

This article first appeared in *International Corporate Rescue*, July 2013

## THE COMPANIES (CROSS-BORDER MERGERS) REGULATIONS 2007: PROCEDURE, CASELAW AND FUTURE

By Richard Smith

### Introduction

It has been five years since The Companies (Cross-Border Mergers) Regulations 2007 (the 'Regulations') came into force in the UK. The Regulations implemented Directive 2005/56/EC on cross-border mergers of limited liability companies (the 'Directive').

In the words of the European Commission, the Directive was 'a big step forward for cross-border mobility of companies in the EU'. However, the Commission has indicated that in 2013 it proposes to analyse the conclusions of a forthcoming study on the application of the Directive and, subsequently, it will consider whether any amendments should be made to the Directive.

This article outlines the cross-border merger procedure in the UK under the Regulations and considers the reported caselaw on the Regulations in the English courts. It also considers what amendments to the Directive and the Regulations might be appropriate from the operation of the cross-border merger regime in the UK and its equivalent legislation in other EU member states.

### What is a cross-border merger?

The Regulations introduced a new form of statutory merger in the UK, a 'cross-border merger'. A cross-border merger must involve at least one UK company and at least one company governed by the law of an EU member state other than the UK.

Under the Regulations, a cross-border merger may take one of three forms, as follows:

- a 'merger by absorption', in which a transferor company transfers all its assets and liabilities to an existing transferee company in exchange for securities in the transferee company (or securities and cash) receivable by the members of the transferor company;
- a 'merger by formation of a new company', in which two or more transferor companies transfer all their assets and liabilities to a transferee company formed for the purposes of the cross-border merger in exchange for securities in the transferee company (or securities and cash) receivable by the members of the transferor companies; or
- a 'merger by absorption of a wholly-owned subsidiary', in which a transferor company which is a wholly-owned subsidiary transfers all its assets and liabilities to its parent company.

In a cross-border merger, as a matter of law:

- all the assets and liabilities of each transferor company are transferred to the transferee company;
- all rights and obligations arising from contracts of employment of each transferor company are transferred to the transferee company;



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- all legal proceedings to which each transferor company is a party are continued with the transferee company in substitution for the relevant transferor company;
- all contracts, agreements or instruments to which each transferor company is a party have effect, notwithstanding anything to the contrary in the relevant contract, agreement or instrument, as if the transferee company had been a party instead of the transferor company;
- other than in the case of a merger by absorption of a wholly-owned subsidiary, each shareholder of each transferor company becomes a shareholder in the transferee company; and
- each transferor company is dissolved without going into liquidation.

### Use of the Regulations

Figures provided by Companies House indicate that during the period since the Regulations came into force to January 2013, there have been 180 mergers involving UK companies completed under the Regulations. Of these, 40 were completed in 2012 and 53 in 2011; 14 were completed in the first half of January 2013.

Whilst the Regulations can be used for arm's length mergers of companies ranging from closely-held private companies to widely-held public companies,<sup>1</sup> the Regulations have been used extensively to facilitate cross-border restructuring. For example, in February 2013 Honda announced that it had completed the merger of each of its European sales subsidiaries into one UK entity; this comprised 14 individual cross-border mergers, each effected under the Regulations.

However, the use of the Regulations can go beyond just group internal reorganisations. It is within the ambit of the Regulations (and the

Directive) for them to be used to facilitate a change in the place of incorporation of the company carrying on a transferor company's operations if the transferee company is a newly-formed company governed, by definition, by the laws of a different EU member state.

### Procedure

In outline, the merger process is as follows:

- the Regulations prescribe a number of 'pre-merger requirements' that must be satisfied by the UK company involved in the merger, following which a certificate must be obtained from the High Court that it has completed these requirements properly. The pre-merger requirements will apply to any UK company that is involved in a cross-border merger under the Regulations. The other EU company involved in the merger will also have to comply with an equivalent procedure as laid down by its own domestic law implementing Directive. That domestic law will state the national authority fulfilling the same role as the High Court in the merger process, namely to monitor the completion and legality of the decision-making process in that EU state.

The pre-merger requirements for the UK under the Regulations involve the following steps:

- (a) the directors of the UK merging company must draw up and adopt a draft of the proposed terms of the merger giving certain prescribed particulars (e.g. details of the merging companies, the consideration and the rights/restrictions attaching to any shares to be allotted by the transferee company, the likely effects of the merger for employees, and an evaluation of the assets/liabilities to be transferred to the transferee company);

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<sup>1</sup>By way of example, the recommended (but ultimately uncompleted) merger between Greencore Group plc of Ireland and Northern Foods plc in 2010.

