



**CZECH REGULATION OF SQUEEZE OUT IN COMPARATIVE
PERSPECTIVE**

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EXECUTIVE SUMMARY

This thesis examines the relation between the Czech regulation of the Squeeze Out procedure and the Human Right to Property as protected by the European Convention on Human Rights (Protocol No. 1) and the Czech Constitution. The Squeeze Out legislation was one of the most controversial pieces of legislation enacted in the Czech Republic in the last years. This thesis analyzes the Czech Squeeze Out procedure in the light of the European Convention on Human Rights and the Czech Constitution, doing so by way of comparison with the German regulation and contrasting it to the requirements stemming from EC Law. The methodology used is primarily empirical (case studies of the relevant bodies of law) and comparative.

The main objective is to suggest a possible decision of the Czech Constitutional Court concerning the constitutionality of the Squeeze Out regulation and to anticipate the reaction of the European Court on Human Rights in case any of the applications concerning the Czech Squeeze Out procedure reaches its premises.

The practical importance of this thesis lies in its competence to equip minority shareholders, who would like to take legal action or to continue in legal action, with a set of legal arguments which might be used when pursuing the claims first against majority shareholders, and later eventually against the state.

INTRODUCTION

The Human Right to Property is one of the most used terms in this thesis. The question immediately arises; from where does this classical private law institute draw the entitlement to be called a Human Right? What qualifies it as a Human Right? One of the aims of this thesis is to provide the reader with a deeper insight into contemporary violations of this right and thus, indirectly, help answering these questions of general importance, namely why we should protect the Human Right to Property and what this protection should entail today.

The importance of the Right to Property has been disputed or denied in various periods in human history, and when this happened it usually brought greater human catastrophes. History has taught us that the poor are nowhere in a more vulnerable position than in countries where there is no respect for private property; disrespect for the Human Right to Property serves as an accelerator for other human rights violations. All this speaks rather persuasively for the importance of this Human Right and testifies that it deserves a strong place among the other civil as well as economic and social rights.

The protection of Property had a stable place in Roman law as well as in the works of philosophers throughout history (Locke, Mill, Smith etc.). As a Human Right, the Right to Property appears first in the Declaration of Rights of Man and Citizen of 1789; nonetheless, the existence of legal right to property could be traced back to the *Magna Charta Libertatum*. Surprisingly enough, despite the human rights boom almost 200 years later, after the Second World War, the Human Right to Property did not appear easily in Human Rights Treaties. This was mainly due to the different perceptions of the two opposite blocks of whether and what part of this right should be protected. Consequently, the Human Right to Property is not part of the most important binding Human Rights

instruments, that is, the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights. In the Western European Regional Document – European Convention on Human Rights (hereinafter ECHR) – it has appeared only in the first Protocol to the Convention. The Human Right to Property is part of the American Convention as well as the African Charter.

Types of violations of the Right to Property have changed over the time and more and more sophisticated ways of interferences were invented. The Law has coped (in some way¹ or another) with historically the most typical interferences, namely, when a state is directly ‘laying hand’ upon the property of individuals through expropriation or, more indirectly, through the control of use of property, further on through the non-revolutionary nationalizations of property or interferences by pursuing measures of economical or social reforms. Of course, the same cannot be said about revolutionary takings of property (nationalizations, expropriations, etc.) as well as confused reactions after the revolutionary period to the injustices which have occurred; this is nonetheless something that will not be tackled in this thesis.

To my mind a more current type of potential interference with the Right to Property in (contemporary) societies are often hidden interferences through non-public legislation, which are difficult to grasp under classical approaches and which therefore pose more actual danger to individuals. I have in mind here different types of private law regulation, one of them being Squeeze Out, which would have been unacceptable in liberal society of the end of 19th century, but which are today, by the means of globalization and economical and political integration, spreading all over the world.

¹ The reaction to these phenomena from the second half of 20th century was not always appropriate in the sense of attempting to compensate individuals to the largest extent possible but still affordable to the society (and unnecessarily so burdening some individuals), but we can still observe – at least in the West - some general legitimizing patterns.

The question might arise; how could private law, which is in essence contractual, interfere with the human rights at all? There are a few layers to this problem. First of all, the mandatory rules penetrating private law do not provide for contractual voluntary solutions to selected problems any longer. Secondly, even default rules in reality become mandatory as the parties seldom renegotiate them, for different reasons. In company law this becomes even more evident as it merges with the problem of substantive inequality of the parties. To defer from the legislative setting, it is necessary to provide for that in the Statute of a company. The people who establish companies are usually not future minority shareholders. The interests of majority and minority shareholders will often differ; however, the interest of the latter group will not be taken into consideration. Moreover, many minority owners enter into possession of shares *ex post factum*, thus they have no possibility to influence the Statute at the beginning nor they have strength to do so afterwards. This is to say that there is a set of good reasons for taking proper care when enacting private law legislation (either “dispositive” or “mandatory”) to balance the interests of the parties in question, as the rules enacted will often in fact govern the relationships. This also implies that the court should scrutinize such legislation with equal care as public laws in order to find out whether the legislator did not cross its margin or discretion.

The safety net that should protect us from intrusive private law legislation equally as from the public legislation², is in place in numerous countries and provides a reliable mechanism to deal with the interferences with different human rights. Among other safeguards which are in place in democratic political systems, the one I have in mind and I will be dealing with in this thesis is the mechanism for the judicial enforcement of human rights. Ideally this mechanism entails firstly the requirement on the legislator to legislate in

² In case the courts finally accept that there are some problems connected with private law legislation, and that the problems always do not lie in public law.

accordance with the highest degree of protection of human rights, secondly the requirement on the judiciary to take seriously its task of interpretation of legal norms in accordance with the constitution and human rights provisions³, thirdly the review of judicial decisions and constitutional review of the legislation and finally recourse to the international human rights body in case a national system fails. This thesis is going to take the Squeeze Out procedure all the way through the described human rights protection mechanism available in (and outside) the Czech Republic, illustrating how to deal with private law regulation which is potentially infringing the Right to Property or another human right.

This thesis will critically assess the Czech Regulation of the Squeeze Out procedure *vis-à-vis* requirement of protection of the Human Right to Property, under national as well as international human rights instruments. The assessment will be based on comparison with the regulation of this institute in Germany (including the case law of the German Federal Constitutional Court – hereinafter GFCC⁴) as well as with basic principles of protection of the Right to Property under the ECHR (hereinafter ECHR). The methodology I have chosen is primarily **empirical** as it examines the Czech legislation and its application in practice, the German legislation and the decisions of the GFCC and the case law of the European Court on Human Rights (hereinafter ECtHR) in Right to Property cases, and **comparative** as the basis of the critical assessment is grounded on a comparison with different bodies of law.

The reason why I have decided to study the problem of Squeeze Out in this thesis is the fact that it seems to be a perfect illustration of the contemporary threats to the Right to Property (though it might be applicable also to interferences with other human rights). What is even more arresting in this particular case is the process of adoption of the

³ There is such obligation in many countries, among others also in Germany and Czech Republic.

⁴ Though references will be made to some other EU Member States as well.

Squeeze Out legislation in the Czech Republic (including amendments), which raised serious doubts as to the legitimacy of the whole process. All this being put in context of a post-communist country and its budding democracy, a serious fear might occur of having a legislator who once again is not taking Human Rights, and especially the Right to Property, seriously.

One of the first decisions that were to be taken in order to accomplish this thesis was the selection of the country for comparison. It appeared that in order to provide the clearest picture possible and to understand what Squeeze Out is really about, what its advantages are and above all how it should be implemented and used, it was necessary to turn to Germany, one of the first countries which, despite the high protection afforded to Human Rights, has accepted the interference with the right to property of minority shareholders for the sake of better liquidity of capital markets. Moreover, the regulation valid in Germany is a kind of default setting, an inspiration of the Czech legislation and it is therefore very clear when the Czech legislator has diverged from the default and reasons for divergence might be therefore tracked more easily. I have decided to point also to other jurisdictions from time to time in order to achieve clarity or to justify some of the claims I raise.

The selection of another body of law, that is, the ECHR and connected case law, was much easier. It is part of the Czech Legal Order and it is binding (for the legislator and Czech Constitutional Court (hereinafter CCC)) also in the sense that the ECtHR is an ultimate interpreter of the rights protected by the ECHR. Therefore, in reality, the CCC cannot provide less protection to the Right to Property than the ECtHR would. Moreover, the CCC has adopted a very similar proportionality analysis for Property cases to that used by the ECtHR and the case law of the ECtHR is a point of reference in the majority of judgments of the CCC. Therefore it was an inevitable choice to discuss the stance of the

ECtHR if we want to predict the decision of CCC as well as, ultimately, the binding interpretation of the Right to Property by the ECtHR.

The aim of this thesis is to examine whether the Czech Regulation of the Squeeze Out procedure, valid at the time of writing, violates the Right to Property of individuals and therefore whether it is constitutional. This is to be done on the basis of analysis of the principles defended by the CCC in its case law, on the basis of comparison with the ‘default’ German regulation and the case law of the GFCC, on the basis of principles stemming from EC Law and lastly on the basis of anticipated assessment of the legislation by the ECtHR. It should enable us to draw a legal map portraying the present state of protection of the Human Right to Property in the region, which might be of use to the CCC.

Another question I will address in this thesis is whether there are any alternative remedies which different bodies of law (ECHR or EC law) might offer to individuals harmed by the Czech Squeeze Out regulation in case the national system fails. This is one of the reasons why two excursuses to European Law were included. The relevance is clear; European Law has to be applied directly by national courts, it addresses the Squeeze Out procedure through the Secondary legislation (Directive on Takeover Bids), but it also provides us with interesting remedies in case the state is in breach of its obligations and is therefore highly relevant for the case at hand.

The chosen structure of the thesis should respond to the considerations mentioned above. Therefore in Chapter 1 I will outline the regulation of Squeeze Out in the Czech Republic, legal problems of the regulation, empirical data regarding the number of Squeeze Outs as well as a description of the situation which followed the enactment of the regulation. The second Chapter tries to describe and analyze the regulation in Germany, including case law of the GFCC, and sets thus a comparative ‘counterpart’ to the Czech

regulation. In this Chapter I will also make one Excursus concerning European Law, dealing with the more general issues of conflicts between national human rights standards and European Law. The following chapter brings into the picture the ECHR and the case law of the ECtHR, and I analyze the Czech Regulation of Squeeze Out in that light. The last chapter finally deals with the question of constitutionality of the Czech Squeeze Out regulation on basis of the case law of the CCC and other bodies of law which are binding on the Czech Republic, such as the ECHR or European Law; and moreover using additional comparative law arguments derived from the case law of the GFCC.

One of the objectives of this thesis is to suggest possibilities as well as offer some practical tools for minority shareholders whose rights were infringed and who might have the possibility to get redress for the harm inflicted on them by this piece of legislation, which has clearly disregarded their interests.

Finally I would like to clarify what the aim of this thesis is not. The aim is not to discuss the legitimacy of the Squeeze Out procedure per se, but rather the legitimacy of the Czech regulation of Squeeze Out as valid today. I acknowledge that a democratically elected legislator has a certain margin of discretion when deciding policy issues; insofar as the discretion is exercised in a manner guaranteeing protection of human rights of individuals. Therefore the question of legitimacy of the Squeeze Out procedure per se is not the object of research or discussion of this thesis, as the main concern of this paper is the legality of legislation enacted by the Czech legislator rather than the legitimacy of the policy pursued by him.

Chapter I. CZECH REGULATION OF SQUEEZE OUT

1.1. *Origins and social background of the regulation*

Perhaps I should start with a question; what is ‘Squeeze Out’? What is so interesting and peculiar about it in the Czech Republic (hereinafter CR)?

To answer to the first question is not a particularly difficult problem. Squeeze Out is a private law institute, which enables majority shareholder holding certain number of shares in a company unilaterally to decide to Squeeze Out minority shareholders, i.e., to buy out their shares and become the only owner of the company. To answer to the second question we will have to turn a bit to the recent history.

The debate about the necessity to regulate Squeeze Out was leading the Czech Legal Environment from the beginning of the new millennium⁵ and the professional and academic public was prepared to accept some sort of regulation of this institute despite its controversial character as will be shown further. The additional dimension to this discussion was added because of the consequences of ‘Coupon (Voucher) Privatization’⁶ and the complicated ownership structure in many companies at that time. The necessity of regulation was justified as a “full stop” after the Coupon Privatization and in principle it had the necessary public support⁷.

⁵ It all started with the regulation of the Squeeze Out Mergers, for more details see infra part 1.1.1 *Dissolution of Company with the Takeover of the Corporate Assets by the Majority Shareholder*.

⁶ The unique way of privatization of state property in the Czech Republic after the communism. The idea behind was very egalitarian, i.e. every citizen should have participated in privatization through acquisition of shares of state companies on the basis of “Voucher / Coupon books”. Unfortunately, this remarkable idea did not work out because of loops in laws and because people were not informed adequately. The ideological father of this concept is (today’s president) Vaclav Klaus.

⁷ See for example Jarmila Pokorna, *Squeeze-out: ochrana menšinových akcionářů nebo efektivita činnosti akciové společnosti?* Právní fórum; 6/2004.

Moreover, during the period of discussion outlined above, the Directive of the European Parliament and the Council Directive on Takeover Bids⁸ (hereinafter Takeover Bids Directive) has been discussed and finally adopted, what strengthened the consensus on the necessity to regulate the Squeeze Out procedure.

The regulation of Squeeze Out in the Czech Republic was proposed by the MP Vladimír Doležal (the content of which we will address below), and it was passed by Parliament in the beginning of 2005. However, due to evident deficiencies, it was returned by the Senate to the House of Commons as they found the text principally unconstitutional. Nonetheless, the MPs passed the regulation again on the 3rd of March 2005 with a qualified majority. Mistakes, discrepancies and evident divergences from the claimed foreign models to the detriment of the minority shareholders were widely debated and therefore they could be hardly concealed from the MPs at the time⁹ of adoption of Doležal's proposal; however, it seems that it did not cause too much trouble to the majority.

A member of the Upper House of Parliament, Senator Novotný, who actually (among others) filed the Application to the CCC in December 2005, described the situation:

"...on this fraud have participated all of the political parties, as well as the majority of the news media which did not write about the problem as the big companies belong also to the big advertisers. It is a model failure of democratic mission of the media. (...) The law is intentionally bad and it radiates the lobbyist order. (...) [How the law works] has been shown illustratively by the company E.ON, when it squeezed out small shareholders from originally Southmoravian and Southczech Energetics¹⁰ for only one third of its value."¹¹

⁸ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids. This Directive regulates in Art. 15 the squeeze out procedure in the takeover bids context.

⁹ Given that many of them were discussed in the Senate as well as in the governmental proposal, not to mention discussions in academia.

¹⁰ Pending cases. Between minority shareholders were mainly municipalities. The last information available is that an *anonymous* offer came to buy out the claims from *Bystric pod Perštýněm*, municipality that applied to the court for the inadequacy of compensation, for the same value the municipality is suing at the court, but after publicizing the issue, the anonymous offeror stepped back. It is held that the anonymous offer came from E.ON. as in very likely case the municipality wins, the would have to give compensation to all other minority shareholders. Moreover, the reputation harm might also play an important role. See Radek Kedron, *Hospodářské noviny* of July 12th 2007, *Z domova*, 4

Moreover, there was a parallel proposal of indisputably higher quality prepared by the Securities Commission in cooperation with the Ministry of Justice. This proposal intended to implement the Takeover bids Directive. After adoption of Dolezal's proposal, the government tried to change the adopted regulation through this proposal, however, the Parliament resisted and if some parts were adopted in the end, they were adopted in a very restrictive manner¹².

Debates about its unconstitutionality were actual from the beginning; the Constitutional Court had the possibility to address the question of Squeeze Out (in a wider sense)¹³, when it was asked to adjudicate upon the constitutionality of Squeeze Out mergers (Dissolution of company with Assumption of Corporate Assets by Majority Shareholder¹⁴), but the Constitutional Court rejected this application on procedural grounds¹⁵.

At the moment, two applications regarding the constitutionality of the Squeeze Out regulation are pending before the CCC, which, on the 10th of January 2007, postponed the decision as it needed time for further examination of the case. In the media the explanation given was that the CCC is waiting for the decision of the Commission in the infringement

¹¹ See Novotný Jozef, Vladimír Doležal; *Vytěšňuje nový Obchodní zákoník malé akcionáře?* <http://www.literarky.cz/?p=clanek&id=1150>. Translation by the author of this paper.

¹² See infra part 1.2. *Regulation of Squeeze out and its deficiencies*

¹³ The CCC could adjudicate in this case regarding constitutionality of institutes of company law which enable for deprivation of property of the minority shareholders. This might have been *Czech Feldmühle decision*, where the CCC could have set standards for legislation and eventually set back latter abusive legislation of squeeze out.

¹⁴ Art. 220p of the Commercial Code.

¹⁵ See *Problematika squeeze-out stále aktuální*; available at http://zakony.idnes.cz/problematika-squeeze-out-stale-aktualni-ffz-/obchodnipravo.asp?c=A040907_010200_obchodnipravo_3869

proceedings with the Czech Republic. This has of course caused a wave of disapproval in the Czech academic circuits¹⁶.

1.1.1. Dissolution of Company with the Takeover of the Corporate Assets by the Majority Shareholder

The first possibility to Squeeze Out the minority shareholders was introduced into the Czech Legal Order from the 1st of January 2001¹⁷; nevertheless, this Austrian model that was adopted was subjected to criticism from its very beginning. The legislator deals with this institute in the part of the Commercial Code concerning *restructuring of the company* and it is constructed as a dissolution of the company without liquidation of the assets while all the rights and obligations pass to the majority shareholder and the outstanding shareholders are entitled to an adequate compensation. In this model, the company does not exist anymore and it is only the ownership of the assets that is transferred. In order to pass this decision, the majority shareholder has to own at least 90% of the basic capital.

The main criticism concerns the inadequate regulation of the compensation of the outside-standing shareholders (which often follows with difficulties) as well as the expensiveness and the complexity of the process which generally proved inappropriate for business purposes¹⁸. Moreover, the majority shareholder cannot use the name of the company without further conditions (the name has to contain a successional appendix). For all these reasons it never became really fully utilized for the purposes it meant to serve.

