use of mergers in a public-to-private transaction in which a listed corporation is merged into a nonlisted one. Minority shareholders will participate in the resulting corporation (not an ideal prospect from the point of view of the acquirer), but delisting still en-

115. For a discussion of par value, real value, and exchange ratios of certain merger processes, see LUIGI A. BIANCHI, *IL GIUDIZIO DI 'CONGRUITÀ' DEL RAPPORTO DI CAMBIO NELLA FUSIONE* (2002).

116. *See supra* Part II.B.

sure a lower regulatory burden and, in many cases, increased flexibility for the controlling shareholders and directors.

With this background, it is revealing to discuss briefly two additional differences between the European and American approaches: (1) procedures governing short-form mergers in Europe, and (2) remedies for dissenting shareholders.

European law provides for simplified procedures designed to facilitate merging a subsidiary with and into a parent corporation that owns a substantive percentage of the subsidiary's shares. The two most important provisions in this respect are Articles 24 and 27 of the Third Directive. The vehicle created by Article 27 bears notable resemblance to the American short-form merger, but also differs in important respects. It is applicable to mergers where 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*.¹¹⁷

There are, however, at least four major differences distinguishing this "European short-form merger" from its American counterpart. First, in the European transaction, both the directors and the shareholders of the target corporation have an inalienable right to vote on the merger. Conversely, DGCL Section 253 and MBCA Section 11.04 require only that the American short-form merger be given the green light from the directors of the acquiring corporation.

Second, under European law, specific and extensive information must be provided to the nonvoting 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.¹¹⁸ This inspection right gives shareholders information allowing them to have a say in the consummation of the merger.

Third, in Europe, a qualified minority of the acquiring corporation's shareholders, representing not more than 5% (though Member States

117. Third Council Directive, *supra* note 110, art. 27.

118. *Id.*

can require a lower threshold), can request that the merger be submitted to the shareholders' meeting and thereby reinstate the regular approval process.¹¹⁹

Fourth, European Law requires that, in both short-form mergers and long-form mergers, substantive documentation, such the merger agreement, financial statements, and expert's fairness opinion, be prepared and made available to shareholders. It is possible to avoid these requirements so long as minority shareholders of the controlled corporation are given the option to receive the fair value of their shares in cash and are afforded, in case of disagreement over shares' valuation, a judicial appraisal process.¹²⁰ This is not a forced cash-out of minorities since it occurs at the election of minority shareholders, who can otherwise 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. Third Directive Article 24 provides that in such a case it is unnecessary to obtain approval at the parent company's shareholders' meeting. In addition, determining an exchange ratio is also unnecessary, since there are no minority shareholders requiring receipt of 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.¹²¹

In sum, 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, enjoy the benefit of a pre-merger fairness opinion by an independent judge-appointed financial expert, and can even bring the entire procedure to a halt by requiring a shareholders' vote.

The analysis becomes more complicated, however, when evaluating dissenters' rights. In fact, this issue is not comprehensively regulated or harmonized in the European context. Instead, the Third Directive sets forth minimal standards, and each jurisdiction mandates different rules. Rather than undertake a detailed discussion of the technical differences

119. *Id.* arts. 8(c), 27(c).

120. *Id.* art. 28.

121. *Id.* art. 24.

among different states, this Article considers the overall framework and highlights a few country-specific examples.

First, the Third Directive requires Member States to regulate the civil liability of directors, managers, and independent experts for misconduct in the merger process.¹²² 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 might be considered a less-than-arm's-length transaction, making it subject to rules governing conflicted transactions.¹²³ Comparative research has convincingly demonstrated that a fundamental difference between European and U.S. corporate law systems is the degree of reliance on shareholder-driven litigation as a tool for enforcement of the fiduciary duties of directors and controlling shareholders.¹²⁴ The reliance is limited in the European context and extensive in the American context.¹²⁵ Complex and multifaceted factors explain this divergence. Procedural obstacles to derivative suits and class actions in Europe play a major role, as does the prevalence of concentrated ownership structures (making the development of extensive *ex post* litigation led by minority shareholders less likely).¹²⁶

It should be noted that neither of these divergent underlying philosophies—U.S. reliance on *ex post* civil litigation and European reliance on *ex ante* statutory procedural protections and shareholder voting—is inherently superior to the other. For the purpose of comparing going-

122. *Id.* art. 20.

123. For an overview of the different approaches to directors' conflicts of interest 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). For information on the regulation of conflicts of interest with respect to controlling shareholders 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. COMPANY & FIN. L. REV. 491 (2007).

124. In this respect, it has been observed:

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 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 mechanisms and generous attorney's fees is also available to support a specialized plaintiff's bar.

Hertig & Kanda, *supra* note 114, at 116 (citations omitted).

125. *See id.*

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

private transactions across the Atlantic, it is sufficient to point out how lawsuits based on a breach of fiduciary duty of controlling shareholders or directors are not nearly as common or relevant to protecting minorities in Europe as in the United States.

In addition to, or in connection with, seeking damages for breach of a fiduciary duty, a European merger may be challenged for lack of authority or other illegalities by dissenting minorities seeking rescission.¹²⁷ The same reluctance showed by American judges in granting rescission of a completed merger¹²⁸ is reflected in the Third Directive and in European corporate statutes and codes. In most jurisdictions, a merger cannot be declared “void” after the publication of the merger deed or for a short period thereafter. From the moment of publication on, only monetary damages can be granted.¹²⁹ The same reasons that discourage shareholders’ litigation for breach of the duty of care or of loyalty in the American context tend to deter recourse to these types of causes of action in the European context.

C. *Appraisal Rights in the Merger Context*

Shareholders of a listed corporation dissenting from a merger in which the surviving corporation is unlisted might enjoy dissenters’ rights similar to U.S. appraisal rights. Once again, however, European law is not harmonized on the subject, and Member States’ rules reflect significant differences. Nevertheless, interesting common traits can be extrapolated from specific examples.

Consider, for instance, appraisal rights under Italian law, where a recent reform profoundly innovated the former approach and introduced a fairly modern set of rules.¹³⁰ In the Italian system, mergers are not always a ground for invoking appraisal rights. Rather, right to appraisal is conditioned on majority shareholder approval of specific amendments to the corporate charter and other relevant corporate events, among which mergers are not included. A merger can, indirectly, represent a ground

127. For a brief description of Spanish law in this respect, see Agustín Madrid Parra, *Transformación, fusión, y escisión de las sociedades mercantiles*, in DERECHO MERCANTIL 669 (2003).

128. See *Ala. Fid. Mortgage & Bond Co. v. Dubberly*, 73 So. 911, 915 (Ala. 1916) (“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.”); COX & HAZEN, *supra* note 22, at 618.

129. See, e.g., Codice civile [C.c.] art. 2504-*quater* (Italy).

130. Marco Ventoruzzo, *Cross-Border Mergers, Change of Applicable Corporate Laws and Protection of Dissenting Shareholders: Withdrawal Rights Under Italian Law*, 4 EUR. COMPANY & FIN. L. REV. 47 (2007).

for the appraisal remedy, but only when it triggers one of the fundamental changes specifically listed in the Italian Civil Code.¹³¹ 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 United States), the transfer of the legal seat abroad (because it might lead to the application of the corporate laws of a different state), and modification of shareholders' voting and economic rights.¹³² 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 who do not approve going private.¹³³ While there is some ambiguity concerning the precise scope of this provision, it can be argued that merging a listed corporation into a closely held one is a ground for appraisal.

