FAIR COMPENSATION UPON SQUEEZE-OUT: A TRANSATLANTIC ACCOUNT

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TABLE OF CONTENTS

I - INTRODUCTION 6

II – A BALANCING ACT: THE CONVERSE INTERESTS AT STAKE IN SQUEEZE-OUT TRANSACTIONS 10

A) Why Squeeze-out? 10

B) Why Protect Minorities? 12

III - THE US APPROACH 14

A) Squeeze-Out Transactions in the United States 14

i) Appraisal Rights: A Brief Historical Account 15

ii) The "Long Form" Merger 16

iii) The "Two-Tier" Merger: 19

iv) *MFW Shareholders' Litigation*: A Unified Standard? 23

B) Fair Compensation Standards 24

i) The Legal Setting 24

ii) Fair Valuation Standards 25

C) How is Fair Value Determined? 29

i) From the Delaware Block Method to the *Weinberger v. UOP* Decision: A Holistic Approach to Valuation 29

ii) The Discounted Cash Flow Technique 32

iii) Other Financial Approaches: The Comparable Company Analysis (Relative Valuation Approach) 32

iv) Control Premiums, Minority Discounts and Price Adjustments 34

A) Squeeze-out Transactions in the EU: The Legal Framework of the Takeover Directive 35

i) Fair Value in the Takeover Directive: The Fair Price Presumptions: Underlying Standards of Fairness? 39

B) The Portuguese Example 43

i) The Implementation of the EU Solution ... 43

ii) The Debate on the Constitutional Validity of Squeeze-Outs: A Further Step in Pinpointing the Real Issue ... 45

V – A TRANSATLANTIC APPRAISAL ... 50

A) The Asymmetries of Both Approaches ... 50

B) What can the EU Learn from the American Experience? ... 54

i) The Availability of Squeeze-out Rights ... 55

ii) Ensuring fairness ... 55

VI – CONCLUDING REMARKS ... 58

ANNEX ... 59

REFERENCES ... 63

ABBREVIATIONS

CCA – Comparable Company Analysis

CMVM – Comissão do Mercado de Valores Mobiliários (Portuguese Securities Commission)

D&O – Directors and Officers

DCF – Discounted Cash Flow

DGCL – Delaware General Corporation Law

EBITDA – Earnings Before Interest, Tax, Depreciation, and Amortisation

ECHR – European Convention on Human Rights

ECJ – European Court of Justice

ECtHR – European Court of Human Rights

EU – European Union

EV – Enterprise Value

MBCA - Model Business Corporation Act

PCC – Portuguese Companies Code

PSC – Portuguese Securities Code

UK – United Kingdom

USA or US – United States of America

> *"Fairness is a range of values. And so it is in more ways than one."*
>
> \- RICHARD A. BOOTH[1]

I - INTRODUCTION

The term "squeeze-out"[2] generally refers to the situation "*where a controlling shareholder exercises his legal right to oblige the minority shareholders of a targeted listed company to sell their shares to him, which brings the target company private*."[3] One of the core problems considered by the theory of corporate law regards the conflicts between the interests of minority and majority shareholders, of which the squeeze-out is a typical example.[4]

In particular, squeeze-out transactions raise the question of what compensation should be paid to the squeezed-out minority shareholders. Indeed, the difficulties in finding the correct balance between minority and majority interests are particularly prominent as regards the establishment of the "fair value" of such compensation. On the one hand, the application of too demanding pro-minority criteria may reduce the number of takeover transactions capable of creating value; on the other, a relaxation of such requirements may boost opportunistic actions from controlling shareholders, leading to transactions to the detriment of the minority.[5]

The general question that this paper therefore proposes to analyse is what constitutes "fair compensation" and how "fair value" should be reached. In looking for answers, I shall consider the very prominent appraisal litigation in the United States of America

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[1] RICHARD A BOOTH, 'Minority Discounts and Control Premiums in Appraisal Proceedings' [2001] 2 <http://ssrn.com/abstract=285649> accessed 18 April 2016.

[2] The terminology is not consensual among authors. The terms "squeeze-out", "freeze-out" and "buy-out" are often used interchangeably. In this paper, I follow the European tradition and use the term "squeeze-out" to refer to these situations, as present in European Parliament and Council Directive 2004/25/EC of 21 April 2004 on Takeover Bids [2004] OJ L142/1, hereinafter the "Takeover Directive".

[3] FELIKAS MILIUTIS, 'Fair Price in Squeeze-Out Transactions' [2013] 5(3) Societal Studies 769.

[4] REINIER H KRAAKMAN and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2004).

[5] MILIUTIS (n3) 770.

(US) – attending to the Delaware case law, as it is undoubtedly the most relevant jurisdiction in this field[6] – and draw a comparison with the European Union (EU) and the Portuguese squeeze-out regimes, where the courts have not as yet reflected so deeply on the issue of the appraisal of "fair value".

One of the most debated topics in the US at both general corporate law and corporate finance levels is the regulation and practical exercise of appraisal rights.[7] The discussion on how courts should determine fair value has become central to this debate. Indeed, particularly since the 1960s, the American scholarly community has discussed the purpose of corporate appraisal rights and proposed different solutions as to how "fair value" should be reached.[8] The courts appear to have joined this discussion and have applied different valuation methods in the last decades.

At the EU level, however, the appraisal rights landscape is less prominent and extensive, mainly since the EU does not dictate a uniformly applicable regime.

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[6] Delaware is the dominant state of incorporation for listed companies in the US. Besides, its laws typically govern the choice-of-law and forum clauses of the majority of merger agreements. *See* ROBERT DAINES, 'The Incorporation Choices of IPO Firms' [2002] 77 NYU Rev. 1559, 1571, finding that 77% of the companies engaged in IPOs are incorporated under Delaware law; MATTHEW CAIN, STEVEN M DAVIDOFF, 'Delaware's Competitive Reach: An Empirical Analysis of Public Company Merger Agreements' [2012] Journal of Empirical Legal Studies <http://ssrn.com/abstract=1431625> accessed 19 April 2016, finding that between 2004 and 2008 about two thirds of the agreements chose Delaware as their governing law and 60% chose Delaware as their choice of forum.

[7] JULIAN J GARZA CASTAÑEDA, 'Appraisal Rights: The "Fair" Valuation of Shares in Case of Dissent' [1999] XXXII 96 Boletim Mexicano de Derecho Comparado 809.

[8] For a sample of the debate, *see* MELVIN A. EISENBERG, *The Structure of the Corporation: A Legal Analysis* (Little, Brown and Company 1976) 69-84; DANIEL R FISCHEL, 'The Appraisal Remedy in Corporate Law' [1983] Am. B. Found. Res. J. 875, 875-884; HIDEKI KANDA, SAUL LEVMORE, 'The Appraisal Remedy and the Goals of Corporate Law' [1985] 32 UCLA L. Rev. 429; BAYLESS MANNING, 'The Shareholder's Appraisal Remedy: An Essay for Frank Coker' [1962] 72 Yale L.J. 223, 226-262; JOEL SELIGMAN, 'Reappraising the Appraisal Remedy' [1984] 52 Geo. Wash. L. Rev. 829, 829-864; ROBERT B THOMPSON, 'Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law' [1995] 84 Geo. L.J. 1, 3-5, 9-42; BARRY M WERTHEIMER, 'The Purpose of the Shareholders' Appraisal Remedy'[1998] 65 Tenn. L. Rev. 661; PETER V LETSOU, 'The Role of Appraisal in Corporate Law' 39 B.C. L. Rev 1121; LAWRENCE A HAMERMESH, MICHAEL L WATCHER, 'Rationalizing Appraisal Standards in Compulsory Buyouts' [2009] 50 Boston College Law Review, 1021; JOSEPH M COLEMAN, 'The Appraisal Remedy in Corporate Freeze-outs: Questions of Valuation and Exclusivity' [1984-1985] 38 Sw. L. J. 775; LUCIAN A BEBCHUCK, MARCEL KAHAN, 'The "Lemons Effect" in Corporate Freeze-Outs' [1999] National Bureau of Economic Research Working Paper 6938 <http://www.nber.org/papers/w6938.pdf> accessed 19 April 2016; JOHN C COATES, '*"Fair Value"* as an Avoidable Rule of Corporate Law: Minority Discounts in Conflict Transactions'[1999] 147(6) U. Penn. L. R. 1251.

Appraisal rights, although not mentioned as such, are implied in some relevant sources of EU legislation, namely in the Third Company Law Directive concerning mergers of public limited liability companies[9] – especially in its Article 28 – and in the Takeover Directive,[10] which sets out the legal framework for corporate squeeze-outs in its Article 15. In the particular case of Portugal, the issue of the general fairness of corporate buy-outs has been much debated. Indeed, the constitutionality of Article 490 of the Portuguese Companies Code (PCC),[11] which establishes the doctrine of *aquisição tendente ao domínio total*, setting the legal framework for squeeze-out[12] transactions for non-listed companies, has been called into question by the courts and has spurred academic discussion.

Against this background, and although the legal rules on squeeze-out transactions differ from jurisdiction to jurisdiction, the objective of this paper is to provide a deeper insight into both the legal framework and the theoretical and practical aspects of squeeze-outs on both sides of the Atlantic. A comparative analysis of the US, EU and Portuguese squeeze-out systems will be undertaken, attempting to find common ground between them, in order to provide a perspective for the EU and Portuguese regimes based on insights drawn from the analysis of the US appraisal litigation and the academic discussion on how "fair value" should be construed. Considering that the number of cross border mergers and acquisitions keeps increasing,[13] the proposed approach seems to be all the more relevant.

The paper is organised as follows: the next section, Section II, discusses the converse interests at stake in squeeze-out transactions, analysing the rationales behind going private operations and the interests underlying the protection of minority shareholders. Section III presents the legal framework for squeeze-out operations in the US system

[9] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] OJ L295 as repealed by European Parliament and Council Directive 2011/35/EU of 5 April 2011 concerning mergers of public limited liability companies [2011] OJ L.110/1.

[10] Directive 2004/25/EC.

[11] Decreto-Lei n.º 262/86, de 02 de Setembro.

[12] In this context, squeeze-outs seem to correspond to the Portuguese *direito de aquisição potestativa,* as regulated in Article 490(3) PCC.

[13] *See* United Nations Conference on Trade and Development, *World and Investment Report 2006. FDI from Developing and Transition Economies: Implication for Development* (2006).

and the judicial approach to fair compensation standards and valuation methods. In Section IV, I discuss the legal framework of the right to squeeze-out in the EU and the applicable standards of fairness, and go on to analyse the Portuguese example. Section V explores the asymmetries between the US and EU approaches and puts the European approach to fairness in the squeeze-out compensation in perspective in relation to the US experience. Finally, Section VI presents some concluding remarks.

II – A BALANCING ACT: THE CONVERSE INTERESTS AT STAKE IN SQUEEZE-OUT TRANSACTIONS

The right to squeeze-out stands between diametrically opposed interests of the controlling shareholder, on the one hand, and the minority, on the other. Indeed, while the controller, often after a tender offer, seeks to consolidate its acquisition of the target company and maximise efficiency gains, minority shareholders are excluded from the future earnings of the company and seek full compensation for their shares, avoiding self-dealing by the controlling shareholder.

The squeeze-out right is thus caught in a zone of tension between opposing legitimate interests and it falls to legislators, courts and policymakers to strike a balance between them.

A) Why Squeeze-out?

The logical outcome for every squeeze-out transaction is the concentration of all shares in a single shareholder, taking the company private. From the controller's perspective, taking a practical point of view, many reasons – of a financial, regulatory or organisational order - can justify squeezing-out minority shareholders in going private operations.[14]

Classically, three different rationales are pointed out. The first regards the costs of compliance with securities laws and regulations.[15] In a cost/benefit analysis, if compliance with regulatory issues and litigation concerns related to the company's public statute demand more time and effort from corporate managers than that devoted to business matters, going private may present a more efficient alternative. Indeed, companies which regain private status are likely to face lower legal, accounting and D&O insurance expenses.[16] A fairly recent example of increased regulatory burdens in

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[14] MARCO VENTORUZZO, 'Freeze-Outs: Transcontinental Analysis and Reform Proposals' [2010] 50 VA. J. INT'L L. 841, 847.
[15] *Id.*, 848.
[16] MARC MORGENSTERN, PETER NEALIS, 'Going Private: A Reasoned Response to Sarbanes-Oxley?' [2004] Kahn Kleinman LPA, 5 <https://www.sec.gov/info/smallbus/pnealis.pdf> accessed 19 April 2016.

the US was the Sarbanes-Oxley Act of 2002 which has arguably induced smaller businesses to exit the market.[17]

Another traditional rationale behind going private transactions concerns market price underestimation. Sometimes, market prices of publicly traded securities do not echo the true value of the company, for various possible reasons, which may result from general market conditions – for example, a sudden increase in interest rates on treasury bonds, which may adversely affect listed companies – or may be firm-specific, resulting, for instance, from inadequate analysts' coverage. In these situations, where the costs of staying public are not reasonably compensated,[18] opting for a minority buy-out can produce a win-win result where the controlling shareholders are able to unlock the hidden value of the company while the minority liquidates its shares for a price that is higher than their current market value.[19]

Thirdly, as noted by VENTORUZZO,[20] the going private alternative may present reduced agency costs by weakening the separation between ownership and control, a common characteristic of closely-held corporations.[21] A very topical example is set forth by MASULIS and THOMAS,[22] regarding risk monitoring in the use of derivative instruments: in public corporations with a broad-based ownership model and low management shareholdings, the boards of directors may be ill-equipped to manage trade in complex derivative instruments. In this particular case of agency problem, a private equity model

[17] *See* ROBERT P. BARTLETT, 'Going Private But Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms' Going private Decisions' [2009] 76 U. CHI. L. REV. 7; EHUD KAMAR and others, 'Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis' [2009] 25 J. L. ECON. & ORG. 107; ELLEN ENGEL, RACHEL M HAYES, XUE WANG, 'The Sarbanes-Oxley Act and Firms' Going Private Decisions' [2007] 44 J. Acct. & Econ. 116; CARL R CHEN, NANCY MOHAN, 'The Impact of the Sarbanes-Oxley Act on Firms Going Private' [2007] 19 Res. Acct. Reg. 119. *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' [2007] 44 Acct. & Econ. 146.