¹⁶ Because these procedures have nothing in common. See e.g. Jan Komárek; *Vytlačování malých akcionářů, ochrana ústavnosti a evropské právo*; available at: <http://jinepravo.blogspot.com/2007/01/vytlaovn-malch-akcion-ochrana-stavnosti.html>

¹⁷ See *Czech Commercial Code, Num. 513/1991 Coll., Art. 220p*

¹⁸ Although some Law Offices underline the taxation aspect of the transaction which is more convenient in this case comparing to the classical squeeze out.

As already mentioned, the CCC had the possibility to adjudicate this case (i.e. Squeeze Out in wide sense), but it has decided to reject the application on admissibility grounds despite strong dissent. This was very unfortunate as this decision might have become the *Czech Feldmühle decision*, where the CCC could have set standards for legislation of this kind and eventually set back (through the authority that the CCC decisions have) latter abusive legislation regarding Squeeze Out.

1.1.2. The first regulation of Squeeze Out – in effect from the 3rd of June to the 29th of September 2000

The institute of squeeze was regulated in Art. 183i to Art. 183n of the Czech Commercial Code¹⁹. It enabled the majority shareholder to buy out participation securities from their owners if such a majority shareholder owns 90% of participation (or substitution) securities that amount to 90% of the company's registered capital or participation securities to which at least 90% of voting rights is attached, to ask the management board of the company to call for a General Meeting within 15 days which will decide upon Squeeze Out by a majority of at least 90% of all votes (preferably shareowners and the majority shareholder are entitled to vote). It has to take place at most 3 months after the takeover bid or other way of gaining the necessary majority in the company. The law provided for the 3 month exemption period when any company, fulfilling the conditions, might Squeeze Out the minority shareholders²⁰. The concept of transfer of the ownership of the securities is built upon the German model, when the ownership passes *ex lege* one

¹⁹ Act No. 913 / 1991 Coll., Commercial Code, as valid on the 3rd of June 2005.

²⁰ In these three months a great number of squeeze outs took place - see infra part 1.2. However, not even such a simple thing, as establishing the exemption period, remained without mistake from the legislator as it was completely unclear when the 3 month period begins, therefore majority shareholders rather squeezed out minority shareholders as soon as possible. See Petr Cech, *K čteným problémům právní úpravy výkupu účastnických cenných papírů (squeeze out)*; Právní rozhledy, 18/2005, 651-653

month after the publication of the incorporation of the decision of the General Meeting in the Commercial Registrar²¹.

Before going to the regulation of Squeeze Out I would like to mention the special provision regarding the Redemption offers in connection with takeover bids (183h of the Commercial Code). This provision was introduced into the Czech Legal Order with the coming into effect from the 1st of January 2001 and to some extent resembles sell out²² except for the fact that it is much more demanding upon minority shareholders²³.

The *Sell Out* provision, as envisioned by the Takeover Bids Directive, is still not transposed. However, in the governmental proposal of the new Takeover Bids Law²⁴, the sell out will be construed as an obligation of the majority shareholder to the Additional Takeover Bid, which should be made up to 30 days from the day when the Takeover Bid lost its binding character (through which the majority shareholder has reached the threshold of 90% of voting rights and capital of the company).

1.2. Regulation of Squeeze Out and its deficiencies

²¹ Interestingly, the one month delay in passing of ownership (which differs from the German model), and has no any reason in hand, has in fact never been explained by the legislator, what leaves the impression that it is an unnecessary concept only for the sake of autonomous (understand Czech) solution.

²² Sell out is a mirror rule to the squeeze out, when the minority shareholder has the right to request the majority shareholder to buy her share for a fair price in case the majority shareholder holds more than a certain percentage of shares.

²³ The Redemption offer provisions stipulate that the Czech National Bank may order, upon request by the minority shareholder, the majority shareholder (or persons acting in concert) to buy out the shares of the minority shareholders of the targeted company (if after a successful takeover bid it has acquired the necessary amount of voting rights) in case the majority shareholder (or persons acting with her in concert) have 95% of the voting rights, the company is listed in the Capital Market and there are serious reasons for requesting so. Such a request will be rejected if the situation on the Capital Market enables for the selling of the shares. The company should be delisted afterwards automatically. There is no time limit for such requests of the minority shareholder. Nevertheless the inclusion between the takeover bids provisions (plus calling the company targeted company) can serve as an interpretation instrument speaking in favor of definite character of the right of minority shareholders (3 months perhaps).

²⁴ Available at <http://www.leblog.cz/>; *Návrh ZÁKON o nabídkách převzetí a o změně některých dalších zákonů*

For a better orientation I will highlight the problems in a uniform structure, which I am going to follow also in the next chapters. Given the aim of this thesis, which is to raise important (and hopefully actionable) issues, inevitably some issues of minor importance will be omitted.

The crucial problems of the legislation in effect from the 3rd of June 2005 are:

1. The statute requires that the person who wants to Squeeze Out minority shareholders should either own 90% of *Participation Securities* **or** have at least 90% of all *Voting Rights*. The problem is that the law, as written, may allow the shareholder who has 90% of ground capital but 50% of it consisting of changeable bonds (which are also participation securities) pursue Squeeze Out while in reality holding only 60% of the capital. Similarly, the person holding 90% of voting rights might in reality be the owner of only 45% of shares if the company had made maximum use of its right to issue priority shares and the voting shares so as to amount only to 50% of all shares. On the other hand the Directive (even though it concerns only takeover situations) talks about the necessity to fulfill both requirements simultaneously, what is also the regulation proposed in the new Takeover Bids Law. German Law provides that the majority shareholder has to hold 95% of capital of the company, but it cannot be said that this brings the same risks as the Czech legislation because the problem here lies in the use of term *Participation Securities*. Moreover the GFCC considers the threshold to be a very important guarantee of protection of minority interests. Therefore enabling to Squeeze Out minority without holding even 90% would amount to a violation of the right to property.

2. All owners of participation securities, including changeable and priority bonds, may vote at the General Meeting, but the law does not find it necessary to address the situation (by stipulating the weight of the votes or any other solution).
3. The problems arising in connection with the position of (1) *attaching creditors* and (2) *other third persons with some rights to Participation Securities* belonging to the owners which are to be squeezed out by the majority shareholder.

The second group is overlooked completely; the first one is “solved” in a manner raising great doubts. It is unclear how, when and which (known / unknown attached creditors) should the company inform about the preparation of the Squeeze Out. On the other hand (we hope that only by a mistake of the legislator), it can be inferred from one provision that attached creditors have no entitlement²⁵.

4. Finally, we come to the point that deserves the greatest criticism and that raises the utmost doubts regarding the constitutionality of the regulation: adequate compensation. In fact, the importance of the issue of protection of minority shareholders property interests for the legislator might be detected from the organization of the legal text, where (in a striking difference from the German regulation) the adequate compensation is mentioned somewhere ‘in passing’ in the second paragraph regulating the invitation for the General Meeting²⁶.

The most serious deficiencies are:

- a) The way of setting the amount of **adequate compensation** – the amount is set by the majority shareholder on the basis of the expert opinion elaborated

²⁵ JUDr. Petr Čech, *K četným problémům právní úpravy výkupu účastnických cenných papírů (squeeze out)*, Právní rozhledy, 657-658. In similar cases, however, the interpretation lies on a judge and such a wide discretion is not common even in the Common Law systems. In the case of unfavorable interpretation the redress might come only from the side of Constitutional Court (as other courts can not change the law, only interpret it). Once the interpretation is that the creditors are not entitled to anything, there is no other way. Nonetheless the CCC has ruled that the laws should be interpreted in the constitutionally conform way, which is the interpretation I suggest or as last resort such creditor can apply to the ECHR.

²⁶ Josková, Pelikán, *Squeeze out po Česku*; Právní zpravodaj, no. 6/2005, 7

by an expert appointed and paid by a majority shareholder, contrary to, for example, the German regulation where such expert(s) are appointed by the court²⁷ (what at least to some extent evokes the impression of independence).

COMPARATIVE OBSERVATIONS: Given the greater degree of subjectivity, an expert opinion is recommended by the High Group of Company Experts (after the comparative examination of legal solutions in Member States), and it should come into play only in case there is no other more objective way of settling the compensation; and this only for cases where such an expert is appointed by a court or a Supervising authority²⁸, other variant (the one adopted by the Czech legislator) not being mentioned at all. Besides, the appointment of experts in an objective way / by a court / is for GFCC one of the most important guarantees of protection of minority shareholders²⁹.

- b) Adequate compensation may be paid out also in securities which is perfectly in accordance with Takeover Bids Directive; however, the legislator somehow forgot to add that there must be a possibility for compensation in money if securities are not listed in the regulated market, i.e. as compensation in the Czech Republic a minority shareholder could have easily got unlisted securities with questionable liquidity.

COMPARATIVE OBSERVATIONS: the German *Aktiengesetz* provides for cash settlement as the only possibility. So is the case in France or Belgium. In the UK the situation is different, the Bidder can decide to pay also in Securities, but they have to

²⁷ Petr Cech, *Další zamyšlení nad úpravou nuceného výkupu akcií*, Právní zpravodaj, 7/2005, 11

²⁸ See Report of the high level group of company law experts on issues related to the takeover; Brussels, 10 January 2002, http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf

²⁹ See German Federal Constitutional Court, Judgment of May 30th 2007; *BVerfG, 1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)*; available at www.bundesverfassungsgericht.de

be liquid³⁰. This requirement also follows from the Art. 15 of the Directive on Takeover Bids because of the obligation of the Member States to *ensure a fair price* of the shares.

- c) The guarantee of payment of compensation. There was no requirement to deposit the funds for payment with a broker or a bank, what was described by many academics as “*evident deficiency of the legal regulation*”³¹.

COMPARATIVE OBSERVATIONS: German legislation provides so. In addition, the GFCC considers guarantee of payment as a very important guarantee of the right to property but also as a proof of sincerity of the legislator’s intention to protect the property rights of minority shareholders. This was an important reason for finding the German Squeeze Out legislation constitutional³².

- d) Sanction for the majority shareholder in case he fails to compensate minority shareholders on time is prohibition to exercise voting rights from participation securities gained through Squeeze Out until he executes the compensation. This solution is apparently not overtly unfriendly to the majority shareholder as the majority shareholder might operate perfectly with 90% of voting rights as all decisions of General Meeting might be passed at maximum by 75% majority (in case the Statute of the company does not provide differently).

COMPARATIVE OBSERVATIONS: Comparing with German solution, it does not seem to be too serious attempt to motivate majority shareholder to perform his obligations. German legislation provides that the majority shareholder has to pay the

³⁰ See Christoph Van Der Elst; *Squeezing and Selling-out, a Patchwork of Rules in Five European Member States*; European Business Law Review, February 2007, Volume 4, Issue 1, page 19

³¹ See e.g. Tomas Dvorak; *Squeeze-out aneb má drobný akcionář důvod k pláči?*; Právní fórum, 7/2005, page 257

³² See German Federal Constitutional Court; Judgment of May 30th 2007; *BVerfG, 1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)*; para 27, available at www.bundesverfassungsgericht.de

moratory interests 2% higher than standard 'statutory moratory interest'³³ in case of delay.

- e) Harshly restricted time for access to the court for revision of the adequacy of compensation is again something that is unheard of.

COMPARATIVE OBSERVATIONS: According to my knowledge, there is no other state in the EU with a similar regulation, i.e. cutting prescription period in such a manner as to leave only 4% of it at the disposal of minority shareholders. (Very often the minority shareholders of companies with non-registered shares found out what happened much later). This evident calculus proves the arbitrariness of the legislation. It is a good ground to argue denial of access to the court.

- f) Judicial costs. In case a minority shareholder decides to claim her rights in court, she has to pay for a new expert opinion, an attorney at law, and the costs of the proceedings. The burden of proof as well as all these costs are transferred to the minority shareholder (the coverage that you get in case you win a case is usually not full), so in the end it is a substantial obstacle for any minority shareholder to turn to the court. In the end the risk to take legal action against the majority shareholder is so great and the potential benefit so small (except for exceptional cases) that the minority shareholder, even if she would be prepared to sacrifice time and effort, has no incentive to go to the court. In many cases the loss would be greater than the profit despite winning the case.

COMPARATIVE OBSERVATIONS: In other jurisdictions, the costs for the judicial proceedings are automatically transferred to the majority shareholder³⁴. In Germany this is regulated by Art. 39c (6) of the Act on Takeover Bids, in Austria by Art. 6 (2)

³³ See ANNEX I to this thesis.

³⁴ JUDr. Petr Zima, *Právo výkupu po x-té a nikoliv naposledy*, Právní rozhledy no. 19/2006, page 708-9

of GesAusG and in the UK by Art 6 (5) of The Takeovers Directive (Interim Implementation) Regulations 2006³⁵.

h) Absence of moratory interests.

COMPARATIVE OBSERVATIONS: In case the majority shareholder does not perform on time, the shareholders under German law have an *ex lege* right to moratory interests 2% higher than those derived from the Civil Code. The Czech legislator did not find it necessary to address this question. In addition, the GFCC has found moratory interests to be an important sign of constitutionality as it contributes directly to protection of rights of minority shareholders³⁶.

1.2.1. Reactions to the regulation of Squeeze Out

As mentioned, on the 3rd of June 2005 the legal embodiment of Squeeze Out came into the effect. According to the immediate reactions of the academic and professional public, the proposal and final text have shown “*the lowest possible quality from the legislative, professional and substantive point of view*”³⁷.

What was actually launched on the market after adoption of Squeeze Out regulation can be easily described as “mania”³⁸ when the majority of companies having required company structure tried to Squeeze Out minority shareholders as soon as possible in order to manage it before the expected revision of the regulation. As Emil Holub, the partner of Clifford Chance LLP, said “*the majority shareholders are turning to us and in many cases*

³⁵ *Ibid.*

³⁶ See ANNEX I. (for the statutory provisions) and the German Federal Constitutional Court, Judgment of May 30th 2007; *BVerfG, 1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)*; para 28, available at www.bundesverfassungsgericht.de (for the applicable case law).

³⁷ See JUDr. Petr Čech, *K četným problémům právní úpravy výkupu účastnických cenných papírů (squeeze out)*, *Právní rozhledy*, page 651

³⁸ See part 1.2.2. *Quantification of Squeeze outs in Czech Republic*

*they have eminent interest to quickly pursue Squeeze Out*³⁹. Lawyers even actively addressed majority shareholders because of the 3-month transition period which provided that companies might Squeeze Out without fulfillment of the time requirements. “*We recommended them to make use of such an unrepeatable situation given by the transition period*”⁴⁰ said Tomas Dolezil, the Attorney at Law of the Prague branch of the Law office Linklaters. As put by Mr. Tomas Dolezil (Linklaters) “*The Attorneys also actively address the majority shareholders. We recommend them eventually to make use of this unrepeatable situation given by the transition period.*”

The transition period raises further concerns. As a justification of Squeeze Out it is said that the shareholders may exclude such a possibility through the company’s statute. However, this (although fictitious⁴¹) possibility was denied to the shareholders who were squeezed out in the transition period as they did not know this possibility will emerge and could not protect themselves through the statute of the company.

1.2.2. Quantification of Squeeze Outs in Czech Republic

In order to have a clearer vision of what was happening and what is happening in respect of Squeeze Outs in the Czech Republic, it is necessary to bring in some statistics. ČEKIA⁴², a state funded organization that is regularly following the events on the Czech Capital Market, issued an opinion in 2005 that there were almost 400 companies that could undertake Squeeze Out with the potential value of several billions of Czech Crowns⁴³. As

³⁹ See *Přehled tisku 1. 7. 2005*, available at:

http://www.bbc.co.uk/czech/pressreview/story/2005/07/printable/050701_czechpress.shtml

⁴⁰ *Ibid.*

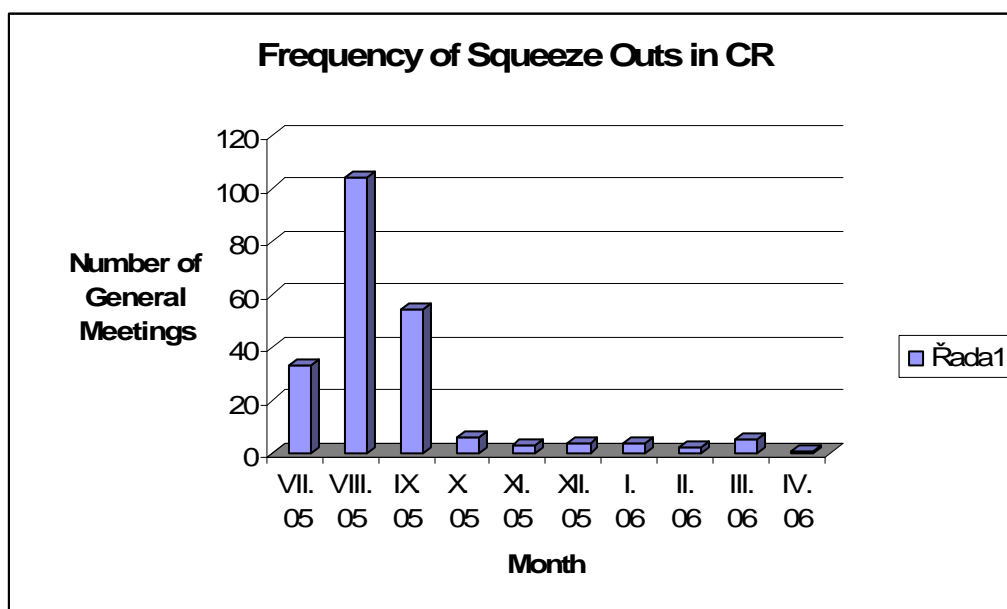
⁴¹ See closer *Introduction* to this thesis.

⁴² Česká kapitálová informační agentura, a.s. se sídlem Krakovská 9, 110 00 Praha 1

<http://www.cekia.cz/?idf=about-us>

⁴³ The exchange rate is 26,730 *Czech Crowns for 1 EUR* Czech National Bank on the 9th of November 2007; <http://www.cnb.cz/en/index.html>

the main manager of CEKIA, Ms. Jana Doležalová, declared: „*If all companies with a majority higher than 90% would Squeeze Out minority shareholders, the whole amount could reach 12 to 13 billion Czech Crowns.*“⁴⁴ Until the end of 2006, 246 companies have announced Squeeze Out procedures; the value of squeezed out shares has already crossed 10 billion Czech Crowns. As mentioned before, the greatest wave has already declined and the biggest players have already done what they intended to do (I am afraid that the legislators as well).



