



**EUROPEAN COMPANY LAW AND
CORPORATE GOVERNANCE**

Implementation of Directive
2005/56/EC on Cross-Border
Mergers of Limited Liability
Companies

A CONSULTATIVE DOCUMENT

MARCH 2007

EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE
IMPLEMENTATION OF DIRECTIVE 2005/56/EC ON CROSS-BORDER
MERGERS OF LIMITED LIABILITY COMPANIES

The Department of Trade and Industry invites your views on its approach to the implementation of the Cross-Border Mergers Directive. This Directive provides a facility enabling cross-border mergers involving public and private companies in the EEA. The DTI consulted on the draft Directive in June 2004.

The Government encourages the facilitation of corporate restructuring activities across the European Union to promote the Single Market. An effective framework of European company law is essential for the internal market and building an integrated European capital market. The Government supported agreement of this Directive to facilitate cross-border mergers and considers that the Directive increases legal certainty and provides adequate safeguards for those who deal with the companies involved.

Issued **5 March 2007**

Respond by: The deadline for responses is 1 June 2007.

Enquiries to: Sudha Oza, Bay 565, 1 Victoria St, London, SW1H 0ET.

Tel: 020 7215 2529. Sudha.oza@dti.gsi.gov.uk.

Contents	Page
Foreword	
Rt. Hon Ian McCartney MP Minister for Trade, Investment and Foreign Affairs	4
1. Executive Summary	5
Purpose	5
Objectives	5
Overview	5
Key Principles in implementing	5
Merger Procedure: Key Issues	6
Employee Participation: Key Issues	6
About this consultation	7
2. Implementation of the Cross-Border Mergers Directive in UK	10
Introduction	10
Background – The need for the Directive:	10
European Situation	10
UK Situation	12
3. Implementation of the Directive -The Government's Approach	13
Legislative Approach	13
Implementation on a UK-wide basis	13
Implementation on a 'light touch' basis	13
'Third Country' Mergers	13
Tax Issues	14

4. Merger Procedures: Proposed Implementing Provisions	15
Scope of the Directive	15
Main features of the merger process	16
5. Employee Participation: Proposed Implementing Provisions	20
UK Regulations	21
Overview of the Draft Regulations	24
6. Other Issues	30
Costs, savings and benefits	30
What happens next	30
Annex A: Summary of Questions	31
Annex B: Cross-Border Mergers Directive	33
Annex C: Draft Regulatory Impact Assessment	47
Appendix: Merger and Acquisition Data (Tables A – E)	74
Annex D: Code of Practice on Consultation	78
Annex E: Draft Regulations – Published Separately.	

Foreword from Rt. Hon. Ian McCartney MP Minister for Trade, Investment and Foreign Affairs

The Government is keen to enable UK businesses and their employees to face the challenge of globalisation. In that context, it is essential that UK companies operating within Europe have available to them a range of flexible, modern and accessible facilities by which they can grow and restructure their operations. It is also key that barriers to such reorganisation, whether they be cultural, legal or administrative, are broken down. Ultimately, this will contribute to the development of the Single Market and strengthen the ability of UK companies to compete successfully on the global scene.

The Cross-Border Mergers Directive was a part of a package of measures in the Financial Services Action Plan, agreed to at Lisbon by EU Member States in 2000, designed to further corporate restructuring. It must be viewed within the context of those measures as a whole – the Takeovers Directive and European Company Statute have already been adopted and implemented in the UK, a further Directive proposal on the transfer of the registered office of companies is expected in the near future from the European Commission. The Cross-Border Mergers Directive is part of that wider range of mechanisms by which European companies may choose to restructure.

In an increasingly global environment with rising merger and acquisition activity, it is right that shareholders and creditors of UK companies should be provided with a clear and transparent framework within which to consider cross-border merger proposals. It is equally right that proper information about the anticipated effects of such mergers for employees should be provided. In that respect, the UK supported agreement on the Cross-Border Mergers Directive and remains committed to extending the opportunities for corporate restructuring across Europe as crucial to the Single Market. We believe the Directive offers practical solutions to the issue of restructuring for businesses, whilst avoiding unnecessary burdens and constraints on business.

We invite your views on the policy proposals to implement this Directive in the UK by December 2007. We have engaged with many of our stakeholders to seek their views on these issues, and as we continue to do so your views would be extremely welcome and would guide us in making the correct judgements in implementation of this Directive into UK law. This will help us to ensure that UK companies are well placed to participate in cross-border merger activity and enhance their effectiveness in the global economy.