[18] Underestimation of securities may wear down advantages of staying public. For example, it may preclude the use of stock options and similar forms of compensation to attract top managers and executives.

[19] VENTORUZZO (n 14) 848.

[20] *Id.*, 849.

[21] JAMES C SPINDLER, 'How Private is Private Equity, and at What Cost?' [2009] 76 U. CHI. L. REV. 311.

[22] RONALD W MASULIS, RANDALL S THOMAS, 'Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance' [2009] 76 U. Chi. L. Rev. 219.

may present a better response: financially knowledgeable controlling shareholders, acting as a closely-held company, can better control trade in derivatives.

Additionally, from a financial perspective, as suggested by LEHN and POULSON,[23] going private may improve the debt-to-equity ratio of the company, as most going private decisions imply a substitution of equity for debt, which in some cases – especially those involving high leverage - may result in tax advantages, where interest payments are deductible as opposed to dividends.

Opting out of public markets may indeed represent a valuable business alternative in many circumstances. In the end, the right to squeeze-out comes to protect not just the private interests of the controller, but also market-oriented interests of propelling value creation in the markets through takeover transactions. Yet it also brings distributive justice issues to the table and poses fundamental regulatory challenges in striking a balance between the interests of the controlling shareholder and the minority.

B) Why Protect Minorities?

Having considered the benefits of taking companies private by squeezing-out the minority, it is now worth questioning what counterpoising interests lie behind minority shareholder protections.

From the perspective of minority shareholders, squeeze-out operations represent an "expropriation" of their shares, and the implicated social and economic rights, as well as an exclusion from the future earnings of the company. As will be further discussed in Section IV of this paper, fundamental legal principles have been addressed at the European level regarding the "expropriation" of the outstanding minority shares as a result of squeeze-out transactions, namely in relation to the right to private property and to free economic initiative.

Other basic legal principles may also play an important role in justifying the protection of minority shareholders, namely the principle of equal treatment. In the US, authors

[23] KENNETH LEHN, ANNETTE POULSEN, 'Free Cash Flow and Stockholder Gains in Going-Private Transactions' [1989] 44 FIN. 771.

such as BRUDNEY,[24] BEBCHUK,[25] and COX[26] have pinpointed the implications of this legal principle in the demand for minority protections in the context of corporate control transactions and in the particular case of squeeze-outs. In the EU legal system, even though the European Court of Justice (ECJ) denied the existence of a general principle of equal treatment of shareholders in the EU treaties in the landmark *Audiolux* decision,[27] some of the rules contained in the Takeover Directive are clear manifestations of a principle of equal treatment of shareholders upon a change of control in companies, in particular regarding the relationship of minority shareholders *vis-à-vis* the controller, as will be further discussed in Section IV of this paper.

Apart from these considerations, however, other market-oriented concerns may justify the demand for minority shareholder protections. Indeed, recent empirical research conducted by GUILLÉN and CAPRON[28] covering the adoption of minority shareholders' legal protections and the development of the stock markets in 78 countries, between 1970 and 2011, shows that the implementation of strong minority protections followed by consistent enforcement by States results in more robust equity markets, with more turnover, higher capitalisation and higher dynamism.

Given these considerations, the issue of compensation seems even more topical: fair compensation is the balancing element between the divergent interests at stake and the factor which allows for a reasonable outcome for both sides. The following sections of this paper discuss the legal mechanisms that have been developed in the US and in the EU to tackle the problem of fair compensation.

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[24] VICTOR BRUDNEY, 'Equal Treatment of Shareholders in Corporate Distributions and Reorganizations'[1983] 71 Cal. L. Rev. 1072.

[25] LUCIAN A BEBCHUCK, 'Toward Undistorted Choice and Equal Treatment in Corporate Takeovers' [1985] Harv. L. Rev., Vol. 98, No. 8, 1693.

[26] JAMES D COX, 'Equal Treatment for Shareholders: An Essay' [1997] 19 Cardozo L. Rev. Vol. 615.

[27] Case 101/08 *Audiolux SA and Others v Groupe Bruxelles Lambert SA (GBL) and Others and Bertelsmann AG and Others* [2009] ECR I – 9823.

[28] MAURO F GUILLÉN, LAURENCE CAPRON, 'State Capacity, Minority Shareholder Protections, and Stock Market Development', [2016] 61(1) Administrative Science Quarterly, 125. The empirical data is available at <https://whartonmgmt.wufoo.com/forms/guillencapron-shareholder-protections-index> accessed 19 April 2016.

III - THE US APPROACH

A) Squeeze-Out Transactions in the United States

There are various possible combinations through which controlling shareholders can appropriate the equity interests of the minority. In the US, the two most common techniques are mergers and tender offers.[29]

Under Delaware law, in particular, two methods have become increasingly popular: the statutory "long form merger" (or "one-tier squeeze-out") and the "tender-offer/short form merger" (or "two-tier squeeze-out").[30]

In the first method, the controlling shareholders can - subject to a prior opinion of the management boards of both merging companies,[31] and to the approval of the majority of the minority shareholders[32] - force out the minority, offering cash or other non-equity securities in compensation, rather than shares of the surviving entity.

The second option, a more recent development, consists of two distinct steps: a voluntary tender offer is placed on all the outstanding shares launched by the parent corporation with the aim of acquiring at least 90% of them, followed by a second-tier short form merger, which derives from a statutory right of a parent company to merge with its daughter company in which it holds at least 90% of the shares.[33] Under Delaware law (as well as in most other American jurisdictions), because there is a set threshold of ownership of 90% of the shares following the tender offer, the decision to squeeze-out the remaining shareholders simply requires the approval of the board of directors of the controlling company, thus excluding the vote of the shareholders of both corporations and the vote of the board of the subsidiary.

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[29] VENTORUZZO (n 14) 852; CLARK W FURLOW, 'Back to Basics: Harmonizing Delaware's Law Governing Going Private Transactions' [2005] 40 Akron L. Rev. 85, 85; MICHAEL J MCGUINNESS, TIMO REHBOCK, 'Going Private Transactions: A Practitioner's Guide' [2005] 30 Del. J. Corp. L. 437, 437-438; FAITH STEVELMAN, 'Going Private at the Intersection of the Market and the Law'[2007] 62 Bus. Law 775, 779.

[30] MILIUTIS (n 3) 772; VENTORUZZO (n 14) 852; FURLOW (n 27) 85; MCGUINESS & REHBOCK (n 27) 437-438.

[31] 8 *Del. C.* § 251 (b).

[32] 8 *Del. C.* § 251 (c).

[33] 8 *Del. C.* § 253.

The following sections will further analyse both forms of squeeze-out.

i) Appraisal Rights: A Brief Historical Account

The development of going private regulations in the US is better understood when seen from a historical perspective.[34]

Traditionally in the US, as in most common law jurisdictions, controlling shareholders did not have the right to forcefully cash-out the minority. Indeed, prior to the shift from the creation of corporations through legislative grants of corporate charters[35] to the statutory incorporation of companies, in the 1870's,[36] unanimity was required to approve any significant amendment to the corporate contract, namely mergers and other business combinations, thereby granting each shareholder a veto right. Gradually, however, the courts chipped away this general rule of unanimity, realising its unsuitability for the modern business environment and the great costs and dangers of "minority dictatorship."[37]

The legislature followed, amending the economic and legal structure of publicly held corporations.[38] Dissenting minority shareholders would conversely be protected through appraisal rights, allowing minority shares to be liquidated at a fair price determined in court. Indeed, legislatures balanced efficiency considerations, discarding the minority's *de facto* power of veto with a protection mechanism that ensured that minority shareholders were not imprisoned in the new corporation resulting from the deal.

Appraisal rights are not uniformly applicable to all types of mergers. Under Delaware's "market out exemption", appraisal is not usually available when the shares of the company are listed on a national exchange or widely dispersed, as, in such cases, the shareholders can, in principle, easily sell their shares on the open market at a fair

[34] For a detailed overview of the development of cash-out statutes in the US *see* ELLIOTT J WEISS, 'The Law of Take Out Mergers: A Historical Perspective' [1981] 56 N.Y.U.L.REV. 624.
[35] WILLIAM J CARNEY, 'Fundamental Corporate Changes, Minority Shareholders and Business Purposes' [1980] Am B Found. Res. J. 69, 82. These legislatively-granted charters were usually made available to companies to carry on businesses of public nature, such as mills, bridges, canals and railroad companies.
[36] WERTHEIMER (n 7) 618.
[37] VENTORUZZO (n 14) 853.
[38] WEISS (n 32) 626.

price.[39] However, in the particular case of cash-out mergers, where the fair value may be significantly higher than the amount offered by the majority as consideration, the exemption fails to provide relief to dissenting minority shareholders. In that light, Delaware law provides for an "exception to the exemption," granting the minority the possibility of judicial appraisal.[40]

Along with a somewhat complex scope of application, the right of appraisal usually entails complicated procedural requirements. Delaware's statutes provide that dissenting shareholders must notify the company of their dissenting intentions before the shareholder's meeting that triggers the right, explicitly dissent, or abstain at the meeting and comply with further notification requisites after the meeting, imposing a heavy burden on the dissenting minority. Besides, appraisal procedures can be lengthy and expensive, where individual plaintiffs bear most of the litigation costs.[41]

Against this background, appraisal rights may sometimes be ill-suited to protecting minorities faced with cash-out mergers, and dissenting shareholders often opt to challenge mergers on the basis of procedural illegalities, such as breach of fiduciary duties. The majority of cases shaping going private transactions in the US regards these kinds of allegations. Often, when adjudicating these claims, Delaware courts have attempted to balance the power of the majority with the protection of the minority and the result is a complex set of leading cases which, together, set the legal framework for going private transactions.[42]

ii) The "Long Form" Merger

The decisive case regarding the regulation of squeeze-out transactions through the classic "long form" merger is *Weinberger v. UOP*.[43,44] Here, the minority shareholders of UOP, Inc. were squeezed out by its controlling shareholder, Signal Companies. Dissenting shareholders brought suit alleging that the price paid was not fair to them.

[39] VENTORUZZO (n 14) 856.
[40] Many other US jurisdictions do not provide for the same exception to the exemption in these cases, ruling out appraisal altogether.
[41] VENTORUZZO (n 14) 857.
[42] *Id.*, 857.
[43] *Weinberger v UOP, Inc.*, 457 A.2d 701 (Del. 1983).
[44] GUHAN SUBRAMANIAN, 'Fixing Freeze-Outs' [2005] 115 Yale L.J. 1.

The Delaware Chancery Court held for the defendants, but the Delaware Supreme Court reversed the lower court's ruling, arguing that the deal process did not meet the *entire fairness standard*.

This decision makes important contributions on many levels, as the Court addressed several different issues.[45] With particular relevance in the regulation of long form mergers, the Court established that the entire fairness standard is twofold: it requires both "fair dealing" and "fair price". The former is a procedural element regarding how the acquisition negotiations are carried on, covering questions of time, structure, disclosure and shareholder approval. The latter is a substantive element, concerning the economic rationale behind the deal: it relates to the economic and financial considerations of the proposed deal, including all relevant factors: assets, market value, earnings, future prospects, and any other elements affecting the intrinsic value of the company's stock.[46] Simultaneously, the Court set out, in a much-quoted *dicta* footnote, how the entire fairness requirement should be met: the company considering a cash-out merger should appoint a special negotiating committee of independent directors, responsible for negotiating the deal at arm's length.[47] The Court would later elaborate on this laconic guideline in two major cases: *Rosenblatt v. Getty Oil*[48] and *Kahn v. Lynch*.[49]

In *Rosenblatt v. Getty Oil*, the oil behemoth Getty Oil became a majority shareholder of Skelly, a competitor in the industry, and considered a merger. The directors of Skelly and Getty Oil engaged in a negotiation process to determine the exchange ratio for the outstanding stock. Having gained the boards' unanimous approval, the deal was submitted to the shareholders of the companies and was subject to approval by a

[45] On the different contributions of the case, *see* ROBERT K PAYSON, GREGORY A INSKIP, 'Weinberger v UOP, Inc.: Its Practical Influence in the Planning and Defense of Cash-Out Mergers' [1983] 8 DEL. J. CORP L. 83; WILLIAM PRICKETT, MICHAEL HANRAHAN, 'Weinberger v., UOP, Inc.: Delaware's Effort to Preserve a Level Playing Field for Cash-Out Mergers' [1983] 8 DEL. J. CORP. L. 59; CAROL B HAIGT, 'Note, The Standard of Care Required of an Investment Banker to Minority Shareholders in a Cash-Out Merger: Weinberger v. UOP, Inc.' [1983] 8 DEL. J. CORP. L. 98.

[46] VENTORUZZO (n 14) 861.

[47] *Id.,* footnote 7.