Spanish law also restricts corporate charter 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.¹³⁴

131. C.C. art. 2437 (Italy); *see also* Ventruruzzo, *supra* note 130, at 62.

132. Ventruruzzo, *supra* note 130, at 62.

133. C.C. art. 2437 (Italy); *see also* Ventruruzzo, *supra* note 130, at 62.

134. According to Spanish corporate law, shareholders have, in limited circumstances, an appraisal—or “withdrawal”—right called a *derecho de separación*. As a leading treatise puts it, pursuant to the *Ley de sociedades anónimas* (LSA), shareholders' rights include the appraisal right in the event of: a change in the corporate purpose; the conversion of a corporation into a general or limited partnership; the transfer of the corporate seat to a foreign jurisdiction; the transfer of the corporate seat of a *Societas Europaea* (SE) to another EU member State; a merger that implies the creation of an SE in another member State and in the event of the establishment of a holding SE (“derecho de separación en los supuestos de sustitución del objeto—art. 147—, de transformación de sociedad anónima 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 fusión que implica la constitución de una SE en otro Estado miembro—art. 320—, y de constitución de una SE *holding*.”) (author's approximate translation). Also important for our purposes is the shareholders' right to maintain their participation in case of a merger pursuant to Articles 229 and 247 of the LSA. *See* Ignacio Lojendio Osborne, *La Acción. Los Derechos del Socio*, in *DERECHO MERCANTIL* 275, 300 (2006). In addition, as kindly pointed out to me by Miguel Trias Sagnier, a new case of appraisal rights in the *sociedad anónima* has been recently introduced by the Ley 3/2009, de 3 de abril de Modificaciones Estructurales de las Sociedades Mercantiles (B.O.E. 2009, 5614), *available at* <http://www.boe.es/boe/dias/2009/04/04/pdfs/BOE-A-2009-5614.pdf>. Email from Miguel Trias Sagnier, Professor, ESADE Business School, to author (Nov. 6, 2009) (on file with author). According to Article 15 of this statute, in case of the conversion of a *sociedad anónima* into a *sociedad de responsabilidad limitada*, shareholders that have not approved the conversion also have a right to withdraw. Before this amendment, under Spanish corporate law, only the conversion of a *sociedad de responsabilidad limita-*

Mergers and spinoffs are also not an independent ground to trigger appraisal rights in France and Germany.¹³⁵ A first observation, therefore, is that while appraisal rights are available in Europe in the merger context, the ground for exercising these rights is considerably more narrow than that afforded in the United States.

A second observation concerns valuation rules for dissenters' shares. In some systems, different rules are provided for listed and nonlisted corporations. For the latter, many states provide criteria inspired by the same rationale as that behind the Delaware Block Method, but with more flexibility.¹³⁶ More important for the purpose of this Article is that European states frequently fail to provide general market exemptions (i.e., rules limiting appraisal rights to unlisted securities) for listed corporations. For appraisal purposes, the valuation of shares listed on an exchange is usually based on the average price of the shares over a set period preceding the event triggering the right to appraisal.

Once again, the Italian regulation offers an illustration. According to Article 2437-*quarter* of the Italian Civil Code, while nonlisted shares are valued by applying a statutory formula resembling the Delaware Block Method, valuation of listed shares 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 shareholder meeting's call.¹³⁷

Corporate statutes of other European jurisdictions provide similar formulas. For example, in Spain, the appraisal value of listed shares for shareholders dissenting from a change of the corporate purpose is estab-

da into a *sociedad anónima* would trigger an appraisal right.

135. Shortly before the enactment of the Takeover Directive, a comparative analysis underlined how, with respect to appraisal rights, unlike the United States, "neither Germany nor France had any comparable *ex ante* exit protection in the case of a merger or takeover." See Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791, 831 (2002).

136. For example, according to Article 2437-*ter* of the Italian Civil Code, the evaluation of the nonlisted shares of a dissenting shareholder requires that three elements be taken into account: 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 130, at 65.

137. See *id.* at 66; see also Marco Ventoruzzo, *I criteri di valutazione delle azioni in caso di recesso del socio*, 50 RIVISTA DELLE SOCIETÀ 309, 393 (2005). A delicate interpretive problem is how to proceed when there are no 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 nonlisted shares.

lished, according to Article 147.2 of the *Ley de Sociedades Anónimas*, by the average market price of the last three months.¹³⁸

This criterion often fails to capture the fair current value of shares, especially when, as is often the case in freeze-out transactions, prices are depressed and when this price depression is the precise factor motivating the controlling shareholder to go private. In addition, as Professor Gevurtz warns, reliance on market prices—especially on a long historical series of prices—is particularly problematic in a freeze-out, for the very reason that “the market price should reflect the risk that the majority will freeze out the minority.”¹³⁹ Bebchuk and Kahan also identify this concern, arguing that the very possibility of minority cash-out mergers may push down market prices.¹⁴⁰

Summing up, cash-out mergers are not generally available for conducting a going-private transaction in Europe. Minority shareholders are protected through specific ex ante devices, the most important being the binding fairness opinion on the exchange rate issued by a court-appointed expert. In line with this limitation, dissenters’ rights play a more limited role in protecting minority shareholders, both in terms of their scope of application and the determination of the fair value of shares.

D. *Statutory Freeze-Out in Europe: Takeover Directive, Article 15*

The fact that cash-out mergers are not the principal method by which to conduct going-private transactions in Europe does not mean that freeze-outs are impossible. A freeze-out can, in fact, be accomplished through a different legal technique, explicitly regulated by Article 15 of the Thirteenth Directive on Takeovers (Takeover Directive).¹⁴¹

In short, Article 15, under certain conditions, grants any shareholder acquiring at least 90% 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.-

138. Juan Manuel Gomez Porrua, *La Modificación de los Estatutos Sociales. Aumento y Reducción del Capital Social*, in *DERECHO MERCANTIL* 378, 401 (2006). In other European jurisdictions, however, some consideration is also given to other elements in determining the fair value of the shares. In Germany, for example, the appraisal valuation is based on a two-prong test that takes into account both market prices and a cash-flow analysis (the so-called *Ertragswertverfahren*), based on standards set by the German Institute of Auditors (*Institut der Wirtschaftsprüfer*). Email from Peter O. Mülbart, *supra* note 10.

139. GEVURTZ, *supra* note 22, at 736.

140. Bebchuk & Kahan, *supra* note 21.

141. Directive 2004/25/EC of the European Parliament and of the Council on Takeover Bids, art. 15, 2004 O.J. (L 142) 12, 21.

style short-form merger. Upon closer analysis, however, important and profound differences emerge. First, 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 either maintain its corporate identity as a wholly-owned subsidiary or can be completely merged into the parent.

To understand this rule and appreciate its nuances, a word on the general EU framework for takeover regulation is necessary. European law, largely inspired by the U.K. experience, provides for a mechanism foreign to U.S. corporate law: the mandatory bid. Set forth in Article 5 of the Takeover Directive, the mandatory bid provides that 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 pre-determined period (between six to twelve months preceding the triggering event of the acquisition of control, according to the individual Member State).¹⁴² During the offer, an all-holders/best-price rule similar to the one set forth in SEC Rule 14d-10 applies.¹⁴³

The rationale for the mandatory bid is twofold: It distributes the control premium to all shareholders and grants a fair way out for minority investors. While the rule can be advantageous for minority shareholders in case of a friendly acquisition (i.e., an acquisition in which the controlling shareholder sells in order to reap the capital gains of her investment), serious doubts are cast on its overall effect on the corporate control market. A mandatory bid might render acquisitions—especially hostile ones—particularly expensive, thereby hindering an efficient corporate control market.¹⁴⁴

142. *Id.* arts. 5(4), 17.

143. Both European and U.S. rules provide that all shareholders should be offered the same consideration for their shares, and that if higher consideration is offered to any shareholder prior to the close of the offer window, that same consideration must be extended to all shareholders. *See* 17 C.F.R. § 240.14d-10(a)(2); Directive 2004/25/EC, *supra* note 141, arts. 5(4), 7. For a history and analysis of Securities Exchange Act 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).

144. Mandatory bids are triggered once the bidder acquires a specified percentage of corporate shares. If the ownership structure of a corporation is concentrated, such that the largest shareholder owns a percentage of shares higher than the threshold triggering the mandatory bid provision, then bidders seeking to acquire corporate control must have the purchasing power to buy all outstanding shares. Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe*, 11 U. PA. J. BUS. & EMP. L. 135, 140 (2008).

Voluntary tender offers on a percentage up to the full amount of outstanding shares are also possible under the Takeover Directive. In such a case, the price is freely set by the bidder. An important exception to the mandatory bid, however, is that an investor that acquires control through a voluntary tender offer on all the outstanding shares is not required to follow up the voluntary offer with an additional mandatory bid.¹⁴⁵ 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 an absolute majority of the voting shares creeps up toward 50% plus one share at a quick pace (depending on the jurisdiction, this might be a 30% acquisition within one year),¹⁴⁶ the acquisition triggers an obligation to launch a mandatory bid under the assumption that a control premium is being paid.

With this 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 (an event known as a “triggering tender offer”), certain conditions are met. 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.¹⁴⁷ The second condition can be described as (super)majority of minority approval; no different, notwithstanding its very high threshold, from Delaware requirements articulated in *Getty Oil*¹⁴⁸ and *Pure*.¹⁴⁹ I will call this first freeze-out right the “majority of the minority” freeze-out.