Rt. Hon. Ian McCartney MP
Minister for Trade, Investment and Foreign Affairs

1. EXECUTIVE SUMMARY

Purpose:

1.1 We are seeking your comments on the implementation of the European Directive on Cross-Border Mergers of Limited Liability Companies (Directive 2005/56/EC), which was adopted in October 2005 and must be implemented in the UK by 15 December 2007. A copy of the Directive is attached at Annex B. A cost and benefit evaluation - a Regulatory Impact Assessment (RIA) - is also attached at Annex C.

1.2 When we have received responses to this consultation we will carefully consider them and if necessary amend the proposed implementing provisions in the light of them. Your views will guide us in implementing this Directive effectively.

Objectives

1.3 In implementing the Directive, we aim to:

- establish a facilitative framework for cross-border mergers to occur between UK companies and companies elsewhere in the EEA. Implementation will introduce a system for cross-border restructuring that did not exist previously. It is assumed that only companies which consider they would benefit from using such a procedure would choose to participate in it;
- remove legislative and administrative difficulties that UK limited liability companies encounter when merging cross-border in the EEA; and
- contribute to the development of the Single Market.

Overview

1.4 The Directive introduces for the first time a legislative framework that enables cross-border mergers between companies in the EEA. New legal provisions, as required by the Directive, will be put in place to apply throughout the UK. The present domestic legislative framework does not provide for **cross-border** mergers between UK companies and companies elsewhere in the EEA. The new legislation aims to be clear, transparent and comprehensible to UK companies wishing to merge cross-border.

Key Principles in Implementing

1.5 The key principles on which the Government intends to approach implementing the Directive are:-

1.6 **Legislative approach:** We aim to make the regulations as accessible as possible to users by producing a single set of self-standing regulations covering both company law and employee participation aspects of the Directive. We are proposing to implement the Directive by making regulations

under section 2(2) of the European Communities Act 1972. The draft Regulations have been published separately as Annex E.

1.7 **Implementation on a UK-wide basis.** We would intend to proceed on the basis that the Regulations apply throughout the United Kingdom.

1.8 **Implementation of the Directive on a “light touch” basis:** Our aim is to retain consistency between domestic and cross-border merger procedures as far as possible. Where employee participation provisions are concerned, our aim is to ensure that the procedures are as consistent with similar legislation as possible.

1.9 **“Third Country” Mergers** – We are not intending to provide for cross-border mergers involving companies in third countries outside the EEA.

Merger Procedure: Key Issues

1.10 **Anticipated use of the new procedures:** We understand that UK companies generally use takeover procedures or other forms of restructuring more than the ‘merger’ procedures provided for in the Directive. Views are, therefore, sought on the likely take up of the cross-border merger procedure by UK companies.

1.11 **Scope of the implementing legislation:** This Directive applies to cross-border mergers involving companies in the EEA. This includes private and public limited liability companies, whether they are small, medium or large companies. However, there are a number of issues related to other types of corporate form to which the legislation facilitating cross-border mergers might be applied and on which views are invited.

1.12 **Detailed Procedures:** This Directive’s requirements for the merger procedures varies, in certain respects, compared to UK domestic merger procedures. These differences are explained in the consultation document.

Employee Participation: Key Issues

1.13 **Scope of employee participation provisions:** the broad intention of the Directive is to protect pre-existing employee participation rights in the merged company. Views are sought on how the requirement in some cases to negotiate with employees about levels of employee participation, is likely to affect the merger process.

1.14 **Departures from similar legislation:** We explained at paragraph 1.8 above that we propose to follow similar legislation as closely as possible. However, there are a few instances where the Directive is silent. These areas are highlighted in this consultation document and views are sought on appropriate solutions.

About This Consultation:

1.15 How to respond:

Your comments on any part of the consultation are welcome and we are particularly interested in your views on the key questions set out in this consultation. A full list of these questions is attached at Annex A at the end of this document. You will also find at Annex C a draft Regulatory Impact Assessment (RIA). We are particularly keen to receive any information or data that may enable us to evaluate the costs and benefits further.

1.16 Consultees are advised to clarify whether they are responding as an individual or representing the views of an organisation. Should you be representing an organisation, please indicate clearly who the organisation represents and, where applicable, how the views were collated.

1.17 This consultation was launched on 5 March 2007 and will close on 1 June 2007. Responses will not be accepted after the closing date.

1.18 Responses will be accepted via letter, fax or e-mail to:

**CBM Consultation
C/O James Carey
Corporate Law and Governance Directorate
Department of Trade and Industry
1 Victoria St
London
SW1H 0ET
Tel.: 020 7215 5782
Fax: 020 7215 0235**

1.19 Electronic responses should be submitted to the following e-mail address: CBMConsultation@dti.gsi.gov.uk

Help with Queries:

1.20 If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Nick Cooper
Consultation Co-ordinator
Department of Trade and Industry
Better Regulation Team
1 Victoria Street
London
SW1H 0ET
Tel: 020 7215 0346
Fax: 020 7215 2235
E-mail: Nick.Cooper@dti.gsi.gov.uk

A copy of the Code of Practice on Consultation is in Annex D.