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

[49] *Kahn v Lynch Communication Systems* 638 A.2d 1110 (Del. 1994).

majority of the minority. The approval of 58% of the outstanding stock was gained, and the integration of the companies was completed. However, the merger was challenged by dissenting minority shareholders, claiming that the exchange ratio was unfair. After a prolonged trial, the Chancery Court found the deal had been entirely fair, which the Delaware Supreme Court affirmed on appeal. The Court decided that, because the merger was approved by an informed majority of the minority shareholders - even though that is not a legal prerequisite – the burden of proving the unfairness of the merger was shifted entirely to the plaintiffs. Under the Getty Oil case law, it was therefore established that using this procedural protection does not alter the standard of review, but it simply shifts the burden of proof.[50]

In *Khan v. Lynch*, Alcatel, which owned nearly 44% of Lynch's shares, pursued a squeeze-out merger with the latter. Lynch's board of directors set up a special committee to negotiate the terms of the merger, and following the negotiations, endorsed a price of $15.5 per share, but only after Alcatel executives informed the committee that they were planning a hostile tender offer directly to the minority shareholders of Lynch, at a lower price. [51]Although the Chancery Court decided that the negotiations were conducted at arm's length, fulfilling the entire fairness standard set in *Weinberger*, the Delaware Supreme Court reversed: while it subscribed to the view that approval by an independent committee shifts the burden of proving unfairness to the plaintiff, it also considered that the threat of a hostile tender offer had a significant impact on the directors' ability to make an independent judgment in protecting the interests of the minority. The case was therefore remanded to the lower court and the burden of proving that the entire fairness standard had been met was shifted back to the defendant.

In this light, with this succession of cases, Delaware's regulation of long form squeeze-outs was well established: *Weinberger* provided the procedural roadmap for squeeze-out transactions, setting out the two-pronged entire fairness test. Under normal entire fairness review, it is up to the defendant to demonstrate the standard was met. However, if certain protections are afforded to the minority, namely the appointment of

[50] VENTORUZZO (n 14) 863.
[51] *Id.*, 864.

a special independent committee, as in *Lynch*, or the approval of a majority of the minority, as in *Getty*, the burden of proving unfairness shifts to the plaintiff, if no external pressures are found.

This gradual trajectory would, however, face new developments with the *In re Siliconix Shareholders Litigation*[52] and *Glassman v. Unocal Exploration Corp.*[53] combination.

iii) The "Two-Tier" Merger:

As noted before, a second technique which can be used to squeeze-out minority shareholders is the "two-tier" merger. In this method, a controlling shareholder should begin, or announce its intention to begin, a tender offer directly to the minority shareholders. The target company should then form a special committee of independent directors to evaluate the transaction, negotiate with the controller and issue a recommendation to the minority. If the controller gains sufficient shares in the offer, reaching 90% of the voting power of the target, it will then execute a short form merger - which does not need shareholder approval - in order to acquire the remaining shares, thus squeezing-out the dissenting minority. Because 90% is the decisive threshold, the controller will usually present its tender offer subject to getting 90% control.[54]

Considering the different strategy behind this method, the question was raised whether it was subject to the entire fairness standard. Historically, transactional lawyers assumed that the tender offer squeeze-outs would also be subject to entire fairness review. However, in 2001, the decisions in *Siliconix* and *Glassman* would shift the picture.

In the *Siliconix* case, Siliconix Inc. was a corporation active in the semiconductors industry. Vishay Intertechnology was the controlling shareholder and, when the market price of Siliconix's shares was particularly volatile, announced a tender offer for the minority shares at the price of $28.82 cash per share, which included a 10% premium over the market price. It was also stipulated that, if the offer reached 90% of the shares, Vishay would proceed to merge Siliconix into one of its subsidiaries through a short

[52] *In re Siliconix Inc. Shareholders Litigation*, No. Civ. A. 18700, 2001 WL 716 787 (Del. Ch. 2001), reprinted in 27 DEL. J. CORP. L. 1011, 1020–21 (2002).

[53] *Glassman v Unocal Exploration Corp*., 777 A.2d 242 (Del. 2001).

[54] THERESE H MAYNARD, *Mergers and Acquisitions, Cases, Materials, and Problems* (Aspen Casebook Series, Third Edition, Wolters Kluwer 2013).

form cash-out merger. With Vishay's encouragement, Silicoix appointed a special committee of independent directors to negotiate the deal, accounting for the interests of the minority. The special committee hired legal and financial consultants and concluded that the price offered was inadequate. After several negotiations Vishay switched to a stock-for-stock exchange offer and included a non-waivable majority of the minority condition.[55]

Minority shareholders brought suit alleging that the exchange ratio being offered was unfair. The Court of Chancery refused to apply the entire fairness review to the tender offer squeeze-out. The court distinguished long form mergers, where the boards of directors are the main negotiators, from the tender offer merger, where the bidder negotiates directly with the minority shareholders, who have the power to decline the offer if they deem it inadequate. Indeed, the court denied entire fairness review on the grounds that the basic conflict of interest that characterises long form mergers is not present in this case.

While *Siliconix* seemed to address the front-end of the two-tier squeeze-out, i.e. the tender offer, *Glassman* focused on the back-end of the method: the short form merger.[56] Unocal owned 96% of its subsidiary UXC and proceeded directly to a short form merger pursuant to Section 253 DGCL.[57] Dissenting minority shareholders brought a class action suit alleging an inadequate exchange ratio in the compensation. The court ruled that the short form merger method was incompatible with the equitable relief based on an entire fairness review. In a short form merger, neither the board of directors of the merged company nor its shareholders are engaged in the negotiation, and nor do they have a say on the deal.[58] The court considered that these procedural characteristics were justified by the minimal dimension of minority interests at play which did not reasonably demand an extensive and costly procedure, such as that required in the long form merger.[59]

[55] VENTORUZZO (n 14) 868.
[56] *Id.*, 869.
[57] 8 *Del. C.* § 253.
[58] VENTORUZZO (n 14) 869.
[59] *Glassman v Unocal Exploration Corp.* 777 A.2d 242 (Del. 2001) 247-248.

The court ruled that, in the case of a short form merger, minorities are sufficiently protected by the appraisal remedy available to dissenting shareholders, even if they do not in fact vote, and therefore cannot dissent in the general sense.

When combined, both decisions seem to clear the way for two-tier going private transactions: neither of the two components – the front-end tender offer and the following short form merger – would be subject to the entire fairness standard, but rather to the regular *business judgement rule*, "*a rule of law that insulates an officer or director of a corporation from liability for a business decision made in good faith if he is not interested in the subject of the business [decision], is informed with respect to the subject of the business [decision] to the extent he reasonably believes to be appropriate under the circumstances, and rationally believes that the business [decision] is in the best interests of the corporation*."[60] Where the party challenging the board's decision is able to allege and prove facts sufficient to overcome the business judgment rule presumption, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.[61]

The resulting asymmetric regulation for the two methods – one-tier and two-tier mergers - has been heavily criticised in academic circles. Two types of transaction, achieving a similar result of eliminating minority shareholders, now faced two very different standards of judicial review.[62]

In response to the major differences in regulation, the Chancery Court tried to reconcile the asymmetries in *In Re Pure Resources*,[63] by instituting further protections for minority shareholders in two-tier mergers.[64] *Pure Resources* involved, once again, Unocal Exploration, who, as the controlling shareholder of its subsidiary Pure Recourses, announced a stock-for-stock tender offer for the remaining shares, subject to acquiring 90% of all Pure's shares, which would be followed by a short form merger pursuant to Section 253 DGCL. For that purpose, a special committee was set up to

[60] *Am. Soc'y for Testing & Materials v Corrpro Cos.*, No. Civ. A. 02-7217, 2005 WL. 1941653 (E.D. Pa. Aug. 10, 2005) (quoting *Cuker v Mikalauskas*, 547 Pa. 600, 692 A.2d 1042 (1997)).

[61] *Krasner v Moffet*, 826 A.2d 277, 287 (Del. 2003).

[62] VENTORUZZO (n 14) 870.

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

[64] VENTORUZZO (n 14) 870.

evaluate the transaction, which issued a recommendation advising the minority shareholders not to sell their shares in the front-end deal. Dissenting shareholders then pursued a class action alleging that the deal did not meet the entire fairness standard.

The court decided in favour of the minority, and enjoined the transaction. Although it considered that the different merger methods should be subject to different standards of judicial review, in light of the greater freedom presented to minority investors to accept the front-end offer in two-step mergers, the court did not ignore the fact that coercion may exist in two-tier mergers, nonetheless. Indeed, minority shareholders may be faced with a *prisoner's dilemma* and therefore pressured into accepting a consideration that is below the optimal value of their shares. In that light, the court in *Pure Resources* sought to achieve a conciliating solution by establishing three requirements needed to dismiss the entire fairness review in two-tier mergers: firstly, the transaction must be subject to the non-waivable approval of a majority of the minority. Secondly, the bidder must guarantee to complete a short form merger in the same conditions as the front-end offer, especially regarding price and exchange ratio stipulations. Finally, the buyer must not impose retributive threats when dealing with the board of directors of the target company.[65]

More recently, new doctrinal developments seem to have taken place in *In re Cox Communications, Inc. Shareholders' Litigation*[66] and *In re CNX Gas Corporation Shareholders' Litigation.*[67] In an attempt to bring the one-step and two-step merger regulation closer together, vice chancellor Strine suggested, in *Cox Communications,* that special independent committees should also play a role in tender offer squeeze-outs. The suggestion was perfected in *CNX Gas,* where the court established that a non-coercive tender or exchange offer followed by a short form merger should only be exempt from entire fairness review if the transaction is negotiated and approved or recommended by a special committee of independent directors, in addition to the *Pure* requirement of approval by a majority of the minority.

[65] VENTORUZZO (n 14) 870.
[66] *In re Cox Communications, Inc. Shareholders' Litigation* 879 A.2d 604, 618 (Del. Ch. 2005).
[67] *In re CNX Gas Corp. S'holders Litig.*, Consol C.A. No. 5377-VCL (Del. Ch. 2010).

iv) *MFW Shareholders' Litigation*: A Unified Standard?

The resulting dual treatment of one-tier and two-tier going private transactions has led to heated debate among scholars and many have criticised this doctrinal outcome.[68] Most critics stress that both transaction methods achieve a similar result of cashing out minorities and, for that reason, assume that the application of different standards of judicial review allows for unequal and unfair treatment of shareholders.

Despite the attempts to find a unified standard of review, the differential treatment persisted. On the one hand, under the *Lynch* line of cases, one-step merger transactions were subject to the entire fairness test, only with the burden of proof shifting when the deal was approved by a special committee of independent directors or when there was approval by a majority of the minority; on the other, two-tier mergers were exempt from the entire fairness test and the business judgment rule would apply, under the circumstances set in the *Pure* line of decisions.

However, in a recent decision in *In re MFW Shareholders' Litigation*, the Delaware Chancery Court[69] and then the Delaware Supreme Court[70] seem to have provided a potentially unifying solution, if the precedent is set consistently.[71]

Indeed, the courts agreed that, regardless of the method used in the transaction, the business judgment rule standard would apply instead of the entire fairness review if the following conditions are simultaneously verified: *i)* the controlling shareholder, from the outset, makes the merger contingent on the approval of both a special committee and a majority-of-the-minority shareholder vote; *ii)* the merger is negotiated and approved by a special committee of independent directors, capable of negotiating or even rejecting the deal, and therefore charged with *de facto* full bargaining power in representing the minority shareholders; *iii)* the special committee meets its duty of care and *iv)* the deal is accepted by a fully informed and uncoerced vote of the majority of

[68] For a summary of the different perspectives raised, *see* SUBRAMANIAN (n 40).
[69] *In re MFW Shareholders' Litigation* 67 A.3d 496, 528 (Del. Ch. 2013).
[70] *Kahn v. M&F Worldwide Corp*., No. 334, 2013 (Del. 2014).
[71] CHRISTOPHER G GREEN, JASON S FREEDMAN, LARISSA R SMITH, 'In re MFW Shareholder Litigation: A New Blueprint for Controlling Shareholder Transactions?' [2014] 28(4) INSIGHTS 2.

the minority investors. This means that the burden to prove (un)fairness lays on the shoulders of the plaintiffs.[72]

The *MFW* opinion provides a precise procedural framework to achieve a business judgement review. If the parties do not precisely follow this framework, the transaction may not be subject to a business judgment review, and the entire fairness test will apply in both one-tier and two-tier going private operations.

B) Fair Compensation Standards

i) The Legal Setting

The legal framework in Delaware[73] for appraising share value in buyouts is set forth in the appraisal rights statute, § 262 DGCL. In particular, subsection (h) of the statute determines that:

> "*After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.*"[74]

Two relevant conclusions may be drawn from the wording of the statute: first, shareholders who dissent are entitled to an award of the "fair value" – a term which is not further defined - of their shares and second, that "fair value" excludes any "element

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[72] *In re MFW Shareholders' Litigation,* 67 A.3d 496 (Del. Ch. 2013), aff'd sub nom. Kahn v. M&F Worldwide Corp. No. 334, 2013 (Del. Mar. 14, 2014).

[73] In other jurisdictions, the Model Business Corporation Act (MBCA) provides the most common legal framework. With particular relevance in this context, the MBCA provides, in § 13.01 (4) that "*fair value means the value of the corporation's shares determined: (i) immediately before the effectuation of the corporate action to which the shareholder objects; (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and (iii) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).*"

[74] 8 *Del. C.* § 262 (h).

of value arising from the accomplishment or expectation of the merger or consolidation."

The concept of "fair value" as a legal term in the American system was first settled over half a century ago in the *Tri-Continental Corp. v Battye* litigation.[75] Here, the Delaware Supreme Court famously stated that "*the basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern*."[76] Other cases have summarised this definition as the *going concern value* or as the *true or intrinsic value* of the stock taken in the transaction.[77]

While these concepts are helpful in selecting appropriate finance methods for measuring the "fair value" of the shares of the minority, they are still open to great ambiguity.

ii) Fair Valuation Standards

Although Delaware courts have developed the concept of the *going concern value* as the correct standard for the valuation of shares, they have also applied other standards for measuring fair value. With particular relevance, two other approaches have been considered by the courts: market value and third-party sale value. While market value relies on the market price of the target company's shares in order to determine their fair value, the third-party sale value approach relies on the value of the entire company in the hypothetical scenario of a sale to a third party.

