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Cross-border Mergers in Europe

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A. Introduction

The immediate reason to discuss cross-border merger[1] between companies incorporated in separate EU Member States, is the adoption of the 10th Company Law Directive[2] on cross-border mergers of companies with limited liability ("Merger Directive") at the end of 2005, and the decision of the European Court of Justice taken on 13 December 2005, which stated that cross-border mergers must be explained under the freedom of establishment rules of Articles 43 and 48 of the EC Treaty ("*Sevic Case*").[3]

The Merger Directive must be implemented in the national laws of the Member States not later than 15 December 2007. Apart from the consequences of the Merger Directive and the *Sevic case*, another alternative to undertake a cross-border merger exists since 8 October 2004: the establishment of a European Company (SE).[4]

One of the purposes of the SE is to enable companies established in various Member States to undertake cross-border merger or to establish a cross-border joint venture company. Since its introduction, however, the SE has not been a very popular supranational legal form. According to the SE-Network only 33 SEs have been incorporated to date, of which only a few operate with a small number of employees.[5] Before discussing the legal and other obstacles for cross-border mergers in the EU and alternative dual company structures, which were chosen by a number of large (Dutch) companies in the past, a general description will be given on the current status of harmonization of European company law.

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1 For purposes of subject application of a statutory cross-border merger, the EU also includes the European Economic Area (EEA).

2 EP and Council Directive on Cross-border Mergers of Limited Liability Companies of 26 October 2005, OJ 2005 L 310/1.

3 Judgment of 13 December 2005 in Case C-411/03, Sevic Systems AG.

4 Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company (SE), OJ 2001 L 294; Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the Involvement of Employees, OJ 2001 L 294.

5 *See* www.seeurope-network.org. (Status as per 1 October 2006).

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B. Harmonization of European Company Law

The EC Treaty of 1957 provides for the "progressive harmonization of the economic policies of Member States in order to promote the proper functioning of the Common Market."[6] This also includes the harmonization of company law. Furthermore, the EC Treaty aims to abolish obstacles to the free movement of goods, persons, services and capital between Member States. The main principle embodied in the EC Treaty for the purposes of cross-border mergers is the freedom of establishment. Pursuant to this principle, nationals (both private persons and enterprises) of Member States have the freedom to establish themselves in the territory of other Member States on the same conditions that apply to the nationals of the host country. Harmonization of European company law is realized by way of treaties, regulations and directives. Only regulations constitute a truly uniform company law, since they have direct effect. Regulations are binding and directly applicable in all Member States. Regulations impose, however, one political problem. They can only be adopted by unanimous vote of all Member States. This might not have been a problem in 1957 when there were only six Member States, but today, only 'light' versions of original drafts are adopted in practice, as a compromise, by all 25 Member States. (27 Member Sates as of 1 January 2007.) Directives are much easier to adopt. The disadvantage of directives, however, is that they must first be implemented in the national jurisdiction of all the Member States within a prescribed period. Individuals, persons or companies may only rely on a directive in so far as it is unconditional and sufficiently precise. As to European company law, only three regulations have been adopted so far for three types of supranational legal forms of entities: the "European Company" (SE);[7] the "European Economic Interest Grouping" (EEIG)[8] and the European Cooperative (SCE).[9] The EEIG took effect on 1 July 1989. The SE came into force on 8 October 2004 and the SCE has been effective since 18 August 2006.

In order to give you an idea of time lines in this respect, the first draft of the European Company Statute was drafted by Professor Sanders from the Netherlands in 1966. After protracted debate and several drafts of both the statute and the accompanying Directive (on the consultation rights of the employees), the SE Statute was finally adopted in 2001 and, as said, became effective on 8 October 2004. The SE is clearly a compromise. Even though it offers a set of European rules, it is governed in many respects by national legislation. The EEIG has not been a real success either.

From my own practice as a civil law notary, I can inform the reader that in the past, I incorporated a total of four EEIGs and have since liquidated all of them.

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6 Treaty establishing the European Economic Community, Trb 1957, Nos 74, 91 as amended.

7 Council Regulation (EC) No. 2157/2001 of 8 October 2001, on the Statute for a European Company (SE), OJ 2001 L 294.

8 Council Regulation (EEC) No. 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), OJ L 199.

9 Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute of a European Cooperative Society (SCE), OJ 2003 L 207.

