

SORAINEN
LAW OFFICES

www.sorainen.com

THE PAN-BALTIC M&A AND BUSINESS LAW FIRM

Cross-border mergers and relocation of companies

Tallinn, 20 April 2006
Risto Agur, Attorney-at-Law

SORAINEN
LAW OFFICES

www.sorainen.com

Table of contents

- Cross-border mergers Directive (Merger Directive);
- ECJ ruling in SEVIC Systems AG case;
- Proposed Directive on the cross-border transfer of companies' registered offices (Relocation Directive);
- Summary.

2

Background of Merger Directive

- First version of the Merger Directive (which applied only to public limited companies) was drafted already in 1984;
- Obstacle at the time – regulation concerning participation of employees, which failed to reach agreement in the European Parliament;
- The European Commission came up with new version of the Merger Directive in 2003;
- The Merger Directive was adopted 26.10.2005 and came into effect 15.12.2005;

3

Merger Directive – to whom and why? (1)

- The Merger Directive is the first tool adopted under the European Commission Action Plan Concerning Company Law;
- The Merger Directive is addressed primarily to small and medium sized entrepreneurs (SME-s), who are not interested in establishing a Societas Europaea (SE) and Pan-European activity, but activity in one or two Member States;

4

Merger Directive – to whom and why? (2)

- Formerly, cross-border mergers were generally impossible because laws of Member States quite simply did not permit this (e.g. in Estonia, Finland, Sweden and Austria), or the laws of Member States contained major differences with respect to this issue, or there were remarkable time and money expenses related to this [e.g. private law procedure in Great Britain];
- The former “alternative” to cross-border mergers was:
 - transfer of the business of the company to be acquired to the acquiring company in the other Member State; and
 - liquidation of the company acquired;

5

Merger Directive and Estonia

- The Member States must bring into force their local legal acts to comply with the Merger Directive by 15.12.2007;
- Estonia has not made remarkable progress in transposing the Merger Directive;
- The analysis regarding what exactly should be changed in local law is under work. Depending on the volume of the amendments required the Ministry of Justice is planning to have the draft law ready by the end of this year or the beginning of next year (Urmas Volens 19.02.2006);

6

Scope of Application of the Merger Directive (1)

- Scope of Application: The Merger Directive applies to mergers of limited liability companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, provided at least two of them are governed by the laws of different Member States;
- The Merger Directive applies to all limited liability companies (initially only AS);

7

Scope of Application of the Merger Directive (2)

- Cross-border mergers shall only be possible between types of companies which may merge under the national law of the relevant Member States (e.g. a Finnish private limited company cannot merge with an Estonian commercial association);
- A company taking part in a cross-border merger shall comply with the provisions and formalities of the national law to which it is subject (primarily the decision-making procedure related to the merger and – taking into account the cross-border nature of the merger – the provisions regarding protection of creditors, owners of bonds and securities, owners of shares and protection of the employees);

8

Performance of cross-border merger (1)

Common draft terms of cross-border merger (1)

- The management or administrative organ of each of the merging companies shall draw up the common draft terms of cross-border merger. The common draft terms of cross-border merger shall include at least the following particulars:
 - the form, name and registered office of the merging companies and those proposed for the company resulting from the cross-border merger;
 - the ratio applicable to the exchange of securities or shares representing the company capital and the amount of any cash payment;
 - the terms for the allotment of securities or shares representing the capital of the company resulting from the cross-border merger;
 - the likely repercussions of the cross-border merger on employment;
 - the date from which the holding of such securities or shares representing the company capital will entitle the holders to share in profits and any special conditions affecting that entitlement;
 - the date from which the transactions of the merging companies will be treated for accounting purposes as being those of the company resulting from the cross-border merger;

9

Performance of cross-border merger (2)

Common draft terms of cross-border merger (2)