1.2.3. Revision of the Squeeze Out provisions – in effect from the 29th September 2005

The Revision of the law in September 2005 removed only few deficiencies and we can speak more or less about a cosmetic revision. Petr Čech even argued that “*the authors of the [first] proposal did not help anybody but maybe the legal representatives of the*

⁴⁴ Petra Doležalová, členka představenstva ČEKIA, manažerka PR, Marketingu, Služeb a Analýz. <http://www.cekia.cz/tiskove-zpravy.php?rok=2006>

⁴⁵ Source of the information: www.CEKIA.cz

parties, which can be looking forward to lengthy court proceedings. (...) quick revision does not change anything on it, contrary, solely brings into the process of Squeeze Out additional questions which should be responded.”⁴⁶

However, in order to silence the protests that the regulation of Squeeze Out (primarily because of “adequate consideration”) was unconstitutional, the legislator introduced the requirement of prior approval of the Supervising Authority on the request of the majority shareholder if she wanted to call for a General Meeting. The problem is that the Supervising Authority of the Capital Market⁴⁷ (Supervisory Authority) has no means to exercise this responsibility in respect of the non-listed companies. The Supervising Authority tried to cope with this task by issuing Guidelines⁴⁸, however it again only showed (and this was the objection of the Supervising Authority from the beginning) that the only thing the Supervising Authority might require and examine are annual reports which cannot show anything that could not be explained and justified in an expert opinion of any quality (objectivity)⁴⁹. This again showed that there was no serious intent on the side of the legislator to protect minority shareholders (and contribute so to the constitutionality of the text).

Let us go step by step and look which problems were removed according to the above mentioned list

1. Without change.
2. Without change.

⁴⁶ Petr Cech; *K četrým problémům právní úpravy výkupu účastnických cenných papírů (squeeze out)*, Právní rozhledy, page 651

⁴⁷ Until the 31st of March 2006 it was Securities Commission, after the concentration of supervision the whole Financial Market is supervised by the Czech National Bank

⁴⁸ See the Position of the Czech Securities Commission of the 18th November 2005, *Stanovisko č. STAN/13/2005 "K některým otázkám spojeným s vytěsněním"*; available in Czech at <http://www.sec.cz/export/CZ/search.page>

⁴⁹ See *Squeeze-out dle Komise pro cenné papíry aneb výkladové stanovisko k procesu vytěsnění (squeeze-out)*; available in Czech at <http://www.epravo.cz/v01/index.php3?s1=Y&s2=3&s3=2&s4=0&s5=0&s6=0&itemsPerPage=15&od=75&PHPSESSID=5b6eee3bbe60b9c51bcd8c518f1658fa>

3. Without change.
4. Changes in order to remove the most striking divergence with foreign counterparts⁵⁰
 - a) The principle remains the same; the ‘protective legislative technique’ added is prior approval by the Supervising Authority which is more or less only a formal protection. This is to say that the majority shareholder has to have an approval from the Supervising Authority which is not older than 3 month in order for the General Meeting Decision on Squeeze Out to be valid. The Supervising Authority always has to assess whether the compensation is adequate. By assessment the Supervising Authority takes account that minority shareholders are deprived of the possibility to decide when to sell their shares and to whom. As mentioned the approval is ineffective in respect of non listed companies. The proposal of new legislation removes prior approval of the Supervising Authority in respect of non-listed companies and the government in the explanatory report gives basically the same reasons as I before in this thesis.
 - b) The legislation from this moment provides that the minority shareholders have the right to compensation in terms of money.
 - c) The company is obliged to deposit the necessary amount for the compensation with a broker or a bank. It is then this institution which pays out the minority shareholders in fact⁵¹.
 - d) Without change.

⁵⁰ The Czech legislator tried to remove or (rather) hide greatest discrepancies between the models, so that the general public gets “calmer”. Moreover, the greatest number of squeeze outs was already over – see 1.2.2. *Quantification of Squeeze outs in Czech Republic*

⁵¹ Of course, this amount is set by the majority shareholder (or his expert) what means that it might prove to be inadequate, but only in case a minority shareholders goes to the court (and after few years) gets a judgment in this issue.

- e) Without change.
- f) Without change.
- g) Without change.

1.2.4. Revisions of the Squeeze Out provisions after the 29th September 2005 until the present day

The provisions have not changed except for the change regarding the concentration of the supervision in the Financial Market, which was completed on the 1st of April 2006, when supervision passed to the Czech National Bank and the Czech Securities Commission has ceased to exist. In relation to the Squeeze Out provision this means that the Supervising Authority body issuing approvals on request of the majority shareholder is today the Czech National Bank.

Nonetheless, as already mentioned, there is a new proposal (hereinafter Proposal) for regulation of Takeover bids⁵². The legislator has this time decided to create a new piece of legislation for the field of takeover bids (because of the specificities of this field of law⁵³), the Squeeze Out provisions will however stay in the Commercial Code. This new Proposal is accurately transposing the Directive on Takeover Bids; there is some expectation for the proper transposition in respect of Squeeze Out provisions, what I will try to show in the next part.

1.3. Excursus to the EC Law

⁵² See *Directive 2004/25/EC of the European parliament and of the Council of 21 April 2004 on takeover bids*.

⁵³ Proposal of the new legislation is available in Czech at <http://www.leblog.cz/>

Non-conformity of the currently valid Czech legislation with the Takeover Bids Directive gave rise to the Infringement Proceedings with the CR⁵⁴. As a matter of legal obligation, the Czech Squeeze Out regulation should be in accordance with the EU Directive on Takeover bids, therefore the courts who would examine it (CCC as well as ECtHR) have good reasons to have a closer look at the Directive. The reason is simple: a legislator, who would set a lower threshold for protection than he is obliged by EC law, should have a compelling reason for a *prima facie* double-ignorant action. In other words, a legislator who has a clear indication of how to regulate certain issues in the competence of Communities and decides to diverge to the detriment of one group (without or with weak justification), exposing himself to the risk⁵⁵ of infringement proceedings, must either have an illegal cause or must suffer from collective mental incapacity.

Some of the requirements posed by EC law are demonstrated by the Report of the High level group of Company Law Experts on Issues related to Takeover bids⁵⁶ (hereinafter Group), which states it is of the **utmost importance**⁵⁷ to ascertain the equitable price of the shares for the protection of minority shareholders in Squeeze Out situations. The Group finds the following solution as the most appropriate, which is later adopted by the Takeover Bids Directive in Art. 5, par. 5, i.e.:

'The highest price paid for the same securities by the offeror, or by persons acting in concert with him/her, over a period, to be determined by Member States, of not less than six months and not more than 12 before the bid referred

⁵⁴ For press release of the Commission see

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/506&format=HTML&aged=1&language=EN&guiLanguage=en>

⁵⁵ This finally materialized.

⁵⁶ Established by the Commission after the refusal of the European Parliament to adopt the prior proposal (among others reasons) because of uncertainty in respect of determination of the Equitable Price

⁵⁷ On page 45 of the Report, the Group says: *The Group considers that the requirement to offer an equitable price is of the utmost importance in the context of mandatory bids to achieve an adequate protection of the minority shareholders. A mandatory offer made for a price which was not equitable would not only fail to achieve such a protection, in that it would deprive the minority shareholders of an opportunity to sell their securities on fair terms. The absence of an equitable price requirement in a mandatory bid may also induce minority shareholders to sell their securities in a voluntary partial bid for a price which they do not deem to be equitable.*

to in paragraph 1 shall be regarded as the equitable price. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired.'

Under some circumstances, the Group accepts that the Supervising Authority may change a price that was ascertained in this way, an example may be the distortion of the market in the relevant period. In case the price ascertained in this manner is lower than the bidder offers, it is on the bidder to substantiate such a claim. Any similar decision of the Supervising Authority should be properly substantiated and publicized. Moreover, where the consideration offered does not consist of liquid securities (as both alternatives are admitted by the Directive) admitted to trading on a regulated market, it shall include a cash alternative.

To pursue a Squeeze Out according to the Directive, the majority shareholder must hold securities representing not less than 90 % of the capital carrying voting rights **and** 90 % of the voting rights in the offeree company. The fair price for shares squeezed in the takeover context of a Squeeze Out is the one by which the majority shareholder has acquired the necessary majority. If the Squeeze Out is not connected to the takeover bids, the member states are obliged to **ensure** that the fair price is **guaranteed**⁵⁸. Furthermore, if the MS opts for the possibility to allow for the Squeeze Out without connection to the takeover bid, it also has to provide for the sell out (which aims, among other things, at assuring the equality between shareholders) procedure under the same conditions. In

⁵⁸ I doubt that a new proposal is not in conflict with the Directive as the obligation of the state to ensure that the fair price is guaranteed does not seem to be fulfilled by the requirement that the majority shareholder base the price on the Expert opinion, again ordered by the Majority Shareholder, and without any guidance to how to set this price. The Legislator seems to rely on the possibility of the minority shareholder to address the court, but the lack of guidance was just one of the main reasons why the EP did not accept the prior proposal. Through the teleological interpretation (which is favored by the ECJ) we could easily come to the conclusion that the state has again implemented the Directive improperly. What is an equitable or fair price might be inferred from the provisions regarding mandatory bid price.

general, there is a three month preclusive period from the decidable moment⁵⁹ during which the Squeeze Out or sell out have to be pursued.

As given by the Directive, the price for mandatory bids is generally ascertained according to the highest price that the offerror has paid for the shares during the 6 to 12 months before takeover. This price is going to be usually higher than the price offered in the market as it is higher for the belief of the offerror that under his control the company might be more profitable. This is even more so if a bid is a voluntary one as the offerror wants to encourage shareholders to contract only with her/him (it has to be attractive enough to encourage the shareholders who might not intend to sell the shares). It is obvious that this price is not going to be only reasonable related to the value of shares, or the price offered in the market to some date, but rather, it will be considerably higher to reflect future business considerations concerning the target company, which make it an interesting deal for the offerror as well as for the shareholders owing the shares. It seems that the Czech regulation diverges on many instances.

Outside the Takeover context the Directive **requires the MS to ensure the payment of the fair price** in the Squeeze Out and sell out procedure. In addition it declares that the price which was paid in the mandatory bid as well as voluntary bid is generally to be taken as fair. The way to ensure fair price is not clearly determined (and it is left to the states to legislate on this issue under their discretion), however the requirement of *ensuring* the fair price, having in mind how this is determined in the takeover context, implies that the Member States do not have unfettered discretion but rather that they should define fair price in line with the protection afforded to minority shareholders by the Directive in general; this being the least ambitious textual interpretation technique. Besides, according to the High level group of Company Law

⁵⁹ Depending which form the Member State chooses, i.e. procedure under Art.15/2 - a) or b).

Experts on Issues related to Takeover bids, most of the MS who had Squeeze Out provisions at the time of the elaboration of the report would set the fair price at **minimum** what was offered as a price in mandatory or voluntary bids through which the majority shareholder has reached the threshold⁶⁰. In cases of a Squeeze Out which does not follow a mandatory or voluntary bid, the Group has recommended the price to be set by an expert or experts appointed by the court or the supervising authority⁶¹. The Directive, unfortunately, does not specify the way how the price should be set⁶², nonetheless as mentioned above, it requires states to **ensure** a fair price.

The only possible conclusion that the CCC can be drawn is that the legislation has ignored its double obligation toward minority shareholders (flowing from the Human Rights Standards – Constitution and ECHR – and EC law), which persuasively speaks in favor of arbitrariness of legislation.

What remains worrisome is that the new Proposal gives raise to further doubts regarding conformity with the Directive. I will also try to explore this aspect here, as this might be another reason for the CCC set more precise standards which are required for the legislation of this type to be in conformity with constitutionally protected Right to Property.

Article 15, par. 5 of the Directive on Takeover Bids, regulating the compensation in Squeeze Out situations, provides that “*Member States shall ensure that a fair price is guaranteed.*” However, the provisions of the Proposal concerning the non listed

⁶⁰ See *Report of the high level group of company law experts on issues related to the takeover*; Brussels, 10 January 2002, http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf page 57

⁶¹ It is worth mentioning that according to the Report (see page 57 of the Report, cited above), the most extraordinary (least protective) solution found in the Member States was „*the consideration to be offered is determined by the majority shareholder and based on a multicriteria analysis and an expert enquiry and report (the expert appointed by the majority shareholder must receive the approval of the securities Supervising Authority)*“. The Czech regulation does not give even this minimum. And it is truth also about the new legislation, which for squeeze out of non listed companies requires solely (sic!) expert opinion by an expert appointed by the majority shareholder. And if someone does not like it, s/he might apply to the court.

⁶² It is difficult to find out why it was not proscribed, but probably the answer would be a subsidiary principle, i.e. least prescriptive regulation.

companies, again provides that it is Majority shareholder who appoints the expert⁶³ for setting compensation; without using any other protective legislative technique. This time, the legislator does not even try to hide that fact behind illusory approval by the Supervising Authority. In addition, in the Explanatory Report to the Proposal, the legislator does not even find it necessary to give us any explanation why again this type of highly controversial appointment found its way in the proposal, nor does it find necessary to explain why some other protective legislative technique was not used. The only comment in this regard that can be found in the proposal is that the legislator does not find it necessary to address the question of the *quality* of the expert opinion, because it is solely a matter of concern of the Law on Experts and minority shareholders have in any case recourse to the court to review the amount of compensation.

These facts point to the conclusion that the proposed legislation might again be in contradiction with the EC legislation. The Takeover bids Directive⁶⁴ is a minimal harmonization directive and grants therefore more space for the discretion of the Member States when implementing it, but in any case the implementation must fulfill the objectives of the Directive. It seems, however, that the Czech Government does not intend to do a ‘good job’ unless there is “an European knife under its throat”⁶⁵, i.e. until the obligation is not explicitly articulated in the EC legislation.

More interesting for the individuals are remedies that the EC provides them with. After *Francovich*⁶⁶ and *Braserie du Pecheur / Factorame III*⁶⁷, it seems that private

⁶³ See Explanatory Report, available in Czech at <http://www.leblog.cz/>

⁶⁴ See Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids.

⁶⁵ It should be noted that there were two proceedings initiated by the Commission against the Czech Republic in connection with the incorrect transposition of the Directive.

⁶⁶ See European Court of Justice; Judgment of the 19 November 1991.; *Francovich & Bonifaci v. Italy* (C-6/90 and C-9/90) in Paul Craig and Grainne de Burca, *EU Law, Text, Cases and Materials*, Second Edition, Oxford University Press, 2002, 236

⁶⁷ See European Court of Justice; Judgment of 5 March 1996 ; *Brasserie du Pecheur SA v. Germany* (C-46/93 and C-48/93) in Paul Craig and Grainne de Burca, *EU Law, Text, Cases and Materials*, Second Edition, Oxford University Press, 2002, 240

individuals have the right to sue states for the failures to implement the Directives properly if it caused damage to the individual. For similar claims the standard statute of limitations period would apply, therefore it enables individuals who were squeezed out after the transposition period ended⁶⁸, to sue the state in front of the national courts for the damage that has occurred. This option is open to the individuals which were squeezed out under the currently valid legislation (where good arguments could eventually be found in decision concluding Infringements proceedings), but also under new legislation, if adopted, for the reasons mentioned above in this part.

As we can infer from these cases, EC law (the case law of the ECJ) provides for redress for non-conformity of national legislation with the EC legislation. However, there is no such possibility for an individual to recover damages which s/he incurred through an unconstitutional legal norm. Another (though not related) advantage is the *application priority* of the EU law. This might be a shortcut in many cases when national legislation seem to be conflicting with EU law as well as national constitutions (which is the case with the implementation of the Takeover bids Directive). Moreover, according to scholarship⁶⁹, the CCC should generally reject the applications which claim that the legislation is in conflict with EU law and at the same time not in conformity with the Constitution (with the reference to the possibility of the court not to apply provisions in question) given the fact that the Supremacy of EU law is *lex specialis* to the procedure according to Art. 95 of the Czech Constitution which request for the examination of constitutionality⁷⁰.

⁶⁸ Transposition period for the Takeover bids Directive ended on the 20th May 2006.

⁶⁹ See e.g. Kuhn; *Vytlačování malých akcionářů, ochrana ústavnosti a evropské právo*; available in Czech at <http://jinepravo.blogspot.com/2007/01/vytlaovn-malch-akcion-ochrana-stavnosti.html>

⁷⁰ *Ibid.*

Chapter 2. GERMAN REGULATION OF THE SQUEEZE OUT PROCEDURE

To understand properly what Squeeze Out is, what its advantages are and above all how it should be implemented, it is necessary to turn to one of the first countries which, despite the high protection afforded to Human Rights, has accepted the interference with the right to property of minority shareholders for the sake of better liquidity of capital markets. The first case concerning the Squeeze Out situation was dealing with restructuralization of company ownership (leading to the Squeeze Out of minority shareholders) in the 1962 GFCC decision in the *Feldmühle Fall*⁷¹ case. This highly competent decision is until this very day cited in studies and articles dealing with the Squeeze Out procedure and it seems to be inevitable to start any analysis of constitutionality of Squeeze Out with a discussion of it. Moreover, this German example is double valid when it comes to countries in Central Europe which often adopt German legislative models or are inspired by the GFCC.

In *Feldmühle Fall*⁷² the GFCC set standards for the ‘restructuralization’ of the capital structure / ownership in companies in a constitutionally conform manner. Therefore the GFCC was probably the first constitutional court to accept the constitutionality of depriving minority shareholders of their shares in the process of transformation of a company’s ownership structure if strict conditions were obeyed by the legislator.

Are these conditions set by the GFCC 45 years ago valid today, serving as a guidance for the EU legislation as well as for many national legislations? The court pronounced two legal sentences. First of all is that the constitution allows the state to legislate in a manner which limits the right to property, but the state is obliged to protect

⁷¹ See German Federal Constitutional Court; Judgement of August the 7th, 1962; *Feldmühle Fal (BVerfG, 1 BvL 16/60)*; NJW 1962, Volume 37, page 1667 and fol.

⁷² *Ibid.*

private property to the highest possible extent as well as give effect to the other constitutional principles, in particular to the equality (before the law), to the principle of free development of one's personality and the principle of rule of law and the social character of the state. Secondly, the court declared the *legislation in question was void as it did not provide for the minimization (of possibility) of abuse through setting-up such formal preconditions which would minimize the possibility thereof*⁷³. These are the core conditions under which Squeeze Out procedure might be accepted.