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The prospects of the SE and the SCE may at first glance not be very different from this.

Directives on company law have a better history. Since 1968, a total of 13 directives on harmonization of company law have been adopted, most of which have been implemented in national laws, at least in those of the former 15 Member States.

What is the current status of harmonization of Company Law? The European Commission (still) firmly upholds its opinion that an effective framework of European company law is essential for the internal market and for building an integrated European Capital Market.[10] "Further globalization makes that there is an ever-increasing need for cooperation between companies from different states, both within the European Union and between the different continents."

On the other hand, it is also clear to the European Commission that they should not focus only on regulations and directives. Given the modest harmonization effect of the regulations and directives so far and the increasing importance of the case law of the European Court of Justice, based on the freedom of establishment rule of Article 43 EC Treaty,[11] Member States have an obligation to respect and recognize the incorporation statute of companies from other Member States. The European Commission decided to adapt its policy slightly as to the harmonization of company law. As an example, the European Commission has adopted several non-binding recommendations which include principles and best practices. One of these recommendations relates to the highly political issue of the remuneration of Board Members of listed companies (2004).

C. National Mergers

The Third Company Law Directive concerns the mergers of Public Limited Liability Companies and was adopted in 1978.[12] This Directive applies only to domestic statutory company mergers and is limited to public companies, though several national legislators have implemented the domestic company Merger Directive for private limited liability companies and other legal entities also. In the Netherlands, such domestic merger is only possible between two Dutch legal entities of the same kind. The Third Directive provides for the protection of the interests of shareholders, creditors and employees.

The main features of a statutory legal merger are:

1. The transfer by operation of law of all assets and liabilities of each company to the surviving, or the new acquiring company or entity;

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[10] *See* Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (21 May 2003) available at: http://ec.europa.eu/internal_market/Company/modern/index_en.htm.

[11] *See* Case 2/74 Reyners; Casce C-81/87 Daily Mail; Case C-79/85 Segers; Case C-212/97Centros; Case C-208/00 Überseering; and Case C-167/01Inspire Art.

[12] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3) (g) of the Treaty concering mergers of public limited liability companies, OJ 1978 L 295.

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2. The shareholders of the companies which cease to exist, automatically become shareholders of the acquiring or the new company; and
3. All merging companies, save the surviving or the new company, automatically cease to exist.

It goes without saying that such features are of great benefit for the merging parties and their shareholders.

D. (No) Rules for Cross-border Mergers. Legal and Other Obstacles

According to article 293 of the EC Treaty, all Member States have an obligation to negotiate on, amongst others, mutual recognition of legal entities, transfer of seat or registered office and cross-border mergers. Until recently, no common rules existed throughout the EU to govern cross-borders mergers. Such mergers were possible only if the companies wishing to merge were established in certain Member States. Only in a very few countries, like France and Italy, specific procedures have been put in place for cross-border mergers.[13] All the other Member States only facilitate regulated domestic, national mergers. Consequently, a cross-border merger where companies from different Member States wish to merge, is highly complex and very costly. In practice, companies elect an alternative, such as a takeover (shares or assets), joint venture, contractual cooperation or a dual company structure.

To put the debate on the lack of common EC rules for transnational mergers (until recently) into perspective, it must be admitted that in practice other obstacles prevail. First, there are legal obstacles in the form of:

- differences in board structure (one tier/two tier) of the merging companies;
- differences in co-determination rules. For instance the "Co-Determination Act ("Mitbestimmungsgesetz") in Germany and labour representation (Works Council);
- regulatory rules such as non-competition rules and Stock Exchange rules;
- anti-takeover measures (which have been installed by listed companies to prevent a hostile takeover); and
- differences in legal and cultural attitude between the Anglo-Saxon model and the 'Rheinland'-model.

