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Mergers and Acquisitions in the Law of the European Union and Their Economical Background

Abstract. The purpose of this paper is to discuss the mergers and acquisitions activity from various perspectives. The concept of mergers and acquisitions always has a strong economic background, which will be considered even if the concept is discussed from a legal perspective. After clarification of the basic terms of mergers and acquisitions, the economic background of mergers and acquisitions will be examined. From legal point of view this paper mainly concentrates on the relevant directives of the European Union. Currently, there are four relevant company law directives related to corporate reconstruction in the law of the European Union: the Merger Directive, which regulates mergers between public companies, the Sixth Company Law Directive, which covers the division of an existing public company into entities, the directive, which concerns cross-border mergers and last but not least the Takeover Directive. From this four company law directives, this paper mainly focuses, besides the economical background and basic terms of mergers, on the Merger and Cross-Border Directive.

Keywords: merger, acquisition, company law, Merger Directive, economical background, synergy, economies of scale, SEVIC System Case

Introduction

The purpose of this paper is to discuss the mergers and acquisitions activity from various perspectives. Mergers and acquisitions always have a strong economical background, which will be considered even if the concept is discussed from a legal perspective.

After clarification of the basic terms of mergers and acquisitions, the economic background of mergers and acquisitions will be examined. From legal point of view this paper mainly concentrates on the relevant directives in the law of the European Union. The scope of this paper does not spread out to the relevant competition law rules in relation to the mergers, because of the different character of competition law rules and company law in strict manner.

The special alchemy of a merger or acquisition is the principle that "one plus one makes three". The key principle behind buying a company is to create shareholder value, over and above that of the sum of the two merging companies. Two companies together are more valuable than two separate companies–at least that is the reasoning behind merger and acquisition.[1]

This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to

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[1] http://www.investopedia.com/university/mergers/mergers1.asp#axzz1XAYBiC3G, time of download: 11.10.2011

achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone. The other main grounds and accelerators of mergers and acquisitions will be discussed in chapter 2.2.

1. Basic Elements of Mergers and Acquisitions

1.1. Distinction between Mergers and Acquisitions

Although mergers and acquisitions are often meant in the same sense and used as they were synonymous, the terms merger and acquisition mean slightly different things.

When one company takes over another and clearly establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded. So in this case, when a company buys a majority stake of a target company's shares, the companies will not merge.

In the pure sense of the term, a merger happens when two firms, often about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals".[2] Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

In practice, however, actual mergers of equals don't happen very often. When a deal is made between two companies in friendly terms, it is typically proclaimed as a merger. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal as a merger, deal makers and top managers try to make the takeover more comfortable.

A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly– that is, when the target company does not want to be purchased so the stronger firm swallows the target firm–it is always regarded as an acquisition. [3]

1.2. Economic Rational of Mergers and Acquisitions

Regardless of their category or structure, mergers and acquisitions all have one common goal that is to create synergy that makes the value of the combined companies greater that the joint value of the two parts. The success of a merger or acquisition depends on the extent this synergy is achieved.

Synergy is the most important word that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following elements:

– Cost reductions: Mergers usually results cost-reductions, for example reduction of the number of employees. Consider all the money saved from reducing the number

[2] http://finance.mapsofworld.com/merger-acquisition/difference-between.html, time of download: 11.12.2011

[3] *Ibid.*

of employees from accounting, marketing and other departments. Job cuts will also include one of the former CEOs, who typically leave with a compensation package.[4]

- Economies of scale: Mergers also translate into improved purchasing power to buy equipment or office supplies, when placing larger orders, companies have a greater ability to negotiate prices with their suppliers.
- Acquiring new technology: To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.
- Improved market reach and industry visibility: Companies buy companies to reach new markets and grow revenues and earnings. A merge may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

The above synergies are not automatically realized when two companies merge. In some cases when two businesses are combined they may gain a better position, but sometimes it works in reverse. In many cases, one and one add up to less than two.[5]

1.3. Types of Mergers[6]

With regard to business structures, there are a number of different mergers. A couple of these types are listed below, distinguished by the relationship between the two merging companies. This distinction is based on an economical perspective; the types of mergers based on the Directive 2011/35/EU[7] will be discussed below.

- Horizontal merger: The merger of two companies that are in direct competition and share the same product lines and markets.
- Vertical merger: The merger of a customer and a company or a supplier and a company, which is the merger of two companies active in different levels of production or supply chain.
- Market-extension merger: The merger of two companies that sell the same products in different markets.
- Product-extension merger: The merger of two companies selling different but related products in the same market.
- Conglomeration: The merger of two companies that have no common business areas.