The Court also commented the claim that this procedure amounted to **expropriation** as provided in Art. 14 (3) of the *Grundgesetz*. The Court disagreed with the applicants that this legislation constitutes expropriation given that it concerned a general law regulating the relations of shareholders and the law itself did not deprive minority shareholders of their ownership⁷⁴. The court stated that the state is allowed to limit the right to property through regulating relations between the shareholders but it has to follow constitutionally entrenched principles.

The GFCC further addresses the question of **adequate compensation**. Here lie the most important observations of the Court. It states (with reference to general doctrinal opinion) that the minority shareholder is due such compensation which is fully corresponding to her capital participation in the company. The court continues that although Art. 14 of *Grundgesetz* allows for a lower compensation in some cases (where a balancing between the majority and the minority interests is required), this eventuality is completely lacking in cases of relations between two equals, especially in this case given

⁷³ See German Federal Constitutional Court; Judgment of August the 7th, 1962; *Feldmühle Fal* (BVerfG, 1 BvL 16/60); NJW 1962, Volume 37, page 1667 and fol.

⁷⁴ Here the decision of the court seems to be at its lowest ebb. The problem is that any explanation until now did not sufficiently explain why this kind of private law regulation is different to the extent that it cannot therefore constitute expropriation. It seems that all 'feel it somehow', but cannot give a proper justification of this proposition.

the fact that the restructuralization is initiated and is mainly in the interest of majority shareholders. For these reasons compensation has to be full compensation.

The Court touched upon **discrimination** claims as well. The court stated that it could not establish the discrimination as it had not been established that the legislator intentionally wanted to harm minority shareholders. The fact that it required proof of an intentional behavior of the legislator is somewhat outdated; probably this would not be the case today. However, what seems more important (for the purposes of a comparative analysis by the CCC when deciding upon this question) is that the GFCC in 1962 has found these **two groups comparable**.

Another era in adjudication of the GFCC concerning issues linked to the topic discussed in this thesis took place after the 1st of January 2002, when the Securities Acquisitions and Takeovers Act (*Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren*) officially replaced the Takeover Code⁷⁵ (a soft law instrument) which was a Code of Best Practices valid in Germany from 1995. At the same time the Stock Corporation Act (*Aktiengesetz*) was amended as to allow the Squeeze Out of minority shareholders that collectively hold less than five per cent of a corporation's capital, this being applicable to all stock corporations, not just those that are listed on a securities exchange.

What are the main features of German legislation? Art. 327⁷⁶ of the *Aktiengesetz* provides that the majority shareholders are the ones who set the compensation, which is to be explained and substantiated. The appropriateness of the cash settlement shall be reviewed by one or more expert auditors chosen and appointed for this purpose by the court on the application of the majority shareholder. It is the auditors who determine the adequate compensation as well as the amount to be deposited by a bank (for the payout

⁷⁵ See Theodor Baums; *The Regulation of Takeovers under German Law*; European Business Law Review, 2004, page 1453

⁷⁶ For the English translation of Art. 327 of the *Aktiengesetz* see ANNEX I to this thesis.

purposes). In case a minority shareholder is not satisfied with the so set compensation she might initiate proceedings in front of specialized the court which might set a higher compensation. From the moment of the announcement of inscription of Squeeze Out into a trade register, the minorities shareholders have right to an interest of 2% higher than the statutory interest.

After the adoption of the Takeover Act and the amendment of *Aktiengesetz*, the GFCC has faced number of constitutional complaints⁷⁷ related to the question of the constitutionality of this institute. In the latest decision (related directly to the question of the constitutionality of Squeeze Out) of the 30th of May 2007, the GFCC gave its final opinion regarding the constitutionality of the regulation in question⁷⁸, where the Court rejected the constitutional complaint because it found that the property rights of the minority shareholders were afforded necessary protection.

The Court states that the legislator is constitutionally authorized to regulate in property issues⁷⁹ and the legislator has done so in a constitutionally conform way. The Court justifies its decision in the following way. Firstly, the legislator has set a 95% threshold for the Squeeze Out procedure which should guarantee that the minority shareholders who only have an investment or capital interests in the company (and no social rights infringements are engaged⁸⁰) are the sole subjects of the Squeeze Out. Secondly, the compensation is determined by expert(s) appointed by the court for this purpose. Thirdly, a bank guarantee further enhances property protection of the minority

⁷⁷ See e.g. German Federal Constitutional Court, Judgment of 30th May 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft* (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)) or Judgment of 20th September 2002, (1 BvR 1691/02).

⁷⁸ This is an accurate claim insofar a minority shareholder does not claim a special interest in the company (family undertakings, etc.), where the social aspects of participation in the company are much more visible, and, according to the court, the result might be different.

⁷⁹ Similarly as in *Feldmühle* decision., para. 60.

⁸⁰ The court however claims that 'Whether it applies for something else, if a shareholder has in individual cases a large, recognize-worth interest in the participation in an enterprise, like for instance with shareholders from the family circle with exempt private companies is conceivable.' See German Federal Constitutional Court, Judgment of May the 30th 2007 (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)), para 23

shareholders. Fourthly, in case the compensation would still not be set on an appropriate level there is the possibility for a correction in a special judicial procedure. Fifthly, the interest charge over the statutory level also corresponds to the constitutional defaults. And the last protection tool is the contestation proceeding (not available if the claim concerns only the adequacy of compensation), which give the reason for the postponement of the inscription to the trade register, which consequently enhances the protection of the minority shareholders. However, in cases where such proceedings are manifestly unfounded, the court might allow for an early inscription. This should serve as a protection from malicious litigation. On the other hand it is balanced by the damages claim of the minority shareholder in case it is shown in further proceedings that the inscription was premature. The court therefore concluded that the attacked regulations meet the principle of proportionality and as such is in conformity with the *Grundgesetz*.

To summarize, the GFCC reiterates⁸¹ that the legislation should be construed (using legislative tools) in such a way as to minimize the possibility of abuse and so provide for a genuine protection of the rights of individuals. The legislator has to balance the interests of the private parties in a fair manner. The high threshold should guarantee that only capital interests of minority shareholders might be touched. The compensation should be set in such a manner as to fully compensate the minority shareholder. The compensation must be determined in the most objective way available (here the court points out that it is not a majority shareholder but in fact an expert appointed by the court who sets the compensation⁸²), the bank guarantee of payment as well as interest rates as being a significant element of property protection of minority shareholders. Moreover, effective procedural guarantees should be in place. The legislative techniques used by the legislator

⁸¹ See above, paras. 60

⁸² See German Federal Constitutional Court, Judgment of May the 30th 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04))*, para 26

render it constitutional. *A contrario*, omission of one or two protective elements would lead to the opposite solution. Not because the legislator has no right to decide how to limit property rights and what the best solution for society is (and the court will not substitute its decision for the legislator's), but because the legislator is limited by constitutional constraints and, unless there is an urging justification for the omission of the tools minimizing the interference with the right, the legislator is bound to use it, because it can reach the aim pursued (if it is not harming one group for the benefit of other) with (relatively) minimal 'collateral damage', i.e., interference with human rights.

2.1. Conflict between the EC Legislation and the National Human Rights standards: The German Lesson

Before we move to the following chapter, it is necessary to take another look at our western neighbor. Namely, given that a decision regarding the Squeeze Out procedure might lead to finding the whole concept of Squeeze Out as unconstitutional, which would mean that part of the Takeover bids Directive as such is unconstitutional, it is useful to have a brief look into the position of the GFCC towards EC legislation and its eventual non-conformity with national Human Rights standards. We will explore, therefore, a set of 'Integration judgments' by the GFCC and eventually draw some parallels.

In German Legal Academia there is still an ongoing conflict between what some authors call the *Etatist*⁸³ approach to Constitutionalism (*Pouvoir constituant*, resp. *Staatsfolk* as a prerequisite of the Constitution) and the *Post-Etatist* approach (where it is a *Political Community* which is a prerequisite for the existence of a Constitution). It is obvious that the *Post-Etatist* approach is more favorable to the project of European Integration. The first

⁸³ Miriam Aziz, *Sovereignty Lost, Sovereignty regained? The European Integration Process and Bundesverfassungsgericht*; EUI Working Papers, RSC Num. 2001/31

approach prevailed for a long period (with one break, namely, the *Solange II* decision) with eventually some move toward the latter approach in more recent decisions.

In Germany, which was from the beginning of the European Community one of the engines of its Integration, it is the GFCC which was the main “counter-revolutionary” actor. This trend was apparent from the *Solange I* decision⁸⁴, where the court states that it would overview the Secondary Community Legislation as long as

*"the competent Senate of the Federal Constitutional Court had, with reference to actual jurisdiction, come to the result that the integration process of the Community had not progressed so far that Community law also contained a codified catalogue of fundamental rights decided on by a Parliament and of settled validity, which was adequate in comparison with the catalogue of fundamental rights contained in the Basic Law. For this reason, the Senate regarded the reference by a court of the Federal Republic of Germany to the Federal Constitutional Court in constitutional review proceedings, following the obtaining of a ruling of the Court of Justice of the European Communities under Article 177 of the EEC Treaty, which was required at that time, as admissible and necessary if the German court regards the rule of Community law that is relevant to its decision as inapplicable in the interpretation given by the Court of Justice of the European Communities because and in so far as it conflicts with one of the fundamental rights of the Basic Law"*⁸⁵.

However, ten years later, the GFCC in *Solange II*⁸⁶ declares that the required Standard of Protection of Human rights has been reached in EC, mainly through the case law of the European Court of Justice (hereinafter ECJ), and therefore the Court is not going to review Secondary legislation (until eventually a lower court does not present arguments supporting the idea that this standard has been lowered in the case being presented). In the words of the Court

"As long as the European Communities, in particular European case law, generally ensure effective protection of fundamental rights as against the sovereign powers of the Communities which is to be regarded as substantially similar to the protection of fundamental rights required unconditionally by the Basic Law, and in so far as they generally safeguard the essential content of fundamental rights, the Federal Constitutional Court will no longer exercise its

⁸⁴ See German Federal Constitutional Court, Judgment of May 29th 1974, *Solange I*, (2 BvL 52/71)

⁸⁵ See German Federal Constitutional Court, Judgment of May 29th 1974, *Solange I* (2 BvL 52/71), para 285

⁸⁶ See German Federal Constitutional Court, Judgment of October 22nd 1986, *Solange II* (2 BvR 197/83)

jurisdiction to decide on the applicability of secondary Community legislation cited as the legal basis for any acts of German courts or authorities within the sovereign jurisdiction of the Federal Republic of Germany, and it will no longer review such legislation by the standard of fundamental rights contained in the Basic Law.”⁸⁷

Interestingly⁸⁸, a few years later, the Court takes another course and (perhaps unnecessarily⁸⁹), enters into confrontation with the ECJ in the highly criticized *Maastricht* decision. The Court says that “*in particular the Court provides a general safeguard of the essential contents of the fundamental rights. The Federal Constitutional Court thus guarantees this essential content against the sovereign powers of the Community as well.*”⁹⁰ The GFCC claims necessity of cooperation between the ECJ and National Courts (not however the dialogue envisaged by the EC Treaty in the form of Preliminary Rulings, which presupposes the ECJ as a final arbiter). The cooperation that the GFCC unclearly envisages is that both National Courts and the ECJ protect Human Rights *vis-à-vis* EC legislation. It is generally regarded that the level of Human Rights Protection in EC is on the level required by *Solange II*. This confrontational ‘tone’ appears even less necessary if we take into account that the Treaty on European Union incorporated Human Rights into the text of Treaties as part of the Community Legal Order.

The last from the list of the famous Integration decisions of the GFCC is the *Banana Markt* decision, which interprets the *Maastricht* decision in such a way to support the ruling in *Solange II*. The Court claims that the referring court had misinterpreted the *Maastricht* decision and that the standard set in *Solange* implies that

⁸⁷ See German Federal Constitutional Court, Judgment of October 22nd 1986, *Solange II* (2 BvR 197/83), para 387

⁸⁸ Especially if we take into account that, according to Aziz, Judge Kirchhof [one of the most persuasive supporters of the *Etatist* approach at the court] had retired from the GFCC by that time already. He has, however, written a number of supportive articles for that decision.

⁸⁹ After *Banana Markt* decision, it seems to be without any real impact (except for reaction of academia).

⁹⁰ See German Federal Constitutional Court, Judgment of 12th October 1993, *Maastricht Decision* (BVerfGE 89, 155), para 378 – 381. See closer Peter Lindseth, *The Maastricht Decision Ten Years Later: Parliamentary Democracy, Separation of Powers, and the Schmittian Interpretation Reconsidered*, EUI Working Papers, RSC No. 2003 / 18, available at http://cadmus.eui.eu/dspace/bitstream/1814/1893/1/03_18.pdf

“the grounds for a submission by a national court of justice or of a constitutional complaint which puts forward an infringement by secondary European Community Law of the fundamental rights guaranteed in the Basic Law must state in detail that the protection of fundamental rights required unconditionally by the Basic Law is not generally assured in the respective case. This requires a comparison of the protection of fundamental rights on the national and on the Community level similar to the one made by the Federal Constitutional Court in BVerfGE 73, 339 (378 - 381).”⁹¹

It is evident that the GFCC will not review the constitutionality of EC legislation. But what happens if some court would find as unconstitutional an institute which is endorsed in EC legislation? As the situation stands now, a constitutional court which would like to give a decision to that effect is forced to address the question in a preliminary ruling to the ECJ who alone is competent to review EC legislation. In case the decision of the court would be that such institute is not in conformity with the human rights protection standards in the EU, the problem would be solved. In case the ECJ would decide differently, it would be on the constitutional court to decide whether it is going to take the same stance as GFCC or it would go into confrontation.

The confrontational stance, at least on a rhetorical level, was taken by the Polish Constitutional Tribunal in an interesting decision from 19th of December 2006⁹², where the court says

“By virtue of Article 8 paragraph 1 of the Constitution, the Constitutional Tribunal is obliged to such recognition of its position that in fundamental issues relating to the constitutional system of the State it shall retain its status of “the last-word court”.

On the other hand, contrary to what we would expect after the above mentioned decision and contrary to the position of the GFCC⁹³, the Polish Constitutional Tribunal has chosen a sensitive (and in the long run very sound) manner of how to deal with the

⁹¹ See German Federal Constitutional Court, Judgment of June the 7th 2000, *Bananamarkt Decision* (2 BvL 1/97), para 39

⁹² Available in English at http://www.trybunal.gov.pl/eng/summaries/documents/P_37_05_full_text.pdf

⁹³ Which was, according to Kuhn, a rather comically-invalidated legislation on procedural grounds.

legislation implementing the European Arrest Warrant given that it is unconstitutional to hand over Polish nationals for criminal proceedings purposes. The Polish Constitutional Tribunal did not try to interpret the Constitution in conforming way, but it suspended the application of the law for 18 months to give the legislature enough time to change the Constitution in this regard. In case it does not happen, the Tribunal would have to declare the legislation void.

On the other hand it is highly improbable that the CCC would take a confrontation stance. Rather, the CCC has chosen a pro-European position in its most important Integration decision and it went too far as to interpret the Constitution in such a manner as to find the European Arrest Warrant constitutional. This happened in a direct opposition to the GFCC decision. The CCC at some point has even criticizes (though not openly) the GFCC decision⁹⁴.

To sum up, it is rather challenging for the courts in new member states to deal with all new issues arising recently in connection with accession to the EU. However, this is not to say that these courts blindly follow or will follow GFCC decisions. It is rather probable that the more they get accustomed to the new reality, the more they will try to form their own voice in the choir of European National Courts⁹⁵.

⁹⁴ Zdeněk Kühn; Constitutional Monologues, Constitutional Dialogues or Constitutional Cacophony? European Arrest Warrant Saga in Germany, Poland and the Czech Republic; The Paper presented on the workshop Integration or Absorption? Legal discourses in the enlarged Union; CONNEX Network of Excellence in cooperation with Technical University Darmstadt & University of Hanover; Hanover, September 28th to 30th 2006

⁹⁵ This fact should not be too surprising given the high self-attributed (self-)esteem of most constitutional courts (judges).

Chapter 3. THE RIGHT TO PROPERTY IN THE CASE LAW OF THE ECHR

3.1. Basic Principles

To give a full answer to possible decision of the CCC, it is necessary to review how the ECtHR would assess the same issue. Not only is the ECtHR an ultimate arbiter regarding the Convention rights, but the CCC has adopted the whole scheme for the assessment of the Right to Property cases, as we will see further, strikingly similar to the ECtHR. Moreover, this assessment has value in itself, as it is not excluded that some cases might end in front of this court. We will start by a review of basic principles for assessment of property claims under the ECHR, which will hopefully set the essential background for the further examination of Squeeze Out under this body of law. The ECHR provides in Article 1 of Protocol No. 1 guarantees to the right to property, as follows:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions.

No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

The Convention itself does not mention the right to property, but uses rather an unclear term *peaceful enjoyment of possessions*. In the *Marckx* case⁹⁶, the ECtHR nevertheless recognizes that it in fact means the right to property.

"By recognizing that everyone has the right to the peaceful enjoyment of his possessions, Article 1 (P1-1) is in substance guaranteeing the right of property."⁹⁷

⁹⁶ See European Court of Human Rights; Judgment of 13th June 1979; *Marckx v. Belgium*, (A31 (1979)), para 63

Moreover it is not excluded that this ‘unclear’ language enabled the Court to develop a rather wide interpretation of the term and to incorporate a number of different legal relations under the protection (or scope) of the right to property.

The steps of the court when it assesses Right to Property case are the following. The court first examines whether the alleged case falls under the scope of the right in question. As already mentioned, the court’s interpretation of the possession is autonomous and it has interpreted “possessions” wide enough to incorporate many different legal relationships to the property. Of course, there are certain preconditions which have to be fulfilled like the existence of property or the existence of an enforceable claim between persons under domestic law. The court has ruled that “possessions” cover (apart from ownership of immovable or movable property) intellectual property rights, final arbitral awards⁹⁸ or entitlements to a rent arising from a contract. Other enforceable claims also may qualify as “possessions”⁹⁹. Lastly, the court considers *shares* as possessions within the meaning of Article 1 of Protocol No. 1¹⁰⁰.