Pursuant to Article 15 of the Takeover Directive, Member States can also opt for the alternative scenario: freeze-out rights triggered when, as a consequence of the tender offer, the bidder holds securities representing not less than 90% of the capital carrying voting rights *and*

145. Directive 2004/25/EC, *supra* note 141, arts. 5(2), 17.

146. This is the case in Italy pursuant to Section 106 of the *Testo Unico della Finanza*. Decree-Law of Feb. 24, 1998, No. 58, Gazz. Uff., Mar. 26, 1998, no. 71, Suppl. Ord. no. 52 (Italy).

147. Directive 2004/25/EC, *supra* note 141, arts. 15(2)(a), 21.

148. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985).

149. *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002).

90% of the voting rights,¹⁵⁰ *independent* of the rate of acceptance of the tender offer. In this instance, minorities are cashed out even if a majority of the shares of the nonaffiliated investors have *not* been tendered, as long as subsequent to the offer, the bidder reached the 90% thresholds.¹⁵¹ This might occur when a shareholder holding a little less than the triggering threshold, or already holding more than 90%, launches a tender offer that receives few acceptances. I will call this the “single threshold freeze-out.”

As previously mentioned, 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.¹⁵² 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.¹⁵³ In most situations, the single threshold approach facilitates the squeeze-out of minorities because no (super) majority of the minority requirement can be met. Coherently with this feature, according to Article 15(2) of the Takeover Directive, Member States that choose to implement the single threshold freeze-out can provide for a threshold higher than 90% and lower than 95%.¹⁵⁴

It should also be noted that if the target corporation has issued multiple classes of voting shares, Member States implementing the Takeover Directive can adopt a “disjoint freeze-out,” allowing for the majority shareholder to exercise his buy-out right by class, but only on the shares of the class in which the relevant threshold is reached.¹⁵⁵

For example, consider a corporation that has issued ten million shares of common stock and ten million shares of preferred stock carrying limited voting rights only on fundamental charter amendments and busi-

150. Owning 90% of the voting capital does not necessarily mean that the bidder holds 90% of the voting rights of the corporation. These percentages might not directly correlate to the extent that voting rights are attached to nonequity securities or notes.

151. Directive 2004/25/EC, *supra* note 141, arts. 15(2)(b), 21.

152. 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. COMPANY & FIN. L. REV. 416 (2004).

153. Silja Maul & Danièle Muffat-Jeandet, *The Directive on Takeover Bids*, in TAKEOVER BIDS IN EUROPE: THE TAKEOVER DIRECTIVE AND ITS IMPLEMENTATION IN THE MEMBER STATES 1, 57–58 (Silja Maul et al. eds., 2008).

154. Directive 2004/25/EC, *supra* note 141, arts. 15(2)(b), 21.

155. *Id.* arts. 15(3), 21.

ness combination—a practice relatively common in Europe.¹⁵⁶ 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, the triggering threshold is set 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 shares 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 shares. The majority shareholder owns 93.5% of the entire voting capital (9.8 million common stock shares, plus 8.9 million preferred stock shares, with over twenty million 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 the offeror could only cash out common stockholders.

The effect of a 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 requiring buying 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, such as Italy and the United Kingdom, have opted for this greater flexibility, while others, such as France, do not allow freeze-outs limited to one class of shares.¹⁵⁷

156. For a discussion and some empirical evidence on the widespread use of limited voting shares in Europe, see ASSOC. OF BRITISH INSURERS, APPLICATION OF THE ONE-SHARE, ONE-VOTE PRINCIPLE IN EUROPE (2005), available at http://www.abi.org.uk/Publications/Application_of_the_one_share_one_vote_principle_in_Europe_1.aspx.

157. Joëlle Simon, *France*, in TAKEOVER BIDS IN EUROPE, *supra* note 153, at 217, 255; see also Commission Staff Working Document: Report on the Implementation of the Directive on Takeover Bids, at 9, SEC (2007) 268 (Feb. 21, 2007), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf [hereinafter *Takeover Directive Implementation Report*] (documenting the adoption of the mandatory bid and freeze-out provisions of the Takeover Directive among the member states); Peter Burbridge, *United Kingdom*, in TAKEOVER BIDS IN EUROPE, *supra* note 153, at 571, 603; Lucia Picardi, *Italy*, in TAKEOVER BIDS IN EUROPE, *supra* note 153, at 391, 415.

E. 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 Takeover Directive provides that “[f]ollowing a mandatory bid, the consideration offered in the bid shall be presumed to be fair.”¹⁵⁸ More specifically, two rules govern the determination of the fair price: one concerns the type of consideration, and the other concerns the amount of consideration offered.

Regarding the first rule, the Takeover Directive provides that the consideration offered in minority squeeze-out situations shall have the same form as consideration offered in a preceding triggering tender offer. In other words, 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 consideration for the freeze-out can be represented by the same type of securities, but cash is a viable alternative. If noncash or not-entirely-cash consideration is offered, Member States can also require the bidder that wants to freeze-out minorities to also offer an all-cash alternative.¹⁵⁹

In terms of fair price, the Takeover Directive provides for two different presumptions of fairness, depending on the type of tender offer that led to the relevant threshold. In the case of a mandatory tender offer triggered by acquisition of control, the minimum price is not freely determined by the bidder. Takeover Directive Article 5(4) 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 six and twelve 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 fair for cash-out purposes.

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 the Takeover Directive, the price of the voluntary offer is presumptively fair only if the shares tendered are more than 90% of those comprised in the bid.¹⁶⁰ A majority

158. Directive 2004/25/EC, *supra* note 141, arts. 15(5), 21–22.

159. *See 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.”).

160. It should be noted that shares acquired during the tender offer’s acceptance period, but

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, whenever the freeze-out follows a voluntary tender offer. In the case of a majority of the minority freeze-out, the presumption of fairness for the tender offer's price is met by definition. This is not always the case, however, in a single threshold freeze-out.¹⁶¹

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% of all shares, and therefore the right to cash out minorities. Nevertheless, no fair price presumption applies because her offer did not reach 90% of the shares included in the offer. In these situations, Member States often set up specific rules to determine fair price. Several Member States use some form of appraisal by regulatory agency, independent expert, or court proceeding.¹⁶²

The Takeover Directive does not, however, further clarify whether the fairness presumption regarding the price of the triggering tender offer is rebuttable—an important issue for litigation purposes. Some authors, in particular German commentators Krause, Austmann, and Mennicke, argue that the presumption is not rebuttable.¹⁶³ While it is

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 under Article 15(5). *See id.*

161. In fact, even if the shareholder exercising the freeze-out owns no shares before launching the triggering tender offer, under the majority of the minority approach, she still has to acquire at least 90% of the shares included in the offer in order to freeze out the minority. This translates into at least 90% of all the outstanding shares. Obviously, if—as is normally the case—the acquiring shareholder already owns a substantial percentage of the outstanding shares and obtains more than 90% of the shares targeted in the tender offer, then she also obtains more than 90% of the total outstanding shares.

162. *See Takeover Directive Implementation Report, supra* note 157.

163. *See* A. Austmann & P. Mennicke, *Übernahmehrechterlicher Squeeze-out und Sell-out*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 846, 851 (2004); H. Krause, *BB-Europareport: Die EU-Übernahmehrichtiline – Anpassungsbedarf im Wertpapiererwerbs- und Übernahmehgesetz*, 3 DER BETRIEBS-BERATER 113, 118 (2004). *But see* P. Mülberr, *Umsetzungsfragen der Übernahmehrechtlinie – erheblicher Änderungsbedarf bei den heutigen Vorschriften des WpÜG*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 633, 634 (2004). Two recent cases in Germany addressed this issue. *See* Oberlandesgericht [OLG] [Trial Court Frankfurt] Dec. 9, 2008, WPÜG 2/08, NZG 2009, 74 (F.R.G.); Oberlandesgericht [OLG] [Trial Court Stuttgart] May 5, 2009, 20 W 13/08, WM 2009, 1416 (F.R.G.). Both decisions favor the theory that the presumption is not rebuttable, but they do not adopt a rigid and final interpretation.

difficult to offer a general answer, one can observe that, even if the fair price presumption is rebuttable, it is highly improbable that a price deemed presumptively adequate by the legislature would be subject to extensive judicial review in the light of specific factual circumstances, especially in civil law countries.