In the practice of Mergers and Acquisitions, other obstacles for mergers or takeovers appear of even greater relevance than the legal obstacles, such as:

- national sentiments. I refer to the recent debate in Europe on the acquisitions in the energy sector in certain countries like France and Spain and the shareholders' fight between Arcelor and Mittal in the steel industry;

13 European Commission, Press Release, 18 November 2003, MEMO/03/233.

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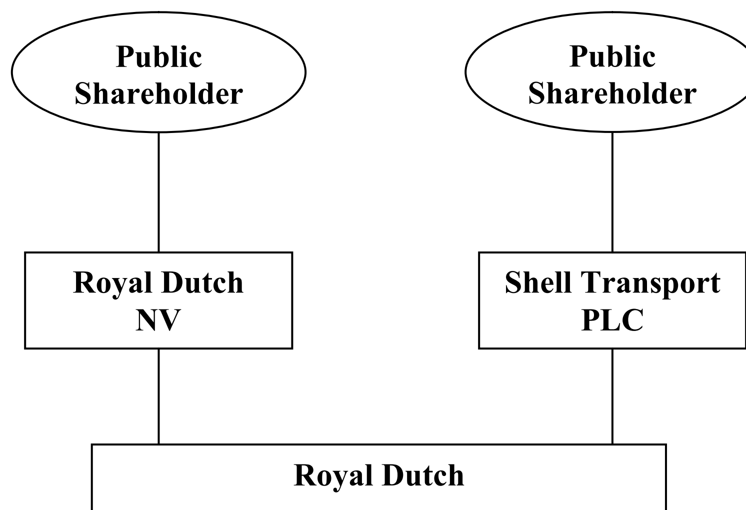
- the choice of domicile of the head office of the merging entities;
- the choice of a new trade name;
- tax issues (capital gain taxation of current shareholders, future level of dividend withholding tax, a loss of tax loss carry forward and the avoidance of double taxation); and
- personal interests of Board Members of the merging companies.

E. Dual Company Structures

In the past, for the reasons just described, large companies that were willing to merge, elected for a "dual company structure". Dutch companies that were involved in a merger process and that installed dual company cross-border structures in the 20th century, are Royal Dutch/Shell (NL/UK), Fortis (NL/Be), Unilever (NL/UK) and Reed Elsevier (NL/UK). The structures of Royal Dutch Shell, Fortis and Unilever are as follows:

Royal Dutch Shell I

- Before 2005 Unification



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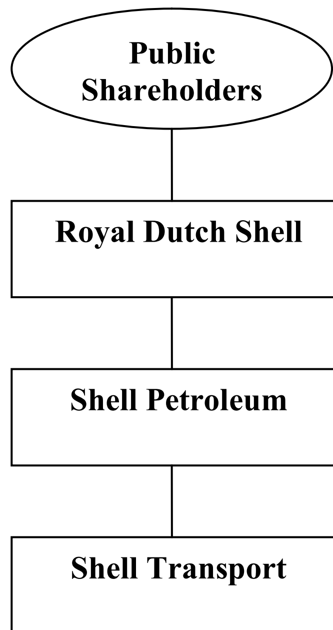
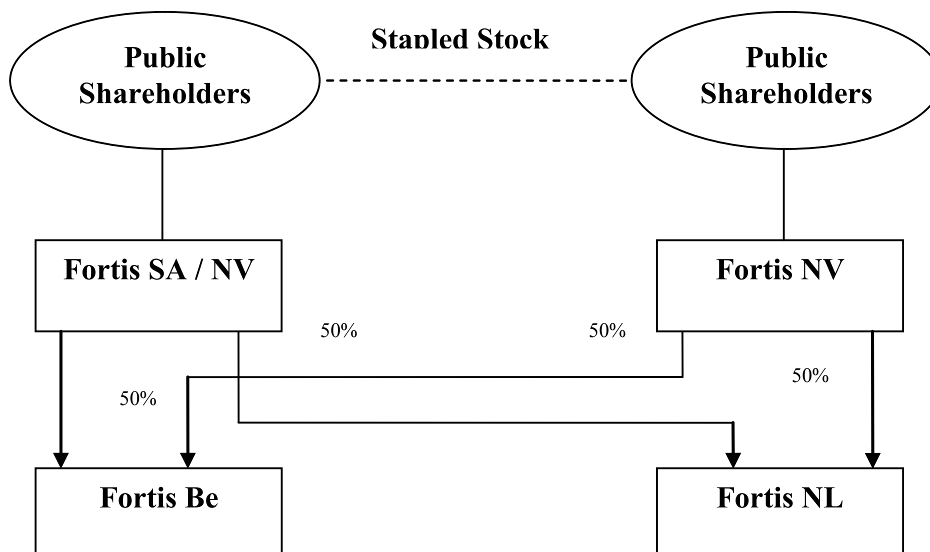
Royal Dutch Shell II