1. Market Value

The supporters of the share market value as the appropriate benchmark for determining the fair value of the squeeze-out compensation argue that, because of the assumption that financial markets are efficient, the value of securities in the market is the most objective measure of fair value available.[78] Indeed, in some European countries market

[75] *Tri-Continental Corp v Battye,* 74 A.2d 71, (Del. 1950).
[76] *Id.,* 72.
[77] For a list of US case law defining the "going concern value" as the correct concept for defining fair value, *see* HAMERMESH, WATCHER (n 7) footnote 79.
[78] MILIUTIS (n3) 780; LUCIAN A BEBCHUCK, MARCEL KAHAN, 'Adverse Selection and Gains to Controllers in Corporate Freezeouts, in Concentrated Corporate Ownership' [1999] Harvard John M. Olin Center for Law, Economics, and Business Discussion Paper 248, 247

price is accepted as a benchmark of fair value. For instance, as will be discussed later in this paper, in Italy, Spain and Portugal, the benchmark for appraising the fair value of the minority's compensation is reached, in certain circumstances, by reference to the arithmetical average of the market prices of a target company over a set period of time.[79]

However, share market prices are, today, widely acknowledged as unfit for the purposes of determining fair value. In different aspects, this benchmark fails to reflect the intrinsic value of the company. First, it cannot be dissociated from a possible illiquidity of the shares in the market, resulting from its thin trading and lack of marketability. As accurately expressed by LONGSTAFF, "*there is a widespread view on Wall Street that the liquidity of a security is a major determinant of its market value*".[80] The more shares are traded on the stock exchange, the more informative the pricing system is, reducing information asymmetries.

Besides, even if enough participants engage in trading and the market is considered efficient and liquid, market prices fail to reflect the fair, intrinsic value of shares. As BEBCHUCK and KAHAN have argued,[81] the presence of a controlling shareholder in the transaction hinders the utility of market price as a measure of fair value: the very power of a controlling shareholder to squeeze out the minority shares – and to set the squeeze-out price equal to the pre-squeeze-out market price – will depress the pre-squeeze-out market price of the minority shares, bringing it below the expected intrinsic value of the minority shares without a squeeze-out. The power to squeeze out the minority creates a "lemons effect" which depresses the market price based on information asymmetries.

In addition, markets will value the firm on the basis of the actions and the plans of the controller: if the market believes that the controller will undermanage the company, or use its resources to extract private benefits, the market price will reflect that belief. Also, when there is a controller, there is, consequently, no market for corporate control,

<http://ssrn.com/abstract=147568> accessed 19 April 2016; BENJAMIN HERMALIN, ALAN SCHWARTZ, 'Buyouts in Large Companies' [1996] 25 J. Leg. Stud. 351, 370.

[79] MILIUTIS (n3) 780.

[80] FRANCIS A LONGSTAFF, 'Optimal Portfolio Choice and the Valuation of Illiquid Securities' [2001] 14(2) The Review of Financial Studies, 407.

[81] BEBCHUCK, KAHAN (n 7); BEBCHUCK, KAHAN (n 72).

as the controller can veto any transaction at its will.[82] But most importantly, a controller interested in an opportunistic going private transaction can simply set the transaction to occur at a time when the market price of the shares is depressed.[83] Or it can even manipulate the prices, causing them to fall, for instance by influencing the market's perception of how it is exercising its control. Indeed, in the case of publicly traded companies where a controller is present, a market price benchmark for fair value would encourage opportunism. In the words of HAMERMESH and WATCHTER "*to the extent that fiduciary-duty litigation could not remedy such opportunism, the market price of the shares would be lower. A market value standard would thus reward the controller for misappropriation by allowing it to take the corporation private at a price reflecting such misappropriation. For that reason alone, share market price cannot be a generally appropriate measure of fair value, and particularly not in the most problematic, where a controller is squeezing-out minority shares.*"[84]

Furthermore, market prices generally tend to under-react to news. Psychologists such as EDWARDS[85] have identified the phenomenon of "conservatism" in the markets, stating that individual investors are slow to change their beliefs in the face of new evidence. Conservative individuals might disregard the full information content of public announcements and thus adjust valuation only partially, understating the fair value of shares. This phenomenon has been confirmed by empirical data, as presented by BARBERIS, SHLEIFER and VISHNY.[86]

At the other end of the spectrum, some authors point out that minority shareholders may also wrongfully benefit from a fair value benchmark based on market prices, by

[82] HAMERMESH, WATCHER (n 7) footnote 187.
[83] *Id.,*1035.
[84] *Id.*,1035.
[85] WARD EDWARDS, 'Conservatism in Human Information Processing' in Daniel Kahneman, Paul Slovic, and Amos Tversky (eds), *Judgment Under Uncertainty* (1st ed. Cambridge Cambridge University Press, 1982) 359-369 (available at Cambridge Books Online <http://dx.doi.org/10.1017/CBO9780511809477.026> accessed 19 April 2016.
[86] NICHOLAS BARBERIS, ANDREI SHLEIFER, ROBERT VISHNY, 'A Model of Investor Sentiment' [1998] 49 Journal of Financial Economics, 307.

engaging in practices that would increase the market price of the shares, in hopes of being awarded a higher compensation.[87]

In this light, it is now widely acknowledged that, because of the associated risks of under-compensating or over-compensating the minority, share market prices cannot serve as the appropriate proxy for determining fair value in the context of corporate squeeze-outs.

2. Third-Party Sale Value

Another potential benchmark for fair value is the third-party sale value. Under this approach, as explained *supra*, the fair value of the compensation to be awarded to the minority shareholders is determined by reference to the value of the entire company in the hypothetical scenario of a sale to a third party. This valuation standard seems to fit the economic definition of value, as measured by the opportunity cost or the "next best use" of a given asset, and for that reason it is often pointed out as an appropriate valuation benchmark in squeeze-out transactions.[88]

However, because of the legal setting in Delaware, which rules out "*any element of value arising from the accomplishment or expectation of the merger or consolidation",* the third-party sale value standard has been deemed inappropriate by Delaware courts as, by definition, it looks to acquisitions of companies considered comparable to the target, and therefore bears in mind the synergies anticipated by the buyers. Indeed, Delaware's legal framework seems to ascertain that the incorporation of merger-specific synergies in fair price appraisal would lead to an unjustified benefit or an excessive compensation for the minority, ultimately hampering the market for efficient takeovers, and, for that legal reason, this standard cannot be applied in Delaware appraisal litigation.[89]

In any case, there are other reasons not to apply this standard. For instance, it can also create incentives for the controller to act opportunistically. Let us first consider the

[87] MILIUTIS (n 3) 782, citing ROLAND STEINMEYER, M HÄGER, *WpÜG: Kommentar zum Wertpapiererwerbs- und Über-nahmegesetz mit Erläuterungen zum Minderheitenausschluss nach §§327a ff. AktG* (Berlin, 2002).
[88] MILIUTIS (n3) 782.
[89] *Id*., 782.

economic perspective of value: in economic theory, value is an equilibrium concept, meaning that all resources are presumed to be in their best use. This means that, in equilibrium, all value-increasing transactions have already taken place and that, therefore, the next-best-use value of the company will necessarily be lower than that of the resources in their current use.[90] In a squeeze-out scenario where a third-party rule would be applied, and, thus, where the minority's shares would be appraised at the value of the highest bid, this would mean that a controller could get a better deal by simply timing the transaction to occur when acquisition price ratios are lower than the actual going concern value of the company.

For these reasons, third-party sale value also cannot be used as a benchmark for fair value appraisal.

3. Going Concern Value

The third valuation standard to consider, and the one used by Delaware courts in appraisal cases, is the *going concern value*. This standard intends to evaluate the true intrinsic value of each company, as an ongoing entity, considering the future value of present and ongoing investments.

The US case law regarding the concept of going concern value and the resulting fair compensation value has evolved over the course of time. In order to better understand how this valuation standard seeks to estimate the intrinsic value of the company, landmark decisions will be analysed and the Discounted Cash Flow (DCF) analysis and other financial methods of enterprise valuation will be discussed in more detail in the next section of this paper.

C) How is Fair Value Determined?

i) From the Delaware Block Method to the *Weinberger v. UOP* Decision: A Holistic Approach to Valuation

Although the right to appraisal is a statutory remedy under Delaware Law, the statutes fail to provide specific valuation techniques, as described above. For that reason,

[90] HAMERMESH, WATCHER (n 7) 1039.

judicial definition of the ambiguous terms of the appraisal statutes looked to existing stock valuation methods applied by expert appraisers to value dissenters' shares.

In 1950, the Delaware Supreme Court reached a landmark decision in *Tri-Continental Corp. v. Battey*,[91] which set forth the procedure for valuation of minority shares under the so-called Delaware Block Method. In *Tri-Continental*, the Court stated that "*the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value*."[92] However, subsequent court decisions interpreted *Tri-Continental* as requiring the averaging of the three most popular fixed valuation factors applied by experts: market value, asset value and earnings/investment value.[93]

Under the Block Method, expert appraisers would establish a weight for each factor according to its relevance in each particular case. The value found under each factor would be expressed as a percentage of the whole, so that the product of the calculations, when added together, would equal 100% and represent the total value of each share. The court would then decide on the reasonableness of the value reached and, when found reasonable, multiply it by the number of shares owned by each dissenter, in order to determine the final value of the compensation to be awarded.[94]

The Delaware Block Method prevailed in appraisal proceedings in the US for a long time as it was considered to provide for the most accurate estimate possible of the fair value of shares. The process itself, and the results of the highly regarded techniques on which the method was based, made it the leading method used in judicial appraisal proceedings.[95] However, it has certain shortcomings; for example, the flexibility afforded by the method concerning the weighting of each of the valuation factors may

[91] *Tri-Continental Corp v Battye,* 74 A.2d 71 (Del. 1950).
[92] *Tri-Continental Corp v Battye,* 74 A.2d 71 (Del. 1950).
[93] DON S CLARDY, 'Valuation of Dissenters' Stock under the Appraisal Remedy – Is the Delaware Block Method Right for Tenessee?' [1994-1995] 62 Tenn. L. Rev. 285.
[94] *See*, e.g., *Jacques Coe & Co. v Minneapolis-Moline* 75 A.2d 244 (Del. Ch. 1950) or *In re General Reality & Utilities Corp.* 52 A.2d 6 (Del. Ch. 1947) For an accurate description of the Delaware Block Method and its elements, *see* GUHAN SUBRAMANIAN, 'Note, Using Capital Cash Flows to Value Dissenters' Shares in Appraisal Proceedings' [1998] 111 Harv. L. Rev. 2099.
[95] CASTAÑEDA (n. 6).

lead to this weighting being influenced by the appraiser's personal interests or by other arbitrary factors.[96]

The inadequacies of this weighted average method were addressed in *Weinberger v. UOP, Inc.*[97]. In this landmark case, a former shareholder of UOP, Inc. (UOP) challenged the elimination of UOP's minority shareholders by a cash-out merger between UOP and its majority owner. Evidence was provided showing that on the date the merger was approved, the stock was worth more than the price offered to the minority shareholders. In support of this, testimony was given by a financial analyst who used two basic approaches to valuation: a comparative analysis of the premium paid over market in ten other tender offer/merger combinations and a discounted cash flow analysis. Restating the statutory principle that the shareholder is entitled to be paid *for that which has been taken from him, i.e., his proportionate interest in a going concern*, the Supreme Court of Delaware concluded that the merger process did not meet the test of fairness applicable to the transaction, and therefore it adopted a less rigid approach to the valuation process deciding in favour of the plaintiff. Indeed, the court rejected the Block Method on the grounds that it excluded generally accepted techniques used in the financial community, and in so doing the court set a new standard for valuation, opening the door to a new wave of court decisions. Under this judicial standard, the financial valuation of dissenters' shares is no longer limited to a given set of factors, but rather entails assessment of all aspects deemed relevant by the financial community, in the particular circumstances of each company.

The *Weinberger* precedent opened the door for the judicial consideration of new valuation techniques used by expert appraisers, namely techniques that were not solely limited to a present value standard but which rather accounted for estimates of the present value of the future earnings of a company, as an element of fairness. For that

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[96] For further criticism of the Delaware Block Method, *see* JOHN T MCLEAN, 'Recent Development: Minority Shareholders and Cashout Mergers: The Delaware Court Offers Plaintiffs Greater Protection and a Procedural Dilema Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)' [1983] 59 Wash. L. Rev. 119 and CLARDY (n 85).

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

reason, there is an increasing tendency to use the DFC technique in appraisal proceedings, especially in Delaware.[98]

ii) The Discounted Cash Flow Technique

The DFC technique is a method of stock valuation, often used under the *Weinberger* standard of fair value, and on which expert appraisers rely the most.

Usually, a business' value lies in its ability to provide a future stream of net cash. The most direct way to measure value is therefore to estimate what this stream will be in the future and assign a present value to it. When applying a DCF analysis, the present value of a business is determined by calculating the future cash flows generated by the business and then discounting them at pre-determined rates which account for the time value of money and the risk of the company's investments.[99] The method therefore entails three basic components: "*1) an estimation of the net cash flows that the firm will generate and when it will do so; 2) a terminal or residual value equal to the future value; and 3) a cost of capital, with which to discount to present value both the projected net cash flows and the estimated terminal or the residual value.*"[100]

Although the DCF method is widely accepted and used within the corporate financial community and is the first choice technique to determine the value of companies in Delaware, after the *Weinberger* case, it raises uncertainties in the calculation of future cash flows and in the selection of the applicable discount rates,[101] opening the door to arbitrary assumptions within the method.

iii) Other Financial Approaches: The Comparable Company Analysis (Relative Valuation Approach)

Another commonly accepted valuation technique within the financial community is the so-called Comparable Company Analysis (CCA) based on valuation by multiples. In

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[98] The *Weinberger* decision has not completely shifted the US courts' approach to appraisal proceedings. In some jurisdictions, the limited valuation factors accounted for under the Delaware Block Method have still been regarded as the standards for fair valuation in some cases.

