



Minority shareholder protection rules in Germany, France and in the United Kingdom

A comparative overview

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Abstract

The thesis examines the three major company law models in Europe from minority shareholder protection aspect. Starting with the general analysis of companies and the different groups of interest the research focuses on understanding the social and economic reasons behind minority shareholder protection. Minority shareholder protection is provided by general principles of law, by statutory remedies and procedural instruments. In this paper an overview was given on these branches of protection, revealing the differences between German, French and English court practice. An additional goal is showing the reader the statutory remedies' difficulties in each jurisdiction and to call attention for the numerous alternatives which are at the hands of minority shareholders to provide their interests in any case of abuse. Nevertheless minority shareholder protection is not a 'bad or good' question: in each phase of policy-making there are competing values and legislator should take into consideration all possible factors in determining the scope of protection. The introduction of these competing values constitutes an essential component of this thesis as well.

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Introduction

This paper deals with European statutory and judicial remedies designed to protect minority shareholders of a corporation. It focuses on statutory provisions but considers also remedies provided by judicial practice. The examination of general concepts and doctrines in favour of minority shareholders constitutes a core element of the thesis as well. The method of the analysis is comparative: two civil law systems and one common law system is going to be introduced and compared with each other. Special emphasis is turned to the question of how effective is the protection offered by the different national solutions against the economic power of majority shareholders.

Member States of the European Union reached a common position in many aspects of company law regulation like publicity, disclosure requirements, maintenance and alteration of capital, single-member private limited-liability companies. Nevertheless, the European Community has made no attempt to provide unified remedy for conflicts arising out from the

dissension of shareholders. Disputes among shareholders should be settled in some way and the abuse of majority position is a clear danger for minority shareholders' interests. As Miller notes at present, there appears to be considerable diversity in the way individual countries address the problems of shareholder dissension and overreaching by the majority shareholders. The remedial measures that have been taken rest largely on judicial discretion which creates an undesirable degree of uncertainty in the law.¹ From 2004 there is some common core of regulation relating to takeover bids, however the majority of rules protecting minority shareholders remained intact.²

What reasons can be found behind the heterogeneity of that regulation? Being ironic one can easily say that only the problems are common in minority shareholder protection legislation: „freezing out” minority shareholders shows the same technics everywhere: termination of employment, refusal to declare dividends, removal of minority shareholder from a position of management, siphoning off of corporate earnings through high compensation to the majority shareholders.³ European company laws differ from many aspects: in Germany the two-tier model, the importance of *Aufsichtsrat* and the universal bank-system and financing of companies by that characterizes company law. Additionally, the workers' involvement into the decision-making of German companies is a main feature. In France, regulation allows the creation wide variety of companies with varying company structures. Two-tier or one-tier model structure can be picked up with a special management structure. In United Kingdom the common law itself differs significantly from civil law jurisdiction. The role and position of management is much stronger than in Germany and France. Supervisory Board is not present in UK companies, therefore the controlling power of management is in the hands of

¹ Sandra K. Miller: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University.

² Council Directive 2004/EC of 30 March 2004 on takeover bids.

³ Richard C. Tinney, J.D.: Oppressive Conduct by Majority Shareholders, Directors, or Those in Control of Corporation In American Jurisprudence Proof of Facts, Database updated July 2006

shareholders. The national company structures require different solutions adopted to protect minority shareholders.

Why it is inevitable for company law to treat in a successful way the problems arising out from minority shareholders' conflict with other stakeholders of a company? There are economic and social reasons behind. Small investors and foreign investments can be encouraged through an effective protection.⁴ In case of multinational firms with billions of income attracting small investors on the stock exchange is a significant aspect. Another way of financing activities is bank loan, but still issuing shares for public remained an important way of raising funds. These small investors are typically feel themselves in a safer position if there are effective rules protecting their interests and prohibiting majority or main investors from abusing their economic power to the detriment of them. In case of close corporations the social function of a company prevails. The company is organized in order to provide mutual benefits for the different groups of interest. To maintain a balance between these interests minority protection rules are necessary, because close corporations are usually created for a long term and the changes in company's members, objects and market conditions can distort that balance under which the company was created.

Chapter I Company interest groups and minority shareholders

I.1 Why to create companies and different groups of interest within a company

People carrying out business activity usually hold two aspects essential: producing the maximum benefit from the activity for themselves and reducing the risks arising out of the activity. In order to have enough capital to continue different business activities but also to reduce the risks, arising out of undertaking several obligations in connection with the

⁴ One of the reasons why foreign investors have been slow to invest in the Czech Republic was because of its relatively weak shareholders protections. See detailed in Carol L. Kline: Protecting minority shareholders in close corporations: modeling Czech investor protection on German and United States law In Boston College International and Comparative Law Review, Spring, 2000

concerned business, different types of companies were developed by all legal systems. Without enumerating all of the aspects how to categorize companies we surely can make a difference according to the primary function of a company: in case of capital-raising companies the persons participating in the company are not familiar with each other. The link between them is that all of them put some form of investment into the company and according to the size of the investment expect some remuneration for the risk. This remuneration can be salary, dividend, bonus or premium. In a so-called 'closely held corporation' the company is formed by persons who have probably other types of connections between each other than pure economic relations, typically family ties.⁵ The consequence of this differentiation is that in capital-raising corporate structures there is no or hardly any personal trust among the members of the corporation.

In a company without personal ties there are two obviously conflicting interests because of the lack of personal solidarity: the individuals' own interest and the the company's overall interest. While these two types of interest are present in closely- held corporations as well, in a company with pure economic purpose the conflict is much more obvious. All the individuals are trying to reach the highest individual benefits: one way to reach the individual maximum benefit is the achievement of the company's maximum profits and make the company functioning in the most effective way.

Nevertheless, the above-mentioned way is not the only one followed by individuals and the different groups of shareholders in order to reach individual highest benefits. Because shareholders are primarily interested in their individual maximum benefits, they can use their actual position to maximize their benefits *without* putting the company a profit-maximizing and cost-saving position. In this latter case certain groups of shareholders or other

⁵ According to Black's Law Dictionary *closely-held corporations* are those whose stock is not freely traded and is held by only a few shareholders (often within the same family). Black's Law Dictionary, 7th Edition, St. Paul, Minn. , 1999, Bryan A. Garner Editor in Chief

stakeholders could suffer harm because of the behaviour of a single shareholder or group of shareholders.

Also there is a need to emphasis here the interests of the *public*. A well-functioning company serves not only the interests of the owners either individually or as a group, but also gives job opportunity for employees, provides services for people and pays tax to the budget. The abuse of the position of some shareholders leads to the dissolution of the company in many cases, which means losing a functioning economic unit from a national macroeconomic aspect. Because of that fact it goes without saying that the state is interested in creating rules which protect the different interests within a company and enhances the stable operation of corporations. In order to determine who should be protected because of the above-mentioned problems, in the next chapter the definition of 'minority shareholders' is going to be dealt with.

1.2 Minority and majority shareholders, ostensible minorities and majorities

Following this short introduction there is a need to find a definition for two notions: 'minority shareholders' and 'majority shareholders'. The common something in the two definitions can be the central interest which determines the behaviour of the certain group of shareholders. There are not necessarily more shareholders in a group, one majority shareholder and one minority shareholder also represents the same problems as more shareholders in the different groups. The shareholders, legally separable from each other, should represent different individual interests. If the individual interests of the several shareholders are the same, there is no conflict of interest between the shareholders and *de facto* they belong to the same minority or majority group.⁶

⁶ For example if in a stock corporation there are more subsidiaries of one company holding different number of shares, legally they seem as individual shareholders, but from an economic point of view they represent the same company's individual interest.

As Cristina Pana notes, there are two ways of determining who is defined as a minority shareholder in a regulation: in the quantitative approach only the ownership matters, which means that the percentage of the capital owned decides how many votes the concerned shareholder has and with this right majority shareholders can direct the company.⁷ This approach could be valid in the one share-one vote era, but nowadays rights and obligations became much more complex.

Therefore the other, so-called qualitative approach, is much more close to reality: here the actual control what matters, not the percentage of capital owned.⁸ With the help of many legal and semi-legal instruments like agreements, contracts, multiplied voting rights, proxies, rights to consent, veto and approval those who apparently seem to be minority shareholders could be in a majority position and *vice-versa*. (ostensible minorites and majorities)

Majority shareholders are those who are in an actual control position to make resolutions and therefore influence the functioning of the company. They are entitled by the doctrine of majority rule to appoint directors in the United Kingdom or appoint the members of the Supervisory Board (*Aufsichtsrat*) in Germany. They can decide directly or indirectly on the salary of the management, on dividends, indirectly on the general guidelines of the functioning of the company. Controlling shareholders are those, according to one definition, who are able to elect directors, cause the break-up of a corporation, merge with another company, cash-out the public shareholders, amend the certificate of incorporation, sell all or substantially all of the corporate assets or otherwise alter materially the nature of the corporation and the public stockholders' interests.⁹

⁷ Cristina Pana: Protection of the minority shareholders of a subsidiary toward the parent company- a comparison between Germany, United Kingdom, France and Romania, CEU Legal Studies IBL L.L.M. short thesis, Central European University, April 2003 p. 7.

⁸ According to Black's Law Dictionary, control is defined as being the direct or indirect power to direct the management and policies of a person or entity, whether through ownership of voting securities, by contract or otherwise; Black's Law Dictionary, 7th edition, West Group, St. Paul, Minn. 1999, Bryan E. Garner Editor in Chief

⁹ Dennis J. Block, Nancy E. Barton, Stephen A. Radin: The business judgement rule- fiduciary duties of corporate directors, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 342.

