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Cross-border mergers – Use it or lose it!

Anthony Turner | 29 January 2020

Brexit takes place at 11.00 pm on 31 January 2020 after a prolonged period of uncertainty for the UK and the EU. There follows a transition period to 31 December 2020 during which the UK and the EU will negotiate the terms of their future relationship.

Directive (EU) 2017/1132 on cross-border mergers of limited liability companies (**Directive**) provides a uniform process to facilitate cross-border mergers of limited liability companies in the EEA. The Directive was enacted in the UK by the Companies (Cross-Border Mergers) Regulations 2007 as amended (**Regulations**).

The Directive provides a common process for cross-border mergers in different jurisdictions. These cross-border mergers are a reasonably well travelled path and, whilst not commonplace, have been used a number of times in relation to UK companies. A cross-border merger represents one of the most efficient ways of merging a UK entity with another EEA entity or vice versa.

It is clear in the UK legislation for Brexit that the cross-border merger regime will cease to apply on 31 December 2020 (and there is little chance of the negotiations during the transition period changing this). As such, now is the time to restructure group companies either to include or exclude UK companies from corporate groups. The reasons for doing so will generally be driven by commercial considerations and, perhaps, a view as to whether a corporate presence in the UK will be an advantage or a disadvantage in the future.

Why use the Regulations to effect a cross-border merger?

Certainty - the consequences of a cross-border merger are that the assets and liabilities of a transferor company (including employees) are transferred to a transferee company by operation of law. The principal advantage of this is that it may avoid the need for third parties (for example those who have existing contractual arrangements with the transferor) to consent to the transfer.

Winding up of a transferor company - a transferor company is dissolved without going through any form of liquidation or administration proceedings, which is both a cost saving and is simpler.

Nature of the company - a cross-border merger may be used for a variety of UK entities, including companies and limited partnerships. However, in spite of the broad nature of the rules, in practical terms the use of the procedure is limited to companies with a relatively closely held shareholder base. In our experience, the Directive is most applicable to privately owned companies (in particular family businesses) which, for good commercial reasons, wish to merge existing group companies or family operations in the EEA. Although possible, the Directive does not easily lend itself to arm's-length acquisitions and certainly not to hostile takeovers.

Process - the Directive is prescriptive and the parties will need to comply with the various enactments of the Directive in the relevant countries. The competent authority in the UK

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is the court (as opposed to many EEA countries where the competent authority is a notary). The UK court will bring an independent mind to consider whether all of the requirements of the Regulations have been met and this may be quite onerous. In addition, the parties will need to go through two court hearings (and will need to instruct a barrister) and timing will be dictated, to an extent, by the court timetable.

Regulatory reasons – there may be a separate legal or regulatory reason why this route needs to be followed, for example to preserve EU tariffs after the end of the Brexit transition period.

In each case, a person contemplating a cross-border merger should consider whether in practice a more standard commercial sale or transfer procedure should be followed as an alternative to a merger under the Directive. A cross-border merger under the Directive is not a short process and will take approximately three months.

Types of merger

The Regulations allow three different types of merger, namely:

(a) A "*merger by absorption*". This merger applies where there are one or more transferor companies, there is an existing transferee company and at least one of the companies is a UK company and one an EEA company;

(b) A "*merger by absorption of a wholly-owned subsidiary*". This is a simpler structure and requires there to be one transferor company which is wholly owned by the transferee company and one of those companies is a UK company and one of them is an EEA company;

(c) A "*merger by formation of a new company*". Under this structure, there needs to be two or more transferor companies, at least two of which are governed by the laws of a different EEA State. Each transferor company, on completion of the transaction, is dissolved and its assets transferred to a new company incorporated for the purposes of the merger. At least one of the companies in the merger must be a UK company.

The consideration will be the issue of new shares in the transferee company to the members of the transferor company and, if agreed, a cash payment.

Procedure for a cross-border merger

In order to illustrate how a cross-border merger may work, we take the example (not dissimilar to a merger we have worked on) of an English company (UKCo) which is wholly owned by two German individuals (family members) and is the holding company of a number of German trading companies. UKCo itself does not actively trade. UKCo was incorporated in England for historical tax reasons (which have ceased to be relevant) and there is no longer a good reason for UKCo to remain in England, with the associated administrative costs. The intention is therefore to merge UKCo with a German company (GrCo) (which is an existing trading company owned by the same shareholders of UKCo). UKCo has one principal creditor but no employees.