- The common draft terms of cross-border merger must contain at least the following data:
 - the rights conferred by the company resulting from the cross-border merger on members enjoying special rights or on holders of securities other than shares representing the company capital, or the measures proposed concerning them ;
 - any special advantages granted to the experts who examine the draft terms of the cross-border merger or to members of the administrative, management, supervisory or controlling organs of the merging companies ;
 - the statutes of the company resulting from the cross-border merger;
 - where appropriate, information on the procedures by which arrangements for the involvement of employees in the definition of their rights to participation in the company resulting from the cross-border merger are determined;
 - information on the evaluation of the assets and liabilities which are transferred to the company resulting from the cross-border merger;
 - dates of the merging companies' accounts used to establish the conditions of the cross-border merger.

10

Performance of cross-border merger (3) Publication of the Common draft terms of cross-border merger

- The common draft terms of the cross-border merger shall be published in the manner prescribed by the laws of each Member State at least one month before the date of the general meeting which is to decide thereon;

11

Performance of cross-border merger (4) Report of the management organ

- The management organ of each of the merging companies shall draw up a report intended for the members explaining and justifying the legal and economic aspects of the cross-border merger and explaining the implications of the cross-border merger for members, creditors and employees;
- The report shall be made available to the members and to the representatives of the employees or, where there are no such representatives, to the employees themselves, not less than one month before the date of the general meeting;

12

Performance of cross-border merger (5) Independent expert report

- An independent expert report intended for members and made available not less than one month before the date of the general meeting shall be drawn up for each merging company;
- As an alternative to experts operating on behalf of each of the merging companies, one or more independent experts, appointed for that purpose at the joint request of the companies by a judicial or administrative authority in the Member State of one of the merging companies or of the company resulting from the cross-border merger or approved by such an authority, may examine the common draft terms of cross-border merger and draw up a single written report to all the members;
- Neither an examination of the common draft terms of cross-border merger by independent experts nor an expert report shall be required if all the members of each of the companies involved in the cross-border merger have so agreed;

13

Performance of cross-border merger (6) Approval by the general meeting

- After taking note of the report of the management organ and the independent expert report, the general meeting of each of the merging companies shall decide on the approval of the common draft terms of cross-border merger;
- The general meeting of each of the merging companies may reserve the right to make implementation of the cross-border merger conditional on express ratification by it of the arrangements decided on with respect to the participation of employees in the company resulting from the cross-border merger;

14

Performance of cross-border merger (7) Pre-merger certificate

- Each Member State shall designate the court, notary or other authority competent to scrutinise the legality of the cross-border merger as regards that part of the procedure which concerns each merging company subject to its national law;
- In each Member State concerned the above mentioned authority shall issue, without delay to each merging company subject to that State's national law, a certificate conclusively attesting to the proper completion of the pre-merger acts and formalities;

15

Performance of cross-border merger (8) Legality

- Each Member State shall designate the court, notary or other authority competent to scrutinise the legality of the cross-border merger as regards that part of the procedure which concerns the completion of the cross-border merger and, where appropriate, the formation of a new company resulting from the cross-border merger where the company created by the cross-border merger is subject to its national law;
- The said authority shall in particular ensure that the merging companies have approved the common draft terms of cross-border merger in the same terms and, where appropriate, that arrangements for employee participation have been determined;
- Each merging company shall submit to the competent authority the pre-merger certificate within six months of its issue together with the common draft terms of cross-border merger approved by the general meeting;

16

Performance of cross-border merger (9) Entry into effect

- The law of the Member State to whose jurisdiction the company resulting from the cross-border merger is subject shall determine the date on which the cross-border merger takes effect;
- That date must be after the scrutiny of the legality of the cross-border merger;
- A cross-border merger which has entered into effect cannot be declared null and void!