[4] http://www.investopedia.com/university/mergers/mergers1.asp#axzz1XAYBiC3G, time of download: 11.12.2011

[5] Harka, Ö.: *Mergers and Acquisitions*. Acta Universitatis Szegediensis, Szeged, 2004. 5.

[6] Based on the classification of Harka: *op. cit.* 6.

[7] Third Council Directive 78/855/EEC of 9 October 1978 based on Art. 54 (3) (g) of the Treaty concerning mergers of public limited liability companies; hereinafter referred to as: "Third Directive", which was replaced by Directive 2011/35/EU of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies; hereinafter referred to as "Merger Directive"

1.4. Types of Acquisitions

From business perspective, acquisition may be only slightly different from a merger. Like mergers, acquisitions are actions through which companies seek economies of scale, efficiencies and enhanced market visibility. Unlike all mergers, all acquisitions involve one firm purchasing another–there is no consolidation as a new company. Acquisitions are often congenial, and all parties feel satisfied with the deal. Other times, acquisitions are more hostile.

According to the main view of the jurisprudence, we can distinguish between share deal and asset deal. In the strict sense, share deal corresponds more to the term of acquisition. In the case of an asset deal an asset or assets will be acquired, without acquiring shares of the target company.

In an acquisition a company can buy another company with cash, stock or a combination of the two. Another possibility as we discussed above, which is common in smaller deals, is for one company to acquire all the assets of another company.

Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on whether this synergy is achieved.[8]

2. Conducting an Acquisition Transaction in General

2.1. The Offer

When the management of a company decides to carry out a merger or acquisition with a public listed company, they will start with a tender offer.

The process usually starts on the way that the acquiring company carefully and discreetly buys up shares in the target company with the aim of building up a position. Such takeovers are highly regulated and strictly reviewed in all jurisdictions. In Hungarian Law this topic is regulated in the Capital Market Act.[9]

2.2. Tender Offers

We should discuss two principles regarding to the tender offer. One is the "all shareholders principle"; the other is the "best purchase price principle". Based on the first all discrimination between shareholders is undersaid. Based on the later principle, except for two step transactions, all shareholders accepting the offer must receive the highest price that was paid to any shareholder during the course of the tender; this however does not exclude the possibility of offering different countervalues to the shareholders during the course of the tender.

Regarding to the process of the takeover with the assistance of financial advisors and investment bankers, the acquiring company will work out an overall price that it is willing to pay for its target in cash, in shares, or both. Investors in a company that is aiming to take

[8] http://www.investopedia.com/university/mergers/mergers1.asp#axzz1ZBqHYkIz, time of download: 11.10.2011

[9] Hungarian Capital Market Act No. 120 of 2001.

over another one must determine whether the purchase will be beneficial to them, therefore the value of the target must be determined.[10]

Of course the two sides of a merger and acquisition deal will have different ideas about the worth of a target company; the buyer to achieve the lowest possible price, but the seller will tend to value the company as high as possible.

The most common method of valuation, which is usually carried out with the assistance of various experts (lawyers, auditors, investment bankers), is the comparison with other companies in an industry. Some other methods of assessment that may be used are the following[11]:

– Comparative Ratios: The most frequently used of these are the price/earnings ratio and the price/sales ratio.
– Replacement Cost: Acquisitions may be based on the cost of replacing the target company, by considering the time needed to assemble a good management, to acquire property and to get the right equipment. This method of establishing a price however cannot be used in the service industry where the key asses are people and ideas which are hard to value and develop.
– Discounted Cash Flow: This is used as a key valuation tool in mergers and acquisitions. It determines the current value according to its estimated future cash flows. Forecasted free cash flows are discounted to a present value using the company's weighted average cost of capital.[12]

2.3. The Target's Response

When the tender offer has been made, the target company can do the following:

– Accept the terms of the offer. In case the target's management and its shareholders are satisfied with the terms of the transactions, they will accept these terms.
– Other option is the attempt to negotiate. In the case when the tender offer price is not being high enough for the target company's shareholders, or the specific terms of the deal are not good enough, then they might try to negotiate better terms. Execute a poison bill or some other hostile takeover is also possible.
– Or the last option is to find a "white knight". The target company's management may seek out a friendlier potential acquirer as an alternative. If a "white knight" is found, it will offer an equal or higher price for the shares than the hostile bidder.

2.4. Closing the Deal

Finally, once the target company agrees to the tender offer and regulatory requirements are met and all permissions are obtained, the merger deal will be executed by means of a transaction. In a merger in which one company buys another, the acquirer will pay for the target company's shares with cash, stock or both.