[99] The basic assumption of the DCF analysis is that $1 today is more valuable than $1 a year from now. Therefore, in order to determine the present value of future cash flows, a discount must be implemented in order to account for that difference, usually with reference to interest rates applied to each investment.

[100] MILIUTIS (n 3) 785.

[101] *Id.*, 786.

this method, several financial ratios (such as deal price/earnings, enterprise value/equity before interest taxes and amortisation, etc.) of comparable companies are used to determine the value of a target company. The fair value is reached by using the metrics of other businesses of similar size in the same industry.

The multiples approach is based on the principle of substitution under which "*one will pay no more for an asset than the cost of acquiring an equally desirable substitute*".[102] The CCA technique operates under the assumption that similar companies will have similar valuation multiples, such as the EV/EBITDA multiple and the Price-Earnings multiple. Analysts will compile a list of available statistics for the companies being reviewed, and will calculate the valuation multiples in order to compare them.

This technique does not take controllers' future plans into consideration and, therefore, such plans remain unknown to the minority shareholders, creating information asymmetries. Unlike in the DCF model, the present value of such future plans is not accounted for in the CCA approach.[103]

Moreover, as some authors argue, a squeeze-out price determined by CCA or valuation by multiples is not in line with the legal standard in Delaware, which expressly excludes any synergies from the transaction, as this technique does not exclude possible control premiums from the share value reached.[104] The implications of control premiums in fair compensation for squeezed-out minorities will be briefly discussed in the next section of this paper.

Researchers suggest that relying on the DCF approach and on valuation multiples derived from comparable companies is likely to produce a more accurate estimate of fair value than when each method is used in isolation.[105]

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[102] DOLLINGER (n 80) 37.

[103] MILIUTIS (n 3) 785.

[104] For an explanation of how this method does not exclude control premiums, *see* HAMERMESH, WATCHER (n 7) 1044.

[105] STEVEN N KAPLAN, RICHARD S RUBACK, 'The Valuation of Cash Flow Forecasts: An Empirical Analysis' [1995] 50(4) Journal of Finance 1059.

iv) Control Premiums, Minority Discounts and Price Adjustments

Case law of the courts of Delaware has suggested that the share price of a target company should be adjusted upwards in the context of squeeze-out transactions.[106] Courts have considered that the determined price of a target's shares entails an implicit minority discount in light of the lack of control inherent to minority shares, and that, therefore, a price adjustment is necessary. In other American jurisdictions, the MBCA provides, in § 13.01 (4), that "*fair value means the value of the corporation's shares determined: (...) without discounting for lack of marketability or minority status*".

This reasoning is based on the fundamental assumption that a corporation and its shares are separate items: shares provide only a limited set of social and economic rights over the corporation and thus do not represent the complete value of the corporation itself.[107] As the Delaware Supreme Court has stated, the goal of appraisal proceedings is to determine the value of a company as a whole and not the value of single shares.[108]

Following this approach, the courts of Delaware attempted to adjust valuation by adding back a "control premium" which "*spreads the value of control over all shares equally...*".[109]

The necessity for an upwards price adjustment based on an implicit minority discount, as applied by Delaware courts, has been profoundly criticised by scholars[110] as incompatible with the modern theory of corporate finance (which asserts that the market price of a share reflects the *pro rata* value of a corporation's discounted net cash flows) and with the statutory requirements of § 262 DGCL, which expressly excludes any merger-related gains from the fair price in appraisal in the context of squeeze-out mergers.[111]

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[106] MILIUTIS (n 3) 786.

[107] *Id.*,786.

[108] *Cavalier Oil Corp. v Harnett*, 564 A.2d 1137 (Del. 1989). *Accord Paskill Corp. v Alcoma Corp.*, 747 A.2d 549 (Del. 2000).

[109] *Agranoff v Miller*, 791 A.2d 880, 887 (Del. Ch. 2001). *See* also *M.G. Bancorporation, Inc. v LeBeau,* 737 A.2d 513 (Del. 1999); *Nebel v Southwest Bancorp, Inc*. 1995 WL 405750 (Del. Ch. 1995)*; Rapid-American Corp. v Harris*, 603 A.2d 796 (Del. 1992); *Borruso v Communications Telesystems International*, 753 A.2d 451 (Del. Ch. 1999).

[110] For a recent critique *see* HAMERMESH, WATCHER (n 7). *See also* BOOTH (n 1).

[111] MILIUTIS (n 3) 786.

IV – THE EU APPROACH

A) Squeeze-out Transactions in the EU: The Legal Framework of the Takeover Directive

At EU level, the right to squeeze-out was introduced by the Thirteenth Company Law Directive on Takeover Bids (the "Takeover Directive"). Under Article 15 of the Takeover Directive, if certain conditions are met, any shareholder who acquires at least 90% of the voting shares of a listed company through a tender offer is granted the right to squeeze out minorities at a fair price:

> *"Member States shall ensure that an offeror is able to require all the holders of the remaining securities to sell him/her those securities at a fair price. Member States shall introduce that right in one of the following situations:*
>
> *(a) where the offeror holds securities representing not less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company, or*
>
> *(b) where, following acceptance of the bid, he/she has acquired or has firmly contracted to acquire securities representing not less than 90% of the offeree company's capital carrying voting rights and 90% of the voting rights comprised in the bid."*[112]

In order to better understand this rule, it is important to take a step back and analyse the general framework for takeovers in the EU.

First of all, it must be noted that takeovers, by nature, fall within a convergence zone between two major orienting EU law principles: free movement of capital and freedom of establishment.[113] Indeed, capital flows generated by transnational investment may fall within the scope of the principle of free movement of capital – if they involve an investment in which the investor does not exercise control over the target company – or

[112] Directive 2004/25/EC, Article 15(2).

[113] JAN WOUTERS, MATTIAS BRUYNEEL, 'The European Takeover Directive: A Commentary' in Paul Van Hooghten (ed), *The European Takeover Directive and its Implementation* (OUP, 2009) 3-75.

within the scope of the principle of freedom of establishment – if the investment generates corporate control over the target company.[114]

Hence, EU legislative initiatives on the market for corporate control – such as the Takeover Directive – have sought to attain two main objectives: *i)* elimination or reduction of the differences in the legislations of Member States which created obstacles to transborder investment, and *ii)* elimination or reduction of Member State obstacles to the freedom of establishment.

It is worth noting that it took several decades for agreement to be reached on the Takeover Directive, reflecting the asymmetries between different Member States regarding the need for regulatory intervention on the market for corporate control. In particular, two visions were in opposition: a more liberal vision from an Anglo-Saxon background, where dispersed ownership was more common, and a more protectionist vision, popular among continental Europe countries, where concentrated ownership was predominant.[115]

In this light, the Takeover Directive merely seeks *minimum harmonisation* between the regulations of the different Member States, allowing jurisdictions to opt for more restrictive legal solutions than the ones contained therein, as provided by Article 3(2)(b).

The general principles set out in Article 3(1) which must be applied by all Member States are *i)* the principle of equal treatment between shareholders holding securities of the same category (Article 3(1)(a)); *ii)* the principle of informed decisions by the shareholders (Article 3(1)(b)) and *iii)* the principle of the effectiveness of the offer (Article 3(1)(e)). The right to squeeze-out established in Article 15 of the Directive is the embodiment of these general principles.

[114] *See*, for instance, ECJ's decision in Case 182/08 *Glaxo Wellcome GmbH & Co. KG v Finanzamt München II*, [2009] ECR I-08591 paras 40 and 47.

[115] STEFAN GRUNDMANN, *European Company Law* (2nd Edition, Intersentia 2012) 717-723. *See* also, KLAUS J HOPT, HIDEKI KANDA, MARK J ROE, EDDY WYMEEERSCH, STEFAN PRIGGE, *Comparative Corporate Governance – The State of the Art and Emerging Research* (OUP, 1998) 639.

Largely inspired by the experience of the UK,[116] the Takeover Directive provides for a twofold takeover system, unknown to US corporate law: a division in regulation between mandatory and voluntary takeover bids.

As provided in Article 5, which establishes the legal basis for the mandatory bid, and in particular in Article 5(1), anyone who, alone or in concert with others, acquires control of a listed company must launch a tender offer on all the outstanding voting shares, including shares with limited voting rights.[117] In mandatory bids the price of the offer cannot be lower than the highest price paid by the bidder for the securities in a pre-determined period.[118] The rationale for this provision stands on two correlated grounds: it intends to grant a fair way out to minority shareholders and to distribute control premiums among all shareholders.[119]

On the other hand, the Takeover Directive also provides grounds for voluntary bids on a percentage that can go up to the full amount of the outstanding shares of a corporation. This legal framework poses an important exception to the mandatory bid regime, in a mechanism somewhat similar to the two-tier merger of Delaware corporate law: if an investor acquires control of a company by means of a voluntary tender offer directed at all of its outstanding shares, there is no requirement for a further mandatory bid, as set in Article 5(2). The *raison d'être* of this legal exception lies in the fact that, in such cases, the offeror has already, necessarily, granted all the shareholders the possibility of selling their shares.[120]

The squeeze-out right contained in Article 15 of the Takeover Directive gains a new light against this background: this provision mandates that Member States provide for squeeze-out rights when, as a consequence of a mandatory or voluntary bid directed at the shareholders and all of the outstanding shares of a company, a set of conditions are fulfilled. Member States can opt between two different solutions:

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[116] VENTORUZZO (n 14) 887.
[117] The concrete threshold which triggers the application of this rule is not harmonised at EU level: as established in Article 5(2), the percentage of voting rights which confers control and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office.
[118] Between six and twelve months preceding the acquisition of control, as set out in the regulation of each individual Member State.
[119] VENTORUZZO (n 14) 887.
[120] *Id.*, 888.

i) In the first option, set out in Article 15(2)(a), Member States must implement a single condition: that the bidder gains ownership of at least 90% of the capital carrying voting rights and 90% of the voting rights, regardless of the rate of acceptance of the offer (the "single threshold squeeze-out").

ii) In the second option, the squeeze-out right is triggered when, as a consequence of the offer, the investor raises his ownership above 90% of the voting rights. However, in this scenario, a second specific condition must be met in order for a legal squeeze-out right to exist: the tendered shares must represent at least 90% of the voting capital and, at the same time, 90% of the shares contained in the offer (the "majority of the minority squeeze-out").

This second condition makes this solution similar to the Delaware requirements established in *Getty Oil* and *Pure*, by setting up a "majority of the minority" requirement.[121] However, the EU solution provides for a less flexible "majority of the minority squeeze-out" when compared to the legal framework in the US: a simple majority rule does not suffice. Instead, a "super majority of the minority" is required, with a minimum threshold of 90%.[122]

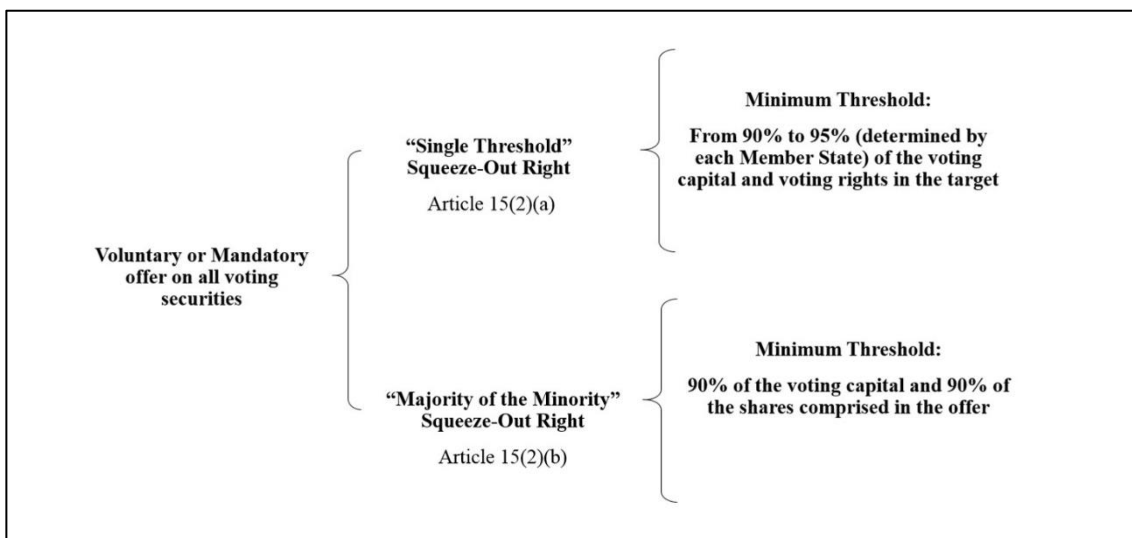

Figure 1: Squeeze-Out Right in the Takeover Directive

[121] VENTORUZZO (n 14) 888.
[122] *Id.*, 888.

Historically, the majority of the minority approach was applied in the United Kingdom while the single threshold solution was adopted in several continental countries. In most situations, the single threshold provides for a more flexible squeeze-out solution, facilitating the exclusion of the minority. For that reason, the Takeover Directive allows member states which opt for the single threshold solution to implement a threshold higher than 90% (but lower than 95%).[123] This is an example of the *minimum harmonisation* the Takeover Directive seeks to afford.

i) Fair Value in the Takeover Directive: The Fair Price Presumptions: Underlying Standards of Fairness?