The broad process, from a UK perspective is set out below. Please note that there is a parallel process in Germany to comply with the German enactment of the Directive.

Preparation of documents

A. As a minimum, the following principal documents will need to be drafted in the UK:

(i) **Draft terms of merger**. The directors of UKCo must draw-up and adopt a draft of the proposed terms of the cross-border merger. This document must contain a number of prescribed particulars, for example, corporate details of each company, the effect of the merger on employees (if any) and information on the assets and liabilities being transferred. This draft terms of merger will ultimately need to be approved by the members of UKCo. This report must be common to all parties to the merger; therefore, an identical document will need to be approved and adopted by each party.

(ii) **Directors' Report**. The directors of UKCo must draw up and adopt a directors' report. The principal thrust of this report is to explain the effect of the cross-border merger for members, creditors and employees of the company and to disclose any interests of the directors in the merger.

(iii) **An independent expert's report**. This largely focuses on valuation and ensuring that the correct consideration is paid to the members of the relevant company. The independent expert's report is not required in the case of a merger by absorption of a wholly-owned subsidiary or a merger by absorption where every member of each merging company agrees that a report is not required. The independent expert's report may be expensive to prepare and therefore if it is at all possible the need for this report should be waived by the shareholders.

In addition, various ancillary documents, such as board minutes, claim forms and witness statements will need to be prepared.

Process

A. As UKCo has no employees, we need not be concerned with the detailed employee participation provisions in the Regulations. If they apply (broadly where there are more than 300 employees), the employee participation provisions are onerous, may be time consuming to comply with, and must be completed before the merger can take place.

B. The competent authority in the UK for the approval of cross-border mergers is the Court (the Companies Court). The nature of the relevant competent authority will vary in each jurisdiction.

An application is made to the Court by UKCo (supported by a witness statement of one of the directors) to summon a meeting of the members of UKCo in order to approve the terms of merger.

If granted, the Court will order that the relevant shareholder meeting be held. UKCo will then call a general meeting of its shareholders in accordance with its Articles of Association. It is important that the date of the general meeting is sufficiently distant from the first court hearing to allow compliance with the public announcement of the merger. The draft terms of merger and the directors' report must be available at UKCo's registered office for the period of one month before the date of this meeting.

C. The directors of UKCo must deliver to Companies House Form CB01, together with the information required by that Form, not less than two months before the date of the first meeting of the members of the company ordered by the Court. Companies House will then publish notice of receipt of the documents

(containing prescribed particulars) in the London Gazette at least one month before the date of the shareholder meeting.

D. In our example, the sole creditor is fully aware of and has agreed to the proposed merger. Although the approval of creditors is not required by the Regulations, the Court may call a meeting of creditors after an application by the UK merging company itself or any member or creditor of UKCo if it feels that the interests of creditors are not fully protected. As such, it is important to ensure that the position of creditors is properly dealt with as part of the terms of the merger. If the Court summons a meeting of creditors the draft terms of merger will need to be approved by a majority in number representing 75 per cent in value of the creditors or class of creditors present and voting either in person or by proxy at the meeting.

E. The relevant meeting of the members is then held. The draft terms of the merger must be approved by a majority in number representing 75 per cent in value of each class of members of UKCo present and voting either in person or by proxy at the meeting. Note that the approval of the members is not required in the case of a transferor company in the merger by absorption of a wholly-owned subsidiary.

F. UKCo returns to Court seeking the grant of a pre-merger certificate certifying for the purposes of the Directive that the company has completed properly the pre-merger formalities for the cross-border merger. UKCo and GrCo then jointly apply to the German competent competition authority to approve the completion of the cross-border merger under German law. The document issued by that authority will then need to be filed at Companies House (within 14 days), which will result in the dissolution of UKCo.

Summary

There are many advantages of this cross-border merger procedure, which will cease to be available to UK companies after 31 December 2020. Therefore now is the time to review group structures to decide whether a cross-border merger of this type will be useful and, if it is, to start the process to implement the merger.

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