1.21 For any queries about the policy concerning issues related to the merger procedure, please contact Sudha Oza. Her contact details are as follows: Tel: 020 7215 2529 or e-mail: Sudha.oz@dti.gsi.gov.uk.

1.22 For any queries about employee participation issues, please contact Carl Davies. His contact details are as follows: Tel: 020 7215 6220 or e-mail: carl.davies@dti.gsi.gov.uk

Additional Copies:

1.23 Further printed copies of this document can be obtained from the DTI Publications Order-line. You may also make copies of this document without seeking permission.

Copies can be ordered from:

DTI Publications Orderline
ADMAIL 528
London SW1W 8YT
Tel: 0845 015 0010
Fax: 0845 015 0020
Minicom : 0845 015 0030
www.Dti.gov.uk/publications

An electronic version can be found at
<http://www.dti.gov.uk/consultations/index.html>

Confidentiality and Data Protection

1.24 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are

primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want other information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.25 In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

1.26 The Department will process your personal data in accordance with the DPA. In the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Implementation of the Cross-Border Mergers Directive in UK

2. INTRODUCTION

2.1 The Government is committed to ensuring that our stakeholders have opportunities to feed in their views on proposed legislation. This consultation document seeks your views on implementation of the European Directive on cross-border mergers of limited liability companies (Directive 2005/56/EC (“the Directive”). The Directive was adopted on 26 October 2005 and must be implemented by 15 December 2007. The full text of the Directive is set out at Annex B. The Directive establishes common rules across the EEA governing cross-border mergers. It extends to a wide variety of limited liability companies in the different Member States. Your views will inform the approach to implementation of the Directive in the UK.

2.2 As well as formal consultations, we are in regular contact with our key stakeholders to gain informal feedback on the practical impact of proposals. This consultation paper already reflects input from a range of stakeholders. We will continue to work with them throughout the implementation process.

2.3 The Government encourages the facilitation of corporate restructuring across Europe to promote the Single Market. An effective framework of European company law is essential to underpin and advance a successful internal market and in building an integrated European capital market. The Directive lays down, for the first time, an EEA legislative framework within which cross-border mergers can take place. The UK, therefore, supported this Directive as providing an additional mechanism by which companies may reorganise their business activities.

BACKGROUND – THE NEED FOR THE DIRECTIVE

The European Situation

2.4 The objective of the Directive was to establish a legal facilitative framework enabling cross-border mergers between companies within the EEA where no legal framework presently exists. In so doing, the Directive provides an alternative approach to facilitating cross-border mergers and enhances legislative clarity for companies looking for such restructuring opportunities.

2.5 This Directive will allow companies across the EEA to merge cross-border based on the approach taken in the Third Company Law Directive (Council Directive 78/855/EEC), which applies to domestic mergers of public limited companies, and the merger provisions in the European Company Statute (Regulation (EC) No 2157/2001).

2.6 A first proposal for a Cross-Border Mergers Directive was published by the Commission in 1984. However, it was withdrawn in 2001 when agreement could not be reached on provisions for employee participation rights. However, a number of other developments in European company law

encouraged the Commission to come forward with a new proposal for a Cross-Border Mergers Directive in October 2003. These were as follows:-

- Agreement of a Cross-Border Mergers Directive remained a commitment under the Lisbon Financial Services Action Plan (2000) to create an integrated European Single Market by 2005. This commitment was renewed in the EU Action Plan on Company Law and Corporate Governance published by the Commission in May 2003;
- High Level Group of Company Law Experts appointed by the Commission in September 2001 who, amongst other issues, examined the possibility of facilitating cross-border company mergers; and
- Agreement in October 2001 of the European Company Statute which provided an infrastructure for companies to merge cross-border to form a European company registered in accordance with that Statute (this instrument addressed both company law and employee involvement issues).

2.7 In the light of these developments, the 2003 Commission proposal made good progress in both the European Parliament and Council and was finally adopted by the institutions in October 2005.

2.8 Since adoption of the Directive, there has been a further development at the European level relating to cross-border mergers of companies. This arose from the judgment of the European Court of Justice (ECJ) in December 2005 in the SEVIC case (C-411/03). That case concerned a cross-border merger proposal between a Luxembourg and German company. Both the companies had approved the merger in accordance with their national laws. However, the German authority refused to register the merger in the companies register on the grounds that German law did not make provision for cross-border mergers between companies.

2.9 The ECJ concluded that cross-border mergers by absorption between EU companies were an exercise of freedom of establishment under the EC Treaty even without the legal framework laid down by the Directive.