[10] Gran, A.: Abläufe bei Mergers & Acquisitions. *Neue Juristische Wochenschrift*, 60 (2008), 1411.

[11] According to Wegen, G.: Mergers and Acquisitions in Germany. *The Comparative Law Yearbook of International Business*, 14 (1992), 35–37.

[12] Miller, E. L.: *Mergers and Acquisitions, A Step-by-Step Legal and Practical Guide*. New Yersey, 2008. 31–40.

A cash-for-stock transaction is fairly straightforward, the target company's shareholders receive a cash payment for each share purchased. If the transaction is made with stock instead of cash, then there is a simply exchange of share certificate.

2.5. Merger Control

Nowadays, merger control bears also relevance in relation to mergers. In most jurisdictions the importance and relevance of competition law is continuously growing, therefore the decision-making bodies of merging companies must always be aware of the restrictions and limitations imputed by merger control.

As written above, the scope of this paper does not spread out to the relevant competition law rules regarding the mergers, because of the difference character of competition law rules and company law in strict manner.

3. Merger and Acquisition Legislation in the Law of the European Union

As in non-European jurisdictions, recent general European trends towards a more market-inclined (shareholder-valued) approach have been observed in corporation attitudes in the last 30 years. For example, the Washington Post reported on 11 March 1999:

> *"...The change in corporate culture and behaviour here in the past few years has been nothing short of radical. The government-coddled climate in France, the cosy shareholder relationship in Germany, the secretive empires of the Italians–are all giving way to American-style cowboy capitalism..."*[13]

The issue of regulatory conformity in the area of company law in the European Union drew particular attention from the other jurisdictions around the time when its internal market was completed in 1992.

Now, there are four relevant company law directives in relation to corporate reconstruction in the EC: the Merger Directive which regulates mergers between public companies, the sixth company law directive, which covers the division of an existing public company into entities, the directive, which concerns cross-border mergers and the Takeover Directive.

3.1. The Third Company Law Directive

Mergers of public companies and divisions of them were conceived within the same idea at the time of proposal of the third and sixth directives. The Third Directive was initially proposed in 1970 and was adopted based on Art. 54 (3) (g) of EC Treaty in 1978, concerning mergers between public companies.

Under the definition of the Third Directive, there were four types of mergers: mergers by acquisition of another company, mergers by formation of a new company, acquisition of a wholly owned subsidiary, and analogous operation. The Merger Directive also contains these four types of mergers. To characterise a merger type of amalgamation in a word, all the assets and liabilities of the acquired company (or companies) are transferred to the

[13] Swardson, A.: In Europe, An Urge to Conquer Hostile takeovers set new standard. *Washington Post*, (1999/03/11), 1.

acquiring company and dissolved without any process of winding up. EU member states were obliged to implement the Third Directive by October 13, 1981.[14] The Third Directive has been substantially amended several times. In the interests of clarity and rationality the Third Directive was replaced by the Merger Directive.

3.1.1. The Scope and the Different Types of Mergers

Article 1 of the Merger Directive regulates the personal scope of the directive, namely the public limited companies, formed validly under national law. The Member States do not have to apply the Merger Directive in cases where the company or companies, which are being acquired or will cease to exist are the subject of bankruptcy proceedings, proceedings relating to the winding-up of insolvent companies, judicial arrangements, compositions and analogous proceedings. Based on Art. 2, the Member States shall, as regards companied governed by their national laws, make provisions for rules governing merger by the acquisition of one or more companies by another and merger by the formation of a new company.

Articles 3 and 4 describe the different types of mergers. Merger by acquisition shall mean the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.

According to Art. 4, merger by the formation of a new company shall mean the operation whereby several companies are wound up without going into liquidation and transfer to a company that they set up all their assets and liabilities in exchange for the issue to their shareholders of shares in the new company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value. Hungarian regulation refers to the two main types of mergers: Para. 80 and Para. 81 of the Hungarian Act on Business Associations[15] mention the two main types of mergers, namely the merger by the formation of a new company and merger by acquisition.

3.1.2. Indirect Protection of Shareholders

It is important to note that the Merger Directive does not contain explicit provisions for direct shareholder protection. We can evaluate the disclosure duties and the expert examination during the merger process as indirect protection of shareholders.

Article 5 contains the details of the draft terms of merger, meanwhile Art. 6 prescribes a disclosure duty, namely that draft terms of merger must be published in the manner prescribed by the laws of each Member State in accordance with Art. 3 of Directive 68/151/EEC. These rules correspond to the typical information model favoured by EC legislature and the *ex ante* protection of shareholders and creditors. We can find the correlating Hungarian provision to the draft terms of merger in Paras 79 and 279 of the Hungarian Company Act.