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- (b) the directors of the UK merging company must draw up and adopt a report that, inter alia, explains the effect of the merger for members, creditors and employees of the company, and states the legal and economic grounds for the draft terms of merger;
- (c) an independent expert's report must be produced on the reasonableness of the number of any shares to be allotted under the merger by the transferee company to members of any transferor company. In certain circumstances an independent expert's report will not be required (i.e. where the cross-border is a merger by absorption of a wholly-owned subsidiary, where all members of all merging companies agree that such a report is not required, or where the cross-border merger is a merger by absorption where 90% or more (but not all) of the shares of the transferor company(ies) are held by or on behalf of the transferee company and certain other conditions are met);
- (d) the UK merging company then applies to the High Court to convene a shareholder meeting to approve the draft terms of the merger. In certain circumstances a shareholder meeting will not be required – see commentary on *Re Oceanrose Investments Limited* below. The Court also has the power to convene a meeting of creditors on the application of the UK merging company or any creditor; the Court will be concerned to ensure that the interests of creditors are properly protected;
- (e) the directors of the UK merging company must file a form,<sup>2</sup> together with a copy of the draft terms of the merger (or confirmation that the draft terms are available on a website) and any order of the High Court to convene a meeting of members or creditors, at Companies House not less than two months before the first members' meeting;
- (f) the draft terms of merger must be approved by a majority in number, representing 75% in value, of each class of members of the UK merging company, present and voting in person or by proxy. If a creditor meeting is summoned, the draft terms of merger must be approved by a majority in, number representing 75% in value, of the creditors, present and voting either in person or by proxy; and
- (g) once the UK merging company has completed the pre-merger requirements, it may apply to the High Court for an order certifying that it has completed properly the pre-merger requirements. The Court will then issue a pre-merger certificate; and
- where the UK merging company is the transferee company (and once each non-UK merging company has obtained a pre-merger certificate under its domestic law), joint application can be made to the High Court for an order approving completion of the cross-border merger. If the UK merging company is a transferor company the merger will need to be approved by the relevant court/authority in the transferee's home state. The order of the High Court or the document issued by the relevant court/authority in the transferee's home state (as applicable) must then be filed at Companies House. The domestic law of the transferee company's home state will determine the date on which the merger will become effective.

### Employee participation

The Regulations contain provisions for employee participation such that, if participation is required, the merger cannot be completed until the employee participation arrangements to apply post-merger have been settled. The Directive requires

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<sup>2</sup>Form CBo1.

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participation where it already exists in one or more merging companies; there is no requirement to introduce employee participation where it does not already exist.

The employee participation provisions in the Regulations apply where the UK merging company is the transferee company and either:

- a merging company has, in the six months before the publication of the draft terms of merger, an average number of employees that exceeds 500 and has a system of employee participation;
- a UK merging company has a proportion of employee representatives amongst its directors; or
- a merging company has employee representatives amongst members of the administrative or supervisory organ or their committees or of the management group which covers the profit units of the company.

In such circumstances, in essence, the merging companies have two options:

- they can agree to be subject to standard rules on employee participation without prior negotiation with the employee representatives; or
- they can agree to set up a special negotiating body (SNB) with a view to agreeing employee participation arrangements with employees.

Where the employee participation provisions apply, a merger cannot be completed until the ongoing employee participation arrangements have been agreed.

### Caselaw

There has been limited reported English caselaw to date on the Regulations.

In *Re Wood DIY Limited and Olivero Franco Sarl*<sup>3</sup> it was held that, where a UK merging company is the transferee company, there was a residual discretion in the court under the Regulations as to whether to grant approval for completion of the cross-border merger. The court went on to say that it was generally considered appropriate to apply the same test as to the basis on which this discretion should be exercised as that adopted for a scheme of arrangement, as expressed in *Re National Bank* that:

‘...the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.’<sup>4</sup>

In *Re Oceanrose Investments Limited*<sup>5</sup> the court had to consider whether the requirement for approval of the draft terms of a merger at a meeting summoned by the court was necessary in a case where the UK merging company has only one member who has formally signified its consent. The court held that a shareholder meeting was required save only in the two cases expressly provided in the Regulations. The first exception is the case of a transferor company concerned in a merger by absorption of a wholly-owned subsidiary (Regulation 13(3)). The second exception applies to an existing transferee company where a number of detailed requirements set out in Regulation 13(4) are satisfied.