2.10 In the light of this background, it is considered that the Directive makes an important contribution towards the strengthening of the Single Market and is a key piece of legislation that will enable cross-border mergers between companies in countries in the EEA. The implementation of this Directive will reduce the risk of cross-border mergers proceeding in the absence of a coherent legal framework and provide for companies seeking to merge via the routes prescribed by this Directive (i.e. merger by formation of new company, merger by absorption and merger by absorption of a wholly owned subsidiary). In doing so, the Directive will provide legal certainty and transparency.

UK Situation

2.11 Presently, procedures for domestic company mergers are laid down by Part 13 (sections 425 to 427) of the Companies Act 1985 (Part XIV (Articles 418 to 420) of the Companies (Northern Ireland) Order 1986 (the 1986 Order) for Northern Ireland). These provisions apply to both public and private companies incorporated under this legislation. Additional requirements are laid down for mergers of public companies (under sections 427A of, and schedule 15B to, the Companies Act 1985 (Article 420A of, and Schedule 15B to, the 1986 Order for Northern Ireland). All of these provisions will be restated by the provisions in Parts 26 and 27 of the Companies Act 2006 which will apply throughout the UK.

2.12 In common with a number of EEA countries, UK does not currently lay down a legislative procedure for UK companies to engage in cross-border mergers. However, a number of devices have been used by business to achieve cross-border restructuring involving companies incorporated in the UK, such as takeovers and dual listing arrangements.

2.13 Accordingly, the UK will need to put in place new legal provisions to provide for cross border merger opportunities as set out in this Directive, thereby increasing legal certainty and providing adequate safeguards for those who deal with the companies involved. It is intended that these provisions will apply throughout Great Britain and Northern Ireland.

2.14 Due to cultural and structural conditions in the UK economy, corporate restructuring practice has seen greater use of takeovers rather than mergers. Takeovers do not lead to the dissolution of the acquired company, but simply involve the transfer of share ownership. Companies listed on the Stock Exchange in the UK usually have shares which are widely held and traded, share owners are readily identified and the market operates against practices which facilitate minority shareholders or a board of directors maintaining control against the interests of shareholders generally. Consequently, market forces can determine the outcome of a takeover bid. In addition, there are few constraints on cross-border investment in equities within the EEA and investors, both institutional and individual, are free to invest in those countries (including the UK) where they wish. The procedures under the implementing legislation will also apply, however, to small private companies in which capital may be more closely controlled.

Q1: Would you/your company consider using the merger framework laid down by the Directive to undertake a cross-border merger in the EEA?

3. Implementation of the Directive The Government's Approach

3.1 We propose to implement this Directive in the UK on the basis of the following principles:

3.2 **Legislative approach:** The Directive must be implemented by legally effective means within the UK. We are, therefore, proposing to implement this Directive in the UK by making regulations under section 2(2) of the European Communities Act 1972. The power under that Act is restricted to matters arising out of or related to implementation of European obligations (i.e. there would be limited capacity to make provision going beyond the scope of the Directive, for instance to make reforms more generally in relation to merger procedures). We are aiming to make the regulations as accessible as possible to users by producing a single set of self-standing regulations covering both company law and employee participation aspects of the Directive.

3.3 **Implementation on a UK-wide basis:** We would intend to proceed on the basis that the Regulations apply throughout the United Kingdom. This is consistent with the approach adopted in the Companies Act 2006 to place company legislation on a UK-wide basis.

3.4 **Implementation of the Directive on a "light touch" basis:** Our aim is to retain consistency between domestic and cross-border merger procedures as far as possible. The provisions of the Directive are broadly in line with UK legislation on domestic mergers of public companies. We intend, therefore, to attempt to replicate the existing blueprint for domestic mergers, making only necessary adjustments to reflect additional or different regulatory requirements in the Directive model. Similarly, as regards the employee participation provisions outlined in Article 16 of the Directive, the Government intends to follow as closely as possible, the existing arrangements for the European Public Limited-Liability Company Regulations 2004 and the European Public Limited-Liability Company Regulations (Northern Ireland) 2004.

3.5 **"Third Country" Mergers** – We are not intending to provide for cross border mergers involving companies in third countries outside the EEA. Within the EEA, Member States' rules on cross-border mergers will be in line and consistent with the requirements of the Directive (for instance, concerning matters such as safeguards as regards shareholder and creditor protection). Outside the EEA, there may not be the same guarantees or safeguards for all the participants – companies themselves, shareholders or creditors. Additionally, logistical uncertainties would arise as regards the interaction of UK Company registries with overseas company registries that are not covered by the regime laid down by the Directive. Finally, we would be restricted in going beyond the EEA as the legislative power available to us (regulations under section 2(2) of the European Communities Act 1972), is confined to matters arising out of or related to the implementation of European obligations.