- After 2005 Unification



Fortis



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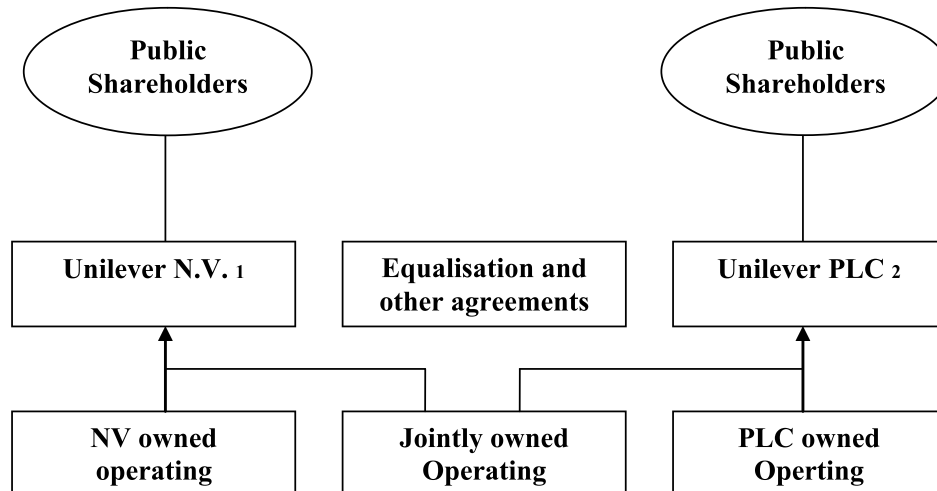
Unilever



[1] Traded in Amsterdam and New York
[2] Traded in London and New York

However, it should be noted that, nowadays, capital markets dislike such dual company structures. This is one of the reasons why the Royal Dutch Shell structure was dissolved and unified in 2005

F. The European Company ("SE")

I. Main Characteristics of an SE

The question which needs to be asked is, what has been achieved by the European Union on the harmonization of company law in general, and on cross-border mergers in particular? One achievement, as indicated, is that since 2004 the European Company (*Societas Europaea* or "SE") has been available in all the EU Member States. According to the SE Statute, an SE is a public limited liability company that can be formed, organized and operated, and can migrate and merge within the EU. The SE is not only governed by the Statute for a European Company. It is also governed by the EC Directive on the Role of Employees, by national corporate laws (since every SE is linked with the EU country where it has its registered office) and its Articles of Association.

An SE has a multinational character. This means that its formation requires at least two existing legal entities in different EU countries. On the other hand, since

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an SE is largely governed by national law, it can also be considered as a national public limited liability company, albeit with a European flavour. An interesting but complicating feature of an SE is that its registered office or seat must be located in the same country as that of the head office or principal place of business. This means that if the head office of the SE is transferred, it has to relocate its registered office and thus amend its Articles. Although not tested in the Court, it could be argued that this specific provision of EC Regulation No 2157 (2001) is in conflict with the freedom of establishment, as provided for in Articles 43/48 of the EC Treaty. In order to acquire legal personality, an SE must be registered in the country of its registered office. The procedure for such registration differs from country to country. Registration, however, is only possible after agreement has been reached regarding the role of the employees of the SE, of course, in so far as applicable.

The main reasons for setting up an SE are the following:

- to align the legal and tax group structure with the management organization;
- to eliminate competitive disadvantages;
- to reduce administrative expenses;
- to be able to transfer the seat/registered office of the SE throughout the EU;
- to merge within the EU with other companies or SEs;
- to harmonize within one enterprise, the employees' participation rules;
- tax restructuring purposes.

II. Methods to Form an SE

According to the SE Statute, there are four methods to form an SE:

1. formation by way of cross-border merger;
2. incorporation of a new holding SE;
3. incorporation of a new subsidiary SE; and
4. converting an existing national EU public limited liability company into an SE.

A condition for each method of creation is that the legal entities, involved directly or individually, should have activities in different Member States. Most interesting, in the area of the availability of options for European cross-border mergers, is of course, the formation of an SE by way of cross-border merger. One of the most important consequences of the legislation and rules surrounding the SE, is that (subject to conditions) a cross-border legal merger can occur between public limited liability companies within the EU, provided that at least two of the merging companies are subject to the law of different Member States.

