The Companies (Cross-Border Mergers) Regulations 2007

Introduction

The Companies (Cross-Border Mergers) Regulations 2007 (S.I. 2007/2974) (the “Regulations”) came into force on 15 December 2007. The Regulations are intended to facilitate mergers between UK companies and corporate bodies governed by the laws of other EEA states.

Background

The EU Directive (2005/56/EC) on cross-border mergers of limited liability companies was published in November 2005. The aim of the Directive was to remove obstacles under national laws which impede cross-border mergers, and lay down a common set of rules across all EEA jurisdictions. UK law generally did not set out a statutory procedure or framework for cross-border mergers and therefore secondary legislation in the form of the Regulations was introduced for this purpose.

Much of the terminology and procedures are nevertheless similar to the provisions introduced in the Companies Act 2006 for the merger of UK public companies as set out in Part 27, which came into force on 6 April 2008, and which is based on EU Directive (78/855/EEC) and EU Directive (82/891/EEC).

The Regulations do not deal with related changes to UK tax legislation – these are instead made under the Corporation Tax (Implementation of the Mergers Directive) Regulations 2007 (S.I. 2007/3186), which came into force on 29 November 2007.

Definition of "cross-border merger"

Regulation 2 of the Regulations requires each company involved in the merger to be governed by the laws of a different EEA State and for one of the companies involved to be a UK Company.

The Regulations define 3 types of merger transaction

(i) “Merger by absorption”:

This is where one or more existing transferor companies are dissolved without going into liquidation, and on dissolution transfer all of their assets and liabilities to an existing transferee company. The consideration for the transfer will be either shares in the transferee company and (if so agreed) cash, which is receivable by members of the transferor company.

(ii) “Merger by absorption of a wholly owned subsidiary”:

This is similar to (i) above, but relates to the specific situation where there is a single transferor company which is a wholly owned subsidiary of the transferee company.

(iii) “Merger by formation of a new company”:

This occurs where two or more transferor companies are dissolved without going into liquidation, and on dissolution transfer all of their respective assets and liabilities to a newly formed transferee company. The consideration for each transfer will be shares in the transferee company and (if so agreed) cash, which will be receivable by each transferor’s members.

The procedures for a cross-border merger are divided into the pre-merger stage and the completion stage:

Pre-merger stage

The Regulations prescribe a number of steps that must be undertaken by a UK company prior to the merger.

Draft terms of merger

The company’s directors must draw up and adopt draft proposed terms of the merger including:

- the name, registered office, legal form and governing law in respect of each transferor and transferee company;
- the ratio of shares in the transferee to be allotted for a given number of shares in the transferor and the amount of any cash payment (the “share exchange ratio”);
- the terms of allotment of shares in the transferee;
- the likely effects for employees;
- benefits to be paid or given to any director; and
- rights and restrictions attaching to shares or other securities in the transferee being allotted to members holding shares or other securities in the transferor to which special rights or restrictions attach.
Directors’ report

The directors must also prepare a report for members, creditors and employees explaining the effect of the merger, and the legal and economic grounds for the draft terms.

Independent expert’s report

The Regulations oblige the company to appoint an independent expert to provide a report (this is not required for an absorption of a wholly-owned subsidiary or where certain other limited exceptions apply).

The independent expert’s report will comment upon the methods used to arrive at the share exchange ratio and the values obtained, and give an opinion as to whether each of these are reasonable. The expert may arrange for a valuation exercise to be carried out to enable him to prepare his report.

Approval by members and creditors

The draft terms of the merger should be approved by a meeting of the shareholders of the Company (unless there is an applicable exemption). For example, shareholder approval is not required for a merger by absorption of a wholly-owned subsidiary.

Shareholders of the Company or creditors have the right to apply for the court to summon a meeting of members of creditors to approve the draft terms of merger.

Availability of documentation

The draft terms of merger, directors’ report and (where required) independent expert’s report are to be made available at the company’s registered office for inspection by members and employee representatives (if applicable) for a month prior to the members’ approval meeting, and copies provided free of charge on request.