The minority shareholder is a shareholder who lacks the actual control position and is dependent on the will and actions of the majority shareholders. Minority shareholder position can be original and successive. What do we mean by these two categories? In case of an original minority shareholder position the shareholder buys a minority shareholder position or in another way intentionally becomes a minority shareholder in a company. In case of successive minority shareholders' the shareholder becomes a minority shareholder because of facts outside of his scope of intention. Why it is necessary to distinguish between these categories? In our view the protection provided by law could be lower in the first case, meanwhile successive minority shareholders should have an option not to remain in the company as minority shareholders or somehow have some instrument to counterbalance the lost original position. In the next chapter comes an introduction on what forms of abuse are present and what main branches of minority shareholder protection instruments can be found in the different legislations.

Chapter II The unfavourable position of minority shareholders

II.1 Forms of abuse majority position

Understanding the conflict of interest between minority and majority shareholders presupposes a short description of how majority shareholders can abuse their power of actual control. This description is also important in order to determine whether the legal instruments available under the different European regimes are adequate to handle the appearing problems.

There are many ways of artificially reducing the corporation's earnings: for example not declaring dividends for the shareholders' meeting but granting extraorbitant salaries or bonuses to the majority shareholder- directors or officers appointed by the majority

shareholders. Another form is leasing from the majority shareholders, for high rentals, real estates or equipment. Majority shareholders can prohibit minority shareholders from being employed in the corporation or to have officer positions. The majority can force the corporation to sell at an inadequate price the assets of a company to another company in which the majority shareholders' have higher interest. Assets can be sold directly to the majority shareholder at unfair price. Mergers with unfair conditions relating to the minority shareholders are also an example how to abuse a majority position.¹⁰

The managers' fiduciary duty owed to the corporation may be infringed by several ways as well. How can be affected the company's overall return by the abusive decisions of managers? According to Mark Blair Barta three categories should be separated.¹¹

In the first case the management's decision to maximize the controlling shareholders' return does not affect the overall economic return of the corporation, but merely transfers some of the returns from the minority shareholders to the controlling ones. An example for that could be the unreasonably high salaries of those controlling shareholders, who are in a managerial position. Under a different patten, the management's decision to maximize the controlling shareholders' return also maximizes the overall return to the corporation, but the controlling shareholders benefit disproportionately from the gain. Here the attributions to the company *together* are able to reach a higher return than individually, but this higher benefit is shared disproportionately among controlling and minority shareholders. Int he third case the management's decision to maximize the controlling shareholder's return has a negative impact upon the corporation's total return. It not only works to transfer some of the gain from the minority shareholders to the controlling shareholders, it also works to lower the overall return.

¹⁰ Hodge O'Neal: Oppression of minority shareholders: protecting minority rights, Cleveland State Law Review, 1986/1987, Close Corporations Law Symposium

¹¹ Mark Blair Barta: Is the imposition of fiduciary responsibilities running from managers, directors and majority shareholders to minority shareholders economically efficient?, Cleveland State Law Review, 1990

The conclusion from this short description is that there are many ways of carrying out action to the detriment to minority shareholders, because the majority takes those decisions which influence the steps of the corporation either directly (shareholders' meeting decides on the dividends) or indirectly (appointment of directors or supervisory board members). The remedies should concentrate on the high variety of forms of abuse.

II.2 Why to protect minority shareholders?

For a national legislation there are many reasons justifying the protection of minority shareholders. There can be mentioned direct and indirect policy considerations behind minority protection rules: first of all, as referred to that previously, the social function of a company is secured by minority protection, which means *pro rata* benefits for each person in the company depending on their performed functions and ownership. Another economic consideration is encouraging investments from small shareholders and foreign investors. Nobody wants to be in a weak and woundable position in a company, therefore the only guarantee for small investors is effective minority protection to secure their interests.

A more indirect consideration behind these rules is the control of management and to secure them to act fairly. Small investors in minority shareholders' position from many aspects can be treated as creditors of a company. They contribute to the capital of the company and expect a *pro rata* return for their contribution according to the born risk. A typical phenomenon for them is risk aversion, which means that investors invest into those companies where they can reach the largest possible benefit with the smallest possible risk. Minority shareholder protection rules decrease the risks of the investment and increase the possible benefits. In a country with weak minority shareholder protection one factor of risk aversion is present, therefore foreign investors do not prefer the concerned country. Minority shareholders also can behave as 'watchdogs' of creditors: with legal instruments such as right to information,

right to propose and control-related rights they can secure the interests of the creditors as well.

Finally the prohibition of abusing majority shareholders' position is also a key element in minority shareholders' protection, but this is much more the source of the above-mentioned problems than the problem itself.

II.3 How to protect minority shareholders?

Because of the huge variety of abusive practices to the detriment of minority shareholders, general concepts at the discretionary power of the courts are necessary to fight against such kind of behaviour. Statutory remedies, as the second major branch of protective instruments, have different function: they are obviously and expressly created by national legislation to prevent the prejudice of minority shareholders' interest. Minority shareholders easily can rely on those provisions and claim for call of shareholders' meeting, amendment of the agenda, appointment of an independent auditor or information relating to the business activity of the firm. They can exercise typically statutory remedies as group rights, which means only above a certain threshold these instruments are available. A third group of minority shareholder protection are formed by those rules which provide some procedural opportunity for certain shareholders to defend the interests of the company parallelly with their own interest.

From another approach there should be drawn a distinction between prevention, treatment and rehabilitation phase of minority shareholder protection. These different stages of protection dispose with special functions. Phase of prevention means that company law regulation should be such to avoid the arising conflicts between minority and majority shareholders. It also includes such an approach that dispute resolution mechanisms may be provided within the internal structure of a corporation. These can facilitate and accelerate problem solving and

exclude the need for the involvement of public power into company's internal affairs. Treatment means general concepts and statutory remedies which are applicable in case of a concrete problem arising from conflict of interest between minority and majority shareholders. The third phase of rehabilitation refers to an approach where the maintaining of the company in spite of conflict of interest between minority and other groups of stakeholder worth a lot for the national economy. Therefore the dissolution of the company only can be seen as an *ultima ratio* solution among the different remedies available for minority shareholders.

Chapter III General legal concepts and courts' practice in favour of minorities

III.1 Courts' practice and general principles in Germany in favour of minorities

Right to withdrawal and right to expel

The central point in German court practice is the *behaviour of the shareholders* and the standards of conduct expected from all shareholders. In case of infringement of these standards there are several remedies for other shareholders to break up the relationship with the other shareholders or with the company. Section 61 of the GmbHG Act provides a quite dramatic solution: the courts are entitled to dissolve the company. Dissolution is applicable only when there is a proven substantial ground (*wichtige Grund*) or when it becomes impossible to accomplish the purposes of the company. Both grounds serve as a general remedy for minority shareholders to ask the court to dissolve the company. But here the question immediately arises is this how the minority shareholders want to protect their interests?

As it has been proven it in the previous chapter, the dissolution of the company as a minority shareholder protection form should be an *ultima ratio* solution, because from national economy aspect the saving of a company has at least the same importance as the protection of minority shareholders. For minority shareholders generally, being in an ordinarily functioning company worth more than destroying the company at all. German courts recognized this conflict and developed two other instruments in case of GmbH to protect minority shareholders' interest: the one is the withdrawal from the company (*Austritt*), the other is the expulsion another shareholder from the company (*Ausschlussung*).¹² Besides, it must be mentioned that articles of a GmbH can also provide the right for withdrawal or expulsion with specified conditions.¹³

The two insitutions are closely linked with each other on terms of functioning and ground. In the case of right to withdrawal the aggrieved shareholder seeks to withdraw from the company and is entitled to obtain a fair market value for its interest in the company. In the case of expulsion the aggrieved shareholder is entitled to expel the other shareholder or shareholders abusing their position with purchasing their interest at a fair market price (*Verkehrswert*). In order to be granted a right to withdrawal or expulsion, the shareholder(s) seeking for expulsion or withdrawal should prove a *wichtige Grund*, which is a key concept of German regulation. What should amount to substantive grounds is a key question to be answered, because it determines the extent of minority protection and at least whether these instruments are applicable to minority shareholder protection. The concept is developed continously by German courts, here some examples are introduced in order to prove that these rights are available for minority shareholder protection: the arbitrary exercise of management by a shareholder constitutes a substantive ground. Special factors such as when the

¹² Sandra K. Miller: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University.

¹³ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-143

shareholder's financial return is undesirable, or where the company's purposes change and pose additional risks to the shareholder are also considered as *wichtige Grund*.¹⁴ One source tries to give a general definition for German courts' practice relating to substantive ground: it exists if the other shareholders cannot reasonably be expected to continue their relationship with a shareholder for reasons arising from the person or conduct of that shareholder and if no less dramatic means are available to remedy the situation.¹⁵ From this general description it may be concluded that minority shareholders are entitled using this instrument to defend their interests. The fact they do not necessarily have to prove negligence or intentional misconduct, on the part of the shareholder to be excluded, enhances our view.

To compare the two instruments the minority shareholders' procedural position should be analysed, too. In case of exclusion it requires an action to be brought in the competent court by the company rather than the shareholders. The shareholders resolution authorizing court action to exclude a shareholder requires a majority of three quarters of the votes cast. The shareholder to be excluded cannot himself vote on the resolution.¹⁶ The minority shareholders therefore can force the management of the company by a resolution to initiate proceedings against the majority shareholder and exclude him from the company. But what happens if there are more majority shareholders and only against one majority shareholder can a *wichtige Grund* be proven? In that case it may happen that minority shareholders cannot reach the prescribed three quarters majority, because the other majority shareholder or shareholders defend the interests of the one to be expelled. Another question is whether there is a possibility of suing parallelly more shareholders if the majority position is abused by more

¹⁴ Sandra K. Miller: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University. Besides the above-mentioned grounds there are other types of grounds, but these are not really relevant for our examinations: extreme financial need of the shareholder, a lengthy and expensive illness, a relocation abroad or the inability to perform the requisite duties.