[14] Ueada, J.: A Comparative Study on Cross-Border Mergers and Acquisitions: Modelling the UK. Germany, the US and Japan for Regulatory Harmonisation. *International Company and Commercial Law Review*, 15 (2004), 358.

[15] Act No. 4. of 2006 on Business Associations.

A merger shall require at least the approval of the general meeting of each of the merging companies. The laws of the Member States shall provide that this decision shall require a majority of not less than two thirds of the votes attaching either to the shares or to the subscribed capital represented. Although, there are possibilities for exemptions laid down in Arts 7 and 8.

The directive does not contain rules regarding to convening of the general meeting or exercising of right to vote. Accordingly, there is no harmonisation regarding these questions.

3.1.3. Report Concerning the Merger

As described above, mergers and acquisitions always have a strong economical background. Article 9 bears in mind this fact, so it prescribes that the administration or management bodies of each of the merging companies shall draw up a detailed written report explaining the draft terms of merger and setting out the legal and economic grounds for them, in particular the share exchange ratio.

The report shall also describe any special valuation difficulties which have arisen. One or more experts, acting on behalf of each of the merging companies but independent of them, appointed or approved by a judicial or administrative authority, shall examine the draft terms of merger and draw up a written report to the shareholders. However, the laws of a Member State may provide for the appointment of one or more independent experts for all the merging companies, if such appointment is made by a judicial or administrative authority at the joint request of those companies. Such experts may, depending on the laws of each Member State, be natural or legal persons or companies or firms.

In the report the experts must in any case state whether in their opinion the share exchange ratio is fair and reasonable. Their statement must at least:

- indicate the method or methods used to arrive at the share exchange ratio proposed;
- state whether such method or methods are adequate in the case in question, indicate the values arrived at using each such method and give an opinion on the relative importance attributed to such methods in arriving at the value decided on.

The report shall also describe any special valuation difficulties which have arisen. Each expert shall be entitled to obtain from the merging companies all relevant information and documents and to carry out all necessary investigations.

Based on Art. 11, all shareholders shall be entitled to inspect at least the following documents at the registered office at least one month before the date fixed for the general meeting which is to decide on the draft terms of merger:

- the draft terms of merger;
- the annual accounts and annual reports of the merging companies for the preceding three financial years;
- an accounting statement drawn up as at a date which must not be earlier than the first day of the third month preceding the date of the draft terms of merger, if the latest annual accounts relate to a financial year which ended more than six months before that date;
- the reports of the administrative or management bodies of the merging companies;
- the reports of the experts.

3.1.4. Protection of Creditors Based on Arts 13–15 and the Effects of Mergers

The laws of the Member States must provide for an adequate system of protection of the interests of creditors of the merging companies[16] whose claims antedate the publication of the draft terms of merger and have not fallen due at the time of such publication.

To this end, the laws of the Member States shall at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and where those creditors do not already have such safeguards.

Such protection may be different for the creditors of the acquiring company and for those of the company being acquired. Holders of securities, other than shares, to which special rights are attached, must be given rights in the acquiring company at least equivalent to those they possessed in the company being acquired, unless the alteration of those rights has been approved by a meeting of the holders of such securities, if such a meeting is provided for under national laws, or by the holders of those securities individually, or unless the holders are entitled to have their securities repurchased by the acquiring company.

The disclosure duty can be seen as one of the main guaranties of creditor protection in the directive. Thus Art. 18 prescribes that a merger must be publicized in the manner prescribed by the laws of each Member State, in accordance with Art. 3 of Directive 68/151/EEC, in respect of each of the merging companies. The acquiring company may itself carry out the publication formalities relating to the company or companies being acquired.

Article 19 contains the effects of merger, which effects have to be mentioned under the fundamental principles of mergers. Correspondingly, Para. 80 and Para. 81 of Act on Business Associations also repeat some of these principles.

A merger shall have the following consequences *ipso iure* and simultaneously: The transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired. The shareholders of the company being acquired become shareholders of the acquiring company and the company being acquired ceases to exist.

3.1.5. Liability Rules Based on Arts 20 and 21

As mentioned above, the provisions concerning the personal liability of shareholders and experts are very important elements of creditor protection.

Based on Art. 20 of the Directive, the laws of the Member States shall at least lay down rules governing the civil liability towards the shareholders of the company being acquired of the members of the administrative or management bodies of that company in respect of misconduct on the part of members of those bodies in preparing and implementing the merger.