In addition, where a shareholder or creditors’ approval meeting is held, copies of the order of the court on an application for summoning of the meeting, the draft terms of merger and specified details of the merging companies must be filed with the Registrar of Companies together with Form COB1 not less than 2 months before the first meeting. The Registrar will then publish notice of receipt in the Gazette one more before the members’ approval meeting including details of the date and time of the approval meeting.

Merger completion

The company will apply to the court for an order certifying that it has completed the pre-merger formalities. The other merging company will apply to the competent court in their own respective EEA state for a corresponding certificate.

Completion of the merger takes place in accordance with a further court order. The competent authority for granting this order is that under the law of the EEA state having jurisdiction over the transferee company.

Each UK merging company must send a copy of the court order approving the merger to the Registrar of Companies together with certain other particulars within 7 days of the order being made.

Effect of cross-border merger

The court order approving the cross-border merger will fix a date on which the consequences of the merger take effect, which must not be more than 21 days from the making of the order. The assets and liabilities of the transferor company are transferred to the transferee company by operation of law. The transferee company is dissolved, and in the case of a merger by absorption or merger by formation of a new company, the members of the transferor companies (but excluding, where relevant, the transferee company) become members of the transferee company.

Once the court order approving the merger has been obtained the order should be filed with the Registrar of Companies who will then dissolve a UK transferor company from the UK register and place a note in the register stating that as from the date on which the merger took effect the assets and liabilities of the transferor company were transferred to the transferee company. Where the UK company is the transferee company it may need to file with the Registrar of Companies a clean print of its articles of association if these were amended by the court order approving the merger.

Employees

Employee interests are central to the operation of the Regulations, and although not highlighted above are relevant at every stage of the merger process.

In particular, the Regulations seek to protect employee participation rights, meaning the mandatory representation of employees on the board of companies of a certain size. The EU Directive sought to establish the principle that the transferee company should be subject to the employee participation laws of the relevant EEA state in which it is to be registered,. Whilst the UK does not have an existing regime for employee participation the Regulations do provide for a UK transferee company to have to introduce employee participation rights where:

- any UK merger company has an average number of
employees which exceeds 500 over the 6 months prior to the merger, and has an existing system of employee participation; or

- a UK merging company has a proportion of employee representatives amongst the directors; or
- a merging company has employee representatives on certain management, administrative or supervisory boards.

In these circumstances, the transferee company has a choice – it can either impose (without consulting employees) the “standard rules” of employee participation provided for in the Regulations, or establish a “Special Negotiating Body (SNB)” with a view to reaching an agreement between that body and the merging companies over employee participation arrangements.

If opting for the latter route, the Regulations provide detailed mechanisms for the election of representatives to the SNB from each country in which the merging companies have employees. However, the minimum requirements prescribed for an employee participation agreement do not provide much by way of concrete participation rights for the SNB (though the Regulations do provide protections so that representatives can take reasonable time off to perform their functions, and that a related dismissal is deemed to be unfair).

Information on employee participation rights has to be included in the draft terms of merger. Employee representatives are entitled to receive the directors’ report, and may provide an opinion on the directors’ report which the directors are required to circulate with future copies.

The Regulations provide for the rights and obligations arising from the contracts of employment of the transferor companies to be transferred automatically to the transferee company on completion of the merger.

Conclusion

The Regulations introduce a new court based procedure to the UK for effecting mergers and acquisitions. Practice in the UK is now beginning to adopt this procedure particularly in the context of group reorganisations. The process set out in the Regulations can be beneficial for some groups to transfer contracts by operation of law avoiding the need for third party consents or to achieve a merger on a neutral basis from a tax or accounting perspective. The structure of the court based approach, whilst not an immediate process, can provide a structured and tax efficient mechanism to ensure assets and liabilities are transferred and assumed by another group entity.

“Very professional, very thorough, and dealt with a number of complex issues very thoroughly

Quotation from Fieldfisher client

“They are very responsive to our requests and able to drive a transaction process forward”

Quotation from Fieldfisher client