France Completes Implementation of Cross-Border Mergers Directive

BY ERIC CAFRITZ, FRÉDÉRIQUE JAÏS-EMERY AND OLIVIER GENICOT

Eric Cafritz is a corporate partner resident at Fried, Frank, Harris, Shriver & Jacobson LLP's Paris office. Frédérique Jaïs-Emery and Olivier Genicot are corporate associates resident in Fried, Frank's Paris office. Contact: eric.cafritz@friedfrank.com or frederique.jais-emery@friedfrank.com or olivier.genicot@friedfrank.com.

In 1984, the European Commission presented a draft Directive on cross-border mergers of companies,[1] which had been the subject of lengthy and contentious negotiations. With the introduction of the European Company (formally, the "*Societas Europeae*," or "SE") in 2004,[2] cross-border mergers became possible in jurisdictions where they had not previously been allowed.[3] In the majority of cases, however, where the possibility to create an SE was not available or was not the objective,[4] companies continued to be subject to myriad legal and administrative requirements of the national jurisdictions involved.

In the absence of EU legislation to determine which country's laws prevail in a cross-border merger, such transactions involved complex legal structuring and tax issues.[5] Consequently, they have remained rare and costly. This situation was clearly in conflict with Article 220 of the Treaty of Rome, pursuant to which "*the Member States shall, in so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals (…) the possibility of mergers between companies or firms governed by the laws of different countries.*" It was also inconsistent with a decision of the European Court of Justice holding that the right to realize a cross-border merger is part of the freedom of establishment mandated by Articles 43 and 48 of the EC Treaty and that, accordingly, any obstacle to the exercise of such a right is incompatible with the Treaty.[6]

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In light of these issues, the European Commission adopted a proposal for a tenth company law directive on cross-border mergers, later renamed Directive 2005/56/EC of the European Parliament and of the Council dated October 26, 2005, on cross-border mergers of limited liability companies ("The Directive") which, following protracted negotiations, and considerable amendments, was finally adopted by the European Council and Parliament in 2005.

The Directive aims to create a new legal framework to allow companies from one Member State to engage more easily and with greater certainty in cross-border mergers with companies from other Member States and, in order to do so, sets forth conflict of laws principles and certain harmonized rules of substantive law at the EU level.

The Directive defers to national laws of EU Member States whenever possible. Companies taking part in cross-border mergers remain subject to the provisions and formalities of the national law to which they are subject, in particular, those concerning the decision-making process relating to the merger and, the protection of creditors, bondholders and shareholders of the merging companies, as well as of their employees, except for the employee participation rights discussed below.

The national laws of EU Member States regarding domestic mergers were already partially harmonized by the Third Council Directive 78/855/EEC of October 9, 1978, based on Article 54(3) (g) of the Treaty concerning mergers of public limited liability companies (the "Third Company Directive"). Hence, cross references to the national laws of EU Member States by the Directive should not lead to substantial differences in the implementation of the Directive in each Member State.

Nevertheless, as the Third Company Directive was of minimum harmonization,[7] Member States could choose to impose additional merger requirements where they deemed it appropriate to do so. Accordingly, certain Member States have adopted more stringent rules for protection of creditors, bondholders and shareholders of the merging companies, as well as of their employees. Most of these more stringent rules will remain applicable to cross-border mergers.

On November 20, 2007, the French Government introduced a bill[8] implementing the Directive into French law before the French Parliament, which was enacted on July 3, 2008, (the "Implementing Law")[9] and finally completed by a decree dated January 5, 2009, (the "Implementing Decree")[10].

This memorandum highlights the principal provisions and innovations of the Directive, as such provisions have been implemented into French law by the Implementing Law and the Implementing Decree.

Scope of the Directive and French Implementing Law

The Directive applies only to the merger of limited liability companies having their registered office, central administration or principal place of business within the European Union, and where at least two of the companies involved are governed by the laws of different EU Member States.