The laws of the Member States shall at least lay down rules governing the civil liability towards the shareholders of the company being acquired of the experts responsible for drawing up on behalf of that company the report referred to in Art. 10 (1) in respect of misconduct on the part of those experts in the performance of their duties.

It has to be repeated, that the scope of the Merger Directive extends only on domestic mergers. However, the expectations of the business life forced out the rules relating to the

[16] See Bakos, K.: Gläubigerschutz bei der Umwandlung von Gesellschaften. In: *European Legal Studies and Research; International Conference of PhD Students in Law*. 3rd ed., Timisoara, 2011. 40–52.

cross-border mergers. Before the examination of the detailed rules of the Cross-Border Merger Directive[17], we shall discuss the SEVIC System Case in order to demonstrate the importance of the regulated legal institution of cross border mergers.

3.2. The SEVIC System Case[18]

The scope of the freedom of establishment regarding companies was in rapid movement over several years. Already in Daily Mail, Centros, Überseering and Inspire Act corporate mobility within the EU was under ECJ's scrutiny. However, SEVIC was the first case dealing with a cross border merger.

Until recently, it was highly disputed whether such transactions can be implemented. Member states, such as Austria and Germany did not provide for cross-border mergers, the legal situation was unclear. Apart from the formation of a European Company by merger, secondary EC law equally did not provide for an explicit legal basis in the area of corporate law. With regard to tax law, however, provisions on cross-border mergers existed since 1990, which recently had been updated and extended. Until SEVIC, the prevailing doctrine remained that cross-border mergers into Germany were not possible.[19]

3.2.1. The Facts of the SEVIC Case

SEVIC Systems Aktiengesellschaft ("SEVIC") with its registered office in Germany and Security Vision Concept SA ("SVC") with its registered office in Luxembourg entered into a merger agreement in which they agreed to dissolve SVC without liquidation and to transfer the whole of its assets to SEVIC.

The local court in Neuwied refused the application for registration of the merger in the German corporate register, citing as grounds that Para. 1 (1) of the German Reorganization Act[20] provides solely for mergers between legal entities established in Germany. This, however, is not given in the present case, because the transferring company is incorporated under Luxembourg Law. Because of cross-border mergers were not possible under the German law; various forms of organization were established by drawing up contracts in order to achieve a result that was as close as possible to that of a merger.[21]

SEVIC brought an action against that rejection decision before regional court in koblenz. Since the latter had doubts as to whether Para. 1 (1) of the German Reorganization Act complies with Arts 43 and 48 EC, it decided to stay the proceedings and referred to the ECJ the following question for a preliminary ruling according to Art. 234 EC:

"Are Articles 43 and 48 EC to be interpreted as meaning that it is contrary to freedom of establishment for companies if a foreign European company is refused registration of its proposed merger with a German company in the German register of companies under

[17] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, hereinafter referred to as: "CBM Directive".

[18] Case C-411/03, SEVIC Systems AG, [2005]–ECR I–10805.

[19] Doralt, M.: Cross-border mergers–A glimpse into the future. *European Company and Financial Law Review*, 4 (2007), 23.

[20] Reorganization Act 1994 (Deutsches Umwandlungsgesetz 1994); hereinafter referred to as: "Reorganization Act".

[21] Becker, A.−Begemann, A.: The German Law on Crossborder Mergers Following the Sevic Decision. *The Comparative Law Yearbook on International Business*, 31 (2009), 201.

Paragraphs 16 et seq. of the Reorganization Act, on the grounds that Paragraph 1 (1) (1) of that law provides only transformation of legal entities established in Germany?"

In the opinions of the Advocate General of 7 July 2005 proposed that Arts 43 and 48 EC preclude legislation of a member state not permitting the registration in the national corporate register of mergers between companies established in that member state and companies of other member states.

In the Advocate General's view Para. 1 (1) of the Reorganization Act constitutes a discriminatory rule, since the provision in question treats companies quite differently depending on their place of establishment, by permitting mergers if the companies in question are established in Germany and prohibiting them if one of those companies is established abroad. An absolute and automatic prohibition which is consequently applicable in a general and preventative manner to all cases of cross-border mergers cannot be satisfied, irrespective of the possible harm or risks associated with them.[22]

3.2.2. The ECJ's Decision

With the decision of the ECJ it was clarified that both the transferring company as well as the acquiring company enjoy the protection of the freedom of establishment. The court held that the provision at stake constitutes a restriction of the freedom of establishment. In the ECJ's view the mere fact that–unlike for mergers within Germany–no provisions for registration of cross border mergers exist, represents a restriction within the meaning of Arts 43 and 48 EC. Nevertheless, the ECJ denied all arguments submitted by the member states. This decision in the SEVIC Case was in line with the court's earlier judicature.[23]