A cross-border merger, as referred to in the Regulation, can occur in two ways:

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1. A public limited company (NV, SA, AG etc.) in one Member State can acquire the assets of one or more other public limited companies in other Member States similar to the Third Company law Directive, under *universal* title, where the acquiring (existing) company takes the form of an SE. The shareholders of the merged companies become shareholders of the acquiring SE and the merged companies cease to exist by the operation of law.
2. A new SE can be incorporated by merger, and this (new) SE acquires the assets of the merging public limited companies under universal title. The shareholders of the merging companies become shareholders of the newly incorporated SE and the companies involved in the merger cease to exist by the operation of law. In both cases, the Regulation refers to "incorporation of an SE by merger". Incidentally, there is no requirement for an SE to be incorporated under the law of one of the companies involved. It is also possible to incorporate the SE in a third Member State. A requirement is that the head office must be located in that Member State. The merger procedure for a cross-border legal merger, where an SE (whether or not a new one) is incorporated, is largely similar to the merger procedure for domestic legal mergers, which is based on the Third Company Law Directive (see under C). The Regulation makes certain parts of the merger procedure mandatory. The national laws of each of the companies involved in the merger apply in areas where the Regulation is silent.

III. Merger Procedure

In general terms, each merger procedure results in the formation of an SE. Each of the merger procedures must comply with the execution of a merger proposal and explanatory notes thereto, including information about the arrangements with respect to the role of employees, executed by the Members of the Management Boards of the merging companies, and the members of the Supervisory Boards, if installed. The merger proposal, as in the case of national mergers, must be examined by an independent expert. The merger proposal has – at least in the Netherlands – to be filed with the companies' Trade Register and, at the same time, it has to be announced in a national daily newspaper. Creditors have a period of one month to file an objection against the proposed merger. Immediately thereafter, the boards and/or the shareholders can resolve to merge, after which the Deed of Merger is executed. Subsequently, the merger is published and the SE is registered.

IV. Advantages and Disadvantages of an SE

The advantages of an SE can be summarized as follows:

- an SE has, without doubt, a European identity, both from a commercial and from a political point of view;

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- the cross-border merger and transfer of seat or registered office is enabled by the formation of an SE, provided of course that, as said before, the centre of management of the SE is also transferred;
- an SE also enables the choice between a one-tier and a two-tier board structure. For example, in the Netherlands and Germany, only the two-tier structure is available to date (Management Board and Supervisory Board), as opposed to the one-tier board composed of executives and non-executive directors which is available in most of the other European countries;
- it is said that administrative expenses are reduced, but that of course depends on each individual case;
- an SE introduces the possibility to align legal and tax structures with actual management organization and, in general, to restructure a company from a tax point of view.

The disadvantages of an SE can be summarized as follows:

- an SE is a complex vehicle. It is governed by a combination of European and national rules in such way that it can trigger forum shopping;
- according to the Directive on the SE, the level of employees' participation should remain the same as it was prior to the formation of the SE. This means that, if applicable, the registration of an SE is only possible if an agreement has been entered into regarding the role of employees or if co-determination has been regulated in some other way, in accordance with the Directive;[14]
- given that tax issues within the EU have not yet been harmonized, the SE brings no advantages;
- the SE is primarily aimed at large companies.

The result is that since 8 October 2004 (the effective date of the SE Regulation and Directive) only 33 SEs have been incorporated in Europe.[15] Please note, however, that in certain European countries, the necessary legislation for SEs has not yet even been promulgated.

G. The Merger Directive

The European Commission announced in its 2003 Action Plan for Company Law and Corporate Governance that it had committed itself to adopting the 10th Directive, i.e. the cross-border Merger Directive on the basis of the need for cooperation between limited liability companies from different Member States. After 20 years of discussion, this Directive was indeed finally adopted on 26 October 2005 (2005/56 EC) and must be implemented in the EU Member States by 15 December 2007. The Merger Directive also applies to private limited liability

[14] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the Involvement of Employees, OJ 2001 L 294.

[15] *See* www.seeurope-network.org. (Status as per 1 October 2006.)