¹⁵ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-144

¹⁶ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-144

shareholders with concerted practice between each other? It cannot be interpreted as broad the expulsion instrument of one shareholder. And these doubts shows the weaknesses of the right to expel, which means that not all of problems coming from majority shareholders abusive practices can be treated effectively by this instrument.

Finally, let us reflect on the problem of compensating the excluded shareholder: the judgement excluding the shareholder must determine the amount of the compensation payable and state that the effectiveness of the exclusion is conditional on the payment of compensation.¹⁷ The company can pay this compensation from net earnings or by reducing its registered capital and from the reduced amount repay the value of the shares of the excluded shareholder. Because of the minimum registered capital requirement, usually reducing registered capital is not possible if it is at the minimum level. Another method of compensation is to appoint a transferee who compensates the excluded shareholder for the received shares. But in case of smaller companies it is not sure that easily can be found somebody to act as a transferee. For minority shareholders one thing is sure: if they *de facto* want to expel a minority shareholder, they have to dispose with some form of economic support to use the *Ausschlissung* in a succesful manner.

In the case of the right to withdrawal minority shareholders are in a stronger position from a procedural point of view: the withdrawal does not require court decision, the minority shareholder addresses his declaration of intention to a manager who represents the company.¹⁸ The court only has to intervene when the company does not want to accept the presented substantive ground by the aggrieved shareholder. In order to get a fair compensation, the company and the minority shareholder is face with the same problem as presented with the

¹⁷ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-144.

¹⁸ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-145.

right of expulsion. Here what makes the compensation conflict more serious is that the remaining shareholders probably do not have any interest in compensating the withdrawing shareholder. The affected shareholder nevertheless should protect his interest from a half in-half-out position.

Duty of loyalty, conflicts of interest and equal treatment of shareholders

While in the German court practice the three general concepts mentioned in the title function as complementary rules to protect minority shareholders they are essential to have a broad and well-functioning minority shareholder protection regime. General concepts of protection are necessary because of the huge variety of forms of abuse. In Germany each shareholder owes a certain duty of loyalty (*Treuepflicht*) both to the company and to his fellow shareholders.¹⁹ The application of this general concept was improved by German courts and this is not an unconditional obligation how to behave. It would be quite unrealistic to expect from shareholders to place the interests of the company in every conflict of interest above his own. The application of this doctrine first depends on whether the shareholder has a dominant influence on the company or not. If this condition is fulfilled the other aspect to check is whether the shareholder has abused his position in a selfish way to favour his own interests at the expense of the company. The application of this doctrine clearly illustrates the German way of thinking of a company's social function: it should serve the interests of all stakeholders in a well-balanced way.

The consequences of breaching the duty of loyalty are oriented by the special circumstances under which the infringement of the principle took place: the other shareholders can claim specific performance of a certain standard of loyal conduct like voting against or in favour of a certain resolution, it could serve as a *wichtige Grund* for the

¹⁹ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23.09. § p.23-123.

expulsion of the concerned shareholder. The resolutions against the duty of loyalty principle can be voidable (*anfechtbar*) or invalid per se (*nichtig*).²⁰

The principle of equal treatment (*Gleichbehandlungsgrundsatz*) requires that no shareholder be arbitrarily subjected to unequal treatment either by the company or by his fellow shareholders unless he gives his consent to such unequal treatment.²¹ Albeit, this principle does not exclude the creation of privileged rights, special rights to consent or approval and preferential shares. In these cases the shareholders may consent with the non-equal treatment of themselves in the articles of association. This of course significantly decreases the importance of that principle from minority shareholder protection aspect since the will of majority determines which is going to be included into the articles of association. Nevertheless, equal treatment provides another ground for the minority shareholders to attack certain decisions of majority or management in favour or detriment of certain members of the company.

The most disputed principle is the 'conflict of interest'- related exclusions from decisions-making processes of certain shareholders. This is a half court improved and a half statutory-based instrument to protect minority shareholders: Section 47(4) of the GmbH Act enumerates four cases when shareholders are stopped from voting when conflict of interest is at issue: discharging from responsibility, releasing from a liability, related party transactions and suits between the company and the concerned shareholder. The importance of the courts comes with the possibility of applying this bar of voting in cases analogous to the above-mentioned situations. The interpretation of this principle is well-developed by German courts: the core point in deciding whether to let a shareholder vote in a certain decision-making or not

²⁰ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-123.

²¹ Rüster, Bernd (editor): Business transactions in Germany, Looseleaf, first published in 1983, New York, 23. 09. § p.23-123.

is dependent on the presence of a *wichtige Grund*.²² Even the personally most significant resolutions can be taken with the participation of the concerned shareholder, because there is no prohibition for the shareholder to protect his legitimate interests with his participation. But when a substantive cause to the future detriment of the shareholder should be taken into account in determining a question, the exclusion of the shareholder becomes a legitimate expectancy from the other shareholders point of view.

III.2 Courts' practice in France in favour of minority shareholders

In France the courts have created two kinds of instruments in order to protect minority shareholders' position: one is the appointment of a temporary receiver (*administrateur provisoire*), the other is the concept of *abuse de majorité*. The dissolution of a company ordered by court is also examined here, because a general definition is applicable by French jurisdiction.

Appointment of an administrateur provisoire

If the minority shareholders petition, the court appoints a temporary receiver in case of a blocked decision-making because of a serious breakdown of trust in the shareholders' meeting. Here the court is entitled to define the powers of the temporary receiver, but basically it entitles the appointed person to manage the affairs of the company in lieu of the existing management until an agreement is reached between the different groups of shareholders to direct the management.²³ This solution gives a quite significant discretionary

²² Bernd gives a few examples from German Federal Court of Justice's practice: a shareholder can vote on resolutions regarding his appointment or removal as managing director, *unless* his removal for cause is present. Furthermore, a shareholder is not precluded from voting on resolutions even if they affect him primarily and exclusively if those resolutions concern share capital increase or the redemption of his share. But if the shareholder's exclusion is at issue for cause he is barred from voting.

²³ Company Law in Europe, Company Law In France (Section D), Managing Editor: Shaun W. Thorpe LLB, Dotesios Ltd., Trowbridge, Wiltshire, Great Britain, Section D, p. D 69 [188].

power to the minority shareholders and for the competent court. What are the facts that court has to examine in order to grant an appointment for the minority shareholders?

Abuse of the majority position (*abuse de majorité*)

French courts faced up to the same problem as is seen in the *business judgement* doctrine of Anglo-Saxon jurisdictions. A limit should be drawn between the internal business decisions of the management and courts' power to intervene into the internal life of a company and take resolutions instead of the competent organ of the company. Management decisions should be protected to such an extent where the abuse of majority power is so obvious that the reliance on the concept of internal business decision would create an unjustifiable situation. French courts therefore adopted a restricted view of the notion of abuse of majority. Not all disputed decisions relating to the management of the company amount to abuse of majority. Here usually those decisions are considered as abuse of the majority position, which serves *only* personal interests of the majority. The court is entitled to cancel the concerned decision, appoint a temporary receiver and/or award damages to the plaintiffs.²⁴

Dissolution of company ordered by court

French law provides for anticipatory dissolution of a company for 'valid reasons' including nonperformance of one's obligations or discord among members. Dissolution is a remedy available to shareholders of the SARL who have irreconcilable grievances with one another. According to Sarah K. Miller the statute provides no guidance as to the definition of

²⁴ Company Law in Europe, Company Law In France (Section D), Managing Editor: Shaun W. Thorpe LLB, Dotesios Ltd., Trowbridge, Wiltshire, Great Britain, Section D, p. D 69 [189]

'valid reasons' and there is virtually no case law to elaborate on the concept.²⁵ In contrast to German law, in French law there is no other way out from the situation of paralyzing the operation of the company than the dissolution remedy. Our conclusion that French law is more inflexible from minority shareholder protection aspects is enhanced by this fact.

III. 3 Courts' practice and common law doctrines in the United Kingdom in favour of minority shareholders

Under this subsection the common law approach towards a company's internal conflicts is analysed and the possible remedies available for minority shareholders are introduced. The traditional viewpoint of common law is extremely rigid from a contemporary aspect: it is based on the principle of separate corporate personality and a reluctance to become involved in a company's internal management.²⁶ There are two sides of this passive behaviour of the common law courts.

The business judgement rule and its exceptions in the *Foss vs. Harbottle* decision

The so-called '*business judgement rule*', as a first aspect, sets certain limits for courts to intervene into the internal business decisions of a company. It is developed under the common law and nowadays has utmost importance in corporate litigation in the United Kingdom and in United States. The origins of this doctrine dates back over 250 years in English law to the *case Charitable Corporation vs. Sutton*.²⁷ The rationale behind the rule is that it acknowledges human fallibility and encourages competent individuals to become directors who otherwise might decline for fear of personal liability. Another justification for

²⁵ Sandra K. Miller: Minority shareholder oppression in the private company in the European Community: a comparative analysis of the German, United Kingdom and French close corporation problem, Cornell International Law Journal 1997, Cornell University.

²⁶ Company Law in Europe, Company Law In United Kingdom (Section D), Managing Editor: Shaun W. Thorpe LLB, Dotesios Ltd. Trowbridge, Wiltshire, Great Britain, Section O, p. O 68 [201].