Once the court establishes that there is a claim which falls under the scope of the protection of Article 1 of Protocol 1, the court examines under which rule the alleged infringement falls. The rules were defined by the court in *Sporrong and Lönnroth v. Sweden*¹⁰¹ in the following words

⁹⁷ See European Court of Human Rights; Judgment of 13th June 1979; *Marckx v. Belgium*, (A31 (1979)), para 63

⁹⁸ See European Court of Human Rights, Judgement of 9th December 1994, *Stran Greek Refineries and Stratis Andreadis v. Greece* (Application no. 13427/87), para 61

⁹⁹ Aida Grgić, Zvonimir Mataga, Matija Longar and Ana Vilfan; *The right to property under the European Convention on Human Rights*; Human rights handbooks, No. 10; Council of Europe, 2007, page 7

¹⁰⁰ See European Court of Human Rights, Decision of the Commission of 12 October 1982 on the admissibility of the applications, *Bramelid and Malmström* (Application no. 8588/79 and 8589/79), page 81 of the file available at <http://cmiskp.echr.coe.int/tkp197/portal.asp?sessionId=3213100&skin=hudoc-en&action=request>

Besides, the Court has declared that there is no claim under the Convention for the business losses of the company and consequently losses of the shareholders.

¹⁰¹ See European Court of Human Rights, Judgment of 23 September 1982, *Sporrong and Lönnroth v. Sweden* (Application no. 7151/75 and 7152/75), para 61

“[Article 1 of Protocol No. 1] comprises three distinct rules. The first rule, which is of a general nature, enounces the principle of peaceful enjoyment of property; it is set out in the first sentence of the first paragraph. The second rule covers deprivation of possessions and subjects it to certain conditions; it appears in the second sentence of the same paragraph. The third rule recognizes that the States are entitled, amongst other things, to control the use of property in accordance with the general interest, by enforcing such laws as they deem necessary for the purpose; it is contained in the second paragraph.”¹⁰²

The second and third rule are special to the first rule and therefore the court examines first whether the alleged infringement falls under one of these rules and if this is not the case, the court assesses the case under the Peaceful possession rule.

Lastly, the court has to determine whether the interference might be justified in a democratic society. In *Sporrong and Lönnroth v. Sweden* the court sets a primary test¹⁰³ for the right to property cases

*‘...the Court must determine whether a **fair balance** was struck between the demands of the general interests of the community and the requirements of the protection of the individual’s fundamental rights... The search for this balance is inherent in the whole of the Convention and is also reflected in the structure of Article 1 [of Protocol No. 1].’¹⁰⁴*

How the court dealt with examining the fair balance in relevant property right cases will be discussed in the next subchapter.

3.1.1. Relevant Case Law of the ECtHR

Given that this is not an exhaustive analysis on the case law of the ECtHR, we will deal solely with the cases which are relevant to the topic of this thesis. As already

¹⁰² *Ibid.*

¹⁰³ As part of the proportionality analysis.

¹⁰⁴ See European Court of Human Rights, Judgment of 23 September 1982, *Sporrong and Lönnroth v. Sweden* (Application no. 7151/75 and 7152/75), para 69

mentioned, the first “big” case under Article 1 of the Protocol 1 was *Bramelid and Malmström v. Sweden*¹⁰⁵ (1982). The facts of the case are as follows.

Two private individuals owned shares of one large Swedish company. A Company Act passed in 1977 provided that any company which owned more than 90% of the shares and voting rights in another company was entitled to “Squeeze Out” the remaining minority shareholders, i.e. to compel them to sell their shares at the same price as would have been paid if it had purchased the shares through a public offer, or otherwise at a price fixed by arbitrators. The Applicants argued that they had had to surrender their shares to the majority shareholders at less than market value (the price had been fixed by arbitrators).

First of all, the Commission considered whether the shares were a possession within the meaning of Article 1 of Protocol No.1. The Commission assessed the character of a share and held that a share is a certificate that promises the holder a share of the company, together with corresponding rights (especially voting rights). A share also involves an indirect claim on company assets. There was no doubt that a share has an economic value and therefore the Commission concluded that shares are possessions within the meaning of Article 1 of the Protocol 1.

When it came to the question of which of the three rules of Article 1 should be applied, the Commission took the position that the application of the Company Act to the shares of the minority shareholders did not fall within the second (“deprivation”) rule as the applicants had argued. The Commission observed that although there was no express reference to “expropriation” in Article 1, its wording showed clearly that the second rule was intended to refer to expropriation, i.e., the action whereby a state “lays hands – or

¹⁰⁵ See European Court of Human Rights, Decision of the Commission of 12 October 1982 on the admissibility of the applications, *Bramelid and Malmström* (Application no. 8588/79 and 8589/79), available at <http://cmiskp.echr.coe.int/tkp197/portal.asp?sessionId=3213100&skin=hudoc-en&action=request>

authorizes a third party to lay hands” – on a particular piece of property for a purpose which is to serve the public interest. This interpretation was, according to the Commission, confirmed by the *travaux préparatoires* of Article 1 of Protocol 1. The Commission considered that the legislation complained of was something *completely different*¹⁰⁶. The legislation concerned relations between private individuals and therefore the second sentence did not apply. As the legislation of the Member States shows, the laws governing private-law relations between individuals usually determine relations also with respect to property occasionally compel a person to surrender a possession to another (heritage provisions, execution, etc.). The Commission considered that this type of rule, so essential in our societies, cannot in principle be contrary to Article 1 of Protocol No. 1. However, the Commission considered it necessary to determine whether such law did not create **“such inequality that one person could be arbitrarily and unjustly deprived of property in favor of another”**¹⁰⁷ and it concluded that this was not the case here.

Bramelid and Malstrom v. Sweden is a case of great importance in the case law of the court on Article 1 of Protocol 1. It declares that share ownership creates “possession” within the meaning of Article 1 of Protocol 1 as well as that this article could be applied to the legislation regulating relations between two private parties. Most importantly to our discussion, the Commission, as I will show further, the interpretation of the Deprivation rule (as not embracing regulation of the relations between private parties) has prevailed over the latter case decided by the Court itself, i.e. *James and others v. UK*.

¹⁰⁶ See European Court of Human Rights, Decision of the Commission of 12 October 1982 on the admissibility of the applications, *Bramelid and Malmström* (Application no. 8588/79 and 8589/79), page 82 of the file available at <http://cmiskp.echr.coe.int/tkp197/portal.asp?sessionId=3213100&skin=hudoc-en&action=request>

¹⁰⁷ *Ibid.*, page 82. It seems to go contra usual rhetoric that the ECtHR does not assess legislation in general for the compatibility with the Convention, but given it was cited in many later cases, it is probably accepted standard in this regard.

In the same year the Court decided *Sporrong and Lönnroth v. Sweden*¹⁰⁸. As already mentioned, the court sets in this decision a ‘**fair balance**’ test which is **applicable to all three rules** under Article 1 (P1). Therefore, also the “arbitrary and unjust deprivation of property in favor of another” test set by *Bramelid and Malmström v. Sweden* has to be interpreted in the light of the fair balance test.

Following the important decision of the court *James and others v. UK*¹⁰⁹ seemed to overrule the Commission’s decision in *Bramelid and Malmström v. Sweden* in many important aspects. The case concerned a UK statute which was regulating the obligatory transfer (on demand) of real estate to the special category of long term tenants for approximately the price of the relevant plot. Again, the statute dealt with relations between the private parties and obligatory transfer of property from one to another¹¹⁰. However, this time the court assessed the legislation under the second Deprivation of property rule without going into more detail¹¹¹. As already mentioned, the court also did not find it necessary to distinguish this case from the *Bramelid and Malmström v. Sweden*. This was interpreted as practically overruling the *Bramelid and Malmström v. Sweden* decision¹¹² and it was expected that the ECtHR was going to apply the deprivation rule also to other private laws (regulating relations between private parties). This would in particular mean that the court would assess whether the legislation in question, eventually deprivation in question was in the ‘public interest’ (instead of ‘general interest’ applicable to the first and

¹⁰⁸ See European Court of Human Rights, Judgment of 23 September 1982, *Sporrong and Lönnroth v. Sweden* (Application no. 7151/75 and 7152/75).

¹⁰⁹ See European Court of Human Rights, Judgment of 21 February 1986, *James and others v. UK* (Application no. 8793/79).

¹¹⁰ For the continental lawyers it might seem relevant that the latter law was rather a ‘public law’, while the law in Swedish case concerned private law regulation, but the court did not deal with this issue (in general the court did not deal with *Bramelid and Malmström v. Sweden* at all or did not try to distinguish) and neither did scholarship elaborate on this point afterwards. Given that James is not cited in this regard in decisions later than 1986, it seems that the court “forgot” about it.

¹¹¹ The court solely points to the fact that the parties did not dispute this issue.

¹¹² See e.g. Jean Raymond, *L’article 1 du Protocole additionnel et les rapports entre particuliers*, in *Protecting Human Rights: The European Dimension Studies in Memory of Gérard J. Wiarda*, Köln Carl Heymanns Verlag KG, 1988, page 531

third rule) as it concerns the most serious interference with the right to property. As I will show further on, this did not happen and the court is still rather confused in this respect¹¹³.

The court in *James* went on and scrutinized public purpose of the legislation. The court responded to the Applicants' objections, who asserted that principally the public interest can not be found in this case as the legislation is benefiting private persons, in the following way:

*"compulsory transfer of property from one individual to another may in principle be considered to be "in the public interest" if the taking is effected in pursuance of legitimate social policies."*¹¹⁴

The court further explains that

*"In particular, the fairness of a system of law governing the contractual or property rights of private parties is a matter of public concern and therefore legislative measures intended to bring about such fairness are capable of being "in the public interest", even if they involve the compulsory transfer of property from one individual to another."*¹¹⁵

It is evident that the court was ready to allow for 'private taking' only for the purpose of legitimate social policies. Therefore, given that *James and others v. UK* was a ruling precedent it would probably be very difficult for the Squeeze Out procedure to pass the test. Nevertheless, as already mentioned, later case law suggests that the court has retreated from this position and reaffirmed the position of the Commission in the *Bramelid and Malmström v. Sweden*. We can observe this trend in *Kind v. Germany*¹¹⁶ as well as in the last decision *Freitag v. Germany*¹¹⁷. On the other hand, the court played with the idea

¹¹³ Taking into consideration flow of incoherent case law, see paras. 97 - 102

¹¹⁴ See European Court of Human Rights, Judgment of 21 February 1986, *James and others v. UK* (Application no. 8793/79), para 39

¹¹⁵ See European Court of Human Rights, Judgment of 21 February 1986, *James and others v. UK* (Application no. 8793/79), para 41

¹¹⁶ See European Court of Human Rights, Decision of 30th March 2000, *Kind v. Germany* (Application no. 44324/98), En Droit, para 1

¹¹⁷ See European Court of Human Rights, Judgment of 19th July 2007, *Freitag v. Germany* (Application no. 71440/01), para 52, 53, 54

of assessing private law regulation under the deprivation rule in *Offerhaus v. Netherlands*¹¹⁸.

In the most recent judgment applicable to the Squeeze Out situations (*Freitag v. Germany*¹¹⁹) the court reaffirms the principles set first in *Bramelid and Malmström v. Sweden* and later reiterated in *Kind v. Germany* and *Sovtransavto Holding v. Ukraine*¹²⁰. The case of *Freitag v. Germany* concerned the transformation of the company with the shareholders of the target company receiving shares in the acquiring company. The court found a violation of Article 6 of the Convention, namely, denial of the access to courts, but in respect of Article 1, Protocol 1 the court found the application manifestly ill-founded. The court established the principles for adjudication of similar cases contrary to the *James* decision, when the court states:

*‘The Court notes, firstly, that in the instant case there was **no direct***¹²¹ *deprivation by the domestic authorities of the applicant's possessions. It follows that Article 1, § 1, second sentence is not applicable in the present case. (...). The Court has accepted that the obligation imposed in certain circumstances on minority shareholders to surrender their shares to majority shareholders could not in principle be considered contrary to Article 1 of Protocol No. 1 as long as the law did not create such **inequality that one person could be arbitrarily deprived of property in favour of another**. (...). The Court has held that Article 1 of Protocol No. 1 imposes an obligation on the State to afford judicial procedures that offer the **necessary procedural guarantees** and therefore enable the domestic courts and tribunals to adjudicate effectively and fairly any disputes between private persons relating to property rights.*¹²²

It appears that once there are proper judicial guarantees, the court will not enter into a wide assessment of the *ad hoc* compatibility of the legislature with the Convention. However, in *Offerhaus v. Germany* the court declares

¹¹⁸ See European Court of Human Rights, Decision of 16th January 2001, *Offerhaus v. France* (Application no. 35730/97), The Law, para 2

¹¹⁹ See European Court of Human Rights, Judgment of 19th July 2007, *Freitag v. Germany* (Application no. 71440/01), para 52

¹²⁰ See European Court of Human Rights, Judgment of 25th July 2002, *Sovtransavto Holding v. Ukraine* (Application no. 48553/99), para 93

¹²¹ This is a rather surprising conclusion given that the Court does not require direct / formal expropriation, but rather accepts that the factual state of affairs is enough.

¹²² See European Court of Human Rights, Judgment of 19th July 2007, *Freitag v. Germany* (Application no. 71440/01), para 52, 53, 54

*'In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realized by any measure **depriving a person of his possessions**. Compensation terms under the relevant legislation are material to the assessment whether the contested measure respects the requisite fair balance and, notably, **whether it imposes a disproportionate burden on the applicants**. In this connection, the taking of property without payment of **an amount reasonably related to its value** will normally constitute a disproportionate interference.'*¹²³

What we can generally observe is that the court stresses procedural aspects and judicial guarantees in the cases where they found violation of the Article 6 of the Convention, but once there is no violation of this article, they go much more into detail in respect of right to property, requiring fulfillment of some substantive conditions¹²⁴.

3.1.2. Compensation

It seems desirable to afford some separate attention to the question of compensation. The matter of fact is that in right to property cases it usually boils down to the question of fair and just compensation. Though the Article 1 does not require compensation to be provided, the court (taking as indicator the national legal systems of the member states) assigned an important place to the compensation in the whole scheme of protection under article 1. The court held in *James and others v. UK* that the compensation is implied as the whole system otherwise would be largely "illusory and ineffective"¹²⁵. The court went on to say that the

*'Taking of property without payment of an **amount reasonably related to its value** would normally constitute **a disproportionate interference** which could not be considered justifiable **under Article 1 (P1-1)**. Article 1 (P1-1) **does not, however, guarantee a right to full compensation in all circumstances**. Legitimate objectives*

¹²³ See European Court of Human Rights, Decision of 16th January 2001, *Offerhaus v. France* (Application no. 35730/97), The Law, para 2

¹²⁴ Compare with the decision in *Bramelid, James, Sporrang, Kind, Offerhaus, Sovtransavto & Freitag*, cited above paras. 97 - 104

¹²⁵ See European Court of Human Rights, Judgment of 21st February 1986, *James and others v. UK* (Application no. 8793/79), para 54

of "public interest", such as pursued in measures of **economic reform or measures designed to achieve greater social justice**, may call for less than reimbursement of the full market value.¹²⁶

Later in *Offerhaus v. Germany* the court specifies that 'the taking of property without payment of an amount **reasonably related to its value** will normally constitute a disproportionate interference'¹²⁷. In this decision the court states that the determination of the value of the shares (by the national court) that is based on stock market price cannot be assessed for the purposes of Article 1 as not bearing the amount reasonably related to its value.

The court does not accept the most favorable standard suggested by the applicants. What the court does is setting the standard at the reasonably related value rather than requiring *full price compensation* (*compensation économique intégrale*¹²⁸) or *reimbursement of fair price* in similar cases¹²⁹. This is, nonetheless, contrary to the rules set by its own case law. Firstly, the court states in *James* that the person may not be entitled to the full compensation in case the legislation is adopted to pursue measures of economic reform or greater social justice. It implies that in other cases, where there are no similar objectives¹³⁰, the person is entitled to the full compensation. Nonetheless, in *Offerhaus* it states that the compensation reasonably related to the value of the property is

¹²⁶ *Ibid.*

¹²⁷ See European Court of Human Rights, Decision of 16th January 2001, *Offerhaus v. France* (Application no. 35730/97), The Law, para 2

¹²⁸ For the position of the German Federal Constitutional Court see: German Federal Constitutional Court, Judgment of August the 7th, 1962; *Feldmühle Fal* (BVerfG, 1 BvL 16/60); NJW 1962, Volume 37, page 1667 and fol. or German Federal Constitutional Court, Judgment of 30th May 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft* (1 BvR 390/04)). For the position of the European Court of Human Rights see: European Court of Human Rights, Decision of 30th March 2000, *Kind v. Germany* (Application no. 44324/98), En Droit, para 1

¹²⁹ From the language the court uses might be inferred that it admits the price is not a full price.

¹³⁰ This of course does not mean that the legislator did not follow any reasonable aim or policy, but rather, that in circumstance where the aim is not connected with the **solidarity among citizens**, the state will pursue its objectives without burdening solely one of the parties.

adequate. But is this full compensation? It seems that in this respect the court should not leave this to the margin of appreciation of the states.

It is an undeniable fact that it is majority shareholder who decides – contrary the will of the other party – on *the fact that* he is going to Squeeze Out and also *when* he is going to Squeeze Out the minority shareholders (although there are usually some statutory time limits), what gives to majority shareholder an inherent advantage over the minority shareholders. Given that the majority shareholder decides the moment of the transfer which has a direct influence on the compensation to be paid (not to mention that in some jurisdictions it is majority shareholder who determines the compensation entirely by herself), the only way how to determine the fair price is to use such mathematical-economical method which would be the most favorable to the minority shareholder in order to secure that the minority shareholder would not be harmed excessively by the inherent advantage of the majority shareholder.

If we apply my considerations to the case of *Offerhaus v. Netherlands*, this would mean that the intrinsic value (which in this case was higher than the market price in the moment of the Squeeze Out), would be a full compensation. Applicants were instead afforded market price though it was obvious that it was a matter of short time until the market price will rise to reach the intrinsic value and that in fact minority shareholders are willfully harmed by setting the price equivalent to the market price in the moment chosen for the Squeeze Out by the majority shareholder. This consideration proved to be true as the market price of shares soon substantially raised. It means that not only the minority shareholder is denied the right to decide whether, when and to whom to sell the shares, but s/he is manipulated in regards the time of transfer as to get the smallest compensation possible in the circumstances. The property rights of minority shareholders were clearly infringed and all the courts who dealt with this case, including the ECtHR, accepted that.