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<sup>3</sup>[2011] EWHC 3089.

<sup>4</sup>[1966] 1 WLR 819 at 829.

<sup>5</sup>[2008] EWHC 3475.

<sup>6</sup>[2012] EWHC 1783.

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The most recent decision is that in *Re Itau BBA International Limited*.<sup>6</sup> The question in this case concerned the meaning of ‘existing transferee company’ for the purposes of a merger by absorption. Regulation 3(1) defines an existing transferee company as ‘a transferee company other than one formed for the purposes of, or in connection with, a cross-border merger’. However, taken literally, the qualification in Regulation 3(1) that an existing transferee company must not have been ‘formed for the purposes of, or in connection with, a cross-border merger’ might prevent, for example, a shelf company acquired from formation agents or a special purpose vehicle being used in a merger by absorption. The court had to decide, therefore, whether it was possible to construe the definition of existing transferee company in such a way that the qualification applied only to exclude a company formed for the purposes of a merger by formation of a new company. The court held that no precedent for a wider qualification could be found in the Directive and that it was inconceivable that if the Secretary of State had intended to broaden the Directive in this important respect in transposing it into English law that this would have been done without explanation. Accordingly, the proper reading of the definition of existing transferee company was ‘a transferee company other than one formed for the purposes of, or in connection with, a cross-border merger [by formation of a new company]’.

### Advantages and disadvantages

The principal benefits of using the Regulations are:

- certainty as regards the transfer of assets, liabilities, contracts and proceedings that might otherwise require third party consents in the context of a business transfer; and

- transferor companies are automatically dissolved without the need for a separate liquidation process.

However, conversely, there may be disadvantages in effecting a transaction under the Regulations. For instance, in the context of a widely held public company, the procedural requirements of the Regulations (and those applicable under domestic law to the non-UK merging company) may be more complex and result in an extended transaction timetable when compared to a traditional takeover offer or scheme of arrangement. Equally the provisions of the Regulations for employee participation, where applicable, may be unattractive.

### The future

The European Commission published an action plan on European company law and corporate governance on 12 December 2012.<sup>7</sup> The plan is the product of a public consultation on European company law undertaken in 2012, one aspect of which was whether there was support for improvement of the cross-border mergers framework. The action plan notes that there seems to be a particular case for enhancing the procedural rules for cross-border mergers in light of issues identified as potential sources of uncertainty and complexity. The particular issues identified in the action plan are:

- a lack of harmonisation as regards methods for valuation of assets (i.e. for arriving at the number of securities in a transferee company (or securities and cash) receivable by shareholders of transferor companies);
- the duration of protection periods across EU member states for creditors’ rights; and

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<sup>7</sup>[ec.europa.eu/internal\\_market/company/docs/modern/121212\\_company-law-corporate-governance-action-plan\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/modern/121212_company-law-corporate-governance-action-plan_en.pdf).

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- the consequences for creditors' rights on completion of a merger (i.e. in some instances an ability to suspend a merger whilst creditors have not been provided with comfort that their claims will be able to be satisfied following the merger).

To these might be added:

- a lack of harmonisation over the time periods required in different member states for the monitoring of the decision-making process and legality of a merger;
- an oversight in the drafting of the Directive (and the Regulations) such that there is a lack of clarity in the timetable for a merger in the situations where a shareholder meeting is not required; and
- legal uncertainty around differing implementation of the employee participation rights.

As regards cross-border mergers, the action plan indicates that in 2013 the Commission proposes to analyse the conclusions of a forthcoming study on the application of the Directive (which will be available in the second half of 2013) and subsequently it will consider the appropriateness of amendments to the Directive.

### Conclusion

The Institute of Chartered Accountants in England and Wales noted in its response to the European Commission's 2012 public consultation that the Directive was 'a very successful piece of legislation'. The Regulations certainly introduced into English law a very useful alternative for the restructuring of merger transactions across EU borders. It is to be hoped that, when the Commission comes to consider its proposals for amendment of the Directive, greater harmonisation can be achieved so that more transactions can benefit from the advantages offered under the Directive and the Regulations. Certainly, the 2012 consultation showed strong support for improvement of the cross-border mergers framework.<sup>8</sup>

It is interesting to note also that the European Commission will also be considering an initiative to provide a framework for cross-border divisions, which may be implemented through an amendment of the Directive.

<sup>8</sup> 331 out of a total of 496 replies.

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