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companies. The Merger Directive provides that each company, and each third party concerned, remains subject to national legislation. "None of the provisions and formalities of national law to which reference is made in this Directive should introduce restrictions on freedom of establishment […] save where these can be justified in accordance with the case law of the European Court of Justice and in particular by requirements of the general interest and are both necessary for, and proportionate to, the attainment of such overriding requirements."[16]

I. Impact of the Merger Directive

In the future, cross border acquisitions can be structured by means of a merger instead of an often complicated purchase and acquisition structure or a dual company structure. The structuring under the Merger Directive may also avoid the need for complicated company group structures. The termination of unprofitable activities abroad no longer requires the liquidation of the relevant subsidiary. Such liquidation has significant disadvantages, *e.g.* beneficial contracts of the subsidiary, usually, cannot be transferred to the parent company without third parties' consent to such transfer. Thus, possibilities for disadvantageous re-negotiating are frequently opened. The relevant subsidiary may instead be merged into the parent without the risks involved in an otherwise necessary liquidation. Contracts between the foreign subsidiary and a third party would not require termination, amendment or third party's consent for the transfer, but would transfer by operation of law to the parent into which the subsidiary is merged.

II. Rules Governing Cross-border Mergers Based on the Merger Directive

The main features of the cross-border merger under the Merger Directive are the same as for national mergers (see section C).

The Merger Directive specifies that the national laws must include provisions relating to:

a. the decision-making process of the merger;

b. the protection of creditors, debenture holders, shareholders and employees. The provisions as to the protection of employee's participation rights will, although not fully similar to the provisions of the SE Directive on the Role of Employees, probably be considered as a disadvantage of the Merger Directive.
   The rules are as follows:
   Generally, the national law of the company, resulting from the cross-border merger, will govern employee's participation rights. If this national law does not provide for employee's participation, the new or surviving entity will not

[16] *See* Consideration (3) of Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3) (g) of the Treaty concering mergers of public limited liability companies, OJ 1978 L 295.

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be subject to employee's participation unless (i) one of the merging entities had, in the six months before the publication of the merger proposal, more than 500 employees and such entity had employee's participation established within the meaning of the Merger Directive; or (ii) the national law applicable to the surviving entity provides for less employee's participation than it was provided for by the national law, for at least one of the merging entities, prior to the merger. In these cases, the parties participating in the merger are required, in accordance with the then applicable national law, to establish a Special Negotiation Body which must agree with the Boards of the entities on an employee's participation scheme. The provisions governing the Special Negotiation Body and the rules of the negotiation must be based on the provisions applicable to the SE Directive. If the parties cannot agree on a participation scheme within six months, Standard Rules as set forth in the relevant domestic jurisdictions established under the relevant implementation laws shall apply. Alternatively, the management of the merging entities may agree on a level of employee's participation based on the highest level of participation in one of the merging entities. In this case, the merger can be executed very quickly, since the otherwise possibly longstanding negotiations with the Special Negotiation Body can be avoided. As a result, the provisions in the Merger Directive governing employee participation rights are designed to prevent an 'escape' from employee's participation by means of a cross-border merger and they allow for a quick execution of the intended merger;

c. appropriate protection must be provided for dissenting minority shareholders. As to the merger procedure, similar steps must be taken to a national merger or a cross-border merger into a SE. Each authority, designated by national legislators to review the merger process as to compliance with national laws and the Merger Directive, must review the merger process of the entity located in its Member State. If all prerequisites are met, the said authority (very often a civil law notary) issues a certificate to the relevant entity confirming the legality of the merger under the relevant national laws. Within six months of receipt, this certificate must be submitted to the competent authorities of the Member State where the surviving entity will reside. This authority will decide on the merger, basing its decision on the laws of its jurisdiction. If a merger becomes effective, in accordance with the laws of the relevant jurisdiction, such merger may not be declared null and void.

As to (b) and (c), the cross-border nature of the merger may be taken into account. This means that national legislators may even validly impose more stringent requirements on cross-border mergers. Thus, like the SE Statute, the Merger Directive will still pose an obstacle to many transactions in light of overlapping or conflicting national laws, particularly as regards employee's participation rights. Its impact may, therefore, be limited.