The three key takeaways of the SEVIC judgement:

– The right of establishment applies to cross-border mergers. This holds true, even if there are no provisions harmonizing such transactions.
– Second, the difference in the treatment of internal and cross-border mergers constitutes a restriction on the freedom of establishment.
– Third, such restrictions can be permitted only if it is justified by imperative reasons in the public interest and provided that it is both appropriate and does not go beyond what is necessary.[24]

3.3. Directive on Cross-border Mergers

Cross border mergers constitute a very efficient method of corporate restructuring which could contribute subsequently to the strengthening of the international market. As described above, Merger Directive regulates national mergers of public limited liability companies; there was no EU legal framework which regulated cross border mergers until 2005.[25]

This was due to completely different approaches to the issue. Some Member States (e.g. Germany) did not allow cross border mergers because they were afraid of possible circumvention of their company and employment law safeguards. If a company wanted to

[22] Decher, C. E.: Cross Border Mergers: Traditional Structures and SE-Merger Structures. *European Company and Financial Law Review*, 4 (2007), 6.

[23] Schindler, C. P.: Cross-Border Mergers in Europe–Company Law is catching up! *European Company and Financial Law Review*, 3 (2006), 188.

[24] Doralt: *op. cit.* 24.

[25] The CBM directive was implemented in Hungarian law by the Act No. 140 of 2007 on cross-border mergers of limited liability companies.

merge with a company from another merger State, there were numerous legislative difficulties which restricted the choice. This situation limited significantly the methods of corporate restructuring which were available to EU companies and as a result restricted their business organisational freedom under the EC Treaty.

After many years of negotiations, the CBM Directive was finally adopted in December 2005. The European Commission strongly believed that it was necessary, with a view to the completion and functioning of the single market. Because of the following reasons we cannot overemphasise the importance of the CBM Directive.

Consistently with the legal framework of European Company Law, the CBM Directive is legally based, first of all, on the right of establishment. The mobility of companies of any Member State within the European Union, in terms of either transferring seat or setting up new companies or branch in the territory of another Member State, is the result of the creation and functioning of a Single Market, namely an area without internal frontiers in which free movement of goods, persons, services and capital is guaranteed.[26]

It contributes to the growth of companies and so it allows to European companies to be competitors of US and Japanese firms.

ECJ in the SEVIC case confirmed that cross-border mergers already had to be accepted, because of the guarantees enshrined in the fundamental freedoms. CBM Directive removed remaining uncertainties. But it is important to note that the CBM Directive does not cover private law transactions with the same effect (merger in broad sense), i.e. share deals and asset deals.

3.3.1. Aim of the CBM Directive

From an economic point of view, European companies may be willing to "move" within the European Union by cross-border mergers since they allow to rationalise corporate structures and to gain efficiencies in terms of economies of scale.[27]

Since the CBM Directive requires to be implemented in each Member States, the CBM Directive does not aim at dictating uniform rules to be applied by the Member States, but rather at laying down guidelines, inspired to common principles and without conflicting with national systems, to be followed in order "to facilitate the carrying-out of cross-border mergers between various types of limited liability companies governed by the laws of different Member States."[28]

3.3.2. The Scope of the Cross-Border Mergers Directive

The directive shall apply 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.

A company, which has its registered office in a Member State adopting the incorporation theory could follow the provisions of the Cross-Border Mergers Directive and merge with another company. This allows "letter-box" or pseudo-foreign companies with

[26] Ugliano, A.: The New Cross-Border Merger Directive: Harmonisation of European Company Law and Free Movement. *European Business Law Review*, 18 (2007), 588.

[27] Rogers, P.: Cross-Border Mergers. *International Company and Commercial Law Review*, 13 (2002), 343.

[28] Preamble 1 to the CBM Directive.

non-EU origins to participate in cross-border mergers. This contrasts with the rules on the formation of the European Company (Socieatas Europaea-SE), the SE Statute requires forming companies of SEs to have their head office within the European Union, unless, in certain limited cases the Member State relaxes this requirement.[29]

The merging companies have to be limited liability company which means a company as referred to in Art. 1 of Directive 68/151 (First Company Law Directive) or a 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 the First Company Law Directive for the protection of the interests of members and others.[30] As far as the first category of limited liability companies is concerned, the First Company Law Directive includes both private and public limited liability companies. This constitutes an advantage of the Cross-border Mergers Directive because it could also be used as a method of corporate restructuring and cross-border establishment by some small- and medium-sized enterprises formed as private limited liability companies. Thus, cross-border methods is not a corporate financial technique limited only to large listed companies, smaller companies with limited liability can also enjoy this product of the European integration. We should not forget that the small and medium-sized companies are special and sensitive parts of the internal market and deserve always the care of the European legislature.