17

Performance of cross-border merger (10) Registration

- The law of each of the Member States to whose jurisdiction the merging companies were subject shall determine, with respect to the territory of that State, the arrangements for publicising completion of the cross-border merger in the public register in which each of the companies is required to file documents;
- The registry for the registration of the company resulting from the cross-border merger shall notify, without delay, the registry in which each of the companies was required to file documents that the cross-border merger has taken effect. Deletion of the old registration, if applicable, shall be effected on receipt of that notification, but not before;

18

Consequences of the cross-border merger

- When a company being acquired undergoes cross-border merger with an acquiring company which is in existence or being established, this shall have the following consequences from the date of effectiveness of the cross-border merger:
 - all the assets and liabilities of the company being acquired shall be transferred to the acquiring company;
 - the shareholders of the company being acquired shall become shareholders of the acquiring company;
 - the company being acquired shall cease to exist and it shall be deleted from the register.

19

Simplified formalities

- Where a cross-border merger by acquisition is carried out by a company which holds all the shares and other securities conferring the right to vote at general meetings of the company or companies being acquired:
 - Simplified formalities shall be applied to the draft terms of merger;
 - The draft terms of merger do not need to be approved by the shareholders of the companies being merged;
 - There is no need for an independent expert report;

20

Employee participation

- The company resulting from the cross-border merger shall be subject to the rules in force concerning employee participation, if any, in the Member State where it has its registered office;
- Several exceptions, in case of which the Member States regulate employee participation in the company resulting from the cross-border merger and involvement of employees in establishment of such rights *mutatis mutandis* in compliance with the principles and procedures stipulated in the SE Statutes Directive and respective involvement of employees in the stipulations of the directive;

21

ECJ ruling in SEVIC Systems AG case (1)

- German company SEVIC Systems AG brought an action against German court decision rejecting its application for registration in the national commercial register of the merger between itself and Security Vision Concept SA, a company established in Luxembourg, on the ground that the German law on company transformations provides only for mergers between companies established in Germany;
- Similar: Commercial Code § 391-6: Merging companies may be of the same class or of different classes of companies entered in the commercial register in Estonia unless otherwise provided by law;
- The German court suspended the court proceedings and on 16.09.2003 filed an application to the European Court of Justice for a preliminary ruling;
- ECJ made its ruling on 13.12.2005 (!);

22

ECJ ruling in SEVIC Systems AG case (2)

- ECJ: It is in contradiction with articles 43 and 48 of the Treaty establishing the European Community if a Member State refuses entry in the national commercial register of a merger upon which a company is dissolved without liquidation and its total assets are transferred to another company, if one of the two companies is located in another Member State, while making such entry is possible upon fulfilment of certain conditions, if the location of both companies participating in the merger is in the territory of the first Member State;
- Conclusions:
 - Based on the ECJ ruling it can be interpreted that also Estonian law contradicts the norms for the freedom of establishment provided in the Treaty establishing the European Community;
 - Based on the ECJ ruling it can be interpreted that cross-border merger is theoretically possible also prior to transposing the Merger Directive into laws of Member States, but the ruling did not make it cheaper or faster;

23

Relocation Directive - definition

- ECJ is expected to issue a draft directive regarding cross-border transfer of companies' registered offices (Relocation Directive). The Relocation Directive would provide a simplified procedure for companies to transfer their registered office from one EU Member State to another;
- According to the present plan, the company transferring its registered office would be registered in the target Member State in such a manner that this company would acquire there the so-called status of local legal person. At the same time, the same company would be deleted from the register of the Member State of its original registered office;
- If necessary, companies undergoing transfer of registered office must reorganise their structure to ensure harmony with the law of the target Member State. At the same time, companies undergoing cross-border transfer of registered office would not be obliged to go through liquidation proceedings in the state of their former location or establish a new company in the target state;