The Implementing Law limits the types of French limited liability companies that may be involved in a cross-border merger to *sociétés anonymes* (public limited companies), *sociétés en commandite par actions* (partnerships limited by shares), *sociétés par actions simplifiées* (simplified form of limited companies), *sociétés à responsabilité limitée* (private limited companies), and European companies registered in France.[11] Partnerships, whether or not trading entities, including in particular general partnerships (*sociétés en nom collectif*) or limited partnerships (*sociétés en commandite simple*), are excluded from its scope, as are UCITS.[12]

The types of mergers subject to the Directive are the same as those subject to the Third Company Directive, *i.e.*, mergers by acquisition and mergers by formation of a new company. Under current French laws, mergers are effected by means of an exchange of stock which may be completed by a cash payment not exceeding 10% of the nominal value of the exchanged stock.[13] Pursuant to the Directive, the Implementing Law[14] makes an exception to the default domestic merger rule with regard to the maximum amount of the balancing cash adjustment. According to this exception, the merger agreement may provide for the payment of a cash payment in excess of 10% of the nominal value or, in the absence of nominal value, of the accounting par value (*pair comptable*)[15] of the exchanged stock, if the merging company has its registered office in a Member State which allows for such payments.[16]

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Procedures Governing Cross-Border Mergers

The procedures governing cross-border mergers are substantially the same as those for domestic mergers in France[17].

The management or administrative body of each of the merging companies is required to draw up draft terms for the merger. The Directive contains a list of twelve compulsory particulars for the common draft terms, which must be published in the manner prescribed by the regulations of each Member State at least one month prior to the date of the general shareholders meeting called to resolve upon them.[18]

The management or administrative body of each of the merging companies must prepare a report on the proposed merger for shareholders and employees that explains the legal and economic aspects and consequences of the merger and its implications. The report must explain and justify the draft terms in detail, in particular with regard to the share exchange ratio and the valuation methods used, which must be the same for the relevant companies, together with the implications of the proposed merger for shareholders, employees and creditors.[19] The report must be made available to the shareholders and to staff or employee representatives at least one month prior to the date of the general meeting held to decide upon the proposed cross-border merger.

In addition, the works' council may henceforth require that its opinion be attached to the report of the board of directors or of the executive board so that they can be presented together to the general meeting of shareholders.[20] The opinion will only be attached to the report, if it is sent at least one month prior to the date of the general meeting to decide upon the proposed cross-border merger.[21]

One or more independent experts (*commissaires à la fusion*) must be appointed by court decision to draft a written report on the terms of the merger, unless the shareholders of all merging entities unanimously decide otherwise.[22] The independent experts must ensure that the relative values assigned to the shares of the merging companies are appropriate and that the exchange ratio is fair. The experts' report must be provided to the shareholders. In addition, if part of the merger consideration is composed of in-kind contributions or confers "special benefits," a separate independent expert must be appointed to assess the value of these in-kind contributions or special benefits.

On the basis of the above documents, the general meeting of each of the merging companies decides whether or not to approve the draft merger terms.

As an exception, parent companies merging with wholly-owned subsidiaries may avail themselves of a simplified procedure in which the approval of the general shareholders meeting of the wholly-owned subsidiary and the reports mentioned above are not required.[23]

Review of Legality of the Merger

(i) Pre-merger formalities

The Directive requires each Member State to designate an authority to review the legality of the crossborder merger for each merging company subject to the national law of such Member State. As is currently the case with respect to domestic mergers, the Implementing Law designates the registrar of the court (*greffier*) of the jurisdiction within which the French merging company has its registered office as the competent authority in France.[24]

That authority must issue a pre-merger certificate attesting to the proper completion of the required premerger acts and formalities. The registrar has a period of eight days from filing of the compliance report within which to issue the certificate.

If the laws of a Member State to which one of the merging companies is subject provides for a procedure to review and amending the ratio applicable to the exchange of securities or shares, or a procedure to compensate minority shareholders, the Implementing Law provides that such procedure may apply to a French company involved in the merger only if the shareholders of the French company explicitly accept the procedure.[25]

In compliance with the Directive, the Implementing Law requires the registrar of the court to issue the compliance certificate even if such a procedure has commenced. The certificate, however, must indicate that the procedure is pending.[26]

(ii) Merger completion formalities

Each Member State must also designate an authority to review compliance with the required completion formalities for the cross-border merger and, as applicable, for the formation of a new company resulting from the cross-border merger, where the

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company created by the cross-border merger is subject to the national law of such Member State.