3.6 **Tax Issues** - Alongside implementation of the company law provisions, HM Revenue & Customs published on 10 November 2006 a Technical Note for discussion and including draft legislation transposing the necessary provisions of European tax law to underpin company cross-border merger activity into UK Tax Law. The publication, "Amendment to the European Mergers Tax Directive - Technical Note and Draft Tax Clauses to Implement the Necessary UK Tax Law Changes," is available on the HMRC website. (http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_026318).

3.7 Comments were invited until 2 February 2007 and HMRC will be taking forward the necessary legislative changes in the light of consultees' comments. Tax issues are not further discussed in this consultation document.

3.8 The detailed measures proposed to implement the Directive are described below. Draft implementing regulations, on which comments are also sought, are included at Annex D.

Q2: Have you any comments on the high level principles that we propose to follow in implementing the Directive?

4. Merger Procedures: Proposed Implementing Provisions

Defining the Scope of the Directive

4.1 The Directive provides for cross-border mergers involving “limited liability companies”. This includes private and public companies with limited liability, but also some other corporate forms. There are exceptions in the directive in relation to co-operative societies (such as industrial and provident societies, friendly societies, building societies) and open-ended investment companies. Taking into account these factors and the SEVIC case (see paragraphs 2.8 and 2.9 above), we wish to explore with consultees their views on the benefits or otherwise of facilitating cross-border mergers in UK legislation for a potentially wide range of companies and other corporate forms.

4.2 We propose to extend the implementing legislation to the following types of companies:

- Public and private companies limited by shares or guarantee;
- Unregistered companies;
- Unlimited companies.

4.3 We are seeking the views of consultees on whether it is appropriate to facilitate through legislation cross-border mergers in respect of the types of corporate form below: -

- Industrial and provident societies (including community benefit societies and credit unions);
- Friendly societies;
- Building societies;
- Limited liability partnerships.

4.4 We do not propose to extend legislation facilitating cross-border mergers to the following types of companies/entities:

- Open Ended Investment Companies;
- Partnerships, limited partnerships and other unincorporated associations.

In the case of partnerships, limited partnerships and other unincorporated associations, such business vehicles are already sufficiently flexible and adaptable to restructure and reform cross-border in the absence of legislation.

Q3: Do you consider that the legislation facilitating cross-border mergers should be extended to:-

- a.) Industrial and provident societies (including community benefit societies and credit unions)?**
- b.) Friendly societies?**
- c.) Building societies?**
- d.) Limited liability partnerships?**

4.5 In giving views on whether or not it would be appropriate for the cross-border merger legislation to include these vehicles, it would be especially helpful if consultees could comment on the following matters:-

- i.) The likelihood of the company/entity utilising cross-border merger procedures (i.e. is there a practical demand from such companies/entities to undertake cross-border merger and acquisition activity of the kind provided for in the framework of the Directive);
- ii.) The extent to which the cross-border merger legislation might need modifying to accommodate the features of the company/entity concerned (the key concepts of the Directive are those of company law (shareholders meetings, etc. to ratify merger decisions) which may not reflect the way that such other companies/entities operate); and
- iii.) Whether there are any special features of the company/entity concerned which would not make it appropriate to extend such legislation to them (for instance, the essentially local nature of activities carried out by the type of corporate vehicle, etc.).

4.6 The main features of the Merger Process

4.6.1 The Cross-Border Mergers Directive recognises three forms of mergers. These are:

- i.) merger by absorption (an existing company absorbs one or more other merging companies),
- ii.) merger by formation of a new company (two or more companies merge to form a new company); and
- iii.) merger by absorption of a wholly owned subsidiary.

4.6.2 In each case, there must be a genuine “cross-border” element to the merger. The merger must involve at least two companies governed by the laws of different Member States.

4.6.3 The Directive applies to merger transactions where the permitted cash payment does not exceed 10% of the nominal value (or, in the absence of a nominal value, of the accounting par value) of the shares representing the capital of the company resulting from the cross-border merger (that is, share for share exchange transactions). It is also provided that the Directive provisions may apply to cross-border mergers where the cash consideration exceeds the 10% nominal (or accounting par) value. The wider definition of merger (including cash consideration exceeding 10%) already applies to domestic mergers. Consistent with our objective of minimising the differences between domestic and cross-border merger provisions, we would, therefore, propose to apply it to cross-border mergers.

