Comparative Corporate Governance

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Unequal Treatment and Shareholders’ Welfare Growth.

Fairness vs. Precise Equality

34 Delaware Journal of Corporate Law 855 (2009)

Rivista delle società, 2009, 697.
British & American Trustee is a company incorporated in the UK, operating both in the UK & USA, managing two different businesses.

The company faces a deadlock.

Vast majority of shareholders agree to divide the business: since demerger was not known, the meeting resolves to reduce the capital and reimburse in kind to some shareholders (Americans).

One shareholder with trivial stake objects violation of the equal treatment.

The House of Lords rejects the claim, upholding the meeting’s resolution.

British & American Trustee & Finance Corp. v Couper, (1894) A.C. 399
Donahue is shareholder to Rodd Electrotype, suing directors for breach of fiduciary duties.

The corporation repurchased shares from Rodd but refused to do the same with Donahue.

The Supreme Court of Massachusetts decided in favor of Donahue, hence affirming the existence of principle granting equality of treatment of all shareholders (the Harvard approach).

Minority shareholders of a close corporation sue the directors for breach of fiduciary duties, as they enacted a share repurchase plan to only employee shareholders.

Indeed, employee shareholders could decide to sell their shares to the company at the time of retirement.

The Supreme Court of Delaware decided in favor of the directors, hence affirming that «stockholders need not always be treated equally for all purposes» (the Chicago approach).

Nixon v Blackwell, 626 A2d 1366 (Del. 1993)
Dir. 2012/30/EU, Article 46

For the purposes of the implementation of this Directive, the laws of the Member States shall ensure *equal treatment* to all shareholders who are in the same position.
A capital increase is decided by majority vote (Dir. 2012/30/EU, art. 33). However:

- whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares.
- The right of pre-emption may not be restricted or withdrawn by the statutes or instrument of incorporation. This may, however, be done by decision of the general meeting.

- Is a pre-emptive right granted in cases the capital is increased by consideration in kind?
- Is a pre-emptive right granted in cases the new capital is offered for subscription to workers or new investors?
A capital reduction is decided by majority vote (Dir. 2012/30/EU, art. 34).

- May the company issue shares which the company (or some shareholders or third people) may compulsorily withdraw without a decision of the general meeting?
- May companies issue shares, so that shareholders are reimbursed at will (redeemable shares)?
- May the company reimburse only some shareholders, or shall it partially reimburse all?
A buy-back or financial assistance, if permitted by the Member States, shall be realized under the following conditions (Dir. 2012/30/EU, Art. 21):

- authorization shall be given by the general meeting
- may not have the effect of reducing the net assets below subscribed capital and non distributable reserves
- only fully paid-up shares may be included in the transaction
- no prejudice to the principle of equal treatment of all shareholders who are in the same position.

- Equal Treatment vs. Fairness: what should prevail?
The Takeover Bids Directive (2004/25/EC) contains minimum guidelines for the conduct of takeover bids, involving securities with voting rights of companies governed by the laws of Member States, where all or some of these shares are admitted to trading on a regulated market. This directive aims at:

- **Ensuring equal treatment of shareholders;**
- protecting minority shareholders in case of change of control;
- prohibiting market manipulation or abuse; and
- providing shareholders with sufficient time and information to make a properly informed decision on the bid.
Market rule vs. equal opportunity rule?

- **Control is itself a corporate asset**: hence, if a premium should go anywhere, it “must go into the corporate treasury”, and indirectly benefit all shareholders (ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 244 (1933));


- All shareholders have an equal opportunity to sell the same portion as the controlling shareholder proportional to the total amount offered [Lucian Arye Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 HARV. L. REV. 1695, 1700 (1985)].

- **Market egalitarianism** is necessary to build efficient markets [Loss, The Fiduciary Concept as Applied to Trading by Corporate Insider in the United States, in 33 MOD. L. REV. 34 (1970)].
What is efficient?

- economic analyses have shown that both the equal treatment rule and the market rule may be efficient. In particular, the equal treatment rule stops some efficient transactions, but also halts some inefficient transactions [Lucian Arye Bebchuk, Efficient and Inefficient Sales of Corporate Control, 109 Q.J. ECON. 957 (1994); Marcel Kahan, Sales of Corporate Control, 9 J.L. ECON. & ORG. 368 (1993)].

