Equal treatment of shareholders and European Union law

Case note on the Decision "Audiolux" of the European Court of Justice

by

Federico M. Mucciarelli*

The European Court of Justice has recently issued a decision on the existence of a general principle of equal treatment of minority shareholders upon a transfer of control. According to the plaintiff, from certain specific acts of EU law (such as, among others, the mandatory bid rule provided for by the Takeover Directive) could be inferred the existence of a principle, according to which the person who purchases the control of a company should then offer to all other shareholders the same opportunity to sell their shares. The ECJ denied that such a principle can be inferred from specific provisions of derivative EU law beyond their scope of application. In addition, the ECJ has put in clear words that, in order to impose to the acquirer of corporate control a duty to purchase all outstanding shares, a specific legislative decision is required, with the aim to weight all involved interests.

Table of Contents ECFR 2010, 158 – 167

* Associate Professor of business law and fellow of CEFIN, Faculty of economics, University of Modena and Reggio Emilia – federicomaria.mucciarelli@unimore.it.

I. Introduction

The issue tackled by the ECJ ruling in the case Audiolux is whether EU law provides for a general principle of equal treatment of minority shareholders upon a change of control. According to the plaintiff, such principle applies independently from the existence of a "positive" rule and, in particular, beyond the scope of application of the mandatory bid rule, provided for by the Directive 2004/25/CE on takeover bids (hereinafter, the "Takeover Directive").

Behind this specific question, which is rooted in company law and securities regulation, the ECJ faced the issue of the relations between EU law and domestic law of member states, which is a general question of the "constitutional architecture" of the EU legal system. Indeed, had the ECJ inferred the existence of such a general principle, the EU would have pre-empted the law-making powers of member states beyond the wording of specific EU derivative acts.

II. The facts and the questions referred to the court

The controversy was raised by the transfer of the control stake of RTL, a Luxemburgish public company listed on regulated markets of Luxembourg, London and Frankfurt.

Before the transaction, RTL had two major shareholders and several minority shareholders. The majority shareholders were GBL, which held 30 % of RTL shares, and Bertelsmann Westdeutsche TV GmbH, which held 37 % of RTL share capital. The latter was controlled by Bertelsmann GmbH, which held 80 % of its shares. In 2001 GBL exchanged its shareholding in RTL with 25 % of Bertelsmann GmbH's shares. Therefore, after the transaction, Bertelsmann held directly 30 % and indirectly, through Bertelsmann Westdeutsche TV GmbH, 37 % of RTL share capital; to sum up, Bertelsmann GmbH in practice controlled, directly or indirectly, 67 % of RTL share capital, while GBL had a significant share of Bertelsmann GmbH capital. After this transaction, RTL delisted from the London Stock Exchange.

Audiolux and other minority shareholders brought a proceeding in front of the Luxembourg's district court for annulment of the agreement between GBL and Bertelsman or, as alternative, to hear them jointly liable to pay compensation to the minority shareholders that did not have the opportunity to share the control price with the new majority shareholder. The claimants argued that a general principle of equal treatment of shareholders upon a change of control should be inferred from a number of rules of derivative EU law. In particular, the claimants mentioned following acts as basis of such a

principle: (a) articles 20 and 42 of the Second company law directive, according to which corporations should respect equal treatment of their shareholders; (b) Recommendation of the Commission of 35.7.1977 concerning a code of conduct on transactions in transferable securities; (c) Directive 79/279/CE on the admission to securities market, that claim for a general duty of equal treatment of investors; (d) Takeover Directive, whose article 5 provides for the mandatory bid rule, as a mean to protect minority shareholders upon a transfer of corporate control. Pursuant to claimants' arguments, behind all these acts lies a general principle of equal treatment of all shareholders, which does not distinguish among transactions *vis-à-vis* the company (such as purchase of own shares) and transactions between shareholders (purchase of corporate control from another shareholder).