One final observation on the fair price presumption that is set forth by the Takeover Directive: Setting the freeze-out price at the same level as that preceding a mandatory or voluntary tender offer—similar to that which is required in Delaware under *Pure*—serves two conflicting goals. The first is to protect minorities from the pressure to tender in a front-loaded two-step acquisition. The second goal, however, is to avoid strategic behavior by minority shareholders. But if minority shareholders are expecting a higher price to follow in the freeze-out, they will be tempted to withhold their shares in the front-end offer even if the price is fair. This strategy, rational at the individual level, might create a market failure because of collective action and coordination problems. If many shareholders follow this reasoning, the front-end tender offer may not reach required thresholds, making it impossible to trigger freeze-out rights. This outcome is damaging not only to the controlling shareholder, but also possibly to the corporation and to minority shareholders.

In light of this dichotomy, a regulatory approach providing for an identical price in front-end and back-end acquisitions is sensible. Likely missing, however, is the present value of the consideration received. Freeze-out consideration is paid *after* that which is paid to shareholders who spontaneously tender their shares. The time lag is not dramatic, but, depending on the specific legal system and the transaction in question, it might be a few weeks to several months. Rarely is interest or other compensation for the delay granted to shareholders that are forced out in the initial stages, and this element, of itself, might pressure these shareholders to tender in the front-end offer. After all, no rational investors would opt to receive \$100 a month from now when they could obtain the same amount today.¹⁶⁴

164. 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. Directive 2004/25/EC, *supra* note 141, art 16. Pursuant to this rule, a shareholder can force the controlling shareholder who 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 month 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 empow-

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

TABLE 2: FREEZE-OUT PURSUANT TO ARTICLE 15 OF THE EU TAKEOVER DIRECTIVE

<i>Type of freeze-out rights that Member States can implement</i>	<i>Statutory ground</i>	<i>Triggering offer</i>	<i>Minimum Thresholds</i>	<i>Consideration</i>
“Single threshold”	Article 15(2)(a)	Voluntary or mandatory offer on all voting securities	From 90 to 95% (determined by the Member State) of the voting capital and voting rights in the target	Same as in the triggering offer or cash. If a noncash consideration is offered in the triggering offer, Member States can mandate a cash alternative
“Majority of the minority”	Article 15(2)(b)		90% of the voting capital and 90% of the shares comprised in the offer	
Fair Price: 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.				

F. *Implementation of Freeze-Out Rights in Some European Member States*

Having discussed the overall framework of the Takeover Directive, this Article now examines how some Member States have implemented its provisions in light of the different regulatory options left open by the European Legislature.

First, it is possible to distinguish between jurisdictions that opt for the Takeover Directive Article 15(2)(a) single threshold freeze-out and those that adopt the Takeover Directive Article 15(2)(b) majority of the minority freeze-out. In the former, it is possible to further distinguish

er 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 cannot 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 nontendered 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 Burkart & Panunzi, *supra* note 5. This right represents an important difference between the American and the European systems.

countries that have conditioned the exercise of freeze-out rights upon the acquisition of 90% of all shares from those that set a 95% threshold.

FIGURE 1: IMPLEMENTATION OF FREEZE-OUT RIGHTS IN SOME EU MEMBER STATES

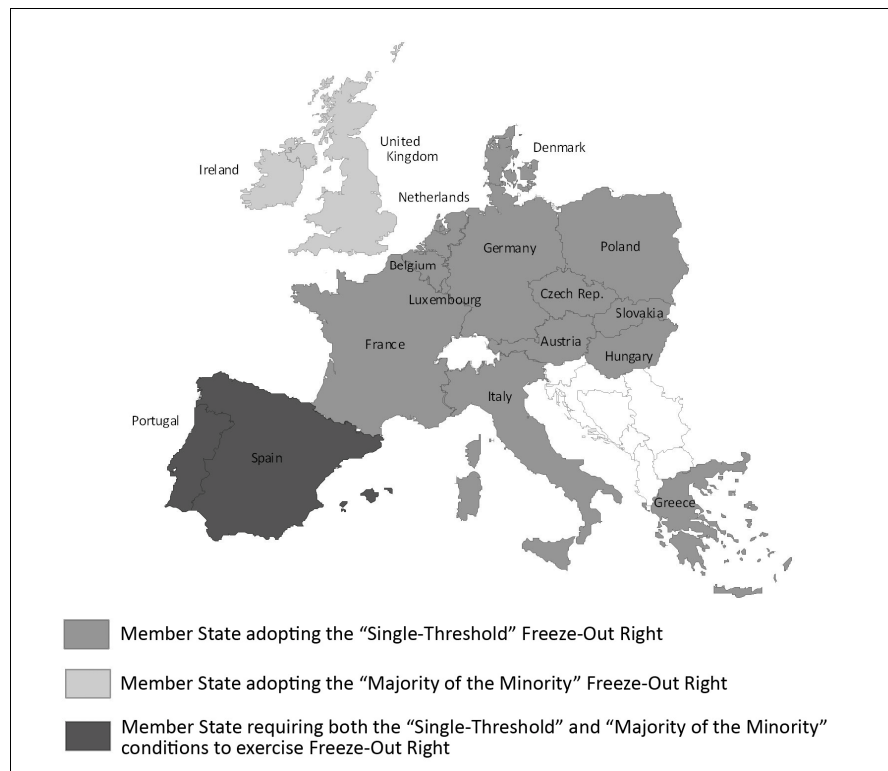


Figure 1 illustrates that the vast majority of continental European countries adopt the single-threshold option. This reflects path dependency, as most countries applied this or a similar approach even before the Takeover Directive went into effect.¹⁶⁵ The only two European states that have adopted the pure form of the majority of the minority freeze-out are the United Kingdom¹⁶⁶ and Ireland,¹⁶⁷ where the right to

165. See, e.g., Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBI. I S. at 1089, last amended by Gesetz, July 31, 2009, BGBI. I S. at 2509, § 327a (F.R.G.) (requiring a single threshold of 95%); see also Testo Unico della Finanza, § 111, Decree-Law of Feb. 24, 1998, No. 58, Gazz. Uff., Mar. 26, 1998, no. 71 – Suppl. Ord. no. 52 (Italy).

166. See Companies Act, 2006, c.46, § 979 (U.K.).

buy out minorities is conditioned on 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.

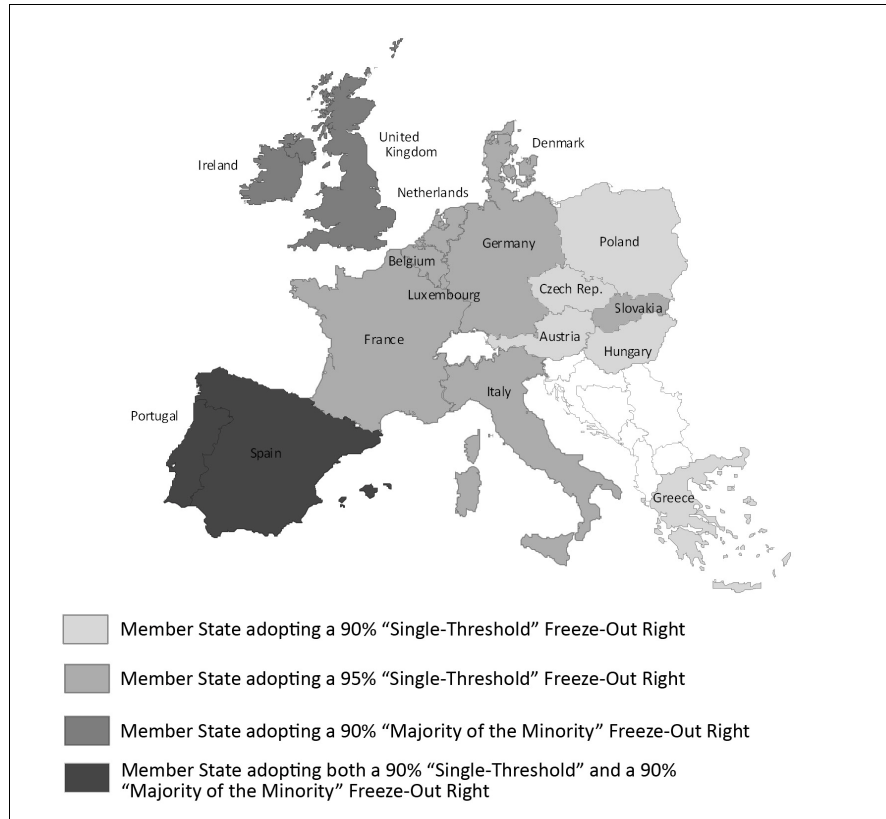
A different solution is provided in Portugal and Spain. In these two jurisdictions, the conditions set forth in Article 15.2(a) and 15.2(b) of the Takeover Directive have been combined, and both conditions—acquiring 90% of the total voting rights and 90% of the voting rights included in the bid—are required to allow the squeeze-out of minorities.¹⁶⁸

Figure 2 illustrates the Member States that, having opted for the single threshold freeze-out, have chosen the highest possible threshold of 95%, as allowed by the Directive. 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 Takeover Directive at 90% of the shares included in the triggering tender offer.