Taking into consideration the position of the parties, where on the one hand one of the parties is in the position to take major advantage of its informational and economical superiority over the other party, and on the other hand, the weaker party, a minority shareholder holding few shares as well as its inherent advantage described above, Squeeze Outs would often result in unjust compensation. In order to minimize the negative effect of the inherent advantage of a majority shareholder, the most favorable standard should be accepted in the future¹³¹. At least to the extent that individuals have right to full compensation, there should be no place for the margin of appreciation of the states.

3.2. Czech Regulation in the light of the ECtHR case law

Finally we should assess the Czech legislation in light of the principles outlined above. Chapter I clarifies in more detail what the biggest problems of the Czech Regulation on Squeeze Out procedure are. In this part we will solely concentrate on the greatest deficiencies, which might have relevance under the Convention as well as their possible consequences (under the Convention). This endeavor is necessary for theoretical as well as practical purposes. There are a number of cases still pending before Czech courts and for the parties it is very relevant to know what their possibilities are if the national proceedings fail to satisfy their claims or in case they would not be afforded compensation if the CCC declares the unconstitutionality of the relevant provisions¹³². Many of these cases might be eligible to go to the ECtHR in terms of procedural (admissibility) requirements. Besides, the CCC is still to decide upon one concrete review

¹³¹ On the other hand it is still questionable to what extent this should be concern of ECHR rather than of the constitutional courts of the contracting states.

¹³² See Radek Kedron, *Hospodářské noviny* of July 12th 2007, *Z domova*, 4

and one abstract review application regarding the constitutionality of the regulation¹³³. However, as already mentioned, the Czech legal system does not allow for the compensation claims of the persons whose rights were infringed by the legislation found unconstitutional by the CCC. Consequently the persons who intend to claim compensation will have to apply to the ECtHR.

The ECtHR already has a well established and predictable procedure of dealing with claims under many of the articles. As mentioned above, this is not so much true if alleged violation concerns legislation “dealing with the relations between the private parties”,¹³⁴. There is some uncertainty as to some other aspects of the relevant court decisions as we had a chance to see, but it is still possible to extract the minimum core which has to be fulfilled in order that the interference satisfies the requirements of Article 1 of Protocol 1.

The court has first to ascertain whether an alleged violation of Article 1 of Protocol 1 falls within scope of the mentioned article. Through the case law, we can infer that shares, due to their economic value, are possessions within the meaning of Article 1 of Protocol 1¹³⁵. The presence of the interference in similar cases was never disputed in the court’s case law¹³⁶, it is only the next step that might raise controversy. According to the *Sporrong* decision, there are 3 rules inherent in Article 1 of Protocol 1 (even if they are not strictly divided) and the court will choose which to apply. As already mentioned, here it might be open to discussion which one should be applied, but as we are going to deal only

¹³³ Up to this moment there is no any Constitutional Complaint (as the proceedings are far from being finished by the Czech courts).

¹³⁴ As mentioned before, on the one side there are decisions like *Bramelid*, *Kind* or *Freitag* (which point to the conclusion that regulation dealing with private parties relations might not be dealt with under the second Deprivation rule of A1/P1) and on the other hand *James* and *Offerhaus* (which point to the opposite direction). All these cases were cited above, paras. 97 - 104

¹³⁵ See European Court of Human Rights, Decision of the Commission of 12 October 1982 on the admissibility of the applications, *Bramelid and Malmström* (Application no. 8588/79 and 8589/79), page 81 of the file available at <http://cmiskp.echr.coe.int/tkp197/portal.asp?sessionId=3213100&skin=hudoc-en&action=request>

¹³⁶ Similarly see decisions of the European Court of Human Rights in *Bramelid*, *Kind*, *Offerhaus*, *Freitag*, etc., cited above paras. 97 – 194.

with the ‘minimal core requirements’, we will assume the court would deal with this interference under least demanding Peaceful Possessions rule.

It is undisputed that the Squeeze Out procedure is based on valid private law norms (though with retrospective effect), which is certain, accessible and foreseeable as required by the ECHR. Finding a **legitimate aim** or (in this case rather) a **general interest** pursued by the legislation will not cause too much trouble¹³⁷ to the state as the margin of appreciation reserved for the states under this consideration is truly wide. Since the court proclaims that the state is in much better position to assess its needs (principle of subsidiarity), the court will react only in case if it is manifestly without reasonable foundation¹³⁸. Given the wide use of this institute in other European States, it would be hardly accepted by the court that this legislation is manifestly without reasonable foundations.

The proportionality is the spot where the minority shareholder might be able to prove that the legislation did not strike a fair balance and that an excessive burden was placed upon the minority shareholder by the Czech regulation. In *Bramelid* the Commission has stated that the obligation of the state is not to create such laws which would produce such *‘inequality that one person could be arbitrarily deprived of property in favor of another’*. It is crucial to our case to predict how the court would interpret this rule once it would be posed against the case where there is obvious bias in the legislation, but the procedural safeguards are in place (at least fictitiously). The question is whether the court would be satisfied with procedural safeguards only (access to court to solve disputes between private parties¹³⁹), disregarding the core of the problem which is the factual impossibility for the aggravated party to access the court) or rather require substantive

¹³⁷ See Chapter IV.

¹³⁸ See European Court of Human Rights, Judgment of 21st February 1986, *James and others v. UK* (Application no. 8793/79), para 46

¹³⁹ As it has already been pointed out in Freitag decision. See European Court of Human Rights, Judgment of 19th July 2007, *Freitag v. Germany* (Application no. 71440/01), para 54

safeguards that the full compensation will be awarded. It is rather encouraging that the court is stressing procedural guarantees mainly in the cases when this important rule of law guarantee, i.e., fair trial rights have failed, which corresponds with the great concern of the court to ensure respecting of these rights¹⁴⁰. Once there is no violation of Article 6, the court tended to look at the substantive issues. This means that in fact the court would scrutinize the adequacy of legislation (whether the legislation itself does not create such inequality as to enable on individual to be deprived of his property in favor of another) as well as the compensation actually provided in a particular case that will be in front of the court.

The major failures¹⁴¹ of the Czech regulation, which will be of relevance to the court, are¹⁴²:

- a) Mode of determination of adequate compensation. The amount is set on the basis of the expert opinion elaborated by an expert appointed and paid by a majority shareholder, contrary to, for example, the German regulation where such an expert is appointed by the court¹⁴³ or contrary to the Recommendation of the High Expert Group on Company Law
- b) The guarantee of payment of compensation – there is no requirement to deposit the funds for payment with a broker or a bank. This fact was admitted also by academic supporters of this particular regulation, who characterized it as “*evident deficiency of legal regulation*”¹⁴⁴. This might have lead to the situations that minority shareholder not only got less than was fair, but even for that s/he would

¹⁴⁰ On many occasions the court has reiterated that observance of the fair trial rights stands in the core of democratic system. See European Court of Human Rights, Judgment of 17 January 1970, *Delcourt v. Belgium* (Application no. 2689/65), para 25

¹⁴¹ For more details consult please the Chapter 1.

¹⁴² Which is mentioned somewhere *by the way* in the second paragraph regulating the invitation for General Meeting, as correctly observed by Josková, Pelikán, *Squeeze out po Česku*; Právní zpravodaj, no. 6/2005, page 7

¹⁴³ Petr Cech, *Další zamyšlení nad úpravou nuceného výkupu akcií*, Právní zpravodaj, 7/2005, page 11

¹⁴⁴ Tomáš Dvořák; *Squeeze-out aneb má drobný akcionář důvod k pláči?*; Právní fórum, 7/2005, page 257

have to pursue legal action. This has been changed after the 25th of September 2005.

- c) Two month foreclosure period to pursue legal action for inadequacy of compensation (set by majority shareholder's expert), restricting so standard prescription period on only 4% thereof without any justification. This is one of the harshest provisions, which presupposes that many of shareholders will not at all have the possibility to reconsider legal action as they will not find out about the Squeeze Out in this period (in case the "shares on owner", where the information requirement is solely to publish this information in newspapers).
- d) Judicial costs. In case a minority shareholder decides to claim her rights in court, she has to pay for a new expert opinion, attorney at law, costs of proceedings. Burden of proof as well as all these costs are transferred to the minority shareholder¹⁴⁵ (the coverage that you get in case you win a case is usually not full), so in the end it is a substantial obstacle for any minority shareholder to turn to the court. Moreover, the court proceedings might not end up well for the minority shareholder (what would cause her to pay immense amount of money as coverage of the expanses also the counter part), so in reality the risk of legal action is so vast and the benefit so tiny (except exceptional cases) that the minority shareholder, even if s/he would be prepared to sacrifice time and effort, can have not even a slight incentive to go to the court. Not to mention the time of proceedings that might take several years. Moreover, the legislator has not set any moratory interest over statutory level as is the case in other countries which might create an incentive to the majority shareholder not to prolong proceedings indefinitely.

¹⁴⁵ Contrary to other legal systems, see paras. 195

All this speaks rather unfavorably of the legislation, and I am convinced that it has created such inequality that it meets the threshold set in the *Bramelid and Malstrom v. Sweden*. The arbitrariness of the legislation is evident also from the deliberate divergence of the obligations set in the Takeover Bids Directive which has led to the initiation of infringement proceedings against the Czech Republic. How unfavorably this legislative setting works for minority shareholders will be even clearer in concrete cases where it is highly likely that the compensation often did not reach even one third of the real value of the shares¹⁴⁶.

Another crucial moment is that of adequate compensation. As many times reiterated by the court, the **compensation**¹⁴⁷ **is crucial** to ascertain whether this fair balance has been struck¹⁴⁸. In some cases – such as economic reform or social measures – it might be justified that the compensation is not a full one (as sometimes states might require solidarity between persons belonging to the society). In all other cases, especially when the legislation tries to find balance between interests of private parties, the fair balance means that the legislator strives to protect the interests of the parties equally¹⁴⁹. This means that the full compensation rationale is inevitable in regulating relations between private parties¹⁵⁰, in the end the equality of parties in the eyes of the law is a basic principle of the whole private law.

In the above mentioned decision (*Offerhaus*), the court has found a reasonable relation when the price was confirmed by the national courts on the basis of objective

¹⁴⁶ See supra Chapter 1 *E.ON. case*, see above, para. 12.

¹⁴⁷ It is very likely that complaints concerning inadequate compensation are going to be in core of applications that might be reaching Strasburg.

¹⁴⁸ Otherwise, according to the court, the protection under Article 1 of Protocol 1 would be only “*largely illusory and ineffective*”. See European Court of Human Rights, Judgment of 21st February 1986, *James and others v. UK* (Application no. 8793/79), para 54

¹⁴⁹ What’s more, in welfare state, a state would often give more protection to the weaker party more in order to balance the factual difference between the parties. The Czech legislator has gone completely different direction.

¹⁵⁰ This is even more so if we consider that minority shareholders are inherently disadvantaged when compared to majority shareholder in squeeze out situations.

criteria - the price of shares on regulated markets (and one other factor). It seems that the court leaves a wider margin of appreciation than it would be desirable. However, though this may not be the most favorable standard and states do have leeway for the way compensation is set, it is obvious that the court will require a certain level of fairness and objectivity. I am convinced that this minimum standard can hardly be met in many cases where the compensation has been set under the Czech legislation¹⁵¹.

3.2.1. Discrimination

In case the court would not find legislation to be in conformity with the standards set in *Bramelid* as well as compensation to be in that particular case rationally related to the value of the property taken (in case the court would sustain such a minimalist and generally inadequate assessment as shown above), there might be a chance to prove a violation of Article 1 of Protocol 1 as read together with Art. 14 of the Convention. Namely, it might be established that the legislation **discriminates** minority shareholders on the basis of property without any objective and reasonable justification.

In general, the principle of equality of treatment would be violated **if the particular distinction** between the groups of people **has no objective and reasonable justification**. A difference in treatment has to pursue a **legitimate aim**, and there had to be a reasonable relationship of **proportionality** between the means employed and the aim sought to be realized.

The problem with discrimination cases is of course setting a comparison groups. Experience has taught us that considerable injustice can be committed by setting misleading groups and coming then to conclusions (which the US academia calls) ‘equal

¹⁵¹ See closer Chapter 1 *E.ON. case*, see above, paras.12

misery rationale’¹⁵². The question here is whether the court would be only willing to take as reference group minority shareholders as opposed to majority shareholders, where there is obvious differential treatment if the big shareholder decided unilaterally about the rights and obligations of the small shareholders, or not. The GFCC did not have a problem to find these groups comparable in *Feldmühle* decision, 45 years ago.

In our case, if the courts would accept comparison of minority and majority shareholders, it seems that for the evident bias in legislation (when bigger shareholders can practically without control appropriate the property of small shareholders and the legislator does not, despite all accessible knowledge, include in the legislation a single protective tool), legislation should not pass proportionality analysis. The Legislator omitted protective legislative techniques which are standard in other member states of the EU¹⁵³, which are part of the Directive regulating the same subject matter and which are held to be of the utmost importance in academic¹⁵⁴ as well as political¹⁵⁵ circles¹⁵⁶. In any case, the assessment of the court in a real case would depend a great deal on the borders of the margin of appreciation the court will leave to the states when regulating by means of private law legislation¹⁵⁷.

¹⁵² In many early discrimination cases (concerning sex discrimination, or sexual orientation discrimination) the courts were reluctant to set groups fairly what lead to the very said results; i.e. there is no discrimination as one gay couple is treated equally as any other gay couple etc.

¹⁵³ Not to mention the fact that without them many national constitutional courts would quash down the legislation.

¹⁵⁴ See *Report of the high level group of company law experts on issues related to the takeover*; Brussels, 10 January 2002, http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf

¹⁵⁵ It is a group of Senators which applied to the CCC regarding the unconstitutionality of legislation, moreover we should also note resistance of Senate to adopt this legislation (the Senate was over voted by the House of Commons).

¹⁵⁶ Moreover, this legislation comes into effect closely after the beginning of transposition period (with a great rush), which also confirms a lobbyist order impression

¹⁵⁷ It is again clear that the public / private law division plays against individuals in case their rights were infringed by ‘innocent and contractual’ private law.

Chapter 4. CONSTITUTIONALITY OF SQUEEZE OUT LEGISLATION

4.1. Review of the case law of the CCC

After examining the jurisprudence of the GFCC and ECtHR, as well as possible consideration of the latter regarding the Czech regulation of Squeeze Out, it is time to turn to the CCC and its case law. The CCC has developed its case law in Property cases mostly with the regulated tenancy issues and restitution issues, but it seems to be applicable more generally as well.

The CCC applies a (quasi) proportionality analysis, which in case of Property claims means that the court assesses¹⁵⁸ whether the interference with the property follows a legitimate aim, whether it is in the accordance with the national law and whether it is proportionate to the legitimate aim followed¹⁵⁹. The CCC elaborated its specific test of proportionality test in right to property cases in line of decisions concerning *Rent-control schemes*. To demonstrate the line of reasoning and the CCC's analysis itself, I will describe the basic features of the case law in the field.

In its Decision No. 42/2003¹⁶⁰ the CCC states that the protection of tenancy rights (of tenants) presents legitimate interference of the property rights as it contributes to the right to have an acceptable level of living in the meaning of Art. 11 of ICCPR or Art. 16 of the European Social Charter. However, when the protection of tenants is motivated by social concerns, it is obvious that the interference with the rights of the owner of the property over satisfying the basic housing needs of the tenant would not pass the

¹⁵⁸ According to the Constitutional Court similarly to the assessment by the European Court of Human Rights. See. E.g. Czech Constitutional Court, *Decision No. Pl. ÚS 42/03* of 28th March 2006, par. 45

¹⁵⁹ Compare e.g. Czech Constitutional Court, *Decision. No. ÚS 482/02* of 8th April 2004, par. III

¹⁶⁰ See Czech Constitutional Court, *Decision No. Pl. ÚS 42/03* of 28th March 2006, para 45

proportionality test. In its Decision No. 47/2005¹⁶¹ the CCC added that the state has to respect the appropriate balance between the requirements of the general interest and requirement of the protection of the human rights of the individual¹⁶². That, according to the CCC, means that even though the regulation of the payments for the tenancy is not expropriation and the right to property is not an unlimited right, it can be *'limited only to the extent in which it does not touch upon the core of the right to property, while even here the prohibition of discrimination is in place'*¹⁶³.

After many decisions where the court declared further and further legislation regarding regulated tenancy unconstitutional and void (as legislation harshly infringed property rights of owners through setting rental fees which could not cover even maintenance of the buildings as well as making it very difficult to end the tenancy rights under any circumstances¹⁶⁴ and the tenancy turned it to be kind of quasi-ownership¹⁶⁵), the court finally in its famous Decision No. 611/05 declared that *'taking into consideration the decision of the ECtHR which considers jurisprudence to be law in material sense, it is on the (Czech) courts to fill up the gaps in legal system through its case law, i.e., to create law, which would be possible to consider to be law in material / substantive terms'*¹⁶⁶. I am aware that this decision might seem commonplace to a common law lawyer, but for a lawyer from a civil law system, who traditionally considers courts to be solely a "Mouthpiece of the Legislation"¹⁶⁷, this is a strong decision. Of course, it was always the role of the courts *to fill up the gaps* through interpretation tools (analogy etc.), but under

¹⁶¹ See Czech Constitutional Court, *Decision. No. ÚS 47/05* of 13th June 2006, para IV.

¹⁶² *Ibid.*

¹⁶³ See Czech Constitutional Court, *Decision. No. ÚS 47/05* of 13th June 2006, para IV.

¹⁶⁴ It was rather a joint venture of (unconstitutional) legislating and practice of the courts which did not usually allow for termination of tenancy contracts after fulfillment of legislative requirements.

¹⁶⁵ In this respect see European Court of Human Rights, Judgment of 19th June 2006, *Hutten-Czapska v. Poland* (Application no. 35014/97). The ECtHR found similar legislation valid in Poland as violating applicant's right to property.

¹⁶⁶ See Czech Constitutional Court, *Decision. No. 611/2005* of 8th February 2006, par. IV

¹⁶⁷ See Montesquieu, in *The Spirit of the Law*. See e.g. a summary at:

http://oll.libertyfund.org/index.php?option=com_content&task=view&id=462&Itemid=287

the civil law doctrine the courts have never been supposed *to create* law. In this case the court requires the ordinary courts¹⁶⁸ to increase the rent in justified cases despite the fact that the law does not provide for such increase of regulated rent. In this moment the court really steps out for the protection of the property rights of the owners of the regulated housing.