²⁷ Dennis J. Block, Nancy E. Barton, Stephen A. Radin: The business judgement rule- fiduciary duties of corporate directors, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 9.

the rule is that it recognizes that business decisions frequently entail risk and uncertainty. Corporate decision makers should be permitted to act decisively and with a relative freedom from a judge's or jury's subsequent second guessing.²⁸

The other aspect is closely linked to the above-mentioned and governed by the famous *Foss vs. Harbottle* decision.²⁹ In this case the totally weak position of minority shareholders lacking proactive attitude of common law courts had been proven, which is nevertheless justified by the above-mentioned one side of the *business judgement rule*. At the shareholders' meeting the majority of shareholders voted against the legal proceedings aiming the directors to be held liable for some fraudulent acts. Majority shareholders therefore barred the minority shareholders from protecting their and the company's interests in the name of the company. The doctrine denies the different interests of internal groups existing within the company and only treats the conflicts between the company and the outside world. Common law courts do not consider it as public interest, as a main rule, to protect minority shareholders. It holds that the company itself has to represent its claims against those who have done some alleged wrong against the company. For minority shareholders the consequence of that approach is that they cannot sue the majority or the management nor under own name, neither in the name of the company. This latter is not accessible for them because of the majority principle as we have seen in the concrete case.

Understanding the problems arising from the strict application of the doctrine, courts created some exceptions derogating from the main rule, among which there are minority shareholder protection instruments. The *Foss vs. Harbottle* rule cannot be invoked where the act complained of constitutes a 'fraud on the minority'. In the *Lindley MR in Allen vs. Gold Reefs of West Africa* case the court held that an act will be considered to constitute a fraud on the

²⁸ Dennis J. Block, Nancy E. Barton, Stephen A. Radin: The business judgement rule- fiduciary duties of corporate directors, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 12-13.

²⁹ Doing business in the United Kingdom, Chapter 19 Types of Business Vehicles, Editor: Barbara Ford, Looseleaf, first published 1985, New York, p. 18-33 point f,

minority if it is a resolution which is not passed bona fide for the benefit of the company *as a whole*. In *Evershed MR in Greenhalg vs. Arderne Cinemas Ltd.* the court states that an act constitutes a fraud on minority if its effect is to discriminate between the majority shareholders and the minority shareholders so as to give to the former an advantage of which the latter would be deprived. From these cases it is obvious that common law uses the same standards as civil law systems to determine which acts create an abuse of the majority position. There it is the company's interest as a whole or the minority shareholders' special interest which serve as indicators to amount whether minority shareholders suffered detriment or not.

Duty of loyalty

Duty of loyalty exists relating to controlling shareholders and towards directors of the company. Under this section both types of this principle and its special relationship with the business judgment doctrine are dealt with.

At the centre of the directors' duty of loyalty the conflict of interest with the corporation is found. Transactions between a corporation and one or more of its directors and transactions between corporations having one or more common directors in today's common law are not automatically voidable, but there is a need of approval by some neutral decision-making body.³⁰ Here immediately arises the question: are minority shareholders able to control such types of transactions because of the need of approval by a neutral majority? If majority is in a special relationship with the concerned director, it cannot be considered as neutral. That means an approval by the neutral part of other shareholders, which practically means the minority shareholders' majority approval. Common law approach therefore

³⁰ This means a disclosure and approval by the majority of disinterested directors or by the majority of shareholders. See detailed in Dennis J. Block, Nancy E. Barton, Stephen A. Radin: *The business judgement rule-fiduciary duties of corporate directors*, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 265-293.

satisfactorily defends the interests of minority shareholders in case of conflicts of interest with a director.

In the case of controlling shareholders' duty of loyalty the minority shareholder protection feature of the principle is more dominant. As we have seen in Germany as well, the common law approach also takes into consideration the own economic interests of the controlling shareholders. The duty of loyalty is not an absolute and unconditional obligation enforcing the controlling shareholders to favour the minority. For example a controlling shareholder is not obliged to sell its share merely because the sale would profit the minority. Even more, controlling shareholder is entitled to sell its shares at a premium not available to other shareholders with no controlling block of shares.³¹

In the case of controlling shareholders standing on both sides of the transaction they are obliged to prove the fairness of the transaction.³² Otherwise, if from the transaction a benefit is derived for the controlling shareholder at the expense of minority shareholders, the transaction is voidable before court on the grounds of infringement of the duty of loyalty principle. To sum up, the controlling shareholders and the directors are allowed to act according to their reasonable economic interests, but this cannot lead to unfair practices favouring themselves on the detriment of the minority shareholders.

Duty of care

The duty of care principle means a standard for directors to act as a person in a like position would act under similar circumstances. Duty of care complements the business

³¹ Dennis J. Block, Nancy E. Barton, Stephen A. Radin: The business judgement rule- fiduciary duties of corporate directors, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 350.

³² According to U.S court practice the concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed, disclosed to the directors and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects and any other elements that affects the intrinsic or inherent value of a company's stock. From Delaware Supreme Court (1983) in *Weinberger vs. UOP Inc.*

judgement rule's exceptions, it creates a general leeway for directors and positive grounds for minority shareholders to hold a fraudulent director liable. If a director is able to prove that he or she acted according to the duty of care principle, no liability can be charged on him. The elements of the duty of care are the following: the director should act in good faith, which means not to act in an unlawful way and not to rely upon information that a director knows to be untrue. Directors should act with care, which expresses the need to pay attention and to act diligently. They shall act as an ordinarily prudent person in a like position under similar circumstances. The first element includes acting with common sense and practical wisdom, the second refers to the nature and extent of a director's role varying by background, qualifications, size, complexity and location of the company's activity. The last 'under similar circumstances' term refers to the overall factual circumstances of the case. Director also has to reasonably believe that he acts in the best interests of the corporation. Reasonableness refers to an objective standard, which takes all the circumstances into consideration not the subjective view of the director.³³ However the duty of care principle does not focus on minority shareholder protection primarily, it can help a lot for minority shareholders how to demonstrate the abuse of their position.

Duty of disclosure

As an auxiliary principle from minority shareholder protection point of view, disclosure obligation help indirectly to minority shareholders to overview the functioning of the company. Transparent functioning is a major precondition to exercise the statutory minority shareholder rights, too. The principle is closely linked to the duty of loyalty and care, it obliges directors and controlling shareholders to provide fully and fairly all material

³³ Dennis J. Block, Nancy E. Barton, Stephen A. Radin: The business judgement rule- fiduciary duties of corporate directors, 5th edition, Volume I, Aspen Law and Business, New York, 1998 p. 118-119.

information to the decision-makers when a minority shareholder action or a shareholders' action is required.

The advantage of common law technic is, in contrast to civil law, that there is no need for general concepts, but the rule itself creates a flexible instrument for courts to remedy all special situations. In civil law systems there is a need for general concepts complementing the statutory provisions giving enough flexibility for the in advance created rules. Nevertheless it is true that the importance of statutory provisions in common law countries increasing, and on the other side the decisions of the courts are going to have more and more influence on latter cases in civil law countries. In the following chapters attention is turned to the statutory remedies and prove how relevant they are, even in the United Kingdom.

Chapter IV Minority shareholder protection with substantive statutory rules

Substantive statutory protective instruments create the other major branch of minority shareholder protection devices. The structure of this chapter differs from the previous one, since there is a great similarity between the statutory provisions of the three countries. The analysis deals with the distinguishing marks of the national solutions after the general introduction of the several statutory institutions protecting minority shareholders. In general statutory remedies are typically better known for minority shareholders than general principles. The role and discretionary power of the courts is much more limited here. There is no need to comprehend the complicated jurisprudence in order to determine how to use a general principle in favour of our minority shareholder's position in a concrete case. Probably because of these reasons the concept of minority shareholder protection is closer connected with these instruments than with general principles and doctrines.

An introductory question: How to apply majority rule with minority shareholders in decision-making and company management?

During the life of a company there is a need to take resolutions. These resolutions can be made at different levels: the shareholders meeting, the supervisory board or the level of the Board of Directors could be taken as examples. The decision-making system of a company firstly depends on the structure of the company. In Europe two basic models exist: the one-tier system and the two-tier system model. In the latter the supervisory board represents the interests of the shareholders (owners) against the management in the decision-making process. This model can be found in Germany and partially in France. In the one-tier system there are only two corporate organs which make decisions: shareholders' meeting and Board of Directors. However, in this latter decision-making could be taken at individual levels or in collective forms depending on the nature of the resolution. Decisions needed to be taken for the day-to-day operation of the company usually are made by executive directors individually. Strategic and long-term resolutions usually are taken by the Board of Directors.

There are two conflicting values which should be taken into account when we analyse the decision-making system of a corporation: the effectiveness of directing the affairs of a company on one hand and on the other the representation of the different interests belonging to the groups within the company. These groups are the differently interested shareholders, the employees, the management and the public interest could be also mentioned as a theoretical category. In this chapter our attention is focused on the minority shareholders' involvement into the decision-making structures of the company.

Because the effectiveness of decision-making, as a guiding value, requires the *majority rule* to be adopted in general, there are exceptions and instruments which provide the representation

of the minority shareholders' interest against the majority's will. These exceptions and instruments are going to be dealt with under the following subsection.

IV.1 The right to convene the shareholders' meeting

If minority shareholders' interests require that there should be held a shareholders' meeting in order to discuss something important for the minority shareholders, one form of protection is to entitle them to convene the shareholders meeting. This instrument, however, in itself does not guarantee a resolution adopted according to the interests of the minority shareholders. What is the relevance of this legal device? First of all it provides for minority shareholders' a possibility to call the attention to something. Secondly, after the convening, they have a chance to persuade other shareholders' about their position. In that case they could be able to collect a majority for adopting a solution in favor of their interests. Typically they can combine this right with others, like unanimity voting, right to propose a resolution etc. in order promote their interest.