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H. Freedom of Establishment under the EC Treaty – the Sevic Case

One of the principles of the free movement of persons is the right of establishment. The other principles are the right of circulation, the elimination of controls at the internal borders and the right of residence. The freedom of establishment as provided for in Articles 43/48 EC Treaty has brought a series of cases to the European Court of Justice in the past ten to fifteen years (*Segers, Daily Mail, Centros, Überseering* and *Inspire Art*).[17] The conclusion of the European Court of Justice (ECJ) in subject cases has been that irrespective of any private international law system of an EU Member State, each entity has the freedom of establishment. Restrictions are only allowed in the case of fraud and in other specific cases. Member States must recognize and respect entities from other Member States. In the case law on this subject, the ECJ has, in my opinion, also ruled out the conflict between the law of the state of incorporation and the law of the state of principal place of business (*siège rèel*). The most recent judgement which is of great significance is that in the *Sevic*[18] case. A Luxembourg company called Security Vision Concept AG, intended to merge with a German Public Limited Liability company called Sevic Sytems AG, in accordance with the German Merger Act (*Umwandlungsgesetz*). The German Commercial Register (*Amtsgericht*) objected to the registration. In doing so, it had hindered the merger from becoming active. The main reason brought forward by the Commercial Register was that the German Merger Act was only applicable to entities with a registered office in Germany. The ECJ ruled that the freedom of establishment (Articles 43/48 EC Treaty) is affected by a cross-border merger. Different treatments between German and non-German entities were in this case, according to the ECJ, only permissible if:

i. such a difference is based on legitimate interests;

ii. compelling reasons of public interest merit such different treatment (for instance, the protection of creditors, employees and minority shareholders); and

iii. the provision is necessary but not excessive, to reach the intended goal. A restrictive measure must be appropriate.

The ECJ concluded that the German Merger Act was in conflict with Articles 43 and 48 of the EC Treaty. Consequently, it can now be stated in Europe that (at least in respect of inbound) cross-border mergers can only be prohibited if, in an individual case, compelling reasons require such prohibitions. Another conclusion can be reached: the general principle of freedom of establishment is applicable to all forms of legal entities (including cooperatives, mutual and

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17 *Supra* note 11.

18 Judgment of 13 December 2005 in Case C-411/03, Sevic Systems AG.

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partnerships)[19], and not only to public or limited liability companies. It may even further be concluded that this general principle is applicable to other cross-border transactions, such as de-mergers.

I. Conclusions[20]

The current status of the European company law is that intra-community cross-border mergers are fully supported by the EC Treaty (the freedom of establishment) and confirmed by the European Court of Justice in the *Sevic* case. The European Commission has further clarified that it is essential for the internal market and for the integration of the European Capital Market that cross-border mergers be effectuated without too many restrictions.

To date, the European Company and the European Cooperative are not sufficiently attractive in light of, for instance, conflicting national laws and complex employee's participation rules. The Regulations on this subject are too much of a compromise. Although the Cross-border Merger Directive has to be implemented in the EU Member States by the end of 2007, it is still doubtful whether it will be used very often. This Merger Directive is likely to give rise to immeasurable overlap or to conflicts between the various national laws.

The *Sevic* case has established that cross-border mergers are one of several methods of establishment in another Member State. According to the judgement in the *Sevic* case, it is not only possible to demand registration of cross-border mergers but also of cross-border divisions in cases where Member States have national rules permitting divisions involving national companies. In the case of mergers, applying Article 43 and 48 directly, Member States must comply with the requirements on restrictive legislation laid down by the EC Treaty, i.e. the requirements of appropriateness and proportionality. In order to ensure that national rules not only safeguard employee's interests but also comply with community law requirements, it would be worth recommending that Member States implement the provisions of the Merger Directive in national law immediately. Given the differences between the local jurisdictions and authorities like Trade Registers that are reluctant to register such mergers, it would be legally cumbersome to pursue cross-border mergers prior to the date of implementation.

I close with the conclusion that, although the European Commission is striving hard to eliminate restrictions for cross-border mergers, in the end national sentiments and tax obstacles may prevail.

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19 *See* Article 48 EC Treaty.

20 *See also* T. Rønfeldt & E. Werlauff, *Merger as a method of Establishment: on Cross-Border Mergers, Transfer of Domicile and Divisions, Directly Applicable under the EC Treaty's Freedom of Establishment*, 3 (3) European Company Law 125 (2006).