Having considered the squeeze-out mechanisms provided by the general takeover framework at EU level, we are now faced with the "million-dollar" question: from an EU law perspective, at what price should the squeeze-out right be exercised? The introductory legal command contained in the Takeover Directive seems to be vague and "*relatively empty*"[124]:"*Member states shall ensure that a fair price is guaranteed*."[125]

Even though this general provision seems to fall short in answering our question, there are further rules which can give us an insight on how "fair price" is perceived in EU legislation. There are two main categories of provisions regarding squeeze-out consideration in the EU Takeover directive: those which consider the type of consideration to be provided and those which concern the amount of consideration to offer.[126]

Regarding the first concern, the EU legislator has ruled that the consideration offered in minority squeeze-out transactions should consist of the same form of consideration offered in the preceding tender offer which triggered the squeeze-out right. If the applicable thresholds were reached in a stock-for-stock offer, then the consideration must represent the same type of securities. In cases where the consideration offered is entirely composed of securities, or when the form of consideration consists of a mix

[123] Directive 2004/25/EC, Article 15(2) *in fine*.
[124] VENTORUZZO (n 14) 891.
[125] Directive 2004/25/EC, Article 15(5).
[126] VENTORUZZO (n 14) 891.

between securities and cash, Member States can also require the bidder to offer a full cash alternative to compensate the minority.[127]

As for rules concerning the "fair" amount of the consideration to be offered in a minority squeeze-out situation, the Takeover Directive makes use of a mechanism which is foreign to US law on this issue: it sets out presumptions of fairness. Indeed, the price is presumed fair in two situations, depending on the type of tender offer that led to the right to squeeze out the minority.

In mandatory bid cases, Article 5(4) of the Directive establishes that the bid must offer a price which cannot be lower than the highest price paid by the bidder in a period of six to twelve months (depending on how each Member State has transposed the Directive) preceding the acquisition of control. This means that, when the bid is mandatory in light of the principle set forth in Article 5, the offeror cannot set the bid price freely. Instead, the offer price must be based on this general rule. If, after the bid has been made public, and before the offer closes for acceptance, the offeror purchases securities at a higher price, it shall increase its offer so that it is not lower than the highest price paid for the securities so acquired.

As provided by Article 5(4)(second paragraph), Member States may authorise their supervisory authorities to adjust the price in accordance with clearly determined criteria. Member States may draw up a list of circumstances in which the highest price may be adjusted upwards or downwards, for example where the highest price was set by agreement, where the market prices of the securities in question have been manipulated or affected by exceptional occurrences, or in order to enable the rescue of a company in economic difficulty. The Takeover Directive also allows Member States to determine the criteria to be applied in such cases, for example the average market value over a particular period, the break-up value of the company or other objective valuation criteria generally used in financial analysis.

On the other hand, in the case of voluntary offers, no statutory minimum is imposed on the offer price and for that reason, through the eyes of the EU legislator, there is no guarantee of fairness. However, the Directive does establish a presumption of fair price

[127] Directive 2004/25/EC, Article 15(5).

in one set of voluntary bid cases: those where the shares tendered represent 90% or more of those comprised in the offer, i.e., whenever a majority of the minority is reached. In these cases, even though market value does not serve as a mandatory bottom line for the offer price, the EU legislator finds that the consent of the majority of the minority is sufficient ground to deem the price as fair. This rule applies in every transposing Member State, even in those which choose a single threshold squeeze-out. In those jurisdictions, even though there is a right to squeeze-out independent of a majority of the minority rule, the price is not presumed fair unless this stronger condition is fulfilled.

The Directive sheds no further light on how fair price should be construed in all remaining cases, i.e., in squeeze-outs deriving from voluntary tender offers where no “super majority” has been reached.

The system of fair price presumptions in the EU Takeover Directive can, thus, be mapped out as follows:

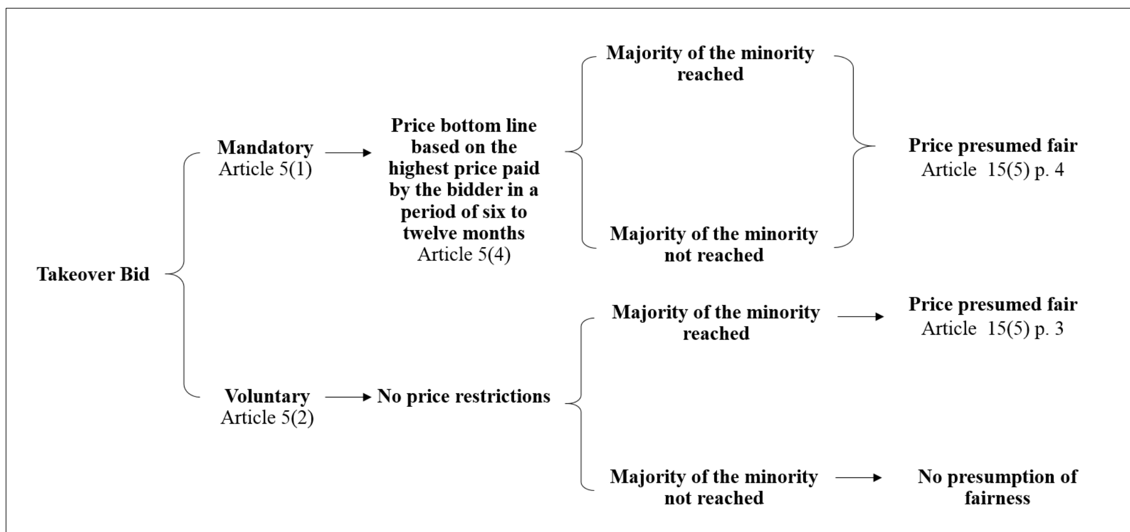

Figure 2: Fair Price Presumptions in the EU Takeover Directive

We can, therefore, draw a conclusion form the legal statutes: there are two different grounds sustaining the legal presumptions of fairness: on the one hand, the highest price already offered by the bidder (*best price rule*) and, on the other, majority of the minority consent. These two factors, which emerge independently of each other, seem to act as legal standards of fairness embraced by the EU legislator.

It must be noted that this system does not account for the present value of the consideration offered to the minority. The price is paid to the minority after the shareholders which have spontaneously tendered their shares have been paid. The time lapse between the two moments may vary from jurisdiction to jurisdiction and depending on each transaction. There is rarely compensation for any delay in payment. This element may pressure shareholders into tendering their shares on the front-end of the merger operation.[128]

Besides, even where the fair price is not freely set by the bidder, i.e., even in the case of mandatory bid squeeze-outs, there are no guarantees that the compensation offered is not based on valuation standards that have long been deemed unfit by the American system, such as market value or third party sale value. This becomes clear in the context of the transposition of the EU rules by some Member States, namely Portugal, where the market value standard is still viewed as a suitable benchmark, as will be further discussed.

The Directive does not provide additional clarification as to whether the fair price presumptions set therein are rebuttable. Some authors have argued that these should not be rebuttable.[129] Their main line of argumentation is that, unlike in the Delaware system, the EU legal framework introduced by the Takeover Directive suggests that squeeze-out specific synergies are included in fair price calculations. That is because a mandatory bid price, which will usually include a premium for control, is presumed fair, and for that reason - they argue - the system seems to be, by nature, over-compensating for the minority.[130]

However, as discussed *supra*, despite staunch criticism, the Delaware courts do not generally exclude control premiums from the fair compensation calculations, even where the legal setting explicitly excludes "*any element of value arising from the accomplishment or expectation of the merger*". Besides, the presumptions of fairness advanced by the EU framework do not always account for control premiums. Indeed, in voluntary bids, even where a presumption operates, the price is set freely and is not limited by the price of the front-end offer.

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[128] VENTORUZZO (n 14) 893.
[129] MILIUTIS (n 3) footnote 94.
[130] *Id.*, 779.

In any case, Member States may set these presumptions as rebuttable, as is the case in the Portuguese jurisdiction which I analyse in the following section.

B) The Portuguese Example

i) The Implementation of the EU Solution

In the Portuguese jurisdiction, regulation regarding the legal doctrine of *aquisições tendentes ao domínio total*, i.e., corporate control acquisitions triggering squeeze-out rights, distinguishes between closed and public companies.

Regarding closed companies, Article 490 PCC[131] determines that when a company acquires 90% of the capital of another company it must notify the latter that it has reached this threshold, within 30 days. In the six months following this notification, it has the right to buy-out the remaining shareholders, regardless of their consent or agreement, by presenting fair compensation. In order to ensure the fairness of the compensation, the PCC mandates that it must be justified by a report of a chartered auditor, independent from the companies involved, or companies or people related to them. The compensation may consist of cash or securities of the controlling company.

Conversely, the regulation of squeeze-outs in public companies, including listed companies, results from a combination of several of the options opened by the Takeover Directive when seeking minimum harmonisation among Member States.

The Portuguese jurisdiction adopted the most restrictive solution regarding the squeeze-out right triggering thresholds. Indeed, regarding public companies, Article 194 of the Portuguese Securities Code (PSC)[132] requires that a general offer - i.e., an offer aimed at all of the shareholders of the target company - reaches at least 90% of the voting rights corresponding to the share capital. It is also necessary that the offer reaches at least 90% of the shares representing the share capital and carrying voting rights covered by the bid. There is, therefore, a combination of the single threshold solution and the majority

[131] *See* translated version of the Article in the Annex.

[132] Decreto-Lei n.º 486/99, de 13 de Novembro. *See* translated version of the Article in the Annex.

of the minority rule as provided for in the Takeover Directive, a combination which is not common among most other EU jurisdictions.[133]

When both conditions are met, the offeror gains the right to buy out the remaining shares in the three months following the offer, by presenting fair compensation, in cash, to the remaining shareholders.

The calculation of the fair compensation must follow specific rules in line with Article 188 PSC[134], which, in turn, regulates fair compensation in mandatory bid cases. The criteria set therein determine that the minimum compensation to be offered must meet the highest of the following share prices: *i)* the highest price paid by the offeror for shares of the same category of the target company, in the six months preceding the public announcement of the offer (*best price rule*) or *ii)* the average market price of the same shares in the same six-month period.

If the fair compensation cannot be calculated through this method or if the Portuguese Securities Commission (Comissão do Mercado dos Valores Mobiliários - "CMVM") finds the resulting price unfair, whether insufficient or excessive, the Code determines that an independent auditor appointed by the CMVM shall fix the minimum compensation in the offer, at the offeror's expenses. For transparency reasons, the Code mandates that the appointment process as well as the fair value reached by the auditor is immediately made public.

As for the squeeze-out compensation in voluntary bids, the same rules apply, but a presumption of fairness is set: when, following a general and voluntary offer, the offeror acquires 90% of the capital carrying shares contained in the offer, the compensation offered is presumed fair, as a consequence of the transposition of the "majority of the minority" fair price presumption contained in the Takeover Directive.

As provided by Article 188(5), the consideration may consist of securities, provided that these securities are of the same type as those to which the bid relates and are admitted or are of the same class of demonstrably liquid securities admitted to trading on a

[133] For a comprehensive map of the implantation of the Takeover Directive in the European Union, *see* VENTORUZZO (n 14) 897.

[134] *See* translated version of the Article in the Annex.

regulated market, and provided that the offeror has not acquired any shares representing the target company's share capital for a consideration in cash in the six-month period preceding the preliminary announcement, in which case an equivalent consideration in cash must be offered.

With a global view of this legal setting, we may conclude that, unlike the understanding of Delaware case law, in the Portuguese legal framework, the market value standard is considered an adequate valuation benchmark, specifically in cases where the highest price paid by the offeror for shares of the same category of the target company is lower than the average market price of the same shares. Other jurisdictions also view market value as an adequate valuation standard. This is the case, for instance, in Spain[135] and Italy.[136]

It must be further noted that the Portuguese jurisdiction clears up the doubt left by the Takeover Directive and determines that the presumptions of fairness established are rebuttable. Indeed, Article 188(3) PSC sets presumptions of unfairness of the compensation in three different situations, upon which an independent auditor should be appointed, as described: *i)* if the highest price has been negotiated between the offeror and the target company in private negotiation. In this regard, it is interesting to note that the PSC does not demand further procedural standards as to how negotiations should be conducted, unlike the current legal framework in the US; *ii)* if the securities present a lower liquidity in reference to the regulated market where they are negotiated; *iii)* if the compensation is calculated by reference to market prices in a regulated market which has suffered exceptional disruptions.

ii) The Debate on the Constitutional Validity of Squeeze-Outs: A Further Step in Pinpointing the Real Issue

In the Portuguese jurisdiction, the squeeze-out right generated in corporate control acquisitions (*aquisições tendentes ao domínio total*), both in closed and public companies, has been, and remains to this date, a controversial legal solution.

[135] Ley 6/2007, de 12 de abril and articles 9, 14 and 47 of Real Decreto 1066/2007, de 27 de julio.

[136] Articles 108 to 112 (in particular Article 111) of section II (*Offerte pubbliche di acquisitio obbligatoire*) of the legislative decree of 1998, number 58 – Testo único delle disposizione in materia di intermediazone finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio de 1996, n.º 52.

Indeed, the constitutional validity of Article 490 PCC was called into question in a 1997 decision of the Portuguese Supreme Court of Justice.[137] The Court decided that the squeeze-out right provided by the Article was unconstitutional due to violation of Article 61(1) (*free economic initiative*), Article 62(1) (*private property*) and Article 13(1) (*principle of equality*) of the Constitution of the Portuguese Republic. In the Court's reasoning, even though the constitutional rights to private property, private economic initiative and equality are not absolute rights, they must only be restricted in face of other constitutional rights or interests and only to the extent necessary to protect them. In this light, the Court argued that these constitute constitutional human rights which may not be arbitrarily, discriminatingly and disproportionally excluded or substituted for cash or other goods by exclusive initiative of majority shareholders and that the "group logic" may not justify the limitation of such constitutional values.