167. See Companies Act, 1963, § 204 (Ir.).

168. See *Takeover Directive Implementation Report*, *supra* note 157, at 18. With respect to Portuguese law, it is worth pointing out that in addition to the freeze-out rules specifically applicable to listed corporations, there are also provisions allowing controlling shareholders of a closely-held corporation to buy out minority shareholders. These provisions, which will not be addressed in this Article, are set forth in Article 490 of the *Código das Sociedades Comerciais*, available at <http://www.legix.pt/docs/CSC.pdf>.

FIGURE 2: IMPLEMENTATION OF FREEZE-OUT RIGHTS IN SOME EU MEMBER STATES



The map in Figure 2 illustrates that most continental European systems adopt the single-threshold approach, and also that, in the largest economies, the threshold triggering the freeze-out right is set at the highest possible level, 95%. This clearly affects the possibility of conducting a public-to-private transaction.

A second important comparative difference to point out among European countries that regulate freeze-outs pursuant to Takeover Directive Article 15 concerns the type of consideration offered to minority shareholders and the fair price presumption. As previously mentioned, the Takeover Directive provides relatively straightforward rules: Consideration shall be the same as that tendered in the triggering offer, but it can also always be in cash. Member States can also provide that, when non-

cash consideration is offered, cash must be offered as an alternative.¹⁶⁹ 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 six to twelve months preceding the offer, according to the individual determination of the particular Member State) is presumed fair.¹⁷⁰ In the second case, the price of a voluntary offer is considered fair if the bid obtained at least 90% of the shares included in the offer.¹⁷¹ The Takeover Directive does not clarify whether these presumptions are absolute or can be rebutted, and it leaves to Member States how to regulate fair price determinations 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, some countries plainly adopt the approach set forth in Article 15(5) of the Takeover Directive and always deem fair the price of a triggering mandatory offer or of a voluntary offer if the offer reaches a 90% acceptance rate. This approach is followed in Italy and the Slovak Republic.¹⁷²

On the other hand, a larger 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 cannot lower the minimum price provisions set forth in Article 15 of the Directive, the enactment of more rigorous rules is compatible with the language of Article 15.

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: (1) provisions of presumptions of fairness that are stricter than the ones provided for by the Directive, and (2) provisions that require or facilitate the appraisal of the shares by third party

169. Directive 2004/25/EEC, *supra* note 141, art. 5(5).

170. *Id.* art. 5(4).

171. *Id.* art. 15(5).

172. On Italy, see Articles 111(2) and 108(3) of the Testo Unico della Finanza, Decree-Law of Feb. 24, 1998, No. 58, Gazz. Uff., Mar. 26, 1998, no. 71 – Suppl. Ord. no. 52 (Italy), and Lucia Picardi, *Italy*, in TAKEOVER BIDS IN EUROPE, *supra* note 153, at 416. On the Slovak Republic, see Branislav Hazucha & Michaela Jurková, *Slovak Republic*, in COMMON LEGAL FRAMEWORK FOR TAKEOVER BIDS IN EUROPE 375 (Dirk Van Gerven ed., 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, taking into account the market prices of the last six months and the offer 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.

expert or court review, either automatically or upon demand by minority shareholders.

In some jurisdictions, for instance, the price of a voluntary tender offer and that 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 United Kingdom follow this approach. This represents an additional requirement when compared to Takeover Directive Article 15(5)'s default rule by which the price of a mandatory tender offer is always considered fair, regardless of the level of acceptance of the offer.¹⁷³

The German model is even more complicated. First, in implementing the Takeover Directive, the German legislature decided to allow freeze-outs following tender offers *only* when the 95% threshold is reached through a mandatory tender offer or a voluntary offer launched to obtain control.¹⁷⁴ Under the relevant statute, the *Wertpapiererwerbs- und Übernahmegesetz*, freeze-out rights are not available to a shareholder 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, the price of the voluntary offer launched to gain control cannot be lower than the price of a hypothetical mandatory tender offer, determined to be the highest price paid by the offeror in the six months preceding the bid.¹⁷⁵ 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, independent of its mandatory or voluntary nature.¹⁷⁶

The German model indicates how some Member States have provided for particularly strict rules compared to other European jurisdictions—rules that limit the ability of the controlling shareholder to freeze out minorities or make it generally more financially burdensome, *ceteris paribus*, than in other jurisdictions.

173. 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.

174. See Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGB1. I S at 3822, last amended by Gesetz, July 30, 2009, BGB1. I S. at 2479, § 31(3) (F.R.G.).

175. See *id.*

176. The German legislature did not expressly regulate what happens when the 90% threshold is not reached, and the fair price presumption does not apply. A judicial 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.

In other systems, further protections are afforded to minorities facing freeze-out. In some jurisdictions, minorities have recourse to an external appraiser, either *ex ante* or *ex post*. The appraiser might be an independent expert, a court, or a national supervisory authority. France provides an example of this approach: There, the *Autorité des Marchés Financières* (AMF) must be notified *ex ante* of the intention to carry out a freeze-out following a tender offer. The AMF decides whether the conditions required for squeezing out minorities have been met and examines the shares submitted by the offeror, assigning different weights to elements such as the value of the corporate assets, past earnings, market value, and business prospects.¹⁷⁷

In the absence of meaningful empirical evidence, it is virtually impossible to say whether the French approach leads, in general, to higher or lower freeze-out prices. For the purpose of this Article, it is simply worth noting that this approach provides for another variation on the theme, and the need to comply with this procedure might affect the smoothness of a freeze-out.

The last few paragraphs have demonstrated how Member States have adopted a wide variety of approaches to implement the freeze-out provisions of the Takeover Directive. Differences exist in the conditions that trigger the freeze-out right, the applicable fair-price presumptions, and even in the regulatory strategies employed by each Member State. This veritable mosaic of approaches symbolizes the compromise underlying the numerous options contained in the Takeover Directive and represents, in itself, a possible obstacle to the creation of a truly integrated corporate control market for cross-border acquisitions. This final point will be argued more extensively in Part IV.B.

G. *Alternative Ways to Freeze Out Minority Shareholders in Some European Jurisdictions*

Before 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 Takeover Directive Article 15 are not the exclusive means by which controlling shareholders can unilaterally cash out minorities. Two examples of additional procedures are the United Kingdom's "scheme of arrangement," and Germany's *Aktiengesetz* (AktG) Articles 327a ff. Each is briefly considered.

Pursuant to British law:

177. Simon, *supra* note 157, at 256.

A “*scheme of arrangement*” or a “*reconstruction*” under [Companies Act] 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 Unless the court orders otherwise, the members or creditors who dissent are nevertheless bound to accept the terms of the scheme.¹⁷⁸

Thus, a “scheme of arrangement” is a flexible procedure used to reach a broad variety of outcomes with the approval of a court. Theoretically, this technique can be employed to cash out minorities. Existing case law is limited on the subject, however, and doubts remain as to whether the procedure is as streamlined as a short-form merger in the United States. An example of a case where the scheme of arrangement was employed is *In re Hellenic & General Trust Ltd.*,¹⁷⁹ where Hambros intended to buy all of the outstanding shares of Hellenic. The transaction was approved at the general shareholders’ meeting by a large majority of the votes. It was opposed, however, by minority shareholders, in particular, the National Greek Bank, which held 14% of the shares. The court did not sanction this scheme. Rather, it required a positive vote of the majority of the (nonaffiliated) minority as a “different class.”¹⁸⁰ The case is illustrative of a certain reluctance to allow a scheme of arrangement for freeze-out purposes when shareholders could otherwise be cashed out pursuant to Article 974ff of the Companies Act of 2006, implemented pursuant to Takeover Directive Article 15. 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.