In France a special court agent (*un mandataire de justice*) is entitled to convene the shareholders' meeting, at the request of any shareholder representing at least one-tenth of the subscribed capital or one or more shareholders who represent at least one-tenth of the shares of the class concerned if a special meeting is petitioned for. In case of an emergency such a petition may be filed by any interested person, hence by a minority shareholder.³⁴ In Germany in the case of GmbH shareholder whose interests represents at least one-tenth of the share capital can demand that the management of the company call a shareholders' meeting. In doing so, the shareholders must indicate the agenda and the reasons why they consider such a meeting necessary. If the company management refuses the petition, the minority

³⁴ Patrick Peguet, Nathalie Carbiner, Jean-Christophe Sabourin: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 76.

shareholders can call the meeting themselves. In case of *Aktiengesellschaft* the articles of association can prescribe a smaller minority than which is determined under the law.³⁵ If the management refuses to call a shareholders' meeting, the minority is entitled to seek a court order authorizing them to call a shareholders' meeting.

The court functions in Germany and France as a filter, it aims to prohibit the unnecessary requests coming from minority shareholders. Nevertheless, the intervention of the court is different in the two countries: in France minority shareholders should go to court *immediately* in order to have a person entitled to call the meeting, meanwhile in Germany court intervention is necessary only when the management refused the minority shareholders' petition. This mechanism is created as a balance between the interests of minority shareholders and the ordinary processing of company. The minority shareholders, without this filter function of the court, would be able to prohibit the normal functioning of the company if permanently they were asking for a shareholders' meeting. (abuse of right) The French court primarily has a discretionary power to designate that agent if it deems it necessary the convening of shareholders meeting.³⁶

The 1985 Companies Act in the United Kingdom establishes certain conditions for those who intend to convene a meeting on a new resolution.³⁷ The petitioners must represent not less than one-twentieth of the total voting rights, or be at least 100 members on whose shares an average of at least 100 pounds per member has been paid up. However, there are additional conditions to be fulfilled: not less than six weeks before the meeting a copy of the proposed resolution signed by petitioners should be deposited in the company's registered office. This act creates an obligation for the company to circulate and notice the shareholders on the proposed resolution. The meeting requisited should be held not less than six weeks

³⁵ Aktiengesetz 122§(1)

³⁶ Yves Guyon: France p. 97. In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

³⁷ Section 376 and 377 Companies Act 1985.

from the notice. This timing requirement puts a major burden on minority shareholders' right to call a meeting.³⁸

A final remark to minority shareholders' right to call a meeting: in every examined legislation it functions as a group right principally, which means that the threshold is defined according to the percentage of voting power or subscribed capital. The linking of this threshold in an optional way to voting power/subscribed capital would protect better the interests of minority shareholders, since subscribed capital percentage does not express the actual degree of control of the concerned group of shareholders.³⁹ Voting power, on the other side, in the era of shareholder voting agreements and multiple voting rights is not in close connection with subscribed capital percentage. Therefore a shareholder with a relatively high percentage of subscribed capital could be in an 'under minority threshold' position.

IV.2 The right to propose or amend the agenda of shareholders' meeting

This right has a close relationship with the one described under Subsection 1 of this Chapter. Minority shareholders' are able to present their proposals before the shareholders' meeting and to persuade the majority of their position. In Germany and France shareholders either individually or collectively should represent at least 10% or 5% of corporate subscribed capital to be entitled. In the case of corporations having a more substantial corporate capital smaller thresholds are sufficient (1/2% or 1%) according to articles of association.⁴⁰ In the case of limited liability companies French law is silent on this subject. Minority shareholders therefore are not able as a main rule to claim a resolution be put on the agenda, unless the

³⁸ Andrew P. Johnstone: United Kingdom In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 245.

³⁹ A concrete example could be a group of shareholders with a 9% of subscribed capital and with, due to multiple voting rights of some of the members within the group, 16% of voting power. (The threshold is 10% of subscribed capital.) Here if instead of the subscribed capital requirement the voting power standard were applied, the shareholders would be able to protect their 9% ownership interest with a 16% of actual control power.

⁴⁰ Yves Guyon: France p. 100 and Theodor Baums: Germany p. 124 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wyneersch, Kluwer Law International, 1999

Articles and by-laws expressly provide for such, or if the minority petition the court to appoint *un mandataire de justice*.⁴¹ This right prohibits the majority avoiding the questions raised by minority shareholders. In itself, however, this right is not capable of defending minority shareholders' against the oppression of majority, but it helps 'to hear their voice'. Another strategy of how to use this right effectively could be to present such problems or proposals in which the majority itself is divided and because of the need to make a resolution for the proposed question the outcome may be to have a resolution in favor of the minority shareholders.⁴²

It is necessary to provide the relevant information (agenda) to the minority shareholders in time in order to use their right effectively. This is really problematic in case of bearer shares, when the company cannot identify its shareholders personally. In this case, the convening notice could only be taken by press announcement. In France, a preliminary notice (*l'avis de réunion*) must be published in an official journal (*Bulletin officiel des annonces légales obligatoires*- BALO) at least 30 days prior to the date of the meeting. The violation of this rule may entail the nullity of the general meeting.⁴³ In Germany, the convening of the general meeting must be published in the Federal Bulletin.⁴⁴ The articles of association of the corporation may provide for additional gazettes, like daily newspapers and the stock exchange regulation also can prescribe some mandatory publications.⁴⁵

⁴¹ Patrick Peguet, Nathalie Carbiner, Jean-Christophe Sabourin: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 76.

⁴² It is necessary to mention here a special German device, the right to counter-motion. (Aktiengesetz 124§(3)), which is different from the above-mentioned rights. This is a proposal to take a resolution deviating from the suggestions of the management. Each shareholder is entitled to make counter-motion. See detailed in Theodor Baums: Germany p. 124 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

⁴³ Yves Guyon: France p. 96 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

⁴⁴ Aktiengesetz 121§(3).

⁴⁵ Theodor Baums: Germany p. 118 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

The exercise of this right is governed by strict time-limits. The purpose is to provide for the other shareholders enough time to be prepared for the additional items on the agenda. In France, in case of a public company minority shareholders have a right to react for the published agenda within 10 days following the publication of preliminary notice.

In other types of companies minority shareholder has a special right to request a special notification of the date on which the general meeting will take place 30 days in advance.⁴⁶

This is necessary because there is another rule according to which the right to request an additional item or the modification of the agenda should be exercised 25 days in advance the general shareholders' meeting. These rules, however, should be criticised. Since there is *no automatic* notification about the general shareholder' meeting for minority shareholders in advance, they never can be sure whether the original agenda is acceptable for them or not. Exercising this right effectively, they have to ask the company to give them the special notification on the exact date and agenda, with which they are put into a position to be able to decide whether to exercise their right to propose an additional item or amendment. In our view, an automatic notification would serve much better the aim of the French regulation.

In Germany, the agenda must be published in the Federal Bulletin at least one month before the general meeting. Where a minority of 5% at least requires so, 10 days after the convening of the general meeting the additional items should be published. The consequence of the non-publishment of the additional items required by minority shareholders is that the general meeting cannot make a resolution on them.⁴⁷ This solution jeopardizes the interests of the

⁴⁶ Yves Guyon: France p. 100. In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

⁴⁷ Theodor Baums: Germany p. 120 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999; Aktiengesetz 124§(4).

minority shareholders, because the negligence of the management basically is born by minority shareholders.

The responsibility for determining the contents of the agenda rests with the board or with its chairman in the UK. The policy is clear in this country: the chairman is entitled to reject amendments and alternative proposals, enhancing the position of the directors and management. Another remark describing very adequately this philosophy is that the objection of those proposing an amendment or alternative resolution can be expressed by a vote against the proposed resolution.⁴⁸

The notification in time requirement has similar or even higher importance than in Germany or France. Section 376 of Company Act empowers shareholders holding at least 5% of the voting power or not fewer than 100 shareholders holding shares on which at least 100 pounds has been paid up to require directors to circulate to the shareholders in advance of an annual meeting any resolution's text which may be decided on the meeting. But petition of a resolution has to be deposited with the company six weeks before the meeting and only a 21 days' notice is necessary to convene the annual shareholders meeting. Therefore *de facto* minority shareholders are prohibited to use this instrument as a right to put additional items on the agenda. An additional disadvantage for minority shareholders is that they should bear the costs of circulation or at least deposit the sum of circulation in case of company decides to bear the costs.

In case of a dispute on one item of the agenda, the meeting itself is entitled to decide whether it is on the agenda or not. Any member is entitled to petition a special resolution to be decided

⁴⁸ Paul L. Davies: The United Kingdom In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999. p. 346.

on a meeting, but notice should be given which contains enough particularity to enable other members decide whether or not to attend and vote for the resolution.⁴⁹

IV.3 Decision-making related instruments

Unanimity, derogations from general majority requirements

All the instruments mentioned in the title of this chapter provides strong protection for minority shareholders, since without their consent it is not possible to take a resolution or direct the affairs of the company.

In Germany in the case of a GmbH a three-quarters majority is required to amend the articles of association or to dissolve the corporation. In the case of Aktiengesellschaft the represented share capital should be at least the three-quarter of the total share capital and for amendment a simple majority of votes given is enough.⁵⁰ Here it should be emphasized again the difference between share capital contribution and voting power.⁵¹

In France limited liability companies take ordinary resolutions with an absolute majority meanwhile amending the articles of association or by-laws needs a three-quarters majority of the shares of company. The *société anonyme*'s extraordinary general meeting requires a two-thirds majority of the votes present or represented. The extraordinary general meeting is solely entitled to amend the articles of association and by-laws of the companies.⁵²

In the United Kingdom there are general meetings which can be attended by all members except those holding shares without that right. Class meetings may be attended only by

⁴⁹ Andrew P. Johnstone: United Kingdom In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 246.

⁵⁰ Matthias W. Stecher: Germany in Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 90.

⁵¹ Shareholders with multiplied voting rights therefore only can amend the articles of association if they represent the three-quarter of subscribed share capital. This mechanism protects very effectively the interests of minority shareholders, since it turns attention to the actual control power and the ownership threshold at the same time.