Following this decision, the Portuguese Constitutional Court was called to issue a final position on the matter. In a 2003 decision, the Constitutional Court decided that the squeeze-out right introduced by Article 490 PCC was in conformity with the constitutional rules.[138] In its reasoning, the Court argued that the patrimonial rights of shareholders suffer natural limitations in the face of the organisation and capital structure of corporations, which naturally operate in light of a majority principle which legitimates the majority of the shareholders to make regular corporate decisions. Besides, the Court argued that the rights conferred to the majority in squeezing out the minority were not disproportionate, given that the legislator established the ground for a fair way out, by stipulating procedural guarantees of fairness in the calculation of the compensation to be offered, with the intervention of an independent auditor, but also by simultaneously establishing a symmetrical sell-out right for the minority shareholders.

[137] Acórdão do Supremo Tribunal de Justiça de 2 de Outubro de 1997, Processo n.º 695/96, BMJ, n.º 470 (1997), 619-629.

[138] Acórdão do Tribunal Constitucional n.º 491/2002, de 22 de Janeiro de 2003 <http://www.tribunalconstitucional.pt/tc/acordaos/20020491.html> accessed 26 April 2016.

This decision, followed by a number of decisions of the Courts of Appeal[139] and later of the Supreme Court of Justice,[140] addressed the criticism of legal scholars regarding the 1997 decision.[141]

Today, the constitutional validity of Article 490 PCC is widely accepted among Portuguese scholars, mostly on the grounds that it allows for an independent valuation of the compensation offered to the minority shareholders.[142] However, the discussion does not seem to have extended to the similar provisions of the PSC. Indeed, Article 194 PSC, regulating squeeze-outs in public companies, has provoked less discussion, in light of the constrained requirements regarding compensation and the oversight and control of the CMVM.[143]

Similar discussions have emerged in other European countries[144] and the problem has been posed before the European Court of Human Rights (ECtHR) in regard to the

[139] Acórdão do tribunal da Relação de Lisboa de 6 de Junho de 2002, CJ, Ano XXVII, T.III, 2002, 92-96; Acórdão do Tribunal da Relação de Lisboa de 29 de Outubro de 2002, CJ, Ano XXVII, T. IV, 2002, 10-119; Acórdão do Tribunal da Relação do Porto de 20 de Abril de 2004, Processo n.º 0430948 <http://www.dgsi.pt>; Acórdão do Tribunal da Relação do Porto de 8 de Janeiro de 2008, Processo n.º 0725170 <http://www.dgsi.pt>.

[140] Acórdão do Supremo Tribunal de Justiça de 10 de Janeiro de 2003, CJ, Ano XI, T.II, 2003, 26; Acórdão do Supremo Tribunal de Justiça de 3 de Fevereiro de 2005, Processo n.º 04B4356 <http://www.dgsi.pt>.

[141] *See,* e.g., MENEZES CORDEIRO, 'Da Constitucionalidade das Aquisições Tendentes ao Domínio Total (artigo 490, n.º 3, do Código das Sociedades Comerciais)' [1998] 480 Boletim do Ministério da Justiça 5; ENGRÁCIA ANTUNES, 'O Artigo 490.º CSC e a Lei Fundamental. Propriedade Corporativa, Propriedade Privada, Igualdade de Tratamento' in *Estudos em Comemoração dos Cinco Anos (1995-2000) da Faculdade de Direito da Universidade do Porto* (Coimbra Editora 2001) 147; ENGRÁCIA ANTUNES, *A Aquisição Tendente ao Domínio Total: da Sua Constitucionalidade* (Coimbra Editora, 2001); HORTA OSÓRIO, *Da tomada do Controlo de Sociedades (Takeovers) por Leveraged Buy-Out e a sua Harmonização com o Direito Português* (Almedina 2001).

[142] JACINTO MONIZ DE BETTENCOURT, 'Cash-Out Mergers in Portuguese Companies Law' [2009] 24 Actualidad Jurídica Uría Menéndez 57.

[143] ANA FILIPA ANTUNES, 'Aquisição Tendente ao Domínio Total no Direito Societário e no Direito dos Valores Mobiliários' in Paulo Câmara (ed), *Aquisição de Empresas*, (Coimbra Editora 2011) 313.

[144] In the UK *see* ELISABETH BOROS, *Minority Shareholders' Remedies* (Oxford, Clarendon Press 1995) 256-316; In the French jurisdiction, *see* DOMINIQUE SCHMIDT, 'Réflexions sur le Retrait Obligatoire' [1999] 76 (Novembre-Décembre) Revue de Droit Bancaire et de la Bourse (Editions du Juris-Classeur) 213-216; In the Spanish jurisdiction, *see* FERNANDO VIVES RUIZ, *Las Operaciones de «Public to Private» en el Derecho de OPAs Español* (Primera Edición, Thomson, Civitas 2008); CÂNDIDO PAZ-ARES, 'Aproximación al Estudio de los Squeeze-Outs en el Derecho Español' [2003] Año XXII, 91 (Julio-Septiembre) Revista de Derecho Bancario y Bursátil, 7; In the Italian jurisdiction, *see* GIANLUCA PERRONE, 'Nature and Rationale of Freeze-Out Under Italian Law on Listed Corporations' (2005)

human right to property protected under Article 1 of Protocol No. 1 to the European Convention on Human Rights (ECHR). The landmark case regarding squeeze-outs in this regard was *Bramelid and Malmström v. Sweden* (1982)[145], where two private individuals who owned shares in a large Swedish company argued, upon being squeezed-out, that they had to surrender their shares to the majority shareholders at less than market value, as the price had been fixed by arbitrators. The European Commission of Human Rights assessed the character of company shares and held that, as a certificate that promises the holder a share of the company, corporate rights, and an indirect claim on company assets, they must be considered as *possessions*, as protected under Article 1 of Protocol No. 1 ECHR. However, the Commission further considered that laws governing private-law relations between individuals usually compel a person to surrender a possession to another (for example, as a result of inheritance, estates or execution rules) and that these types of rules, essential to our societies, cannot, in principle, be contrary to Article 1 of Protocol No. 1 ECHR. Nonetheless, the Commission considered it necessary to determine whether such rules did not create "*such inequality that one person could be arbitrarily and unjustly deprived of property in favour of another*". It concluded, however, that that was not the case in *Bramelid and Malmström v. Sweden*, despite the below market value compensation offered in that case.[146]

The discussions regarding the validity of the right to squeeze-out, both in closed company and public company scenarios, in terms of human rights with constitutional and international protection, namely the right to property, take us a step forward in pinpointing the problems raised by this legal solution. Even though the debate seems to have been settled in most jurisdictions and the validity of the squeeze-out right is widely

<http://ssrn.com/abstract=958753> accessed 21 April 2016; In the German jurisdiction *see* Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], Sept. 19, 2007, 1 BvR 2984/06 (F.R.G).

[145] *See Bramelid and Malmström* App no 8588/79 (Commission Decision, 12 of October 1982) <http://echr.ketse.com/doc/8588.79-8589.79-en-19821012> accessed 26 April 2016.

[146] *See* MARIJA BARTL, 'Czech Regulation of Squeeze Out on Comparative Perspective' (2007) CEU eTD Collection 52 <http://www.etd.ceu.hu/2008/bartl_marija.pdf> accessed 21 April 2016, considering that several ECtHR decisions fail to grant full protection of the human right to property foreseen in Article 1 of Protocol No. 1 ECHR by accepting market value (and below market value) compensation, when lower than the companies' intrinsic value.

accepted, the discussions demonstrate the need for reinforced protections. In this light, the need for a compensation mechanism which takes the minority shareholders' interests into account gains renewed importance: it stands between a fair legal option and a violation of fundamental rights.

V – A TRANSATLANTIC APPRAISAL

A) The Asymmetries of Both Approaches

Having considered the legal framework of the right to squeeze out minority shareholders both in the United States and in the EU, it is worth recapitulating them briefly, in order to put their similarities and asymmetries into perspective.

In the US, two different forms of squeeze-out are generally available: the long form cash-out merger and the two-tier short form merger. Dissenting minority shareholders may either challenge the merger on the grounds of procedural illegalities, namely for breach of fiduciary duties, or exercise their right to judicial appraisal and have their shares valued in a court proceeding.

After a long line of case law which distinguished between both merger squeeze-out methods in applying fairness standards, courts have come to a unified standard after the fairly recent *MFW Shareholders' Litigation* decision: the business judgment rule standard shall apply instead of the entire fairness test if the following conditions are simultaneously verified: *i)* the controlling shareholder makes the merger contingent on the approval of both a special committee and a majority-of-the-minority shareholder vote; *ii)* the merger is negotiated and approved by a special committee of independent directors charged with *de facto* full bargaining power in representing the minority shareholders; *iii)* the special committee meets its duty of care and *iv)* the deal is accepted by a fully informed and uncoerced vote of the majority of the minority investors. This means that the burden to prove (un)fairness lies with the plaintiffs.

As for the judicial appraisal of fair value, case law determined the need for a going concern value standard of fairness in the squeeze-out compensation and developed a holistic approach to valuation with the *Weinberger* precedent opening the door to the judicial consideration of valuation techniques used by expert appraisers, namely those not limited to a present value standard, accounting for estimates of the present value of the future earnings of a company as an element of fairness.

In Europe, the main method used for going private transactions is the statutory squeeze-out right following a mandatory or voluntary tender offer, as harmonised by the Takeover Directive, in a procedure somewhat close to the American two-tier short form merger. In the "single threshold squeeze-out" (more common in continental Europe), the offeror obtains between 90% and 95% of all the outstanding shares and voting rights in the triggering offer. In the "majority of the minority squeeze-out" (the British rule), the offeror obtains 90% of the shares included in the offer. In either case, the controlling shareholder forces minority shareholders out of the target company 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 equal to that of the voluntary offer when a minimum of 90% of the securities involved have been tendered. Due to the minimum harmonisation purposes of the Directive, variations of this rule can be found locally in Member States.

From the above, we can identify both similarities and differences in the legal frameworks of the right to squeeze-out in the US and in the EU.

First of all, in the EU, just as in Delaware's two-tier merger procedure, the unilateral acquisition of the remaining minority shares follows a tender offer. The long form cash-out merger is not a generally available option in Europe, under the Takeover Directive.

On both sides of the Atlantic, the default squeeze-out right triggering threshold is set at 90% of the target company's share capital. However, in the EU, this threshold can be higher, with the Takeover Directive allowing Member States to opt for up to a 95% threshold.

Secondly, both systems take the acceptance of the following offer by a majority of the minority shareholders as a ground for a presumption of fairness. However, following *Pure Resources*, a simple majority is sufficient grounds to approve the offer in the American system, while in the EU the acceptance rate must be of, at least, 90% of the shares. As KAISANLAHTI has pointed out, the European "super majority" rule seems to place a greater importance on the securities of those rejecting the bid and therefore

draws an emphasis on the opinion of the minority of the minority: a minority of 10.1% of the shares included in the offer can set apart the fairness presumption.[147]

However, in the American system, additional requirements are demanded regarding the way the transaction is conducted. A set of ex-ante, procedural fair dealing protections are foreseen. On the one hand, the merger must be negotiated and approved by a committee of independent directors, fully empowered to definitively reject the proposal, and to freely employ its own legal and financial advisors. On the other, the majority of the minority investors must be fully informed and uncoerced. In light of the *Pure Resources* case law, this means that the acquiring corporation cannot pose any retributive threat to minority shareholders. The fulfilment of these requirements forms a presumption of fairness, materialised in the application of the standard business judgement rule. This presumption is, from the outset, deemed rebuttable, and implies only that the burden to prove (un)fairness in the deal lies with the dissenting minority. The Takeover Directive does not provide for similar procedural protections and does not further clarify whether the presumptions of fairness set therein are rebuttable, leaving that matter to the discretion of the Member States.

Thirdly, it should be noted that in the EU system, unlike the situation in the US framework, the squeeze-out may follow a mandatory tender offer pursuant to Article 5 of the Takeover Directive. As pointed out by some authors, because the minimum price of mandatory bids must be at least equal to the price paid by the bidder for securities of the target company prior to the offer, the squeeze-out compensation may, in most cases, include a premium for control.[148] In the US, the legal framework for squeeze-outs set out in section 262(h) DGCL excludes any element of value arising from the accomplishment or expectation of the merger from the fair price valuation, which has led some American authors to argue that control premiums should not be included in fair compensation calculations, even though, as pointed out in section III (C)(IV) of this paper, Delaware case law generally seems to accept its inclusion.

[147] TIMO KAISANLAHTI, 'When Is a Tender Price Fair in a Squeeze-Out' [December 2007] 8(4) European Business Organization Law Review 496, 507.
[148] VENTORUZZO (n 14) 906.

Fourthly, judicial appraisal of the fair compensation seems to be more available in the American system, where a line of case law has developed on the valuation methods to be employed. In the EU system, appraisal by the courts seems to be a secondary route for the minority in seeking remedy: its use is subsidiary to the fair price presumptions set out in the Takeover Directive and it is only available in a pre-determined set of situations.

Finally, the European system seems to rely on market value as a possible standard of fairness. Even though the EU Takeover Directive does not include a precise reference to market value as a valid valuation standard, some Member States do adopt this valuation benchmark in squeeze-out compensation calculations. This is the case, for instance, in the Portuguese, Spanish and Italian jurisdictions. However, it is widely acknowledged by scholars and experts, as well as by American case law, that, because of the associated risks of under-compensating or over-compensating the minority, share market prices cannot serve as the appropriate proxy for determining fair value in the context of corporate squeeze-outs.

In light of these differences and similarities, some authors argue that it is more difficult to squeeze out minorities in Europe than in the US.[149] Considering the legal framework for squeeze-outs on both sides of the Atlantic,[150] I tend to only partly agree with this conclusion.