In this regard, the Implementing Law appoints notaries, or the registrar of the court of the jurisdiction within which the company to be formed by the merger will be registered, as the competent authority in France. To that end, notaries or court registrars must ensure that the merging companies have approved common draft conditions for the merger and that arrangements for employee participation have been determined in accordance with applicable labor laws.[27]

The legal review of completion formalities must be effected within 15 days of receipt of the following documents:

- the common draft terms of the cross-border merger;
- the bylaws of the company to be formed as a result of the cross-border merger;
- a copy of the notices required to be published (in a legal notices journal and in the official French gazette of civil and commercial announcements "*BODACC*");
- a copy of the minutes of the general meetings of shareholders and bondholders of each of the merging companies;
- a document certifying that the merging companies have approved the proposed merger on the same terms and that arrangement for employee participation have been determined in accordance with the provisions of the French Labor Code.[28]

Pursuant to the Implementing Decree, a notary (or firm of notaries) designated to review the legality of the merger must not have given private legal advice with regard to the merger.[29]

(iii) Effectiveness of the merger

The registrar of the court of the jurisdiction within which the company formed by the merger is registered must notify the registrar or competent authority for the registered office of each company involved in the transaction as soon as the merger becomes effective. For a French company involved in the merger, the registrar of the jurisdiction within which such company is registered then removes the company from the local register.[30]

A merger may take effect only after having been reviewed by a notary or a court registrar as described above, and cannot take effect after the end date of then pending fiscal year of the beneficiary.[31]

Employee Participation

One of the most contentious issues in the Council discussions of the Directive was employee participation.[32] As participation schemes across Member States of the European Union differ widely, certain Member States such as Germany feared that cross-border mergers might strip away employee participation rights subsequent to the merger of a company into another entity registered in a Member State that did not otherwise provide for such rights.

To break this deadlock, the European Commission adopted the same compromise as for the SE, by requiring the maintenance of the *status quo* for employee participation rights: a cross-border merger must not reduce or circumvent the existing participation rights of employees in the Member State in which the merging entities are established. However, a cross-border merger does not create a right of employee participation where such a right did not previously exist in either merging entity. Accordingly, Article L. 2371-2 of the French Labor Code provides that the implementation of an employee participation scheme is optional if none of the merging companies had a participation scheme at the time of registration of the company formed by the merger.[33]

Employee participation rights are determined by agreement among the managers of the merging companies and the employee representatives following negotiations by a special negotiating body. Failing agreement, such rights are determined by a committee within the company resulting from the merger, which determines the applicable form of participation after consideration of the various national systems in force within each of the companies involved in the merger.[34]

Shareholders of each company involved may make the completion of the merger conditional upon their subsequent approval of employee participation rights in the company resulting from the cross-border merger.[35] In effect, this implies that each general shareholders meeting of the merging companies must approve the employee participation rights in the company formed by the merger.

The domestic law of each of the merging companies will apply to the obligations to inform and consult with employee representatives concerning the planned merger. The cross-border nature of the

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merger will require that consultation procedures among companies from different member States must be coordinated, as well as, if applicable, the consultation procedures among employee representatives at national and European levels, if a European works council is in place amongst any of the companies involved in the merger.

Conclusion

With the adoption of the Implementing Decree, France has finally completed the implementation of the Directive nearly four years later. Despite several shortcomings and omissions, the Implementing Law and Implementing Decree should help companies that wish to operate as a single entity in more than one Member State.

Pursuant to the Directive, the European Commission will revise its provisions in December 2012 in light of the experience acquired in applying it and will, if necessary, propose amendments.[36]