4.6.4 The Cross-Border Merger Directive lays down some standard procedures that need to be followed for every cross-border merger. These procedures are very similar to the system currently in use for domestic mergers of public companies under Part 13 of the Companies Act 1985 (or, in Northern Ireland, Part XIV of the Companies (Northern Ireland) Order 1986). The main procedures are listed below:

- i.) Each of the companies involved is required to have prepared and circulated to shareholders:-
 - a.) draft terms of merger proposal. This must include information about matters such as the form of company that will result from the merger, the proposed share exchange ratio, the likely repercussions on employment of the merger and the assets and liabilities to be transferred;
 - b.) a directors' report. This is intended for the members of the company and should explain the legal and economic aspects of the merger together with the implications for members, creditors and employees;
 - c.) an independent expert's report. In the UK, it is presently required for domestic mergers that the independent expert's report be prepared by a qualified auditor. It is intended to replicate this requirement for cross-border mergers.
- ii.) details of the merger proposal must be published. In the UK, this is done by the Registrar of Companies notifying receipt of the merger proposals in the Gazette;
- iii.) The merger proposal must be approved by the shareholders of the company (in the UK, mirroring the domestic merger regime, the proposal must be approved by shareholders on a class by class basis);
- iv.) the above pre-merger formalities to be certified by a competent authority. In England and Wales or Northern Ireland this will be the High Court and, in Scotland, the Court of Session.

v.) once the pre-merger formalities have been certified in respect of each of the companies involved in accordance with their national law, the competent authority in the Member State in which the company resulting from the merger is to be registered must then scrutinise the cross-border elements of the merger and determine the date from which the merger shall have effect. In the UK, it is again proposed that the competent authority be the High Court/Court of Session.

4.7 Simplified Formalities - Article 15 of the Directive requires or permits certain relaxations of the provisions of the Directive in relation to mergers involving wholly owned or substantially owned subsidiaries. These are as follows (and the implementing legislation has been drafted accordingly):-

i.) merger by absorption of wholly owned subsidiaries:

a.) The common draft terms of merger do not have to contain details of the share exchange ratio, the terms of the allotment of shares in the resulting company or the date from which the holding of such shares will entitle the holder to share in profits.

b.) There is no requirement for an independent expert's report.

c.) There is no requirement for the shareholders of the subsidiary to approve the common draft terms of cross-border merger.

ii.) merger by absorption of substantially owned subsidiaries (where a holding company holds 90% or more, but not all of the shares/securities conferring rights to vote at general meetings of the subsidiary company). The independent expert's report is not required.

4.8 Provisions Not Required By Directive: This Directive does not lay down all of the requirements that are set out in relation to domestic merger procedures by Part 13 of the Companies Act 1985 and Part XIV of the Companies (Northern Ireland) Order 1986. As our general approach is to make both the domestic and cross-border framework consistent with each, we, therefore, intend to extend such key aspects of the domestic merger regime to cross-border mergers. This includes in particular (mirroring the provisions of section 425 of the Companies Act 1985 and Article 418 of the Companies (Northern Ireland) Order 1986):-

i.) Meetings of shareholders –it is proposed that the implementing legislation will require approval of the proposal by three quarters in value of each class of shareholders (i.e. not simply by the company in general meeting) present and voting either in person or by proxy; and

ii.) Creditors' Meetings – The court will be empowered, following an application to it, to order meetings of creditors to consider the cross-border merger proposal. In such cases, approval will require the

support of three quarters in value of each class of creditors present and voting either in person or by proxy.

4.9 The full set of draft Regulations to implement the Directive have been published separately as Annex E.

Q4: Do you have any comments, as regards the merger procedures, on the implementing measures described to give legal effect to the Directive?

Q5: Do you have any comments on the draft Regulations (Parts 1 to 3) proposed to give legal effect to the merger procedures provisions of the Directive?

5. Employee Participation: Proposed Implementing Provisions

5.1 Article 16 of the Directive requires that any cross-border merger operations carried out under this Directive must take into account employee participation arrangements where these exist in one or more of the merging companies. The Article seeks to ensure that existing employee participation levels of the merging companies, save for a few exceptions, are protected. The Directive does not impose any new participation requirements where employee participation rights do not exist in any of the merging companies.

5.2 Employee participation¹ is a system designed to give employees a statutory right to involvement at Board level. Employee participation already exists in some Member States (such as Germany, Austria, the Netherlands and Sweden). In the UK, employees currently have no right to be members of company boards, although there is nothing to prevent employers and employees from creating such arrangements voluntarily.

5.3 The principle on employee participation is that the company resulting from the cross-border merger will be subject to the rules in force concerning employee participation, if any, in the Member State where it will have its registered office.

Exceptions to the principle

5.4 However, if the employees in one (or more) of the merging companies already enjoy employee participation rights, then participation rights may have to be provided for in the newly formed company.

5.5 More specifically, the general principle is qualified in three cases:

1. Where at least one of the merging companies has, in the six months before the publication of the draft terms of the cross-border merger, an average number of employees that exceeds 500 and is operating under an employee participation system.