Sections 327a through 327f of the German AktG also provide a means by which to freeze out minorities outside the scope of Takeover Directive Article 15, while at the same time granting meaningful protec-

178. LEN SEALY & SARAH WORTHINGTON, *CASES AND MATERIALS IN COMPANY LAW* 605 (8th ed. 2008). I wish to thank David Cabrelli and Paul Davies for discussing with me the scheme of arrangement as a possible way to cash out minorities in the United Kingdom. Email from David Cabrelli, Lecturer, Univ. of Edinburgh Sch. of Law, to author (Aug. 14th, 2009) (on file with author); Email from Paul Davies, Professor, Univ. of Oxford, to author (Aug. 14th, 2009) (on file with author). Obviously, mistakes on this issue are solely mine.

179. 1 W.L.R. 123 (Ch. 1976); *see also* SEALEY & WORTHINGTON, *supra* note 178, at 610.

180. *In re Hellenic & General Trust Ltd.*, 1 W.L.R. 123, 123 (Ch. 1976).

tions for minority shareholders. This procedure is available when a shareholder holds 95% of the shares.¹⁸¹ In short, the controlling shareholder convenes a meeting of all shareholders to approve the cash-out procedure.¹⁸² Because the squeeze-out is not preceded by any tender offer, the fairness of the cash-out price cannot be determined based on presumptions regarding the price of the triggering offer.¹⁸³ Rather, a court-appointed expert evaluates the fairness of the proposed price. The expert's positive opinion limits the possibility of challenging the transaction in court.¹⁸⁴

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

In conclusion, Article 15 of the Takeover Directive is not the *exclusive* freeze-out provision in all European jurisdictions. But, to the extent that other rules exist in Member States, they are significantly less liberal than in the United States. This follows naturally from the bedrock European principle that minority shareholders enjoy a quasi-absolute right to remain members of the corporation in which they have invested. Because these additional freeze-out provisions are generally ineffectual, exist in only a handful of Member States, and lack harmonization, they do not undermine the reform proposals advanced in the final Part of this Article.

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

A. *Comparative Differences in Context*

In the preceding analysis, this Article has considered some of the most important differences concerning freeze-out transactions in the United States and Europe. Before discussing the causes and consequences of these differences, a brief recapitulation is necessary.

181. See AktG, *supra* note 165, § 327a; see also VOLKER EMMERICH & MATHIAS HABERSACK, AKTIEN- UND GMBH-KONZERNRECHT § 327a, ¶¶ 1–31 (2008).

182. See *id.*

183. See AktG, *supra* note 165, § 327b; see also EMMERICH & HABERSACK, *supra* note 181, § 327a, ¶¶ 3–9.

184. See AktG, *supra* note 165, § 327b; see also EMMERICH & HABERSACK, *supra* note 181, § 327a, ¶¶ 1–15.

In the United States, freezing out minorities without 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 shareholders, but rather on ensuring that the cashed-out investors obtain the fair value of their shares.

Dissenting minority shareholders can either exercise their right to appraisal and have their shares valued through a court proceeding, or challenge the merger on one of several possible grounds. The former remedy, for the reasons discussed above, is not particularly effective. The latter remedy is more widely used and extensive case law exists on the subject.

When challenged in court, a one-step, long-form merger with a controlling corporation is considered a self-dealing transaction and is therefore subject to the entire fairness standard of judicial review, a standard significantly less deferential to directors than the business judgment rule. Normally, the defendants must positively prove entire fairness. If, however, certain procedural protections are adopted in approving the deal, the burden of proving (un)fairness is shifted to the plaintiffs. These procedural protections are either: (1) approval of the deal by a special committee of independent directors, entrusted with the responsibility of negotiating the deal with veto power, or (2) approval of the deal by a majority of the minority shareholders who are not affiliated with the controlling acquiring corporation.

Alternatively, if a controlling shareholder employs a two-step procedure, for example, a 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 a conflict of interest because the bidder and the minority shareholders are not related parties. In the event of a challenge, the two-step freeze-out (short-form merger) is reviewed subject to the deferential business judgment rule standard if the controlling shareholder meets three conditions: (1) the tender offer is subject to a nonwaivable majority of the minority condition; (2) 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 by which the offer was launched; and (3) the buyer does not engage in any retributive threat capable of manipulating the deci-

sion-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 EU Member States. Even in those jurisdictions where transactions leading to similar results are hypothetically possible, they are not generally employed. In any case, they present significant differences, and less flexibility, than the American cash-out merger.¹⁸⁵

Nonetheless, mergers are still employed as a means to go private and delist by creating pressure on minority shareholders to sell their shares. In general terms, however, consideration for all shareholders of a corporation to be extinguished by way of merger must be, at least in part, shares of the surviving entity.

In Europe, the principal mode for going private, harmonized by the Takeover Directive, is a statutory freeze-out right following a mandatory or voluntary tender offer on all outstanding shares. In the single-threshold freeze-out (more common in continental Europe), the controlling shareholder/bidder obtains between 90% and 95% of all the outstanding shares and voting rights in the triggering offer. In the majority of the minority freeze-out (the British rule), the controlling shareholder/bidder obtains 90% of the shares included in the offer. At this point, in either regime, the controlling shareholder forces minority shareholders out by purchasing their shares 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—equal to that 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 its differences and similarities with respect to the Delaware two-step freeze-out.

185. Consider, for example, the possibility of using a scheme of arrangement under British law, or Section 327a of the German Corporation Statute. *See* AktG, *supra* note 165, ¶ 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 United States, a cash-out merger, in fact, can always be unilaterally approved by the majority shareholders: approval by a majority of the minority simply has the effect of shifting the burden of proving entire fairness if the merger is challenged in court. It is not a condition for the consummation of the deal.

First, in Europe as in the United States, the unilateral acquisition follows a tender offer. However, the European system is more flexible than that of the United States because 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. Rather, following the exercise of the freeze-out right, the European subsidiary can survive as a corporation of a single shareholder.

Second, with respect to the percentage of shares that must be acquired to cash-out minorities, European law is more rigid than its American counterpart. Under Delaware law, a unilateral short-form cash-out merger is possible where the controlling shareholder reaches 90% of capital. In Europe, the threshold is higher: The majority of the countries adopting the single-threshold freeze-out opt for a 95% threshold. The few countries that follow the majority-of-the-minority freeze-out require that the bidder acquire at least 90% of the shares included in the offer on all the outstanding shares. Practically speaking, this means that the bidder must obtain more than 90% of all the outstanding shares because freeze-outs are rarely pursued by a subject that launches an offer without already owning substantial participation in the target corporation.

A very simple example can clarify this point. A controlling shareholder holds 60% of the common stock of a corporation that has only issued one class of equity securities. If he wants to freeze out minorities in the United States, he 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 would have to acquire an additional 30% of the outstanding common stock. On the contrary, in Germany—a country adopting the single-threshold freeze-out—the bidder would have to purchase 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% (i.e., 36% of the outstanding shares in absolute terms). Other things being equal, it is more expensive in Europe than in the United States to achieve a position in which one can actually cash out minorities.

Third, the European and American regimes diverge on how to determine the fair price of a freeze-out. On this point, European law is less favorable to going-private transactions. Though Takeover Directive Article 15(5) and Delaware jurisprudence follow a surprisingly similar rule for regulating the matter (i.e., both systems presume fairness of the price offered in the front-end bid only where a majority of the minority accepts the tender offer), since *Pure*, a simple majority is sufficient to ap-

prove the bid in the United States, whereas in Europe the acceptance rate must be at least 90%.

If our controlling shareholder starts her acquisition owning 82% of the shares, Delaware law requires that she tender of a minimum of 9% (plus one share) of the remaining 18% of the capital for the presumption of fairness to apply. 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.

Thus, the European rule implies that “more weight is given to the securities that belong to those rejecting the bid.”¹⁸⁶ 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 nine shareholders out of ten. When compared to U.S. law, this approach puts an emphasis on the opinion of the minority of the minority, rather than on that of the majority of the minority.¹⁸⁷

Fourth, in Europe, the freeze-out might follow a mandatory tender offer pursuant to Takeover Directive Article 5. This scenario is not directly comparable to any similar situation in Delaware because the mandatory tender offer does not exist in U.S. jurisdictions.¹⁸⁸ It is worth noting, however, that, in this case, the freeze-out price will 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 includes a substantial premium for control.