The court has always reiterated that the protection of the right to property goes always hand in hand with prohibition of discrimination. And indeed, the court has a remarkable ‘anti-discrimination case law’ connected to the right to property¹⁶⁹. It is important to note that there is only one case of the CCC which is directly relevant to the situation presented in Squeeze Out procedure, this is not caused by non interest of the applicants but rather refusal of the court to deal with the issue on the basis of admissibility criteria¹⁷⁰.

4.1.1. Discrimination

The perception of the discrimination in the case law of the CCC has some general features. The basic rule, on which the whole case law derives, is Art. 11 (1) of the Charter: *‘everybody has right to own property and the property rights of all owners have the same legal content and protection’*. As in many other legal systems, the court refuses the

¹⁶⁸ The Constitutional Court of Czech Republic is not part of the system of the ordinary judiciary (Art. 91 of the Constitution), but rather a specialized court for the protection of constitutionality (Art. 83 of the Constitution). The Czech Republic has adopted a specialized and concentrated system of constitutional review, contrary to the diffuse system known e.g. in the USA.

¹⁶⁹ Of course, the adjectives used here are suitable for the context of the countries which have left the Communist regime recently and their case law can hardly be compared with the countries where the Constitutional courts or Supreme Courts are deciding compatibility cases for decades.

¹⁷⁰ Refusal to deal with case concerning Transfer of the property to the majority shareholder on the basis that it was lodged by unauthorized person (despite the strong dissent). Also postponing decision on the squeeze out, which is lodged already for 2 years, leaves the impression that the CCC is rather hoping that other law will come into effect before the decision.

absolute understanding of equality¹⁷¹. Rather, it tries to protect relative equality, which means that only inequality not based on reasonably justifiable objective criteria should be removed. In other words, from the postulate of equality does not follow that the substantive equality should be achieved but rather that the law should not unjustifiably favor one before the other¹⁷².

The principle of relative equality (introduced by the Czechoslovakian Constitutional Court (hereinafter CSCC) in Decision No. 11/1992) entails also that it is in the competence of the state to provide for less favorable treatment of some groups comparing to the others. However, it is crucial that the state bases its decision on the objective and rational criteria.

'In case that the law assigns disproportionate obligations to one group and simultaneously favors another, this might happen only with the reference to the public values (public interest)',¹⁷³

In another decision the CCC interprets the equality paradigm¹⁷⁴ so as to entail requirements of 1) exclusion of the arbitrariness from the action of legislator when differentiating between the subjects, as well as 2) the 'constitutional acceptability' of the reasons for the differentiation¹⁷⁵. However, in any case after establishing that the differentiation based on the rational and objective criteria, the test of proportionality has to take place. This we will address in the last part of this Chapter.

However, before we go to the following part (where we will apply the principles extracted from the examined case law to the present situation of Squeeze Out), it is necessary to have a closer look on the one of the most relevant cases. In the Decision No.

¹⁷¹ This is generally in line with the case law of the European Court of Human Rights.

¹⁷² See e.g. Czech Constitutional Court, *Decision. No. ÚS 38/2001* of 12th March 2003, par. IV

¹⁷³ See Czechoslovakian Constitutional Court, *Decision. No 11/1992*, Sbírka usnesení a nálezů ČSFR, nález č.11, 1992

¹⁷⁴ See Czech Constitutional Court, *Decision. No US 30/2004* of 14th March 2006, par. IV

¹⁷⁵ These considerations are of course common in foreign jurisprudence, where the commonly used terms for the second requirement is permissible (as opposite to usually enumerated impermissible) grounds for differential treatment and for the first requirement the necessity (for the legislator) to prove the existence of objective and justifiable criteria on which differentiation is based.

38/2001, the CCC has assessed the differential treatment of majority shareholders who have acquired their shares in privatization process and all the other majority shareholders, where the first were exempted from the obligations in respect of mandatory takeover bids. The CCC rejected the arguments of state that this treatment was necessary for the successful and speedy privatization and found that there are no any reasons which could objectively justify disparate treatment of different groups of majority shareholders¹⁷⁶. In this decision the CCC states that any interference with the basic human right is incompatible with the constitutional order of the Czech Republic unless it *‘does not respect the principle of minimalisation of the interference with the right and simultaneously maximalisation of preserved content of the basic right’*¹⁷⁷.

4.2. Application of the constitutional principles to the Squeeze Out procedure

From the previous part it can be inferred that the court would address the question of constitutionality of Squeeze Out legislation on two different levels. The first level would concern constitutional implications of Squeeze Out on the right to property itself, the second one would concern issues regarding discrimination of minority shareholders. Given the fact that both issues pose us different questions, we will consider them separately.

The court would first have to deal with the question of whether the law regulating Squeeze Out violates the right to property and whether it is therefore unconstitutional. There are three sets of important issues that the court will have to address before it reaches the answer. For the purposes of this thesis, I am going to discuss the questions raised *only*

¹⁷⁶ Relevant provisions did not discriminate only between different groups of majority shareholders but also between different groups on minority shareholders to whom in first line the protection offered through mandatory takeover bids was offered.

¹⁷⁷ See Czech Constitutional Court, *Decision. No 38/2001* of 12th March 2003, par. IV

to the extent that they might seem relevant for the decision of the CCC. I am not going to enter theoretical discussions regarding these issues as that is far beyond the scope of the thesis which is namely to portrait what is a possible general outcome of state regulation at issue.

The first set of questions concerns **expropriation**. What does our Constitution imply under the word expropriation? Could a similar regulation be understood as expropriation, or private taking? The second set of questions tries to answer the question of what rights ownership of a **share** incorporates. Which rights of a shareholder might be violated by similar legislation? The last set of questions concerns which the **requirements posed by the legislature** when regulating relations between private parties are. Are there any positive obligations of the state to protect the property of minority shareholders by all accessible legislative tools? Does the Constitution require the state to use all the available legislative tools for protection of property of minority shareholders in this case? What should the legislature take into consideration when choosing legislative tools for the protection of property in this case? Was the right to property of shareholders violated by the legislation in question?¹⁷⁸

The first set of questions was largely debated in the Czech legal community after the enactment of the Squeeze Out regulation. To summarize, one group considered the Squeeze Out procedure not to be expropriation as they relied mainly on the historical arguments as well as the prevailing contemporary understanding of the Expropriation, i.e. *ad hoc* “taking of the property by the state in administrative proceedings through issuing an administrative act from which the individual deprived of its property had appeal”¹⁷⁹. Apparently, this does not reflect even a restricted position taken by the ECHR which takes

¹⁷⁸ The only question which has been already solved is whether “shares” constitute property within the sense of Art. 11 of the Charter of Fundamental Rights and Freedoms.

¹⁷⁹ See e.g. JUDr. Bohumil Havel, *Vyvlastnění, vytlačení akcionářů a ústavnost*, Právní rozhledy, 6/2006, page 215

into consideration factual situation and assesses whether it is not an expropriation *de facto*, rather than just looking on the formal conditions.

On the other hand the group arguing that the Squeeze Out procedure might constitute expropriation emphasized rather functional approach to this question and ascertained that the most important attribute of expropriation is ‘forced deprivation of property’¹⁸⁰ on the basis of legislative authorization. Therefore if we are to interpret the constitution seriously, we have to stick to the purpose for which these provisions were enacted, i.e., to protect persons from similar interferences by the state. If the CCC had taken this stance it would have serious implications on the Squeeze Out procedure as every Squeeze Out should pass the ‘public interest test’ in each case (unless there is a change in the Constitution). Among other problems, this would not be in line with Directive on Takeover Bids¹⁸¹.

Given diverging theoretical opinions, it is rather unlikely that the court would choose a confrontational position and would probably decide in line with the ECtHR and other constitutional courts which give preference to the first position, perhaps for utilitarian reasons. Concluding the first set of questions, there is a very slight possibility that the court would find Squeeze Out to create expropriation with all the consequences that this might bring under the Constitution.

The second set of questions concerns character of the share, rights incorporated in ownership of a share and the question of rights might be actually infringed by the Squeeze Out. The ECtHR has addressed this question in *Bramelid and Malstrom v. Sweden* where the ECtHR says that

¹⁸⁰ See e.g. Mgr. Martin Škop, *Některé ústavně právní rysy úpravy vytlačení minoritních akcionářů*, Právní Rozhledy, 24/2005, page 883

¹⁸¹ See also *supra* Chapter II, 1.3. *Excursus to the EC Law*

*'A company share is a complex thing: certifying that the holder possesses a share in the company, together with the corresponding rights (especially voting rights), it also constitutes, as it were, an indirect claim on company assets.'*¹⁸²

It is obvious even from this simplistic definition that shares entail some property claims as well as social claims. The CCC would probably reach for legal definition which in Art. 155 of the Commercial code stipulating that a

*'Share is a security which entails right of a shareholder to (in accordance with this code and statute of the company) take part in managing of company, on its profits and on the liquidation balance in case of termination of company activities.'*¹⁸³

It seems that we might accept that the share entails social and property rights (and consequently claims) what makes it more difficult to justify the Squeeze Out procedure. However, there hardly is any dispute regarding the actual impact of rights of minority shareholders in situation where the majority shareholder holds 90 % or more of the company voting rights and basic capital, the minority shareholder in fact has no influence on the management of a company¹⁸⁴ and the only remaining interests are investment interests. It still does not mean that the shareholder might be arbitrarily deprived of his shares, but rather that it would be difficult to argue for the special status of the share ownership (when comparing to other property claims) due to the societal aspects of share holding. Consequently the argument that more protection is due to the shareholder because of the social aspects of ownership of a share (closely related therefore to the right to self-realization and personal autonomy) is very weak and it is very unlikely that it would be accepted by the CCC (as it was also was never accepted by other constitutional courts) and

¹⁸² See European Court of Human Rights, Decision of the Commission of 12 October 1982 on the admissibility of the applications, *Bramelid and Malmström* (Application no. 8588/79 and 8589/79), page 81 of the file available at <http://cmiskp.echr.coe.int/tkp197/portal.asp?sessionId=3213100&skin=hudoc-en&action=request>

¹⁸³ See Act no. 913/1991 Coll., *Commercial Code*, Art. 155 (1).

¹⁸⁴ Though there might be some exceptions – if the minority shareholder owns 5% or more the law gives her certain rights, eventually because of the special position of the shareholder in a company due to other characteristics then the number of shares held.

the share ownership would be assessed as a mere investment¹⁸⁵. Of course, the CCC might underline similarly to the GFCC, that in some special cases this assessment might end up differently.¹⁸⁶

The response to the third set of questions would lead us to the conclusion forming part of the decision of this case. Here the court will have to use (standard) judicial tools outlined previously in this chapter. Namely, the court will have to consider through a proportionality analysis whether interference with the right to property of the shareholders (which has been never disputed in front of any court) has constituted violation of the right to property or not.

The CCC would first assess¹⁸⁷ whether the interference with property follows the legitimate aim, whether it is in the accordance with the national law and whether it is proportionate to the legitimate aim followed¹⁸⁸. Given the substance of the Squeeze Out (decision of the majority shareholder – without regard to the will of minority shareholders – to squeeze them out with payment of a compensation), the issue whether the procedure constitutes **interference** will hardly be disputed.

The court will then proceed to the assessment of **legislative aim** of the Squeeze Out regulation. Benefits of this regulation were summarized as by some Czech authors as follows¹⁸⁹. Firstly, Squeeze Out eliminates conflicts between the interests of the mother undertaking and the partly owned daughter undertaking in inter-holding transactions.

¹⁸⁵ Here again I repeat that I will not go into detail on these particular questions because we are interested in the decision of the court rather than theoretical scholarship on company law. The similar conclusion was reached by the German Federal Constitutional Court; Judgment of August the 7th, 1962; *Feldmühle Fal* (BVerfG, 1 BvL 16/60); NJW 1962, Volume 37, page 1667 and fol. as well as in See German Federal Constitutional Court, Judgment of May 30th 2007; BVerfG, 1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04); available at www.bundesverfassungsgericht.de, para 23 - 35

¹⁸⁶ See German Federal Constitutional Court, Judgment of May the 30th 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft* (1 BvR 390/04), para 23

¹⁸⁷ According to the Czech Constitutional Court similarly to the European Court of Human Rights, see paras. 147

¹⁸⁸ See e.g. Czech Constitutional Court, *Decision no. ÚS 482/2002* of 8th April 2004, para III.

¹⁸⁹ See JUDr. Martin Uzsak, LL.M., *Co se o squeeze-out(u) nepíše (I. část)*, Bulletin advokacie, 4 / 2007, page 16

Secondly it is claimed that it benefits the minority shareholders as it enables them to divest of illiquid shares. Thirdly, it motivates majority shareholder to the further investments and finally, Squeeze Out eliminates costs connected with the existing minority (information costs, obligatory revealing of potentially abused information, etc.). It is argued that the Squeeze Out procedure is therefore highly effective and contributes to the liquidity of the capital markets, what is indispensable for the modern liberal economies to function properly¹⁹⁰. Similar justification was adopted also in the Report of High Level Group on Company Law. Of course, there are many different opinions regarding the effectivity of Squeeze Out¹⁹¹ given by the highly estimated authorities in the field. However, the opinion of the majority favors the first position and squeeze as such has become reality in today's world. Therefore I do not find it very likely that the court would find it to oppose this conclusion¹⁹².

Once the court established the existence of a legitimate aim, it would examine whether the interference follows rules stipulated in national legislation (which is however more applicable to constitutional complaints; what is not the case of applications lodged with the CCC) and then try to find out whether the means chosen are proportional to the aim followed.

The importance of the protection of property rights of minority shareholders is an undisputed objective of regulation of Squeeze Out declared by EC legislation as well as national legislations. The importance of this aim follows also from the High Level Group

¹⁹⁰ See *Report of the high level group of company law experts on issues related to the takeover*; Brussels, 10 January 2002, http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf

¹⁹¹ Christoph Van Der Elst, *Squeezing and Selling-out ± Patchwork of Rules in Five European Member States*, European Business Law Review, Feb. 2007, First Edition 2007

¹⁹² As was the case in the decision of the Constitutional Court of Georgia which found the institute itself unconstitutional because such solution is not proportional to the aim followed (greater effectiveness of companies). The Georgian Constitutional Court would allow for squeeze out on *ad hoc* basis, if special need is proven. <http://jinepravo.blogspot.com/2007/07/squeeze-out-auf-deutsch-stavn.html>

report, decisions of the different national courts¹⁹³ throughout Europe as well as decisions of ECtHR. Besides, the threshold for the Squeeze Out was set in such a manner as not to raise doubts regarding the proportionality of a limitation of the right to property although it could have been argued that the effectivity would be served better if the threshold was lower¹⁹⁴.

The second prong of Proportionality analysis requires the use of the **least restrictive means** to reach the aim pursued. The objective for the legislator is to reach the aim with the minimum infringement upon the content of the right or, in the words of the court, “*to respect the principle of minimalisation of the interference with the right and simultaneously maximalisation of preserved content of the basic right*”¹⁹⁵.

What does this imply? The case law of the CCC, the doctrine¹⁹⁶ as well as comparative studies lead us to the conclusion that the least restrictive means proposition requires the legislature **to use such legislative techniques or tools as to reach the aim of legislation with simultaneously minimizing interference and maximizing preserved content of the right to property of the minority shareholders**. We can draw a parallel with the Squeeze Out decision of the GFCC¹⁹⁷ where the GFCC found that the legislator used least restrictive means because, firstly, the legislator has set a 95% threshold for the Squeeze Out procedure which should guarantee that those subject to Squeeze Out are solely minority shareholders who have only investment or capital interests in the company

¹⁹³ Similarly German Federal Constitutional Court; Judgment of August the 7th, 1962; *Feldmühle Fal* (BVerfG, 1 BvL 16/60); NJW 1962, Volume 37, page 1667 and fol. or French Supreme Court, Judgment of 29 April 1997, *Association de défense des actionnaires minoritaires et autres against Société Générale et autres*, Recueil Dalloz 1998, pages 334-338.

¹⁹⁴ Similarly German Federal Constitutional Court, Judgment of 30th May 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft* (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)), para 23

¹⁹⁵ See Czech Constitutional Court, *Decision. No 38/2001* of 12th March 2003, par. IV

¹⁹⁶ Similarly many contemporary legal philosophers, e.g Alexy, Kumm, A. Barak, etc.

¹⁹⁷ See German Federal Constitutional Court, Judgment of 30th May 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft* (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04)), para 23 - 35

and no social rights violation is engaged¹⁹⁸. Secondly, the compensation is determined by the expert(s) appointed by the court for these purposes. Thirdly, a bank guarantee further enhances property protection of the minority shareholders. Fourthly, in case compensation would still not be set on appropriate level there is a possibility for correction in a special judicial procedure. Fifthly, the interest charge over the statutory level also corresponds to the constitutional defaults. And lastly, the protection tool is an appropriate contestation proceeding.

The CCC should establish whether the legislator has used such legislative techniques as to provide for appropriate protection of minority shareholders. To find out which techniques are available to the legislator, it is necessary to research provisions of other legal systems, EC legislation, case law of the ECtHR as well as other national constitutional courts decisions and lastly (but not least) the positions of academia, which might prove to be helpful in this case. In particular, this means that the Court needs to look into 1) in the case law of the ECtHR, 2) further on in the EC legislation and supporting documentation, namely the Report of the High level Group on Company Law on Takeover bids Directive¹⁹⁹ and 3) the court could find useful guidance in legislations²⁰⁰ of other EU Member States as well as decisions of the their Constitutional / Supreme courts²⁰¹.

I have dealt with all above mentioned sources in different parts of this thesis and conclusions were drawn regarding the tools commonly used in Europe for the protection of

¹⁹⁸ The German Federal Constitutional Court (in decision cited above - paras. 184) states that '*Whether applies for something else, if a shareholder has in individual cases a large, recognize-worth interest in the participation in an enterprise, like it for instance with shareholders from the family circle with exempt private companies is conceivable.*' (para 23)

¹⁹⁹ See supra the first Chapter, 1.3. *Excursus to EC Law*

²⁰⁰ The framework is provided in e.g. Article 513 of the *Belgian Companies Code* and (amended) *Royal Decree of 1989 on Takeovers*, in Article 433-4 of the *French Civil Code*, in Section 327a of the *Aktiengesetz* or in Article 2:92a *New Dutch Civil Code*.