In practice, the real reason why Audiolux adopted this argument is very simple. The transaction of RTL control occurred in 2001 and at that time Luxembourg securities regulation did not provide for a mandatory bid rule and the Takeover Directive was not yet in force. In addition, the mandatory bid rules provided for by the Londoner City Code on Takeover and Merger and by French law, where RTL shares were also listed, does not apply to foreign corporations[1]. As result, the Audiolux and its barristers, in order to obtain a portion of the control premium, had only one way in front of them: to argue that the mandatory bid rule, which was explicitly provided for only in 2004 by the Takeover Directive, proves the existence of a general principle of EU law that existed even before the enactment of the directive.

The District Court and the Court of Appeal of Luxembourg rejected the claim of Audiolux, stating that no general principle of equal treatment of shareholders upon the change of corporate control exists under EU law, but only certain equality rules provided for by specific directives. The ruling of the Court of Appeal was then brought in front of the Court de Cassation of Luxemburg, which suspended its judgement and referred some questions to the ECJ for a preliminary ruling. The questions referred to the ECJ can be summarized as follows: (1) whether the specific derivative acts mentioned above are manifestations of a general principle of EU law of equal treatment of shareholders; (2) whether this principle (if ever existing) applies only in the relation between companies and their shareholders or also between minority and majority shareholders upon a change of control; (3) if questions 1 and 2 are answered in the positive, whether such a principle should be considered as existent even before the approval of the Takeover Directive.

1 Rule 9 City Code on takeover and Mergers and article L433–3 *Code Monetaire et financier.* See: Ryngaert, "Cross-Border takeover regulation: a transatlantic perspective", in *ECFR* (2007) 441.

III. The decision of the ECJ

The ECJ answered all three questions in the negative, using the arguments summarized hereunder.

First, the Court denied that a general principle of equality upon a transfer of control can be inferred from non-binding acts such as a Recommendation of the Commission[2]. As a consequence, the Court focussed its attention upon the Directive 77/91 on increase and reduction of the legal capital, the Directive 79/279, on the transparency requirement, and the Takeover Directive.

The Directive 77/91 on capital requirement is the second directive aimed at harmonizing company laws of member states (hereinafter, the "Second Directive"). Its article 42 states that "the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position". However, the ECJ points out that from this article it is not possible to argue the existence of a general principle of equal treatment, as the scope of application of the former is limited to "the purposes of the implementation of this Directive", that is to say to increases and reductions of legal capital and to own shares' repurchases[3].

The Court rejected also the argument based on the Directive 79/279 (which was on the conditions for the admission of securities to official stock exchanges). Pursuant to Point 2(A) of Schedule C of this Directive, listed companies "shall ensure equal treatment for all shareholders who are in the same position". This Directive was then replaced by the Directive 2001/34 on listing and transparency requirements, whose article 65 provided for an identical principle of equal treatment of shareholders by the issuer company. However, the Directive 2004/109/CE eliminated this article and provided for a more restricted principle of equality regarding the information[4]. As a result, also from these rules can not be inferred the existence of a general principle of EU law.

Finally, the ECJ turns its attention to the mandatory bid rule provided for by the Takeover Directive, according to which if a person acquires the control of a listed company, he or she should then launch a tender offer for all outstanding shares at the same price paid to purchase the control. The question arises as to whether the mandatory bid rule is expression of a general principle of EU law, which pre-exists to the enactment of the Takeover Directive and, hence, applies beyond the its scope of application. The ECJ Rejected this

2 Audiolux, par. 34

3 Audiolux, par. 37.

4 Article 17 Directive 2004/109/CE. See Audiolux, par. 41: it is worth to mention that the ECJ mistakenly attributed article 17 to the Directive 2001/34 not to the latest Directive 2004/109. See Advocat General Opinion, par. 12.

interpretation, holding that the mandatory bid rule provided for by the Takeover Directive is a specific provisions, which applies only to well-defined situations within the scope of application established by the Directive itself[5].