NOTES

1. COM (1984) 727.
2. *See* "The *Societas Europeae*, Thirty Years Later," Fried, Frank, Harris, Shriver & Jacobson (Europe), Client Memorandum, December 9, 2004.
3. The European Commission noted that cross-border mergers were not legally possible in the Netherlands, Sweden, Ireland, Greece, Germany, Finland, and Denmark. European Commission, press release, November 18, 2003, MEMO/03/233.
4. Two or more corporations may merge to form an SE only as long as at least two of the merging companies are incorporated in different Member States. n addition, several substantive requirements may limit its use, such as the requirement that an SE be formed by *sociétés anonyme* or their equivalent and have minimum stated capital of Euro 120,000 and mandatory employee participation negotiations.
5. A transfer of the registered office could result in adverse tax consequences. A system of neutral tax rules was adopted pursuant to Directive n°90/434/EEC of July 23, 1990, as amended by Directive n°2005/19/EEC of February 17, 2005. Article 221 of the French General Tax Code enacted by the 2005 Finance Act provides that "*the transfer of the registered office to another European Community Member State, whether or not entailing the loss of legal personality in France, does not result in the termination of the undertaking.*"
6. ECJ judgment dated December 13, 2005, matter n° C-411/03, *Sevic Systems AG*, D. 2006, p. 451.
7. A minimum harmonization directive establishes a 'floor' below which Member States may not fall. The 'ceiling,' circumscribing the legitimate scope of more stringent measures introduced by Member States is constituted by the EC Treaty. (*See*, Aher-Waggon GmbH v. Bundesrepublik Deutschland Case C-389/96, judgment of July 14, 1998, nyr).
8. *Projet de loi portant diverses dispositions d'adaptation du droit des sociétés au droit communautaire* (Doc. Ass. Nat. No 411).
9. Law N°2008-649 dated July 3, 2008, *Journal Officiel* dated July 4, 2008, p. 10,705, codified under Articles L. 236-25 through L. 236-32 of the French Commercial Code.
10. Decree N°2009-11 dated January 5, 2009, *Journal Officiel* dated January 7, 2009, codified under Articles R. 236-13 through R. 326-20 of the French Commercial Code.
11. Article L 236-25 of the French Commercial Code. The Directive applies to any company with share capital and having legal personality, possessing separate assets which alone serve to cover its debts and subject under the national law governing it to conditions concerning guarantees such as are provided for by Directive 68/151/EEC for the protection of the interests of members and others (Article 2b).Doctrinal authors have queried whether single-member forms of the aforementioned companies would come within the scope of the provisions on cross-border mergers. Since single-member companies are not deemed to constitute separate legal forms from those of multi-member companies, the answer should be in the affirmative.
12. Undertakings for Collective Investment in Transferable Securities whose management is governed by the principle of risk-sharing and whose shares are, at the interest-holder's request, bought back or redeemed, whether directly or indirectly, using such company's assets, including investment funds (*sociétés d'investissement à capital variable* -"SICAV") and investment companies with variable capital investing primarily in real estate (*sociétés de placement à prépondérance immobilière à capital variable* – "SPPICAV").
13. Article L. 236-1 of the French Commercial Code.
14. Article L. 236-26 of the French Commercial Code.
15. Accounting par value is defined by the Implementing Law as the proportion of the share capital represented by one share obtained

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by dividing the share capital by the number of existing shares (Article L. 236-26 of the French Commercial Code). It is meant to be a substitute for nominal value whenever a company has not set a nominal value for its shares.

16. Article 210-O-A of the French General Tax Code, which applies to domestic mergers, should be amended in order to take into account the possibility to make a balancing cash adjustment in excess of 10% for purposes of cross-border mergers benefiting from neutral tax rules.
17. The Implementing Law cross-references extensively current French provisions when implementing the Directive.
18. The list of information to be contained in the draft terms of the merger is set forth in Article R. 236-14 of the French Commercial Code, whilst the list of information to be contained in the notice relating to the draft merger which has to be published in a legal notices journal and in the official French gazette of civil and commercial notices ("*BODACC*") is set forth in Article R. 236-15 of the French Commercial Code.
19. Article R. 236-16 of the French Commercial Code.
20. Article L. 236-27 of the French Commercial Code, implementing Article 7 of the Directive.
21. Article R. 236-16 of the French Commercial Code, implementing Article 7 of the Directive.
22. Article L. 236-10 of the French Commercial Code, implementing Article 8 of the Directive.
23. Article L. 236-11 of the French Commercial Code.
24. Article L. 236-29 of the French Commercial Code.
25. Article L. 236-28 of the French Commercial Code.
26. Article 10(3) of the Directive and L. 236-30 of the French Commercial Code.
27. Article L. 236-30 of the French Commercial Code.
28. Article R. 236-19 of the French Commercial Code implementing Article 11 of the Directive.
29. Article R. 236-18 of the French Commercial Code implementing Article 10 of the Directive.
30. Article R. 123-74-1 of the French Commercial Code implementing Article 13 of the Directive.
31. Article L. 236-31 of the French Commercial Code implementing Article 12 of the Directive.
32. The Implementing Law defines employee participation as the influence of the body representative of the employees and/or the employees' representatives in the affairs of a company by way of (i) the right to elect or appoint some of the members of the company's supervisory or administrative organ, or (ii) the right to recommend and/or oppose the appointment of some or all of the members of the company's supervisory or administrative organ (Article L. 2371-1 of the French Labor Code implementing Article 2(k) of Directive 2001/86/EC).
33. If one of the companies involved in a cross-border merger is subject to an employee participation scheme, and the same is true of the company resulting from the merger, the surviving entity must adopt a legal form which allows for the exercise of participation rights (Article L. 236-32 of the French Commercial Code).
34. Article L. 2372-4 of the French Labor Code.
35. Article L. 236-28 of the French Commercial Code.
36. Article 18 of the Directive.

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