24

Relocation Directive

- ECJ in its ruling of 1998 regarding Daily Mail explicitly stated that transfer of registered office from one Member State to another results in problems that cannot be solved by the rules regarding the freedom of establishment and which are to be addressed by future legislation (this is different than the ruling of SEVIC Systems);
- Problems include *inter alia* contradiction of national laws of Member States, the requirement to liquidate the company in its former state of location, protection of the rights of minority shareholders and creditors, involvement of employees and tax issues. This currently makes transferring of a company's registered office very complicated and expensive, if not impossible;

25

Relocation Directive

- Current "alternatives" to cross-border transfer of registered office:
 - establish a new company in the desired Member State (target state);
 - transfer the business of the company of the state of location to the company established in the target state;
 - liquidate the (shell of the) company in the original state of location;
- According to answers to public polls carried out by the European Commission, undertakings have a pressing need for EC law to allow transfer of their registered office from one Member State to another without having to carry out liquidation proceedings in the first Member State;
- The Relocation Directive would enable undertakings to change their location and organisation structure quickly in accordance with the market situation and the undertaking's position in these markets;

26

Relocation Directive – why and to whom?

- In professional literature mainly the following things are mentioned as regards the need of cross-border transfer of registered offices:
 - more favourable tax regimes of certain countries (Estonia);
 - interest towards business environments with less regulation – easier to do business;
 - interest in having advantages similar to competitors in a cross-border market (e.g. the same cross-border market, different operating conditions);
 - some shareholders prefer to act *incognito*.
- Therefore Estonian companies may also be interested in transferring the registered offices of their companies, but we rather anticipate higher interest by undertakings of other Member States to move to Estonia than vice versa;
- Same purposes which in terms of transfer of registered offices also apply to cross-border mergers;

27

Relocation Directive – procedure

- The Relocation Directive has been processed for approximately 10 years, but specific wording to a draft directive is still missing; according to forecasts the draft should be adopted in the “next few years” (Jaap Winter, September 2005);
- There should be no hindrances similar to those of the Merger Directive (primarily the issue of involving the employees, protection of creditors) – solutions are in place and transfer of registered office only concerns a single company;

28

Summary (1)

- Similar to rules applicable on mergers within single Member States it is not very likely that cross-border mergers regulated by the Merger Directive would be widely adopted in case of mergers and acquisitions (M&A) of companies belonging to different groups of undertakings;
- It is more likely that the Merger Directive will create favourable conditions to restructuring of companies belonging to the same group of undertakings, making the process less complicated and reducing both legal and administrative costs;
- According to the ECJ ruling in the case of SEVIC Systems, cross-border merger is also possible before transposing the Merger Directive into national laws of Member States, but it was not made cheaper or easier by the ECJ ruling;

29

Summary (2)

- The Relocation Directive has a greater potential in terms of promoting relocation of companies (and thereby competition), because of only affecting a single company;
- The work on both directives is a long step towards achieving the EC objectives regarding promotion of the efficiency of business and competitiveness with emphasis on cross-border transactions, without forgetting protection of the rights of shareholders and third parties;
- These cross-border possibilities may prove very useful to both Estonia as a country and Estonian undertakings.

30

SORAINEN
LAW OFFICES
www.sorainen.com

Thank you!

Risto Agur

E-mail: risto.agur@sorainen.ee

Estonia

Parnu mnt. 15
10141 Tallinn, Estonia
Tel: +372-6 400 900
Fax: +372-6 400 901
Email: sorainen@sorainen.ee

Latvia

Kr. Valdemara iela 21
LV1010 Riga, Latvia
Tel: +371-7 365 000
Fax: +371-7 365 001
Email: sorainen@sorainen.lv

Lithuania

Jogailos g. 4
LT01116 Vilnius, Lithuania
Tel: +370-5 2685 040
Fax: +370-5 2685 041
Email: sorainen@sorainen.lt

Finland

Fredrikinkatu 55 A 1
00100 Helsinki, Finland
Tel: +358-9 43 690 840
Fax: +358-9 43 690 841
Email: sorainen@sorainen.com