The second category of companies which fall within the scope of the Directive are companies with limited liability[31] which comply with some requirements of the First Company Law Directive (registration, accounting, publicity, capacity, nullity, representation).

A further condition is prescribed by Art. 4 (1) (a) of the Cross-Border Merger Directive: cross-border mergers shall only be possible between types of companies which may merge under national law of the relevant Member States.

If national company law does not grant right to a company to merge with another domestic company, the company will not have the right to participate in a cross-border merger.

The Cross-Border Mergers Directive describes three ways of completing a merger in compliance with the Third Directive.

Article 2 (2) states that merger means an operation whereby: one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company, the acquiring company, in exchange for the issue to their members of securities or shares representing the capital of that other company and, if applicable, a cash payment not exceeding 10% of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities or shares or two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, the new company, in exchange for the issue to their members of securities or shares representing the capital of that new company and, if applicable, a cash payment not exceeding 10% of the nominal value, or in the absence of a

[29] Papadopoulos, T.: Legal Perspectives on the Scope of the Tenth Company Law Directive on Cross-Border Mergers. *European Current Law*, 17 (2008) 10, 78.

[30] Directive 2005/56 Art. 2.

[31] I.e. legal personality and separate assets.

nominal value, of the accounting par value of those securities or shares; or a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities or shares representing its capital.

3.3.3. Conditions Relating to Cross-border Mergers

Article 4 contains the detailed conditions relating to cross-border mergers. Save as otherwise provided in the CBM Directive: cross-border mergers shall only be possible between types of companies which may merge under the national law of the relevant Member States; 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. The laws of a Member State enabling its national authorities to oppose a given internal merger on grounds of public interest shall also be applicable to a cross-border merger where at least one of the merging companies is subject to the law of that Member State. This provision shall not apply to the extent that Art.21 of Regulation (EC) No 139/2004 is applicable.

The provisions and formalities shall, in particular, include those concerning the decision-making process relating to the merger and, taking into account the cross-border nature of the merger, the protection of creditors of the merging companies, debenture holders and the holders of securities or shares, as well as of employees as regards rights other than those governed by Art. 16.

A Member State may, in the case of companies participating in a cross-border merger and governed by its law, adopt provisions designed to ensure appropriate protection for minority members who have opposed the cross-border merger.

3.3.4. Procedural Rules of the CBM Directive

The procedural mechanism, on one hand, is consistent with that provided by the Merger Directive on domestic mergers and, on the other hand, in consideration of the international features of the mergers in question, constantly refers to the national laws of the participating companies.[32]

The first step of the merger process is the drawing up of common draft terms of the cross-border merger by the management of administrative organs of each of the participating companies. Article 5 provides the minimum mandatory content, which might be integrated by the Member States with the implementation of directive. In particular, the following details have to be specified in the draft terms:

- 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;

[32] Ugliano: *op. cit.* 602.

- 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;
- 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 pursuant to Art. 16;
- 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.

The common draft terms must be made public in each of the Member States of the Participating Companies in accordance with the respective rules set out under Art. 3 of the First Directive, at least one month before the date of the general meeting convened to decide on the draft terms.

3.3.5. Reports on Common Draft Terms

The common draft terms must be accompanied by two types of reports. The first one includes the reports drawn up by the management or administrative organ of each participating company for the purpose of explaining and justifying the legal and economic aspects of the transaction, as well as the relative implications for members, creditors, and employees.[33]

The second one covers the reports drawn up by independent experts, natural or legal persons, acting in the interest of each participating company, but independent of them, and appointed and approved by a judicial or administrative authority.

3.3.6. Approval by the General Meeting

Further to the exam of the reports of the management body and of the independent experts, the general meeting of each of participating companies is to approve the common draft terms of the 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.

3.3.7. The Merger Phase

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.

[33] Article 7 of CBM Directive.

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, in accordance with Art. 3 of Directive 68/151/EEC, 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.

3.3.8. Protection of Creditors and Shareholders

The protection of creditors and shareholders is guaranteed under the CBM Directive through the provisions and formalities of national laws to which the participating companies are subject, so such interests are protected in compliance with the national provisions of the Member States governing domestic mergers.[34] It is noteworthy, however, that such national provisions and formalities should be applied "taking into account the cross-border nature of the merger".