The ECJ concludes its reasoning with some general remark on the scope of application of EU powers. The ECJ points out that, even assuming that a general principle of "equal treatment" exists under EU law, one needs to establish the legal means aimed at enforcing such principle and to protect minority shareholders. This goal needs a specific rule aimed at balancing different interests. As a consequence, the principle of equality claimed by Audiolux can not be a "general principle of EU law", but is simply a rule that should be enacted through a specific political choice, either at EU or Member states' level[6], that weights the different interests involved in the transaction (e. g. minority shareholders v. new control shareholder)[7].

IV. Equal treatment of shareholders

The decision of the ECJ to reject Audiolux's claims deserves to be praised. Indeed, the plaintiff blurs the distinction between equal treatment *vis-à-vis* the corporation and equality upon a change of control. The former is a duty burdened to the company, which applies to decisions that affects shareholders' interests, while the latter is a duty of the majority shareholder to share the control premium with all minority shareholders. A brief description of these two kinds of "equality" will clarify this issue.

1. Equal treatment of shareholders *vis-à-vis* the corporation

The equal treatment of shareholders *vis-à-vis* the corporation is a duty imposed to company's bodies. However, the language "equal treatment" or "equality" is only apparently clear and under such a wording one can mean different legal rules. Indeed, we should distinguish two different "equalities": on the one hand, the general criterion of equality regarding rights and duties attributed to shareholders by the articles of association and by the law[8] and, on the other hand, equal treatment of shareholders *vis-à-vis* companies' decisions on the basis of the general criterion of equality[9].

5 Audiolux, par. 50.
6 Audiolux, par. 61.
7 Audiolux, par. 62.
8 In the German wording: *Gleichberechtigung.*
9 *Gleichbehandlung.*

The former is the basic distributive principle upon which the relations among shareholders are built, which answers the basic question "Equality of what?"[10]. Shareholders might have many things in common, but not all of these are relevant for company law and for the rule of equal treatment, so it is necessary to establish whether different shareholders are in the same situation or not. Usually, the distributive criterion adopted by company law is the share of legal capital held by shareholders, but the competent jurisdiction could provide for different criteria or allow the article of association to distinguish among different classes of shares.

By contrast, the equal treatment of shareholders *vis-à-vis* the company is a limit to the powers of company's bodies, so its infringement might lead to annulment of a corporate decision or to sue the directors for damages[11]. Being this a duty burdened to behaviours and decisions of company's bodies, the competent jurisdiction can admit exceptions under specific circumstances[12]. In addition, in all jurisdictions the question arises as to whether company's decisions that treat shareholders formally equal, but in reality affect them differently due to personal positions or interests of such shareholders, are encompassed by equality *vis-à-vis* the company or by other principles or fiduciary duties, such as the "abuse" of majority powers or the "fraud" on the minority. To sum up, each jurisdiction is free to shape autonomously the contours of this principle. In addition, there is no shared view among legal scholars and among member states regarding the content of the principle of equal treatment[13].

2. Equal treatment of shareholders upon a change of control

Differently from equal treatment of shareholders *vis-à-vis* the company, the "mandatory bid rule" provided for by the Takeover Directive aims at attaining equal treatment of shareholders upon a change of control and *vis-à-vis* the majority shareholders.

According to the mandatory bid rule, any change of control triggers the duty to launch a tender offer for all outstanding shares. The rationale behind this

10 See: Sen, *Equality of what? Tanner Lecture on Human Values,* Stanford 1979.

11 See: Verse, *Der Gleichbehandlungsgrundsatz im Recht der Kaptalgesellschaften,* Mohr Siebeck, Tübingen (2006) 8 *et seq.*

12 For example, see German case law: BGH "Minimax II", BGHZ 33, 1960, 175 ss., according to which the exclusion of pre-emptive rights of certain shareholders is justified to defeat the bid of a competing firm that, after the purchase of control, would have liquidated the company ("eine ungleiche Behandlung der Aktionäre […] zulässig [ist], wenn sie sachlich berechtigt ist und damit nicht den Charakter der Willkür trägt", p. 186).