⁵² Patrick Peguet, Nathalie Carbiner, Jean-Christophe Sabourin: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 76.

holders of shares of the relevant class. This latter type of meetings usually are convened when resolutions affecting the special type of class shares are in question. Ordinary resolutions are passed by a simple majority. Extraordinary majority is prescribed either by the statutory provisions or by the articles of association. The typical examples for extraordinary majority are: winding up, merger, amending the articles of association, amendment of memorandum relating objects of company. In the articles of association unanimity may be required for any type of resolution.⁵³

Voting rights

From minority protection aspects these questions have absolute primacy. Voting rights significantly influence the question of how to reach majority or the necessary threshold to adopt a decision. The articles of association basically determines how many votes does a shareholder could have as a maximum or which classes of shares do not entitle their owner to vote. In addition, certain types of shares could entitle their owner or the representative of the owner for multiplied voting or for a veto right in some matters.

German and French law are dominated by the 'one share, one vote' principle.⁵⁴ However, there are some exceptions where a shareholder is not entitled to vote: in case of non-voting shares which provide privileged dividends, conflicts of interest, lack of formalities or non-execution of an obligation.⁵⁵

⁵³ Andrew P. Johnstone: United Kingdom In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 245.

⁵⁴ Aktiengesetz 12§(1)

⁵⁵ Yves Guyon: France p. 104. In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999.

For minority protection a 'conflict of interest' situation is a typical example where the shareholder who is personally interested and affected in the resolution is not entitled to vote.⁵⁶

In France the articles of association may confer a double voting right to holders of registered shares for at least two years. From a subscribed capital aspect a shareholder could be taken as a minority shareholder in that case, but the voting rights conferred to this shareholders may be more than the half of the votes at the shareholders meeting.⁵⁷ Multiplied voting rights therefore could be considered as a method creating ostensible majorities and minorities. In Germany multiple voting rights were inadmissible until the enacting of the '*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*' according to which specific approval is necessary from the Secretary of Commerce in order to grant these rights.⁵⁸ Today, under certain circumstances, preferred stock without voting rights may be issued and on the other side, with the mentioned approval, multiple voting rights are permitted, but their practical significance is irrelevant.⁵⁹

IV.4 Right to information

From a minority protection aspect the aim of this right is to provide the shareholder with the information necessary to exercise its minority status- related right. To put it simply, this legal device has a complementary character. Right to information can be exercised in written or in oral form, during a personal meeting with a management or at the shareholders'

⁵⁶ Concluding a contract between a manager and a company, determining the salary of a manager who is the owner of the company etc.

⁵⁷ In a hypothetical example if the minority shareholder holds the 26% of the subscribed capital, he is entitled to the 52% of the votes in case of a double voting right. The remaining 48% of the votes is shared between shareholders of the 74% of subscribed capital. The 'minority' shareholder here individually may adopt simple majority decisions if only the voting power matters.

⁵⁸ Theodor Baums: Germany In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999; p 125.

⁵⁹ Matthias W. Stecher: Germany In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 90.

meeting. The scope of this right covers all the information which can be provided by management by documents or by experts, which relates to the functioning of the company in all aspects.

In Germany, the management is obliged to provide information in accordance with the principles conscientious and loyal account.⁶⁰ As Bauns notes, it must be complete and correct, the management has very limited grounds to excuse itself. Of course, in case of complex issues, there is a time which the shareholders should give to the management to elaborate the answer.⁶¹

The limits of right to information: misuse of right to information, if it would lead to disadvantages of the company.

According to the 132§. of the *Aktiengesetz*, this right is enforceable before courts. What is more important, wrong or incomplete information could serve as a basis for annulment of a resolution.

In France, which is a counter-example of United Kingdom from a right to information aspect, at the moment of the convening notice any shareholder is entitled to submit written questions to the managers. The chairman is obliged to reply to all questions, even those without any real interest, which reflects a totally distinct policy of what UK has. Because of abusive practices the chairman is entitled to use filter mechanisms such as officers of the company or special discussions to avoid superfluous administration tasks. Any shareholder with at least 10 % of the corporate capital may submit written questions relating to any issue jeopardizing the continuance of business activity. A general right to access is provided for the last three years' accounts and documents, limited by the protection of business secrets of the company.⁶²

⁶⁰ Aktiengesetz 131§(2).

⁶¹ Theodor Bauns: Germany p. 121 In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999

⁶² Yves Guyon: France in Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999. p. 101-102.

In the United Kingdom shareholders have no general right to ask questions at the general meeting, especially questions outside of the scope of the business. Nevertheless, a fairly common practice has evolved at companies general meetings: a session of general questions and answers is held when the annual report and accounts come up for discussion.⁶³

The right to information is also very limited in British common and statutory law. There is no general right to access the books and accounts of the company and in exceptional cases proof of proper purpose is still necessary. Only a partial functional substitute exists which provides access to the Registrar of Companies for public officials and members of the company. Here ordinary and extraordinary resolutions can be examined and copied, but there is no access to managerial information or directors' decision.

IV.5 Minority rights in relation to independent auditing and supervision

In Germany in case of GmbH statutory provisions do not provide minority shareholders with any such rights; however, they may be included in the Articles of Association. In case of AG shareholder can, with a simple majority, appoint a so-called *Sonderprüfer*. If shareholders cannot reach a simple majority, minority shareholders with a 1/10 % of share capital may request the court to order the special audit. Additionally, minority shareholders with 1/20 % of share capital can request the court to order a special audit when there are grounds to assume that certain items are not insignificantly undervalued in the year-end balance sheet or that an appendix to the annual report does not contain all or some of the required information.⁶⁴

In the United Kingdom the Department of Trade may appoint investigators to investigate the affairs of the company and report on them in the circumstances if an application is made by

⁶³ Paul L. Davies: The United Kingdom In Shareholder voting rights and practices in Europe and the United States, Editors T. Baums and E. Wymeersch, Kluwer Law International, 1999. p 351

⁶⁴ Matthias W. Stecher: Germany In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 92.

not less than 200 members or members holding at least 10% of the issued share capital. In practice such an appointment is very rare.⁶⁵

In France both in SA and SARL the shareholder in exercise of the rights of communication and information may be assisted by an expert registered on a list kept with the court. Shareholders with 10% of registered capital are entitled to ask the court for the appointment of an expert to report on one or several management operations.⁶⁶

IV.6 Minority shareholders' protection in a takeover context: mandatory bids, equitable price, the right and obligation to squeeze-out, complementary rules

Before introducing and evaluating the protection rules of takeovers it should be determined what really a takeover is and why and from whom the target company's shareholders should be protected. Understanding the economic reasons behind the regulation gives the chance to measure how effective is present minority shareholder regulation.

First let's focus on the definition of the takeover itself: takeover is the acquisition of ownership or control of a corporation. According to Black's Law dictionary there are two types of takeovers: friendly and hostile.⁶⁷ In the first case the company's board of directors approval is present, meanwhile in the latter the takeover is resisted by the target corporation's board of directors. However this concept mirrors the Anglo-Saxon corporate structure, for a starting point it serves well the defining of takeover. The methods of takeover are different: merger, acquisition of shares or assets. To create a European definition for takeover let us use the proposal for a 13th Directive on company law concerning takeover and other general bids (in the following: Takover Directive).⁶⁸ According to Article 2 it means a public offer made to

⁶⁵ Andrew P. Johnstone: United Kingdom In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 246.

⁶⁶ Patrick Peguet, Nathalie Carbiner, Jean-Christophe Sabourin: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 76.

⁶⁷ Black's Law Dictionary, 7th edition, West Group, St. Paul, Minn. 1999, Bryan E. Garner Editor in Chief

⁶⁸ Directive of the European Parliament and of the Council on takeover bids, 30 March, 2004, In Baums-Thoma (ed.): Takeover Laws in Europe, July 2003, Cologne, Germany

the holders of the securities of a company to acquire all or some of the said securities, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law.

The second phase of analysis concentrates on why and from whom minority shareholders should be protected. Here minority shareholders are understood as those who are not in the actual control position of the company. Their interest can conflict with the interests of majority shareholders, the actual management or the acquiring company's shareholders. Majority shareholders could be interested in selling all shares of the company or just their own shares, which provides the actual control of the company. In the first case minority shareholders are able to prevent the company from an advantageous transaction saying that they do not want to sell their shares. Here they are in a position to prevent majority shareholders to sell their shares if the potential acquiring company is only interested in purchasing all of the shares. In the second case minority shareholders are exempted from deciding whether they want to stay in the company with the new shareholder exercising actual control. In this case minority shareholders are fully frozen into their minority position since they are not able to sell their shares because exercising actual control does not make it necessary for the acquirer the purchase of remaining shares above a certain threshold.⁶⁹ The shares of minority become valueless therefore and both the new and the former majority are in conflict with the minority shareholders.

The other channel of conflict of interests exists between target company's management and minority shareholders. Management has many ways to help another company to takeover the target company. With an intentional bad management the value of shares decreases and attracts the attention of other competitors. Here minority shareholders cannot prohibit the

⁶⁹ In a hypothetical example if the acquiring company purchased 88% of shares and exercises a 88% of voting power in the company and supposing that there are no unanimity requirements in the articles of association only 75% supermajority rules, the acquiring company holds actual full control without any restrictions. It can freely amend the articles of association, appoint management, decide on dividends etc.

purchase of their shares at a price far below valid market price. On the opposite management can prevent the shareholders and among them minority shareholders from a highly advantageous takeover transaction if their interest is to preserve their management position. This latter case is much more probable in Anglo-Saxon jurisdictions where the powers of management are higher.

To sum up minority shareholders should be protected from the abusive practices of majority shareholders and management in order to preserve the real market value of their shares and not allow the holding of a minority position to be meaningless. On the other side takeover regulation should protect the interests of majority shareholders and acquiring company's interests, since minority shareholders themselves are able to abuse their position under certain circumstances.