These conditions must be met cumulatively. The nature of the employee participation arrangement can be legal, statutory or non-binding. Therefore where there is an arrangement within the definition of “participation” in place, it will satisfy the second condition described above.

Or,

¹ “Participation” means the influence of the body representative of the employees and/or the employees’ representatives in the affairs of a company by way of:

- The right to elect or appoint members of the company’s supervisory or administrative organ; or
- The right to recommend and/or oppose the appointment of some or all of the members of the company’s supervisory or administrative organ.

2. Where the national law applicable to the resulting company would give the employees participation rights which are less than those operated in any of the merging companies²; or
3. Where the national law where the newly formed company has its registered office does not provide for employees of establishments of the company in other EEA States the same entitlement to exercise participation rights as those employees in the state of registration.

UK REGULATIONS

5.6 A company resulting from the cross-border merger that has its registered office in the UK will be obliged to provide for employee participation where the exceptions referred to above apply (see draft Regulation 22(2)). To bring these provisions into effect the UK Government proposes to follow, where possible, the arrangements for the well-established European Public Limited-Liability Company Regulations 2004³, more commonly referred to as the “European Company Statute” (ECS). In Northern Ireland the equivalent legislation is the European Public Limited-Liability Company Regulations (Northern Ireland) 2004⁴. The Government proposes to implement the employee participation provisions on a UK-wide basis and is in consultation with the NI authorities in order to adopt a similar approach to that already undertaken in the European Cooperative Society (Involvement of Employees) Regulations 2006.

5.7 Where participation arrangements exist in one or more of the merging companies, and the law of the Member State does not (outside of the context of a cross-border merger) provide for employee participation, the management of the merging companies have two options. They can either:

Agree to adopt “standard rules” (see below) which contain a default standard of employee participation. They may do this without reference to the employees and without setting up a Special Negotiating Body (SNB - see below); **or**

Set up an SNB in accordance with the principles contained in the ECS, with a view to agreeing employee participation arrangements. The management and the SNB can negotiate for up to 6 months to agree the employee participation arrangements (including the board structure) that will exist in the merged company, although this period can be extended by mutual agreement to 12

² Measured by reference to the proportion of employee representatives amongst the members of the administrative or supervisory organ or their committees or of the management group which covers the profit units of the company, subject to employee representation (Article 16(2)(a) Directive).

³ SI 2004 No 2326

⁴ S.R. 2004 No. 417. DTI intends to revoke these NI Regulations and instead, extend the equivalent GB instrument to cover the whole of the UK.

months. Where no agreement has been reached at the end of the period, the merging companies can agree that the standard rules will apply.

The Negotiating Process

5.8 The negotiation process requires the setting up of a Special Negotiating Body (SNB) to represent the employees of all the merging companies. SNB representatives must be elected or appointed in accordance with rules drawn up by individual Member States. The management of the merging companies are required to meet all costs of the negotiation process (including the cost of one expert who may be appointed to assist the SNB). Decisions of the SNB must be taken by an absolute majority of the SNB members (other than in limited specified circumstances where a two thirds majority is necessary), thereby representing an absolute majority of the employees.

5.9 In all cases, the highest “level” of employee participation rights must be maintained and extended across the merged company as had previously existed in any of the merging companies, unless the SNB decides otherwise. Where at least 25% of the overall numbers of employees have participation rights, a special two-thirds majority of the SNB is required for any reduction in the level of participation rights.

If the negotiating process fails

5.10 Where no agreement is reached, a set of standard rules on employee participation will apply. The merger cannot be completed until this process had been concluded.

Standard Rules

5.11 The SNB and the management of the merging companies can agree to be bound by the Standard Rules on employee participation. The management of the merging companies can also decide unilaterally to be bound by the Standard Rules. Where no such agreement or choice has been made, the Standard Rules will apply by default provided that participation applied to at least one third of the total number of employees of the merging companies employed in EEA states. The Standard Rules will give the employees of the newly formed company and/or their representative body the right to elect, appoint, recommend or oppose the appointment of a number of members of the administrative or supervisory body of the merged company. The merged company may limit the level of employee participation rights to the maximum level in any of the merging companies, subject to a ceiling of 33.3%. The Standard Rules impose no requirements in relation to the board structure of the merged company.

5.12 In the situation where managements have agreed, without any prior negotiation, to adopt the Standard Rules relating to employee participation and where there exists more than one form of employee participation amongst

the merging companies, the Directive currently makes no provisions as to which type of employee participation system should exist, or how agreement could be reached for the newly formed company.