Fifth, Delaware and EU freeze-out doctrines each require that for the presumption of fairness to apply, the second step of the acquisition (short-form merger in the United States, statutory buyout in Europe) must be completed within a set time limit after the acquisition. The pur-

186. Kaisanlahti, *supra* note 5, at 507.

187. *Id.* at 507.

188. See Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INT'L L.J. 171, 189 (2006). It should be pointed out, however, that some anti-takeover devices allowed in some U.S. jurisdictions rely on mechanisms similar to the mandatory bid in that they require 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).

pose of this rule is clear: The later the second step is completed, the higher the pressure is on minority shareholders to sell their shares at the initial tender. In short, the present value of consideration at the second step of the freeze-out is clearly lower in the absence of corrective mechanisms, such as the payment of interest rates. But whereas Delaware law requires simply that the short-form merger be consummated “promptly” after the tender offer (to date, a generic and elastic requirement), the Takeover Directive requires that the short-form merger occur within three months of the conclusion of the tender offer.

A sixth, and final, distinction concerns the requirement set forth in *Pure* that in order to presume the fairness of a two-step freeze-out, the acquiring corporation cannot pose any retributive threat to minority shareholders. As elusive and difficult to apply as 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 the national laws of individual jurisdictions. To the extent that it is possible to generalize, in some systems, similar conduct might theoretically be considered a breach of controlling shareholders’ fiduciary duties. However, it is 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 such a duty. In addition, in terms of regulatory technique, this requirement is a typical example of a “standard,” as opposed to a “rule.”¹⁸⁹ As such, it would probably be less easily and effectively applied in continental civil law systems than in common law systems where the accumulation of precedents contributes to specifying the content of the requirement.

In sum, under EU law, it is more difficult to squeeze out minority shareholders than in the United States. Not only is one of America’s primary going-private vehicles—the one-step, long-form cash-out merger—generally unavailable in Europe, but the Takeover Directive’s statutory freeze-out right, notwithstanding similarities to the American two-step freeze-out, is less accessible to controlling shareholders for reasons already stated.

Needless to say, numerous 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

189. For the distinction between these regulatory techniques, see Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, in *THE ANATOMY OF CORPORATE LAW*, *supra* note 114, at 21, 23.

also be defined somewhat differently with respect to different corporate law jurisdictions. However, empirical evidence appears to confirm both the general picture described in the previous pages and the conclusion that stems from it.¹⁹⁰

B. *Causes and Consequences of the Diverging Approaches*

Different overlapping elements explain the origins of different approaches to freeze-outs in the United States and in Europe. The interactions among these elements are complicated and nuanced, and this Article does not capture all of them. It does, however, seek to spell out some of the most crucial ones.¹⁹¹ Four explanations for the comparative differences can be identified: (1) the federal structure of the American corporate law system and the related chartering competition among states, (2) the risks and costs of litigation associated with the status of listed corporations, (3) the potential role of freeze-out rules or the absence thereof as a springboard for hostile corporate acquisitions or a protection for entrenched shareholders, and (4) a path-dependency phenomenon linked to how the legal system and local culture have 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 regulatory competition among states and the existence of a market for corporate charters.¹⁹² The

190. See Toby Stuart & Soojin Yim, *Board Interlocks and the Propensity to be Targeted in Private Equity Transactions* (Nat'l Bureau of Econ. Research, Working Paper No. 14189, 2008), available at <http://www.nber.org/papers/w14189.pdf>.

191. 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 to being enforced in court, thus further limiting recourse to lawsuits.

192. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 148–51 (1993). The literature on regulatory competition in corporate law is extensive. The following are 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 FRANK H. EASTERBROOK & DANIEL R. FISHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 212–27 (1991); 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). For examples of authors more critical of the beneficial effects of regulatory competition, see 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, 1168 (1999); Lucian A. Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1820 (2002); William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE

scholarly debate has largely explained the different dynamics of regulatory competition in the United States and Europe, to the extent that corporate mobility exists in Europe.¹⁹³ 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 jurisdictions generally characterized by a more permissive 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 corporations considering going public, which could potentially be more interested in going private in the future, supports the conclusion that legislatures and policy makers have few incentives to facilitate these types of transactions.¹⁹⁴

The second, and related, explanation concerns the risk of litigation. To the extent that a system relies on litigation to enforce shareholder rights, going private will be an attractive option to controlling shareholders. In the United States 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 with these events for the corporation, its controlling shareholders,

L.J. 663, 705 (1974). For a general discussion of regulatory competition, see Joel P. Trachtman, *International Regulatory Competition, Externalization, and Jurisdiction*, 34 HARV. INT'L L.J. 47, 59–81 (1993). For an examination of the issue of regulatory competition in securities regulation, see Merritt 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); Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525 (2005).

193. 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).

194. Marco Ventrone, *“Cost-based” and “Rules-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). It is important to clarify a couple of matters that have been pointed out to me by Geoffrey P. Miller. The role of regulatory competition in fostering “easy” freeze-out rules in the United States can be ambiguous. In fact, the major actors that might desire this regulatory approach are acquirers that are not always incorporated in Delaware, and who therefore have little influence (at least in terms of threat to leave the state) on the local policy makers. On the other hand, target corporations, which are often incorporated in Delaware, do have the possibility to influence the Delaware legislature, but only some of them have an interest in being sold. Targets fearing this possibility might prefer rules that create obstacles to going private. The implied assumption in the explanation of the peculiar American approach to freeze-outs based on regulatory competition is that the forces pushing for “easy” freeze-out are stronger than the possible opposition. Email from Geoffrey P. Miller, Professor, N.Y. Univ. Sch. of Law, to author (Nov. 25, 2009) (on file with author).

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 the risk 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 United States earlier and more forcefully than in Europe. For American legislatures and judges it became crucial, especially in 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 United States 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 a 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 of litigation (and losing this litigation) is low while the possibility of exploiting the private benefits of control are more significant than in the United States.¹⁹⁵

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 leveraged buyouts and management buyouts can be sustained financially only by bringing the corporation private and cashing out minorities. This might be the case for different reasons, perhaps because of the tax benefits of substituting equity with debt, or because the debt incurred to take over the corporation can be serviced only by cutting compliance expenses, or because the corporation needs an organizational turnaround that cannot be

195. See Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998). This motivation for the different development of freeze-out rules in Europe and in the United States has also been noted by Geoffrey P. Miller. Email from Geoffrey P. Miller, *supra* note 194.

effectively and efficiently accomplished in the presence of minority shareholders.

When potential buyers know that achieving 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 concentrated ownership structures that do not favor the proliferation of hostile acquisitions, stricter rules concerning freeze-outs might also serve as an indirect, but relatively effective, deterrent to some takeovers, to the advantage of existing controlling shareholders.¹⁹⁶

A fourth and final explanation for the different approaches to freeze-outs in the United States 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.¹⁹⁷ In some Member States, freeze-out statutory rights have even raised constitutional law challenges on the grounds that they might be considered unconstitutional takings based on private, rather than public, interests.¹⁹⁸

196. The fact that equity buy-out activity in Europe is as relevant as in the United States, if not more, 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 to be significantly less common in continental Europe than in common law systems. See John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation*, 95 GEO. L.J. 1727, 1738 (2007); Marina Martynova & Luc Renneboog, *Mergers and Acquisitions in Europe* 42 (Eur. Corporate Governance Inst. Finance, Working Paper No. 114/2006, 2006), available at http://www.ssrn.com/abstract_id=880379; Venturuzzo, *supra* note 144, at 170.

197. GERMAIN, *supra* note 112.

198. For example, the Czech Republic's Constitutional Court addressed this issue in 2008 and not only denied the unconstitutionality of the freeze-out right implemented pursuant to Article 15 of the Takeover Directive, but also observed that the rule might raise some questions of compatibility with the constitutional protection of property rights. See *nález Ústavního soudu čj. 56/05 / 2008 / Sbirka nálezů a usnesení Ústavního soudu*, available in English at <http://www.usoud.cz/clanek/726>. Also, the German Federal Constitutional Court confirmed the constitutionality of freeze-outs, holding that Section 327a is not in conflict with the constitutional right to property, as in Section 14 GG. See Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], Sept. 19, 2007, 1 BvR 2984/06 (F.R.G.). 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, the question was raised as to whether freeze-out rights are compatible with the Italian Constitution. In Italy, a local judge can decide whether there are sufficient grounds to submit the question to the Constitutional Court. The local court, howev-

Allowing controlling shareholders to unilaterally buy out minorities is at odds with this view. In Europe, it is still the dominant view 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.