13 See Advocat General Opinion, par. 89.

rule is debated[14]: one important reason is to mitigate the pressure to tender on target's shareholders[15], but also equal treatment of minority shareholders can be one of its goals. Indeed, if the bidder purchases the target's control through a private transaction, the mandatory bid rule allows minority shareholders, who have been previously neglected, to sell their shares and to gain a portion of the control premium. In other words, if a mandatory bid rule is in place, all shareholders are treated equally regarding the opportunity to share the control premium. This is particularly true in the EU, as pursuant to the Takeover Directive the new control shareholder should offer the highest price paid for target's shares during a period of 6 to 12 months prior to the bid, unless the competent authority allows an exception in specific circumstances to be established on a case by case basis according to domestic law[16].

However, according to Audiolux the mandatory bid rule is not simply a specific rule provided for by the Takeover Directive, but is the manifestation of a general principle, which applies also to non listed companies and beyond the scope of application of the Takeover Directive.

This theory is not completely new. In Germany, for instance, before a mandatory bid rule was in place[17], some scholars[18] argued that, after having purchased the control of a company, the new majority shareholder owes to their fellow-shareholders a duty to share with them a portion of the control premium. According to these theories, such duty should be inferred from general fiduciary duties that shareholders owe one another[19], which should be extended to market decisions that might affect the interests of other shareholders. However, this ingenious[20] theory can not be accepted, as minority shareholders are not in the same position as control shareholder and,

14 Enriques, "The mandatory bid rule in the Takeover Directive: harmonization without foundation?", *ECFR* (2004) 440.

15 This is the case also for s.c. "two-tier" bids, where the bidder launches a second bid for outstanding shares at a price lower than that offered in the first partial bid.

16 Article 5(4) Takeover Directive.

17 The German Takeover Act (*WpÜG*) entered into force in 2002.

18 Reul, *Die Pflicht zur Gleichbehandlung der Aktionäre bei privaten Kontrolltransaktionen,* Mohr Siebeck, Tübingen (1991) 161 *et seq.* and page 306; Weber, *Die Vormitgliedschaftliche Treubindung,* Beck, München, 379 *et seq.* (fiduciary duties exist even before the purchase of control).

19 See: BGH "*ITT*", *BGHZ* 65, 15 (fiduciary duties among shareholders of private limited companies – *GmbH*) and BGH "*Linotype*", *BGHZ* 103, 185 (fiduciary duties in closely held public companies). Cf. Hirte, *Kapitalgesellschaftsrecht*[6], RWS, Köln, 2009, par. 3.292.

20 This theory picks a relevant aspects of the mandatory bid rule, which is basically a fiduciary duty of the majority shareholder *vis-à-vis* other shareholders in a specific circumstance: Ebenroth / Wilken, "Kollisionsrechtliche Einordnung transnationaler Unternehmensübernahmen", 90 *Zeitschrift für Vergleichende Rechtswissenschaft* (1991) 242.

hence, control premium does not "belong" to them and they should not have the right to share it[21].

In addition, we should bear in mind that the mandatory bid rule reveals a significant drawbacks as it reduces the overall amount of control transactions and the disciplinary power of the market for corporate control upon directors' behaviours[22]. The law-maker can obviously introduce such rule, but this choice requires an explicit political decision that weights the interests of minority shareholders against the interest of potential acquirers and of the market.

V. General principles of EU law and the competences of EU bodies *vis-à-vis* member states.

But the most important criticism against Audiolux' arguments is related to the concept of "general principle of EU law" and to the limit of the competence of the EU *vis-à-vis* member states.

General principles of EU law are "constitutional" principles[23] that define the limits to the competences and powers of the EU bodies. Such principles are commonly acknowledged as the principle of loyal-cooperation, of subsidiarity, of proportionality and legal certainty, of non discrimination[24] and the human rights of individuals *vis-à-vis* public authorities[25]. By contrast, a principle of equality upon a control transaction is a rule that regulate private transactions and such rule needs to be explicitly enacted by a law-making body that has jurisdiction on this field. This point will be made clearer by referring to the main arguments used by Audiolux.

