**Analysis of the Proposed Directive on Cross-Border Conversions, Mergers and Divisions**
**Corporate Governance Implications**

***Briefing paper series on the Company Law Package***

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***What problems are the proposed Directive addressing?***

- Barriers to freedom of establishment, in particular to cross-border conversions (majority of MS do not allow) and divisions (majority of MS do not allow)
- Possible abuses of minority shareholders and creditors which might result once MS are required to permit conversions and divisions
- Defects in protection for minority shareholders and creditors in existing provisions relating to cross-border mergers

***What is in the proposed Directive (main provisions)?***

- Conversions and divisions:
  - **Draft terms of conversion** to set out details of safeguards offered to creditors, rights conferred on shareholders enjoying special rights, cash compensation offered to shareholders opposed, likely repercussions on employment, procedures and possible options for employee participation (Art 86d and 160e)
  - **Report to shareholders** (Art 86e and 160g) must set out aim, company's plans and safeguards for shareholders, and be made available to employees, although shareholders can unanimously waive the requirement to produce (Art 86e(4) and 160g(4)).
  - **Independent expert report** for medium and large companies on both reports and on draft terms to allow national competent authority to assess accuracy and provide factual elements for assessment whether constitutes an artificial arrangement (Art 86g).
  - **Majority of shareholders to approve the terms** (Art 86i and 160k): 'majority requirement for such a vote should be sufficiently high in order to ensure that the decision… is a collective one' (preamble, paras 15 and 48), majority should be not less than two thirds but not more than 90%, and not higher than national law requirement for approval of CBMs (Art 86i(3) and 160k(3))
  - **Shareholder exit right** (Art 86j and 160l), with cash offered in return for shares purchased by company (subject to national rules on company acquiring own shares), members or 'third parties in agreement with the company carrying out the conversion'
  - Shareholders have right to demand recalculation of cash compensation within one month of acceptance of offer (Art 86j(5) and 160l(5)), and in the case of divisions, can challenge the share-exchange ratio and seek cash compensation (Art 160l(7) and (8))
  - **Creditors can challenge** within one month if not satisfied with safeguards set out in draft terms, but presumptions of adequate protection operate (Art 86k and 160m)

- Mergers:
  - Relatively minor changes
  - New rules require terms to set out envisaged protection for minority shareholders and creditors, with presumptions as for conversions and divisions (Art 126b)
  - Report to shareholders to address implications for future business and management strategic plan, an explanation and justification of share exchange ratio, implications for members, right to challenge (Art 124). This must be available to employees (Art 124(3), but shareholders can waive by unanimity (Art 124(4))
  - Shareholder exit right (Art 126a) as for conversions, and right to challenge the ratio set out in the terms as for divisions (Art 126a(8) and (9))

    - Creditor right to challenge safeguards (Art 126b) as for conversions.

**What are the shortcomings and what could be done to fix them?**

- Existing accrued rights of creditors and minority shareholders are protected through the publication of draft terms for division, merger or conversion, a right for shareholder approval and exit, and a right for creditors to challenge. These rights will presumably rule out the possibility of MS introducing further rules to protect these interests and justifying them as necessary and proportionate to protect overriding requirements in the public interest under the CJEU's *Centros* and *Polbud* line of case law.
- Where existing shareholders or third parties purchase dissenting shareholder shares, this gives rise to concerns about manipulation of general meeting composition (including potential impacts on ESOPs). Some national systems will have relevant rules, but it might be worth considering a specific provision in the directive to allow remaining shareholders to object to the identity of the purchasers.
- How is quality of creditors' new claim to be assessed? By credit rating agencies (CRAs)? The EU is supposed to be reducing regulatory reliance on CRAs.
- What does 'undue' add to prejudice? How is undue to be assessed? By reference to national law?
- Pension funds are vulnerable in the event of cross-border restructuring, but there is wide diversity in pension provision across MS. Pension funds need to be referred to more explicitly in the Directive.

**Recommendations**

- Tax authorities and pension funds should be explicitly named in the provisions aimed at protecting creditors
- The Directive should guarantee third party input into in-depth assessments and guarantee to companies and specific third parties (including tax authorities, employee representatives) the right to challenge certification decisions
- The **report addressed to the members** company to explain the implications of the cross-border move on the future business and the management's strategic plan and its implications for members **should be mandatory and included in BRIS** – articles 86e, 124 and 160g currently foresee the possibility of a unanimous member vote to waive this requirement, which could be prejudicial to the interests of employees and prevent full transparency/scrutiny.
- The Directive should require the draft terms to include the safeguards offered to pension schemes, and provide explicitly that pension funds and tax authorities have the right to challenge the safeguards offered to them, and that presumptions of adequacy resulting from the expert report do not apply in relation to them
- The Directive should mandate the independent expert to report on impact on pensions, and give pension funds **right of access** to the shareholder report, employee report and independent expert report (and a right to offer comments and opinions)
- In instances where an independent expert report is not required, a member or creditor of the company should be able to ask a competent authority to compel the preparation of a report within a stated period if there are concerns about the report provided by the company.
- To prevent conversions to avoid obligations to creditors, the directors of the converting company should be required to make a declaration, based on the information available to them at the date of the declaration, that they have made reasonable inquiries and are unaware of any reason why the company would be unable to meet its liabilities after the conversion. The current language in article 160m is permissive.
- Additionally, information about any directors of companies that fail to meet liabilities that fall due after the conversion could be updated in the Business Registries Interconnection Service (BRIS) and prevented from becoming directors in future companies.

**Annex**

**Recommendations for change**

- The Preamble should state the Directive aims to protect pension funds against abuse and opportunistic evasion of responsibilities, and that companies should make good their existing obligations to their pension funds and remedy all deficits before restructuring will be permitted

**Other comments**

Shareholder approval of mergers is addressed by the 2017 Directive: Art 126(1) provides that the general meeting of each of the merging companies to decide on the approval of the common draft terms, but MS are permitted to exclude approval of the acquiring company unless, per Art 94, one or more shareholders demands a right to approve (with the threshold for demand being set no higher than 5%). **Creditors can challenge** within one month if not satisfied with safeguards set out in draft terms, but presumptions of adequate protection operate where: (a) independent expert report concludes no reasonable likelihood of prejudice, or (b) terms offer a right to claim on converted company/third party, which can be brought in same jurisdiction as original claim and 'is of a credit quality at least commensurate with the creditor's original claim. MS can require directors to give declaration of solvency (Art 86k and 160m)

Introduce rules regarding artificial arrangements for mergers to ensure harmonised rules and avoid new these rules facilitating abusive practices (see 2$^{nd}$ briefing paper in series for elaborated proposal)