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. Accordingly, the appropriate form of protection for minority shareholders is to guarantee a fair value on their 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 compatible with the interests of the minority, so long as minority interests are liquidated at fair value in a coercion-free environment. This view assumes that with the consideration received, minority shareholders can find alternative investments in a robust, efficient market.

V. PRESCRIPTIVE ANALYSIS AND POLICY IMPLICATIONS

A. *What the United States Can Learn from Europe*

The comparison between the European and 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 U.S. jurisdictions following the Delaware model and the statutory freeze-out in Europe pursuant to Takeover Directive Article 15. The first lesson to draw from these similarities is that very different systems, originating from distinct perspectives and characterized by dissimilar law-making processes have nonetheless converged toward a common framework. This is not only an interesting theoretical observation, but it offers some support to the soundness of Delaware jurisprudence in *Pure* and its progeny.

er, dismissed the constitutionality issue three times, both at the preliminary injunction stage and at the merits stage. *See* Trib. di Milano, 13 Mar. 2003, *Società*, 1, 87 (observing that freeze-out rights are compatible with Article 42 of the Italian Constitution, and stating 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); Trib. di Milano, 8 June 2001, 1236/48, *Banca Borsa Titoli di Credito II*, 162; Trib. di Milano, 6 Mar. 2001, *Società*, 10, 1235. Even if these constitutional challenges have been dismissed, the very fact that they were raised suggests the existence of a less favorable approach to freeze-out rules than in the United States.

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-step freeze-outs is so profound that, as mentioned before, long-form cash-out mergers are not often possible; while in the United States, they are possible, but subject to 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-step 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 perspectives, reached a 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 way to improve Delaware law in this area. Rather than overhauling the existing doctrinal framework, as other scholars propose, the preceding analysis supports a view that simply fine-tuning the rules set forth in *Pure* will have substantial wealth-maximizing effects. The idea is to adjust the threshold of the majority of the minority approval requirement.

As discussed earlier, 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 minority shareholders. In other words, requiring greater majority-of-the-minority approval tends to encourage the controlling shareholders to offer better conditions both in the front-end offer and in the following freeze-out procedure.¹⁹⁹

199. See *supra* Part IV.A.

One of the criticisms of the current Delaware approach, in light of the empirical evidence, is that shareholders could receive less in two-step freeze-outs than in one-step freeze-outs.²⁰⁰ As discussed above, the empirical foundations of this critique are questionable,²⁰¹ but an easy way to improve, on average, the conditions offered to minority shareholders and to bridge the gap 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 a simple majority to a higher threshold. Even if (as will be argued in the next Section) the 90% European rule is too demanding and prevents value-maximizing deals, a middle ground is possible, whereby two thirds of the minority approval would be required to exercise freeze-out rights. This would be an easy and flexible way to increase minority protection in the *Pure* framework, without contradicting or restructuring the underlying philosophy of Delaware law.

B. *What Europe Can Learn from the United States*

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

First, the preceding analysis suggests that Europe would benefit from more substantive harmonization of freeze-out rules across jurisdictional lines. Broader harmonization serves the general goal of achieving a more integrated European financial market and the more specific goal of creating a level playing field in the market for corporate control. As mentioned above, the opportunity to freeze-out minority shareholders is an important consideration in virtually every acquisition plan, especially the hostile takeover.²⁰² Excessive burdens and divergent local rules hinder mergers and acquisitions and, in some circumstances, protect entrenched controlling shareholders.²⁰³ On this view, it is surprising that the debate over the Takeover Directive has focused so little on the link between corporate acquisitions and freeze-out rules.

The harmonization should proceed in two directions, encompassing the regulation of mergers and the regulation of statutory freeze-out pro-

200. Subramanian, *supra* note 4, at 7.

201. See Bates et al., *supra* note 8, at 29.

202. See *supra* Part IV.A.

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

visions set forth in Takeover Directive Article 15. As to the former, European legislatures should further liberalize cash-out mergers. Such a move requires a policy shift that corresponds to a more modern vision of financial markets in which minority shareholders are protected not by an inalienable right to remain as shareholders, but rather by a right to receive fair value in exchange for their shares. Value-maximizing cash-out mergers unlock hidden value, leading to more efficient outcomes.²⁰⁴ Historically, European merger regulation has followed a trajectory similar to the one observed in the United States.²⁰⁵ But the European evolution stopped short of a consequential step, failing to allow cash-out mergers even under controlled circumstances. Path dependency and the desirability for smooth transactions might suggest requiring supermajority approval for cash-out mergers, but banning these transactions altogether pays mere lip-service to shareholder protection while putting European markets at a distinct disadvantage when compared to their American counterpart.

In legal systems that are less reliant on litigation, the fairness of the cash-out price must be ensured by different techniques than the opportunity to challenge mergers in court. Also, the typical procedural protections devised by Delaware law—approval by a committee of independent directors or by the majority of the minority—might prove inadequate in countries characterized by concentrated ownership structures and extensive cross-ownership connections among listed corporations.²⁰⁶ Alternative legal instruments, however, can ensure adequate protection of minorities. In fact, the independent, court-appointed experts currently employed in European jurisdictions to protect minority interests in the merger context could be employed as a check against abusive cash-out offers.

Second, European reform should address freeze-out rights set forth in Takeover Directive Article 15. More specifically, it should address the conditions triggering the freeze-out right and the fair price presumption. As for the former, the single-threshold freeze-out is the more desirable of the two approaches allowed by the Directive. The majority-of-the-minority freeze-out, adopted in the United Kingdom and Ireland, makes it difficult to cash out minorities even in situations where it is reasonable. Convergence toward the single-threshold freeze-out, adopted by the

204. See, e.g., discussion *supra* note 8.

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

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

vast majority of the EU Member States, reduces the risk that minorities of the minority can scuttle value-maximizing deals. Regarding the latter, it is too strict to presume fairness only where the front-end bid is accepted by offerees holding 90% of the outstanding shares. If Delaware law should require a higher threshold in the two-step freeze-out than the current simple majority, then European law should require a lower threshold. The current threshold grants excessive relevance to the position of (a small) minority of the minority.²⁰⁷ Once again, a balanced solution would condition the presumption of fairness upon the tendering of two thirds of the shares included in the initial 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 this could easily be extended to the European framework. Even if such a requirement is more difficult to apply and rarely invoked in jurisdictions where corporate litigation is infrequent, the absence of a rule against retributive threats “closes the system.” Thus, a prohibition against retributive action should be explicitly and uniformly provided across the European Union.

CONCLUSION

Profound and meaningful differences exist between different legal systems concerning freeze-out rights. Striking similarities exist, too. No system is free from flaws, just as no system is inherently superior to the other. The last two sections have advocated that the United States and Europe each learn from the other to improve their own approaches to freeze-out transactions.

The specific reforms proposed are more profound and complicated in Europe, while they are more simple in the United States. In neither case, however, do these reforms call for an overhaul of the existing legal framework. Rather, the reforms suggested in this Article can largely be characterized as part of a natural evolution along an already-existing trajectory. By learning from each other, the two systems might also move toward greater transcontinental harmonization.

Legal harmonization does not have 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 gener-

207. See Kaisanlahti, *supra* note 5, at 507.

ate monsters or betray their own original purposes.²⁰⁸ The recent financial crisis, with its origins in the United States, might suggest looking beyond the U.S. system of corporate law and financial governance as a model for reform. At the beginning of a new decade, a call for convergence blows against the protectionist winds whistling through Europe and the United States. If superficial slogans are to be abandoned for more serious discussion, however, it is undeniable that each system claims some of the most advanced freeze-out regulations in the world, and valuable lessons and ideas can be derived from studying the systems in parallel. The transatlantic corporate governance dialogue should facilitate mutual understanding of comparative differences and advance reform proposals inspired by this deeper comprehension. In light of the substantial interdependence of financial markets demonstrated by the financial crisis, greater convergence toward rules that strike a balance between efficiency and investor protection is more desirable than ever. Freeze-out rules are a small, but important, piece of this dialogue.

208. As I have argued, this is the case with respect to the mandatory bid in the Takeover Directive, transplanted from the United Kingdom to continental Europe, in systems with a more concentrated ownership structure. See Ventrizzo, *supra* note 144.