The first argument was based upon the equal treatment of shareholders *vis-à-vis* the company provided for by article 42 of the Second Directive on company law. I have already shown that from this principle it is not possible to infer an equal treatment of shareholders upon a change of corporate control, even under domestic company law. In addition, it is relevant to point out that this rule applies only within the scope of application of the directive itself, i. e. to capital' increases and reductions and to shares' repurchases. Secondly,

21 See: Stella Richter Jr, *Trasferimento del controllo e rapporti tra soci*, Giuffrè, Milano (1996) 245 *et seq.*; Verse, *Der Gleichbehandlungsgrundsatz im Recht der Kaptalgesellschaften* (nt. 11) 183; D'attorre, *Il principio d'eguaglianza tra soci nelle società per azioni,* Giuffrè, Milano (2007) 371.

22 Bebchuk "Efficient and Inefficient Sales of Control" 109 *Quart. J. Econ* (1994) 957

23 See: Pernice, "The Treaty of Lisbon: multilevel constitutionalism in action", in 15 *Col. J. Eur. Law* (2009) 369 *et. seq.*

24 See: Wyatt & Dashwood's European Union law[5], Thomson, London (2006) 235 *et seq.*

25 See: Advocat General Opinion, par. 67 *et seq.*

Audiolux inferred the principle of equality upon a transfer of control from the mandatory bid rule of the Takeover Directive. However, the Takeover Directive was enacted only in 2004 and before its approval a mandatory bid rule was not commonly accepted by all member states[26]. We should conclude that EU law, at the moment of the transaction of RTL control, did not explicitly pre-empted member states regarding the issue of whether a rule of equal treatment of shareholders upon a transfer of control should be in place.

Consequently, the question arises whether the existence of an unwritten principle can be inferred beyond the explicit scope of application of certain EU acts. The answer should be in the negative, as the admission of such unwritten principle would infringe the "constitutional" order of EU law and, in particular, the separation of powers between EU bodies and member states.

We should bear in mind that the European Union enjoys only those competences attributed by the Treaty. In the ECJ's words: "the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals."[27] Regarding company law issues, the EU competences are not exclusive but are shared with member states. This means that if the EU has not yet exercised its power to harmonize company law, no obligation arises for member states, which are consequently free to regulate the subject matter. In addition, even if the EU exercises its competence, member states are not completely pre-empted and usually can regulate each issue within the frameworks of EU rules.

Let's turn our attention again to the Second Directive and to the Takeover Directive. Article 42 of the Second Directive does not fully harmonize the issue of equal treatment *vis-à-vis* the company, as it does not put in clear words the contours of this "equality". As a consequence, member states are free to shape this rule and its limits in the way they prefer, even within the scope of application of the directive (capital increases or reductions an stock repurchases)[28]. By contrast, the mandatory bid rule of the Takeover Directive has a more stringent content, as it burdens the new control shareholder with a specific duty to launch a tender offer at a certain price. However, precisely the

26 In particular, Luxembourg and the Netherland did not provide for the mandatory bid rule before implementing the Takeover Directive. See: Wymeersch, "Übernahmeangebote und Pflichtangebote", in *ZGR* (2002) 520 ss.

27 See: Case 26/62, Van Gend & Loos v. Nederlandse Administratie der Belastingen, 1963 E.C.R. 1 *et seq.*

28 For instance, English company law does not provide for a clear rule of equal treatment of shareholders *vis-à-vis* the company, but reaches similar results through other rules (the most relevant is the "unfair prejudice" of Section 994(1) Companies Act 2006): Davies, *Gower and Davies' Principles of modern company law*[8], Thomson, London (2008) 681 *et seq.*

fact that this rule has clear contours gives evidence that member states were pre-empted only within the scope of application of the Takeover Directive and no unwritten rule can be inferred from it.