What background did have the different countries examined in this paper from a takeover regulation aspect? In France and in the United Kingdom takeover bids were a well-known phenomenon. The situation was quite different in Germany. The occurrence of even friendly takeovers was relatively seldom, much less hostile takeovers, and there was no takeover statute at all.⁷⁰ This situation encouraged the community law legislation to introduce a minimum level of legislation not precluding Member States from the possibility to introduce or keep broader and stricter provisions.

In the following attention is turned to those instruments which primarily focus on the protection of minority shareholders in a takeover context, therefore not all takeover-related instruments are dealt with. First comes the examination of the role of mandatory bids, than the

⁷⁰ There are many reasons why in Germany the role of takeovers is insignificant: the number of stock corporations is relatively low, the universal bank-system and bank-centered corporate finance, strict merger control, labour representation, minimum capital requirements, prohibition of acquiring proper shares, two-tier management system, voting right restrictions. For more details see Klaus J. Hopt: *European Takeover Regulation: Barriers to and problems of Harmonizing Takeover Law in the European Community* In Klaus Hopt, Eddy Wymeersch (ed.): *European takeovers- Law and practice*, Chapter 6, 1992, London p. 167-172.

squeeze-out right and sell-out rights and other complementary provisions like the concept of equitable or fair price in the Takeover Directive and in UK, French and German national legislations.

Mandatory bids

Article 5 of the Takeover Directive expressly refers to the protection of minority shareholders with a mandatory bid at an equitable price. Under this section both elements are analysed.

It does make sense to start with Community legislation, because the wording of Article 5 Point 1. is general enough to understand the policy behind mandatory bids. The central point in the provision is that the natural or legal person, with persons acting in concert with him, as a result of the acquisition of securities in addition to those which are held by that person before, directly or indirectly give him the *control* of the company. The approach used by the Directive enhances our position that much more the actual control matters from minority shareholder protection than the percentage of ownership. The Directive does not use a concrete threshold but the concept of control to determine the scope of minority shareholder protection. Under such circumstances bidder is obliged to address its offer to all holders of shares for all their holdings at an equitable price.

In United Kingdom one of the cornerstones of the Takeover Code, which is a non-statutory code, is Rule 9: any person or group of people acting in concert who acquire 30% or more of the voting rights of a company is required to make an offer for all the other shares of that company. In France the threshold for a mandatory takeover bid is 33+ 1/3% or an additional 2% when already having a 33+1/3% with a participation lower than 50%. The mandatory bid procedure is regulated in Regulation Number 89/03 of the Stock Exchange Commission (C.O.B.) relating to takeovers and acquisitions of controlling interests. The reasoning behind the rule is the same as we see in Community legislation: the control of the company passes

into one hand by the acquisition, meanwhile before the takeover the company was controlled by another controller or was not controlled at all. The passing of control usually involves the payment of a premium for the acquisition of control, not just a market price for the controlling shares. Law should provide an equitable share of that premium among all shareholders not allowing only the controlling shareholder to receive that. The acquisition of the economic benefit arising out from the takeover generates inherent conflicts between the shareholders of the target company and the rule prohibits and settles in advance the problem. The possible conflict with new controlling shareholders also indicates the need for a right whereby shareholders are entitled to sell out of the company.⁷¹

We referred to the different background in Germany where takeovers and even hostile takeovers are very rare. Part 4 Section 29 of the Securities Acquisitions and Takeovers Act of December 20, 2001 defines takeover bids as bids that are intended to acquire control and control means the holding of at least 30 % of voting rights of the target company. Therefore after a long time Germany accepted takeover regulation and the mandatory bid instrument.

The concept of equitable or fair price

Article 5 of the Takeover Directive in Point 4 gives some guidance on how to determine the equitable price in a takeover bid: the highest price paid for the same securities by the offeror, or by persons acting in concert with him, over a period of between six and twelve months prior to the bid referred to in paragraph 1 shall be regarded as an equitable price. Nevertheless authorities dealing with takeover bids have a discretionary power to adjust this price according to in advance determined circumstances.⁷²

⁷¹ T. Peter Lee: Takeover regulation in the United Kingdom In Klaus Hopt, Eddy Wymeersch (ed.): European takeovers- Law and practice, Chapter 5 Regulation of Takeovers in selected national legal systems, Butterworths, 1992, London p. 137.

⁷² Concrete examples when adjustment is necessary: highest price was set by agreement between purchaser and seller, market prices have been manipulated, market prices in general or certain market prices have been manipulated by exceptional occurrences. Under some circumstances equitable price may be determined as an average market value over a particular period, the break-up value of a company etc.

Squeeze-out and sell-out right

Takeover Directive's Article 14 deals with the offeror's right to squeeze-out minority shareholders remaining in the company. The Member State does not have discretion power, it should guarantee for those offerors holding a share, after or before acquisition, representing not less than 90 % of the capital of the offeree company to require the holders of remaining securities to sell him at a fair price. The only possible derogation from the rule is that Member States may set a higher threshold until 95 % of the company's capital. Why Directive uses capital representation as threshold indicator, why not voting power? A possible answer can be that if voting power derogates from capital percentage, it is usually more than the capital percentage. Using capital percentage as indicator of majority and minority position means that a less strict threshold is applied. It involves both voting power majority and ownership majority in the same time. Nevertheless it does not entitle voting power majorities to squeeze-out voting power minorities.⁷³ The reason behind this rule is that majority shareholder should be economically able to purchase the remaining shares at a fair price. According to the regulation the maximum amount of shares to be purchased is 10% of the company's capital. Economic reasons behind the squeeze-out rule are that the continued protection of the rights of a small minority imposes disproportionately high cost on the majority owner. As Burkart and Panunzi notes, minority shareholders may use their rights to jeopardize the majority owner's plans with the sole purpose of extorting undue concessions. Acquirer is prevented from exploiting all synergies from takeover. Another economic reason for minority shareholders could be that acquirer would be willing to offer more for a 100 % shares of a

⁷³ A majority with 52% subscribed capital and with 92% voting power is not entitled to squeeze-out and minority is not entitled to require squeeze-out. In this hypothetical example minority with 48% of company's capital should be bought out, which puts an extremely high burden of costs on majority shareholder.

company than a 90%. The premium paid for purchasing the whole amount of shares is divided between all shareholders.⁷⁴

Sell-out right is regulated under Article 15 of the Directive. The structure mirrors those of the squeeze-out right. Minority shareholders are able to compel majority shareholder to buy their shares at the price offered in the preceeding takeover bid. Reasoning behind the rule is the following: after a takeover, the majority owner may abuse his position by extracting private benefits at the expense of the minority shareholders.⁷⁵ What is the relationship between sell-out right and mandatory bid? Mandatory bid enables all shareholders to sell their shares while sell-out only grants the right to sell if majority shareholder holds at least 90 % after the takeover. The sell-out right applies after the completion of a takeover, while mandatory bid rule applies prior to the completion of the bid.

Rules and principles with complementary character

In Takeover Directive and consequently in national legislations there are many rules securing the efficiency of the introduced minority protection rules. Article 3 deals with the equivalent treatment of all holders of securities, the sufficient time and information to be able to make properly informed decision. It obliges board to act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid.

Article 6 provides information on the bid to supervisory authority and employees, Point 3 determined minimal mandatory elements of the bid.

Article 8 deals with disclosure obligations. The function of making a bid public is to ensure market transparency and integrity, the prevention of publication or dissemination false or misleading information.

⁷⁴ Mike Burkart, Fausto Panunzi: Mandatory bids, squeeze-out, sell-out and the dynamics of the tender offer process In Ferrarini, Hopt, Winter and Wymeersch: Reforming Company and Takeover Law in Europe, Chapter 11, p.753-754.

⁷⁵ Mike Burkart, Fausto Panunzi: Mandatory bids, squeeze-out, sell-out and the dynamics of the tender offer process In Ferrarini, Hopt, Winter and Wymeersch: Reforming Company and Takeover Law in Europe, Chapter 11 p. 756.

Article 9 is on the unenforceability of restrictions on the transfer of securities and voting rights: it is prohibited against the offeror during the period of the acceptance of the bid, nor in articles of association neither in contractual agreement between company and holders of securities.

Chapter V Procedural instruments and aspects of minority shareholder protection

V.1 Derivative suits

Under this subsection we turn our attention to the question: are minority shareholders entitled to enforce rights and claims in the name of the company against other shareholders, directors or third parties. The *locus standi* granted for minority shareholders provides them with an effective remedy to hold liable those persons who prejudiced their interests in some way. The reason behind this instrument in every legal system is the same: the lack of confidence in other shareholders and in management leads minority shareholders to defend the interests of company in their own name, hence the company's interest has become the same as what minority shareholders' have because of the abusive practices exercised by management and/or majority shareholders.