EU vs. US approaches

- **US:** Market rule applies; however all holders rule (17 C.F.R. § 240.13e-4(f)(8) (2008)) provides that: [n]o issuer or affiliate shall make a tender offer unless: (i) [t]he tender offer is open to all security holders of the class of securities subject to the tender offer; and (ii) [t]he consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer (see also Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

- **EU:** Where [anyone acquires] control of [a listed] company, Member States shall ensure that such a person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings at the equitable price (art. 5 Takeover Bids Directive).
RTL was a listed company (Luxembourg, Bruxelles and London); Audiolux SA was a minority shareholder in RTL, while majority shareholders were BBL (30%), Bertelsmann Group (37%) and Pearson (22%).

BBL and Bertelsmann exchanged BBL’s holding in RTL (30%) for Bertelsmann own stock, while Bertelsmann acquired Pearson holding (22%); then, RTL delisted from LSE in 2002.

Audiolux claims it should have been offered to exchange the shares in RTL with Bertelmann’s shares, according to the principle of equal treatment of all shareholders.

Question is raised as to whether the principle is to be applied only to relations between the company and its shareholders or also among shareholders when acquiring or strengthening control.

Case C-101/08 Audiolux, ECFR 2010, 158 ss.
✓ «... the provisions of secondary Community law to which the national court refers do not provide conclusive evidence of the existence of a general principle of equal treatment of minority shareholders» [n. 52]

✓ «According to settled case-law, the general principle of equal treatment requires that comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified (see Case C-127/07 Arcelor Atlantique and Lorraine and Others [2008] ECR I-0000, paragraph 23, and the case-law cited)». [n. 54]

✓ «the general principle of equal treatment cannot in itself either give rise to a particular obligation on the part of the dominant shareholder in favour of the other shareholders or determine the specific situation to which such an obligation relates» [n. 57].

✓ «A principle such as that proposed by Audiolux presupposes legislative choices, based on a weighing of the interests at issue and the fixing in advance of precise and detailed rules» [n. 62].

Case C-101/08 Audiolux, ECFR 2010, 158 ss.
Other cases on equal treatment

- Sihotur case: compulsory withdrawal or squeeze-out (declared unlawful)
- Novoprint case: selective capital reduction in kind (declared lawful)
- Rural informàtica: selective share repurchase (declared unlawful for breach of art. 46 Dir. 2012/30/EU)
Shareholder democracy requires that all shares grant the same rights: this generally entails proportionality in dividend distributions and one-share, one-vote.

Shareholder democracy also requires that the majority principle applies as means to solve deadlocks in taking decisions: this, however, entails disparate treatment of shareholders.

Those holding the majority decide, the others do not concur.
Imagine WWW Ltd. needs a new copy machine. Both Ron and Harry, WWW Ltd shareholders (R. 30%; H. 10%), sell copy machines (at similar price and quality). What shall Tom, shareholder (60%) and sole director, do to treat shareholders equally?

A) buy two copy machines, two halves or none?

B) make a lottery?

C) buy one copy machine from another dealer?

What happens if Tom is to repurchase shares with limited resources?

No shareholder has a right to sell shares to the company, or to urge an equal treatment in case of a buyback. However, the directors must behave fairly and in good faith.
Imagine WWW Ltd. with two shareholders Ron and Harry (R. 60%; H. 40%).

WWW Ltd. business grants 1.5 ROI. Ron has a business opportunity granting 3 ROI. Ron calls a meeting for a capital reduction or dissolution (causing WWW Ltd. to abort the business). Harry complains that after the reduction or dissolution his investment will have a 0 ROI.

Is Ron decision unfair to Harry?
This article argues that a strong or rather mechanical equal treatment rule in share repurchases, distributions in kind, or capital reductions is not efficient. An economic analysis of the law shows that disparate treatment of shareholders may increase shareholders' overall welfare. Disparate treatment, however, should not result in the oppression of minorities.

Rather, oppression of minorities should be prevented with the fairness standard. Fairness requires one to consider the interests of others, but not to pursue others’ interests to the detriment of one’s own. Unfairness is a disregard for the interests of the minorities which could be taken into consideration at no cost.