It is certain that, for three general reasons already stated, the squeeze-out right is less available in Europe than in the US: *i)* in the EU the long form merger procedure is not generally an available option to squeeze out minorities; *ii)* in Europe the squeeze-out right triggering thresholds may be higher than in the US and *iii)* in the EU, the majority of the minority fair price presumption sets a "super majority" requirement which does not exist in the US.

[149] VENTORUZZO (n 14) 907.

[150] Other factors, other than the legal aspects, namely economic issues, are implicated in determining whether it is in fact more difficult to squeeze out minorities in the EU. As pointed out by VENTORUZZO (n 14) 908, empirical evidence seems to confirm this conclusion. *See* TOBY STUART, SOOJIN YIM, 'Board Interlocks and the Propensity to be Targeted in Private Equity Transactions' (2008) Nat'l Bureau of Econ. Research Working Paper 14189.

Yet it must also be noted that other factors indicate otherwise: first of all, the Takeover Directive mandatory bid price is presumed fair regardless of the rate of acceptance of the tender offer by the outstanding shares. Besides, ex-ante material protections – such as the appointment of a special committee of independent directors charged with *de facto* full bargaining power in representing the minority shareholders and the demand for a fully informed and uncoerced vote of the minority – are not required in the EU.

One can point out different reasons why the systems differ in this way. On the one hand, the existence of a relatively more flexible squeeze-out system in the US can be explained by the very federal structure of the country which creates regulatory competition among the various federal states.[151] On the other, the cultural framework of most European systems seems to result in the interests of minority shareholders being classified as connected to property rights. Even if the constitutional challenges have been settled, the fact that a constitutionality debate developed in Europe is a clear indicator of why the squeeze-out right is less flexible in the EU. Some authors go further and argue that in most civil law systems legislatures face less pressure from controlling shareholders, managers and lobbyists to facilitate going private transactions because the risk and likelihood of litigation and minority shareholders' class actions is less preeminent than in the US.[152]

B) What can the EU Learn from the American Experience?

In light of all that has been said, we are now faced with a concluding query: what lessons can the European squeeze-out compensation system take from the extensive American case law and statutes reviewed?

I believe there are two main issues to address: The first relates to the availability of squeeze-out rights in the EU system. The second concerns the guarantees of fairness in the squeeze-out process.

[151] For a sample of the debate on how the regulatory competition between states has shaped the US corporate law system, *see* VENTORUZZO (n 14) footnote 192.

[152] RAFAEL LA PORTA and others, 'Law and Finance' [1998] 106 J. POL. ECON, 1113; VENTORUZZO (n 14) at 910.

i) The Availability of Squeeze-out Rights

The first observation one could make is that, in some respect, the European system could become less restrictive of squeeze-out transactions, when compared to its American counterpart. From a legislative perspective, this could be achieved with the adoption of two main measures: *i)* on the one hand, Europe could implement a mechanism inspired by Delaware's one-step merger along with the already existing two-step method present in both mandatory and voluntary bids and *ii)* on the other, in the case of the voluntary bid "majority of the minority" presumption, a less restrictive threshold, could be applied.

In the end, the choice between a more restrictive and a more lenient squeeze-out system comes down to a public policy decision. On the table is the opportunity to create a wider and more flexible market for corporate control and a financial market more welcoming of transborder investment, ultimately more robust and open to the creation of value. Indeed, the possibility of squeezing out the minority shareholders is an important aspect in every merger or acquisition strategy, especially in the context of hostile takeovers. The existence of excessive requirements may deter value-generating transactions and can ultimately be considered, in cases where the opportunity to squeeze out is decisive, an anti-takeover measure, protective of the *status quo*.

ii) Ensuring fairness

I believe, however, that attaining a more squeeze-out-friendly system does not necessarily imply adopting a less favourable framework for minority shareholders, from a material standpoint. For one thing, European jurisdictions, after all, saw the problem through the right lens when questioning the validity of this legal doctrine in relation to the fundamental right to property. A few lessons can be drawn, however, from the American framework.

The first of these lessons is procedural in nature. US case law has developed a set of ex-ante "fair dealing" protections ensuring, or at least indicating, the material fairness of each squeeze-out transaction. These protections translate, namely, into the legal requirement of the appointment of a special committee of independent directors

empowered to accept or reject each deal proposal, and the demand for a fully informed and unpressured or uncoerced minority to accept the offer. One may point out that the mandatory appointment of a special committee creates inflexibility in the squeeze-out process and may not be suitable for every company in abstract. Or it might also be argued that the terms "independent", "fully informed" and "uncoerced" are merely words on a paper, especially in a system where close ownership prevails. But the fact is that, from a legislative standpoint, these types of procedural protections could be implemented with minor effort and would bring an element of fair procedure to the table in the EU system, which does not exist currently.

And because procedure matters, every squeeze-out deal is worth reviewing. The extensive squeeze-out related litigation in the US proves that fairness, as it stands, demands a case-by-case appraisal. Valuation proceedings in a court of law or by certified expert appraisers should be more widely available in the EU system and not limited to a definite set of situations, as they currently stand under article 5(4) of the Takeover Directive. Consequently, the presumptions of fairness implemented should be defined as rebuttable in order to allow for judicial appraisal whenever the material aspects - including procedural aspects - of each case so demand. I believe, however, that appraisal litigation does not represent, for the minority, an abusive means of placing pressure on the majority shareholders. Presumptions of fairness present, in abstract, a balanced solution in setting aside abusive minority strategies to clog up reasonable squeeze-out deals. They should not, nonetheless, stand in the way of "real" fairness.

Finally, another lesson to learn is that there is a call for a holistic approach to valuation. This is the conclusion of the long line of American cases leading up to the *Weinberger* standard. Under this judicial precedent, the financial valuation of dissenters' shares is no longer limited to a given set of factors, and the assessment of all aspects deemed relevant by the financial community, in the particular circumstances of each company, is called for. As one might say "*Fairness is a range of values. And so it is in more ways than one*."[153] However, not all standards of valuation can be admitted as benchmarks of fair value. American and European academia have raised voices expressing a multitude of reasons why market value should not be adopted as a standard of fairness. This

[153] RICHARD A BOOTH (n 1) 2.

conclusion demands important legislative revisions in some European jurisdictions – namely in Portugal – which, in some situations, rely on market value elements such as an average of market prices over certain periods of time as a legal benchmark in fixing the squeeze-out compensation.

I believe that wider availability of squeeze-out rights - based on the creation of other squeeze-out mechanisms and a more lenient triggering threshold - ultimately attaining a broader and more robust market for corporate control in the EU can co-exist with a sturdier standard of fairness grounded in a guarantee of fair procedure and more open access to judicial or expert appraisal.

Lastly, with VENTORUZZO,[154] I present one final consideration: the European system would certainly benefit from greater harmonisation of squeeze-out rules across Member States. A more substantive synchronising of rules would promote a more integrated and wider financial market at the European level and a united legal framework for the market of corporate control on this side of the Atlantic.

[154] VENTORUZZO (n 14) 914.

VI – CONCLUDING REMARKS

The right to squeeze-out comes with the challenge of striking a balance between very opposite interests. On the one hand, opting out of public markets by squeezing out the minority shareholders may represent a valuable business alternative in many circumstances and a way to exploit hidden value in the target companies. In the end, the right to squeeze-out comes to protect not just the private interests of the controller, but also market-oriented interests of propelling the creation of value in the markets through takeover transactions. On the other hand, however, the introduction of lighter requirements to trigger the squeeze-out right and to deem the compensation offered as fair may encourage opportunistic behaviour from controlling shareholders leading to transactions.

After reviewing the legal framework on both sides of Atlantic, it is clear that two very different legal systems have come to patently similar solutions. However, important differences remain between both systems.

In the US, while there is wider availability of squeeze-out methods, there is also open access to appraisal litigation and a review of fair dealing in the squeeze-out process. Extensive litigation has come to shape the concept of fair value as a going concern value which accounts for a holistic approach to valuation and sets aside rigid valuation standards such as market value or third-party sale value.

In the EU, the statutory squeeze-out right is framed in the mandatory and voluntary tender offer alternatives provided by the Takeover Directive, while the review of the fairness of each deal is limited by the presumptions of fairness established therein. Litigation has put the right to squeeze-out in confrontation with fundamental social and economic rights with a constitutional dimension, shedding a new light on the debate of how the scale of contrasting interests in the squeeze-out process should be balanced.

In light of these differences, the EU can draw valuable lessons from the American experience both in the direction of a more flexible and mature market for corporate control, capable of generating value creating transactions, and, simultaneously, in the direction of stronger guarantees of fairness providing minority shareholders with a fair way out.

ANNEX

TRANSLATED RELEVANT PORTUGUESE LEGISLATION

Article 490 of the Portuguese Companies Code[155]

(Acquisition leading to total control)

1. A company which, by itself or together with other companies or persons referred to in Article 483, paragraph 2, owns quotas or shares corresponding to at least 90 % of the capital of another company, shall inform the latter of this within 30 days following the date on which such shareholding is reached.
2. In the six months following the date of notification, the controlling company may present an offer to acquire the shares of the remaining shareholders, for a consideration in cash or in its own quotas, shares or bonds, supported by a report prepared by a chartered auditor independent of the companies concerned, which shall be deposited in the registry and disclosed to the interested persons in the registered offices of the two companies.
3. The controlling company may become owner of the shares or quotas belonging to free shareholders of the controlled company if it so declares in the proposal, the acquisition being subject to registration by deposit and publication.
4. Registration can only be made if the company has deposited the consideration, in cash, shares or bonds, for the shares acquired, calculated in accordance with the highest values contained in the auditor's report.
5. If the controlling company does not timely make the offer permitted by paragraph 2 of this Article, each free shareholder may at any time require in writing that the dominant company makes, within a period of not less than 30 days, a tender offer for the acquisition of his/her quotas or shares with consideration in cash, quotas or shares of the controlling companies.
6. In the absence of the offer or if it is considered unsatisfactory, free shareholders may request that a court declares that the shares or quotas are acquired by the controlling company from the moment the suit is filed, and that the court fixes their value in cash

[155] Free Translation.

and orders the controlling company to pay him/her in accordance. The suit shall be filed within 30 days of the deadline referred to above or of the date when the offer is received, as applicable.

7. The acquisition leading to total control of a company with its capital open to public investment is governed by the provisions of the Portuguese Securities Code.

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Article 188 of the Portuguese Securities Code[156]

(Consideration)

1. The consideration for a mandatory take-over may not be less than the highest of the following amounts:
   a) The highest price paid by the offeror or by any individuals involved in some of the situations described in Article 20(1), for the acquisition of securities of the same class, in the six months immediately prior to the date of publication of the preliminary announcement of the offer;
   b) The average price of these securities verified in a regulated market during the same period.
2. If the consideration may not be calculated by reference to the criteria described in sub-article 1 or if the CMVM understands that the consideration, in cash or securities, proposed by the offeror is not duly justified or equitable, is insufficient or excessive, the minimum consideration will be calculated, at the offeror's expense, by an independent auditor nominated by the CMVM.
3. A consideration, in cash or securities, proposed by the offeror, shall be presumed to be inequitable in the following circumstances:
   c) If the highest price has been set by means of an agreement between the purchaser and the seller through private negotiation;

[156] Translation of the Portuguese Securities Code provided by the CMVM website <http://www.cmvm.pt/en/Legislacao/National_legislation/CodigodosValoresMobiliarios/Pages/Securities-Codes.aspx?pg> accessed 21 April 2016.

d) If the securities in question have low liquidity with reference to the regulated market on which they are admitted to trading;
e) If such consideration was determined on the basis of the market price of the securities in question and this market price or the regulated market on which the securities are admitted to trading has been affected by extraordinary events.

4. The CMVM's decision concerning the appointment of an independent auditor to determine the minimum consideration, as well as the amount of the consideration determined in this way, shall be made public without delay.
5. The consideration may consist of securities, provided that these securities are of the same type as those concerned by the bid and are admitted or are of the same class of demonstrably liquid securities admitted to trading on a regulated market, and provided that the offeror and any person that is in any of the circumstances contemplated in no. 1 of article 20 with regard to the offeror have not acquired any shares representing the offeree company's share capital for a consideration in cash in the six-month period preceding the preliminary announcement, in which case an equivalent consideration in cash must be offered.

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Article 194 of the Portuguese Securities Code[157]

(Compulsory takeover)

1. Any person that, following the launch of a general takeover bid over an offeree which is a publicly traded company subject to Portuguese law as its personal law, achieves or exceeds, directly or in the terms of no. 1 of article 20, 90% of the voting rights corresponding to the share capital up to the determination of the outcome of the bid and 90% of the voting rights covered by the bid may, in the subsequent three months, acquire the remaining shares for a fair consideration, in cash, calculated in the terms of article 188.

[157] Translation of the Portuguese Securities Code provided by the CMVM website <http://www.cmvm.pt/en/Legislacao/National_legislation/CodigodosValoresMobiliarios/Pages/Securities-Codes.aspx?pg> accessed 21 April 2016.

2. If an offeror, as a result of acceptance of a general voluntary takeover bid, acquires at least 90% of the shares representing the share capital and carrying voting rights covered by the bid, it shall be presumed that the consideration for the bid corresponds to a fair consideration for acquisition of the remaining shares.
3. The controlling shareholder who makes the decision for a compulsory takeover should immediately publish a preliminary announcement and submit same to the CMVM for registration.
4. The provisions of Article 176(1) (a) to (e) apply to the contents of the preliminary announcement, with the necessary adaptations.
5. The publication of the preliminary announcement obliges the controlling shareholder to deposit the consideration with a credit institution, to the order of the holders of the remaining shares.

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