In Germany *actio pro socio* was recognized by courts in case of GmbH. The minority shareholders can pursue the legal action only if majority shareholders do not want to enforce them. The limit of the *actio pro socio* is that it only allows to enforce claims which arise from shareholder-company relations, but not from contracts between shareholder and company. It is a great deficiency of *actio pro socio*, since it does not provide a remedy against abusive practices by contracts with majority shareholders. Another problem with the German derivative suit model is that according to the prevailing opinion the individual shareholder cannot pursue any claims which the corporation has against directors or third parties. The scope of derivative suit is highly limited therefore. In the case of *Aktiengesellschaft* a minority

which holds at least 10 % of the share capital can demand that the corporation sue for damages the founders or the members of the board of directors. However, there is no real derivative suit in this latter case, because only the company is allowed to represent its own interests.⁷⁶

In France, the situation is totally the inverse. As a main rule partners and shareholders are not entitled to initiate proceedings on behalf of the company *unless* their actions are based upon the liability of either the manager or the directors in which case they may initiate a derivative action. Starting lawsuits is in general the task of legal representatives, but if they fail to assert claims any of the shareholders individually may initiate proceeding regardless of capital percentage. The lack of threshold provides for a greater flexibility to minority shareholders than in Germany. The weakness of the French model is that minority shareholders are not entitled to act on behalf of the company against another shareholder or a third party.⁷⁷

The rule in *Foss vs. Harbottle* does not prevent minority shareholders from bringing an action in respect of acts which are *ultra vires* the company or illegal. Nevertheless the UK's concept is strongly based on the traditional view: only the company and not every individual shareholder can assert claims on behalf of the company. In the *ultra vires* cases derivative suit aims to prohibit an act beyond the competence of the company. Also a shareholder is entitled to sue in the name of the company when there is a case of exception under the *Foss vs. Harbottle*: e.g. an illegal act when the alleged wrongdoers are in control of the company preventing company from suing in its own name. The most significant problem with the „derivative suits” concept of common law in United Kingdom is that it cannot treat effectively the overlaps between personal claims of shareholder and protection of company by

⁷⁶ Matthias W. Stecher: Germany in Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 94.

⁷⁷ Patrick Peguet, Nathalie Carbiner, Jean-Christophe Sabourin: France In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 80.

individual shareholders. If the committed act is detrimental to company and against a personal interest of a shareholder, the practice is not consistent in deciding whether to grant a derivative suit for the individual or not.⁷⁸

V.2 Winding up of a company

The UK's Insolvency Act from 1986 entitles shareholders to petition the court for the winding up of a company on the grounds that it is *just and equitable* to do so.⁷⁹ This instrument could be useful for those companies where there is a breakdown of trust between shareholders. From practice arise three major branches of cases when just and equitable dissolution of a company is typical. First is expulsion from office, which typically occurs in case of partnerships or closely held corporations. A simple majority can decide on removing a director from office and a three-quarters majority is needed for winding up. Removing the minority shareholder from director position leads to exclusion of him from remuneration and if there is no offer to him purchasing his shares at fair price he absolutely lost all interest in the company. In *Re Westbourne Galleries* the court held that minority shareholders are not entitled to obtain a winding up order on just and equitable ground, even if all the shareholders had reasonable expectation to remain in salaried office, unless it be shown the power [of removal] was not exercised bona fide in the interests of the company or that the grounds for exercising the powers were such that no reasonable man could think that the removal was in the interests of the company.⁸⁰

⁷⁸ Andrew P. Johnstone: United Kingdom In Protection of minority shareholders, series editor: AIJA, volume editor: Matthias W. Stecher, Kluwer Law International, London- The Hague-Boston, first published in 1997, p. 245.

⁷⁹ Company Law in Europe, Company Law In United Kingdom (Section D), Managing Editor: Shaun W. Thorpe LLB, Dotesios Ltd. Trowbridge, Wiltshire, Great Britain, Section O, p. O 68 [202].

⁸⁰ In that case the court applied the 'fraud on minority' doctrine's test, which we dealt with under the derogations from the *Foss vs. Harbottle* rule. For this see Robin Hollington: Minority shareholders' rights, Sweet & Maxwell, 1990 p. 34.

Under the second category those cases are found where minority shareholders loss confidence in the probity of the board of directors. In order to be granted an order minority shareholders should prove fairly extreme facts justifying their position.⁸¹

The third group under which winding up could be obtained is a total deadlock in the management of affairs of a company. Statutory provisions and articles of association usually try to avoid situations where there is an absolute impossibility to make a resolution. Casting vote with the chairman or succession of right to decide from board to general meeting are remedies for deadlock problems. Nevertheless if it is inevitable the deadlock, as a final solution the court can order a winding-up.⁸²

The dissolution of the company is possible under the French and the German law, too. But as we have seen previously, it is regulated in the Corporations Act there and in Germany this is really an exceptional institution behind more frequently used legal devices.⁸³ In France there is a need to prove some valid reasons in order to be granted a dissolution. In the UK the discretionary power of the court seems to be wider and exactly improved tests show the limits of winding up orders.

V.3 Procedural aspects of the business judgement rule: the position of a minority shareholder before a common law court

Holding a director liable for a business decision, even if fraudulent against minority shareholders, is significantly different under common law than in civil law jurisdictions.

⁸¹ In one concrete case the board was dominated by the majority shareholder; the majority shareholder regarded the company as the product of his own labours; majority shareholder tried to buy out minority shareholders at under value. These circumstances proved to be fairly extreme. The court also pointed out that the lack of confidence in directors should be grounded not regarding their private life or affairs but the business of the company. For this see Robin Hollington: *Minority shareholders' rights*, Sweet & Maxwell, 1990 p. 38.

⁸² What do we mean by deadlock is very clearly expressed with the words of Lord Cozens-Hardy: "it is impossible for the partners to place that confidence in each other which each has a right to expect" see detailed In Robin Hollington: *Minority shareholders' rights*, Sweet & Maxwell, 1990 p. 34.

⁸³ In Germany dissolution is applicable only when there is a proven substantial ground (*wichtige Grund*) or when it becomes impossible to accomplish the purposes of the company. Both grounds serve as a general remedy for minority shareholders to ask the court to dissolve the company. In France anticipatory dissolution of a company for 'valid reasons', including nonperformance of one's obligations or discord among members, is available.

Minority shareholders face up with a high burden of proof in order to be granted a remedy from a court. Business judgement rule is a tool of judicial review, not a standard of conduct, therefore it has far-reaching procedural consequences. It creates a presumption that directors or decision-making bodies acted in accordance with each of the elements of the rule: the concerned decision is a business decision, disinterestedness and independence are present, due care, good faith and no abuse of discretion are provided. Also there is a presumption that the challenged decision does not constitute fraud, illegality, ultra vires conduct or waste. Therefore minority shareholder should rebut this presumption by presenting facts against the business judgement rule. Then the directors should bear the burden of proof and only if they are able to prove that they acted according to the duty of care or in way fair to the corporation are free from liability.

Conclusion

The understanding of how the three introduced legal regimes protect minority shareholders give me the possibility to draw some consequences and evaluate in general the situation of minority shareholders protection. Three groups of protective measures were focused on: first taking into consideration those general principles and doctrines which can be used as minority protection methods. Secondly substantive rules, which are present at each phase of the decision-making and in every moment of lifetime of a company. From that aspect it can be differentiated two minority protection legal regimes: a static and a dynamic branch of law. Dynamic is used here as a reference to those rules which protect the interests of minority shareholders in case of a change in the position of control of the company. Mandatory bid, squeeze-out and sell-out rights belong to that group. The other group represents the static state of affairs or the ordinary course of business. Here the decision-making of shareholders' meeting, the appointment and removal of company organs, the need

of information to take resolution according to the best individual interests and the fundamental changes of the company creates the focal points of regulation.

To show how broad is the minority shareholder protection inventory research's scope was extended beyond company law and statutory business law regulation. In the third branch procedural instruments were found in favour of minority shareholders. These instruments are regulated in insolvency acts or in litigation acts.

The first conclusion arises from the fact that there is great variety of abusive practices exercised by company organs. Majority shareholders, management, auditing and accounting organs may jeopardize to a major extent the economic interests of minority shareholders. That makes it inevitable to guarantee for minority a broad range of instruments to defend their interests. The general principles serve well this „heterogeneity problem”, but their advantage is their weakness in the same time. Courts' discretion power, contradicting decisions, financial burden of compensation and the burden of proof on minority indicate the need for other available remedies. In Germany general principles concentrate first and foremost on the behaviour of individual shareholders. This is true both for right to withdrawal and right to expel. The French approach much more focuses on the well- functioning of the company as a whole. The appointment of a temporary receiver and the concept of *abuse the majorité* shows that French legislation concentrates more on conflicts between groups of interest within the company than conflicts between individual shareholders. The United Kingdom, it goes without saying, cannot be compared on the same grounds with German and French jurisdiction. The doctrine-centered body of common law makes minority shareholder protection rules very flexible and concrete at the same time. The exceptions under the *Foss vs. Harbottle* rule are phrased in general terms allowing courts to treat a great variety of cases.

The statutory remedies are available for minority shareholder groups. The actual control is expressed in two ways: in a percentage of share capital or in a percentage of voting power.

We proved that share capital percentage does not indicate the real control power behind the held percentage. Nevertheless, using share capital as a threshold does not create a bar for minority shareholders since if their real control power is higher than their share capital they are not going to use their minority shareholder protection rights at least.

Determination of a threshold should take into consideration two competing values: the proper functioning of a company and real protection of minority shareholders. If threshold is too low, insignificant groups easily can prohibit the normal functioning of a company, while a too high threshold prevents minority from protecting its interests.

Prohibiting the abuse with minority shareholder protection rights can be reached by the involvement of court or a competent administrative body into the exercise of those rights. A common feature in all legislation is the designation of such a body and the entitlement of it to supervise the exercise of such rights.

Another general statement should be made regarding the *form of the company* in question: typically in case of stock corporation (with publicly traded shares) the minority shareholder protection rules are broader in terms of scope, applicability and availability. In Germany, for example in case of limited liability company, right to claim for independent auditing is missing, in France the right to amend the agenda is not provided for minority shareholders of SARL.

An additional remark to *timing requirements*: especially in the United Kingdom but in the other two member states as well timing-requirements prevent minority shareholders from effective use of their rights.

All the consequences stated in this chapter encourages a more simple minority shareholder protection regime from aspects of burden of proof, timing. Court's discretionary power should be reduced to some extent. Economic reasons justifying a better regulation are small-investors

protection and foreign investment attraction. On the other side, minority shareholder protection legislation in all of the three countries are much more developed than in countries of Eastern and Central Europe. The comparison between these two groups of countries is not in the scope of this paper, nevertheless such legislations can serve as best practices for countries in transition.

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