²⁰¹ See e.g. German Federal Constitutional Court; Judgment of August the 7th, 1962; *Feldmühle Fal* (BVerfG, 1 BvL 16/60); NJW 1962, Volume 37, page 1667 and fol. or French Supreme Court, Judgment of 29 April 1997, *Association de défense des actionnaires minoritaires et autres against Société Générale et autres*, Recueil Dalloz 1998, pages 334-338.

minority shareholders in Squeeze Out situations. At this point I will solely highlight some of the most repeated conclusions that the court must discover through any such comparative analysis. Moreover, the conclusions valid for the ECtHR are double valid for the CCC, as constitutional courts do not have limitations that lay on the ECtHR.

First of all the court would find that the crucial element for all legislators as well as the courts was the amount of compensation and the way such compensation is set. As correctly pointed out by the ECtHR in *James*, protection of the right to property without right to compensation in cases of deprivation would become solely illusory. Therefore, starting from the first case dealing with similar questions (*Feldmühle*), the courts have given strong emphasis on the right to adequate and fair compensation.

There is number of ways how EU Member States set the amount of compensation for the purposes of Squeeze Out. The most often being 1) the ‘premium price’ (highest price) paid by the majority shareholder for the share during settled period (in case majority shareholder has reached threshold in the previous 3 months), 2) price offered in the takeover bid – mandatory or voluntary (if the majority was acquired through such bid in certain period), 3) price set by two or more experts appointed by the court or Supervising Authority or 4) price set by the company which has to be assessed by the two or more experts appointed by the court or Supervising Authority. Expert opinion being in any case the most subjective variant, there is often guidance which economic analysis to apply set either by the secondary legislation or in Supervising Authority.

Turning to the Czech legislation, the most important moments which should be addressed by the court:

1. The statute requires that the person who wants to Squeeze Out minority shareholders should either own 90% of *Participation Securities* **or** have at least 90% of all *Voting*

Rights. As mentioned before such regulation might lead to the result that the minority shareholders are deprived of the shares (majority) shareholder who has 90% of ground capital but 50% of it is consisting from the changeable bonds (which are also participation securities) pursue Squeeze Out with in reality holding only 60% of capital. Similarly, the person holding 90% of voting rights might in reality be owner of only 45% of shares if the company had made use maximally of its right to issue priority shares and the voting shares so create only 50% of all shares. As mentioned before, the threshold is one of the most important guarantees for the minority shareholders.

The legislator might have excluded danger by requiring both conditions to be fulfilled simultaneously (as is the case in most jurisdictions) or to exclude unconstitutional effect through reformulation of the provision.

2. The most serious deficiencies in respect of Adequate Compensation are:
 - a) The way of setting the **adequate compensation** – the compensation is set by the majority shareholder on the basis of the expert opinion elaborated by an expert appointed and paid by a majority shareholder.

This is in the sharp contrast with the practice in the rest of EU countries. Given the highly subjective character of such an opinion, this is the least desirable solution for setting the compensation and therefore, at minimum, the expert(s) should be appointed by a court or the Supervising Authority. Eventually also a mathematical method for ascertaining compensation could have been set by the legislator. However, the legislator did not make any attempt to objectivize the setting of compensation in order to protect the interest of minority shareholders.

- b) Time restricted access to the court for revision of the adequacy of compensation.

The legislator never gave any reason for this unprecedented restriction of the statute of limitations' period. It is debatable whether this provision might not be found unconstitutional already on the first prong of the Proportionality test, i.e., means rationally connected to the aim, as the legislator never gave any explanation of the restriction of prescription period down to the 4% of the standard prescription period²⁰².

c) Judicial costs.

In case the minority shareholders decide to claim their rights before a court all costs are transferred to the minority shareholders, which is a substantial obstacle for any minority shareholder to turn to the court. Given the disparity between the risk undertaken by the minority shareholders who carries all the costs of the proceedings, and the potential benefits that the minority shareholders might obtain through proceedings is so great, that it will often lead to complete insulating potential violators from the risk of a lawsuit. Consequently, the less minority shareholders a company has, the greater the probability that violations of minority rights will occur as the majority shareholder can be sure that there is little risk s/he would be sued. In cases where the law itself does not provide for guarantees of full compensation through different legislative techniques, it enables the stronger party to arbitrarily deprive the minority shareholders of the part of their property.

Given the fact that all the costs are transferred to the parties whose rights are being at stake, moreover, these costs might create a substantial obstacle to access to justice in these particular cases, the legislator should have provided for

²⁰² This provision could have been explainable in case the inscription to the trade register would be connected to the end of contestation proceedings but there is no any such requirement.

expenses to be covered by the majority shareholder (as is the case in other countries²⁰³).

d) Moratory interests.

The legislator does not provide for another tool which should motivate the majority shareholder to fulfill its obligations toward minority shareholders and on the other hand provide compensation for delay of payment.

In conclusion, the legislator did not use necessary techniques to minimize the interference with the right to property of minority shareholders in Squeeze Out legislation. It implies that the legislator did not use the least restrictive means of interference with the right to property and therefore the regulation of Squeeze Out is unconstitutional for violation of Art. 11 of the Charter on Fundamental Rights and Basic Freedoms²⁰⁴.

This all leaves little doubt as to whether the Court would find this piece of legislation unconstitutional, in case the CCC decides at all. The Court should not also avoid addressing other formative considerations, such as the inherent advantage on the side of majority shareholder to manipulate the timing of Squeeze Out to the detriment of minority. Finally, it is necessary to remark that the possible grounds for decision, as presented in this part of the thesis, are **minimum grounds** for finding unconstitutionality of the legislation. It is unquestionable that there are some more issues in the 'air' which are not to discussed here for the sake of maximal reliability of answers given by this thesis.

4.2.1. Discrimination

²⁰³ See Petr Zima, *Právo výkupu po x-té a nikoliv naposledy*, Právní rozhledy no. 19/2006, page 708-9

²⁰⁴ See Charter of Fundamental Right and Basic Freedoms, *Constitutional Act no. 2/1993 Coll.*

As mentioned in the beginning of this Subchapter, another claim that the CCC should examine is discrimination between shareholders. However, it is necessary to note that the Court would probably not enter into an examination of the discrimination claim in case it establishes a violation of the right to property. It would be however a significant decision if the court decides to do so (because of the innovative setting of the comparison groups in the case law of the Court). I will avoid the question of whether the court could find illegal discrimination in connection with the Right to Property or as standing alone, as it is not decisive to the result in this case and the court uses both conceptions²⁰⁵.

As reiterated many times after the Decision of CSCC No. 11/1992, it is within the competence of the state to decide to provide less favorable treatment for some groups comparing to others. However, it is crucial that the state bases its decision on objective and rational criteria. *'In case that the law assigns disproportionate obligations to one group and simultaneously favors another, this might happen only with the reference to the public values (public interest).'*²⁰⁶

To assess any discrimination claim it is crucial to first set the comparison groups. In which case the court decides that the groups are comparable or contrary is a difficult question. The court alone admits that this is one of the most difficult tasks²⁰⁷. For our purposes the CCC has found as comparable groups in property cases for example group of tenants and house owners in its Decision No. 30 / 2004. The situation between these groups seems to be similar to the one we have in the Squeeze Out setting. Both groups stand on the different stands, one is weaker (and therefore unjustifiably) favored, while the other presumably stronger is therefore discriminated against. The situation in the Squeeze Out is even 'easier' to the extent that differential treatment is detrimental to the interests of

²⁰⁵ See Bobek, Boučková, Kuhn, *Rovnost a Diskriminace*, C.H.Beck, Praha, 2007, Page 182-185

²⁰⁶ See Constitutional Court of the ČSFR, *Decision. No 11/1992*, Sbírka usnesení a nálezů ČSFR, nálež č.11, 1992.

²⁰⁷ See Czech Constitutional Court, *Decision No. Pl. ÚS 42/2003* of the 28th March 2006, para 57

the weaker party. Moreover, it is of relevance that the GFCC has found these groups (minority and majority shareholders) comparable already in *Feldmühle decision*²⁰⁸.

In case the court would accept that the minority and majority shareholder are comparable groups for the purposes of this comparison, it is expectable on the basis of the CCC case law that the court would find discrimination of the minority shareholders. The grounds for such decision, as outlined above in the Decision No. 30 / 2004, are that the court will scrutinize two aspects 1) exclusion of the arbitrariness from the action of legislator when differentiating between the subjects as well as 2) requirement of the ‘constitutional acceptability’ of the reasons for the differentiation. After ascertaining that the differentiation between majority and minority shareholders is justified with reasonable and objective criteria, the court would pass to the proportionality analysis.

The legislator has differentiated between the two groups, i.e. majority and minority shareholders, perfectly legitimately, as otherwise the purpose of regulation could not be served. Coming to the proportionality, the court would ask whether there is a rational connection between the ends and the means used. Never being the strictest part of proportionality analysis, legislation would likely pass this part of the test and the court would go to the least restrictive means test. The arbitrariness might be found in the legislation in question because of the collision with the requirement that the “*law assigns disproportionate obligations to one group and simultaneously favors another, this might happen only with the reference to the public values (public interest)*.”²⁰⁹ We can interpret this legal sentence to mean that arbitrariness might be found if the legislator gives barely any protection to the rights of one group for the benefit of the other without proper

²⁰⁸ See e.g. German Federal Constitutional Court; Judgment of August the 7th, 1962; *Feldmühle Fal (BVerfG, 1 BvL 16/60)*; NJW 1962, Volume 37, page 1667 and fol. and German Federal Constitutional Court, Judgment of 30th May 2007, *Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR Ausschluss von Minderheitsaktionären aus einer Aktiengesellschaft (1 BvR 390/04))*, para 23 -35

²⁰⁹ See Constitutional Court of the ČSFR, *Decision. No 11/1992*, Sbírka usnesení a nálezů ČSFR, nálež č.11, 1992

justification on the basis of public values. Of course, there are some values for which such division would be eventually acceptable – such as social justice – but this is not the case here; **there is no any justification for this asymmetrical division of the benefits in this case.** Moreover, the situation is even reversed comparing to the owners ↔ tenants setting as the ones worth protection (weaker parties) are the ones against whom is being discriminated. From all these reasons it is expectable that the court would decide that the legislation unjustifiably discriminates against minority shareholder (under condition that the court finds the groups comparable) and as such is unconstitutional.

CONCLUDING REMARKS

This thesis attempted to shed light on the Czech regulation of the Squeeze Out procedure, its rationale and deficiencies, in a Europe-wide context. All the way through the different stages of examination of this piece of legislation, it has been shown that the legislation is hardly fulfilling the requirements posed by existing human rights standards. The Czech Regulation of Squeeze Out is in sharp contrast with the requirements posed by the GFCC as to the German counterpart, it seems not to satisfy rather low standards set by the ECtHR and finally, it does not fulfill standards set by the Czech Constitution as interpreted by the CCC in its case law.

If we look more closely to the results of the thesis, the predominantly empirical first chapter of this thesis tried to portray the somewhat worrisome circumstances present in the Czech Republic shortly before and after the adoption of Squeeze Out regulation. The widespread outcry of the academic and political (Senate) community did not practically influence the decisions of the legislator (enactment of the legislation and later amendments). It seems that the whole idea of democracy was endangered in this moment when the concept of 'Free Mandate' (sic!) was brought to its extreme. This concept should nevertheless entail that MPs are not be bound by will of their electorate, but rather decide on the basis of rational (and moral; depending on taste) arguments for the benefit of the whole. If MPs exercise collectively irrational choice, it seems, on the contrary, that the mandate was everything else but free.

The core of the thesis, however, lies in legal analysis of Czech regulation of Squeeze Out under two distinct bodies of law, ECHR and Czech Constitution, combined with brief instrumental assessments under German and EC law in order to expose the arguments of the two main analyses.

The analysis of the ECHR and case law of the ECtHR has shown that there is a solid legal basis for the court to find this legislation in violation of Convention under the *Bramelid* standard. The decision of the court will depend nonetheless on a policy decision, i.e. how great of a margin of appreciation the court will leave to the states in respect of this type of legislation. It is to be taken into account that the private law legislation assessed by the ECtHR in previous cases has hardly been ever so evidently lacking basic protective legislative techniques, that the ECtHR might be willing to send a message to the states that the margin of appreciation does not go so far to allow the legislator arrogantly to disregard interests of one group; not even in case of private law legislation. Moreover, given that the Convention is to be interpreted dynamically and standards and requirements of protection of Human Rights raise, as well as acknowledgement of danger stemming from the private law legislation, it is more likely that the court would step in this case. As a matter of fact, the private law regulation inadequately triggers less scrutiny than public law would, but this should not remain a principle as it is irrelevant whether our rights are infringed through private or public law legislation.

Given that the CCC has no any constraints similar to the ECtHR, there is little doubt that the court would find this legislation unconstitutional. This conclusion stems also from other considerations. Primarily it could hardly set much lower standards than the GFCC, as it would raise a great wave of disapproval in academia and undermine the position of the CCC. Additionally, there is no leeway to distinguish between the Czech and German legislations as they are conceptually similar and therefore there is no path to avoid tackling with the unpleasant issues. Finally, the supra-constitutional review in Strasbourg is a good incentive for the national courts to “behave”.

Reflection is also deserved by one of the latest development in the Czech Republic. The proposal for a new Civil Code embeds in article 3 (1) the principle that the Code

should be interpreted in accordance with the Charter on Fundamental Rights and Basic Freedoms. This doctrine, initially developed by the GFCC as the doctrine of indirect horizontal effect of human rights, has gained particular acknowledgment in Czech Private Law, detaching it from the constitutional adjudication of CCC. It is evident that the principles of constitutionalization of private law are gaining on force. This acknowledgement that human rights are to have some indirect force in private relations renders it even more obscure such an irrational resistance to submit private laws to equally strict scrutiny as public laws, when it is solely good old doctrine of the vertical effect, i.e. that the state is bound to protect our Fundamental rights and legislate in such a way not to interfere unnecessarily.

The irony of Squeeze Out is that the legislator allows the ‘rich and powerful’ to decide to deprive “poor and weak” of the benefits from taking part in a company once they do not need their capital any more or they do not want to share the profits. The irony, however, of Czech legislation is that it allows them to do so ‘without paying’²¹⁰.

²¹⁰ Metaphorical expression.

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ANNEX

Stock Corporation Act²¹¹
of 6 September 1965
(Federal Legislative Journal I p. 1089)
last amended by Art. 2 of the
Act of 12 June 2003
(Federal Legislative Journal I p. 838)

Fourth Part **Exclusion of Minority Shareholders**

§ 327a **Transfer of Shares in return for Cash Settlement**

(1) The general meeting of a stock corporation or a partnership limited by shares may, upon the request of a shareholder to whom shares in the company amounting to 95 per cent of the share capital belong (principal shareholder), resolve the transfer of the shares of the other shareholders (minority shareholders) to the principal shareholder in return for payment of an appropriate cash settlement. § 285 para. 2 sentence 1 shall not apply.

(2) § 16 paras. 2 and 4 shall apply for the purposes of determining whether 95 per cent of the shares belong to the principal shareholder.

§ 327b **Cash Settlement**

(1) The principal shareholder shall determine the amount of the cash settlement; it must take account of the situation of the company at the time of the passing of the resolution by its general meeting. The managing board must provide the principal shareholder with all documents and information necessary for this purpose.

(2) The cash settlement shall bear interest from the time of announcement of the registration of the transfer resolution in the commercial register at an annual rate of 2 per cent above the relevant base interest rate pursuant to § 247 of the Civil Code; this shall not preclude the bringing of claims for additional damage.

(3) Before the calling of the general meeting, the principal shareholder must transmit to the managing board a declaration by a credit institution authorised to carry on business in the area of application of this Act in which the credit institution guarantees fulfilment of the principal shareholder's obligation to pay to the minority shareholders, without undue delay following registration of the transfer resolution, the cash settlement determined for the shares transferred.

²¹¹ The translation is taken from the German Law Archive, available at <http://www.iuscomp.org/gla/index.html>

§ 327c**Preparation of the General Meeting**

(1) The announcement of the transfer as an item for the agenda must contain the following details:

1. commercial name and seat of the principal shareholder, in the case of natural persons name and address;
2. the cash settlement determined by the principal shareholder.

(2) The principal shareholder must provide the general meeting with a written report in which the preconditions for the transfer are set out and the appropriateness of the cash settlement is explained and substantiated. The appropriateness of the cash settlement shall be reviewed by one or more expert auditors. They shall be chosen and appointed by the court on the application of the principal shareholder. § 293a paras. 2 and 3, § 293c para. 1 sentences 3 to 5 and §§ 293d and 293e shall apply accordingly. In Ordinances pursuant to § 293c para. 2 the decision pursuant to sentence 3 in conjunction with § 293c para. 1 sentences 3 to 5 may be transferred accordingly.

(3) As from the time of the calling of the general meeting, the following shall be displayed for inspection by the shareholders in the business premises of the company

1. the draft of the transfer resolution;
2. the annual accounts and management reports for the last three financial years;
3. the report of the principal shareholder provided pursuant to paragraph 2 sentence 1;
4. the review report provided pursuant to paragraph 2 sentences 2 to 4.

(4) Each shareholder shall, upon request, be provided with a copy of the documents referred to in paragraph 3 without undue delay and free of charge.

§ 327d**Conduct of the General Meeting**

In the general meeting the documents referred to in § 327c para. 3 shall be displayed. The managing board may give the principal shareholder an opportunity to orally explain the draft of the transfer resolution and the computation of the amount of the cash settlement at the beginning of the proceedings.

§ 327e**Registration of the Transfer Resolution**

(1) The managing board must apply for registration of the transfer resolution in the commercial register. A counterpart or publicly certified copy of the minutes of the transfer resolution and its appendices shall be appended to the application.

(2) § 319 paras. 5 and 6 shall apply accordingly.

(3) Upon registration of the transfer resolution in the commercial register all shares of the minority shareholders shall pass; to the principal shareholder. If share certificates have been issued in respect of such shares, they shall, until they have been handed over to the principal shareholder, certify only the claim to the cash settlement.

§ 327f

Review of the Settlement by the Courts

An action for avoidance of the transfer resolution may not be based on § 243 para. 2 or on the fact that the cash settlement determined by the principal shareholder is not appropriate. If the cash settlement is not appropriate, the court specified in § 2 of the Award Procedure Act shall, upon application, determine the appropriate cash settlement. The same shall apply if the principal shareholder has not offered, or has not properly offered, any cash settlement and an action for avoidance based thereon has not been commenced within the avoidance period, has been withdrawn or has been finally and unappealably rejected.