This provision seems to allow Member States to include additional protections to such categories in case of cross-border mergers.[35]

In the light of the procedural overview, it is possible to argue that the CBM Directive may provide the European companies with significant advantages in engaging in cross-border transactions.

It is a very positive development for the internal market that both national and cross-border mergers are regulated at EU level. The fact that private companies as well as public companies could take part in cross-border mergers and acquisitions does not restrict the benefits of freedom of establishment and EU corporate restructuring to one category of companies only (as the Merger Directive does).

The Cross-Border Mergers Directive also embraces companies with no head office in the Community and prescribes a very relaxed cash balance requirement if any Member State allows it, allowing transactions similar to public offers of shares.

3.4. Takeover Directive[36]

If we examine the basic directives in the Law of European Union regarding to mergers and acquisitions, we shall also mention briefly the takeover directive, which was adopted on 21 April 2004. It came into force on 20 May 2004 and had to be implemented into national law by all Member States by no later than 20 May 2006. The main objectives of the Directive, when it was first tabled before the European Parliament were to provide a framework of common laws for takeovers in the EU, address the barriers to takeovers and ensure an adequate level of protection for minority shareholders across the EU in public offers. As a

[34] Ugliano: *op. cit.* 607.

[35] Rickford, J.: *The European Company*, *Developing a Community Law of Corporations*. Antwerp–Oxford–New York, 2003. 108 and Rickford, J.: The Proposed Tenth Company Law Directive on Cross Border Mergers and its Impact in the UK. *European Business Law Review*, 16 (2005), 1408.

[36] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, hereinafter referred to as "Takeover Directive".

result of over 14 years of either languishing in stalemate or being the subject of intense political negotiation and debate, the Directive in its final form is a product of political compromise.

Under the Takeover Directive, individual member nations are supposed to create a regulatory framework for takeovers, including appointing supervisory agencies to review and approve proposed takeovers. The directive also mandates equal treatment of shareholders, states that bids must be conducted in a timeframe long enough to allow people to reach informed decisions, and requires companies offering to make takeovers to provide projections on how they will affect employment. Each member nation is expected to use the Takeover Directive in establishing their own laws for handling takeovers.

After the passage of the Takeover Directive, some critics accused it of including protectionist language and of actually hindering takeovers, rather than facilitating them. Others felt that the legislation did not go far enough in terms of clarity and protections for people involved in takeovers. The conflict between these sides is illustrative of the results of the compromise negotiations used in developing the directive.[37]

Many European Union members had difficulty implementing this piece of legislation. Implementation proposals have varied in scope and nature as the individual governments of member nations work to implement the directive. In some cases, reorganizations and reforms have been needed within a nation's financial regulatory system to meet the terms of the directive and this has required substantial negotiation and discussion.

Conclusion

Generally speaking, the European harmonisation process carried out in the view of creation and consolidation of a European Company Law seems to have been developed through two different tracks:[38] On the one hand, harmonisation of national rules and laws through the enactment of directives; on the other hand, creation of European Company forms (i.e. the SE), as supranational corporate vehicle, through the adoption of regulations.

In relation to the first track, it has been widely discussed by the scholars, the necessity and the effect of harmonisation measures as to company laws in the context of European Union, especially in the light of the so-called "Delaware effect" stemmed from the US experience.[39]

On the one side, harmonisation has been regarded as a mean to avoid such an effect and the "race to the bottom" that it might imply, namely to avoid that the country with the most liberal and flexible company legislation might be the most attractive and might be followed by other countries, on the other hand, absence of harmonisation of national company laws has been supported on the grounds that it may encourage competition between countries and, as a result, the creation of "the best company law".

[37] http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=2875, time of download: 15.11.2011

[38] Werlauff, E.: *EU Company Law*. Copenhagen, 2003. 102.

[39] The name comes from the US State of Delaware which adopted a more liberal company law, in terms of minimum degree of interference by the management, procedural simplification, minimum capital requirements, in order to attract companies, willing to be incorporated there, and thereby to gain more revenue for the state through taxation and use of services.

Consistently, the company law directives regarding to merger and acquisitions do not prevent each Member State from applying its own company law, but they ensure minimum standards which have to be met in order to avoid the possible negative effects mentioned above.

"A dynamic and flexible company law [...] is essential for deepening the internal market and building an integrated European capital market. Essential for maximising the benefit of enlargement for all Member States, new and existing."[40]

[40] Communication from the Commission to the Council and the European Parliament−Modernising Company Law and Enhancing Corporate Governance in the European Union−A Plan to Move Forward, 2003/0284, Introduction.