Q6: The Government proposes the following options to address the situation at paragraph 5.12, and invites respondents' views accordingly:

Option 1: To set up an SNB whose sole purpose will be to determine which type of employee participation system shall be adopted in the newly formed company; or

Option 2: The management boards of the merging companies decide which type of employee participation shall be adopted in the newly formed company. The management boards in question would be in a position to voice the most appropriate form of employee participation on behalf of their respective employees who either elected or recommended their appointment to the board; or

Option 3: Another form of consultation – direct or indirect – with employees. If so, which method do you think the Government should adopt, and how?

5.13 Similarly, in circumstances where there exists more than one form of employee participation amongst the merging companies, the Directive requires the SNB to choose which of the existing forms of participation should apply in the new merged company. However it makes no provision as to what should happen in the absence of a decision by the SNB.

Q7: With reference to paragraph 5.13 and where draft Regulation 36(4)(i) applies, how do you think the form of participation should be decided?

5.14 As in the ECS, Member States are given the option of not applying the standard rules relating to participation. However, use of this option would effectively prevent any merged company from registering in that country unless there are no existing participation rights in any of the merging companies or a voluntary agreement has been reached that provides for participation if it previously existed in the participating companies.

Overview of the draft UK⁵ Regulations relating to employee participation

Chapter 1 – Application of this part

5.15 Regulation 22 outlines the circumstances under which it is necessary for a UK company to follow the provisions of Part 4. This is the Government's interpretation of Article 16(2) of the Directive and may be amended in light of responses to this consultation.

Chapter 2 – Merging Companies and Special Negotiating Body

5.16 Regulations 23 to 24 outline the duty to provide information to the employees' representatives or, if no such body exists, to the employees themselves. The information is used to calculate the number of Special Negotiating Body representatives needed and their allocation across the Member States concerned. Here it also sets the minimum level of information required and, in the case where a Special Negotiating Body (SNB) has been created, the necessity to keep it informed of plans and progress of establishing a transferee company. Where the management of the merging companies fail to provide the required information, or where the information is thought to be false or incomplete, employee representatives or employees may present a complaint to the Central Arbitration Committee (CAC).

5.17 Regulations 25 and 26 outline the function of the SNB and its composition. The SNB and the directors have the task of reaching an employee participation agreement. Regulation 26 details how the composition of an SNB should be achieved. The employees in each Member State are collectively entitled to elect or appoint one member of the SNB for each 10%, or fraction thereof, that they represent of the total workforce of the emergent company – two examples are illustrated below. Given this requirement, all SNBs will always have a minimum of ten members. It should be pointed out that there may not necessarily be any correspondence between the number of participating companies in a Member State and the number of SNB from that Member State.

Example 1

Member State	% of total employees	No. of SNB members
A	81%	9
B	19%	2
Total SNB members		11

⁵ Respondents should note that as the proposed Regulations extend to Northern Ireland, references in this consultation document to the CAC, EAT, employment tribunal or ACAS also apply to the Northern Ireland equivalents of the Industrial Court, High Court, Industrial Tribunal or Labour Relations Agency respectively. The draft Regulations currently reflect the GB position, however, the final Regulations will address the Northern Ireland position.

Example 2

Member State	% of total employees	No. of SNB members
A	38%	4
B	25%	3
C	22%	3
D	15%	2
Total SNB members		12

5.18 Regulation 27 provides that, where it is believed that the SNB has not been established at all or has not been established properly, a complaint may be presented to the CAC.

Chapter 3 – Negotiation of the Employee Participation Agreement

5.19 Regulations 28 to 32 detail the requirements for the negotiation process in order to agree an employee participation arrangement. The duty to negotiate commences one month after the publication of the details of the last SNB member to be elected or appointed. The deadline for negotiating an employee participation arrangement is six months after the date on which the duty to negotiate commences although this can, by mutual agreement, be extended to 12 months. The employee participation agreement must be in writing and shall specify its scope, the type and level of the participation arrangement, and the date of entry into force.

5.20 Each member of the SNB has one vote, regardless of the number of employees represented. With certain exceptions, the SNB must take decisions by an absolute majority of its members, provided that such a majority also represents an absolute majority of the employees. Where at least 25% of the employees employed by the merging companies have participation rights, any SNB decision that would result in a reduction of participation rights must be taken by a two-thirds majority vote provided this represents two-thirds of the total employees.

5.21 The SNB may decide by two-thirds majority (provided they represent two-thirds of the total employees) not to open negotiations, or terminate negotiations once they have begun.

5.22 The SNB must publish the details of any decision in such a manner as to bring the decision to the attention of the employees within 14 days of the decision being taken. A complaint may be brought to the CAC within 21 days of the publication of the SNB decision where it is believed that the decision was not taken by the required majority or that the SNB failed to publish its decision.

Chapter 4 – Election or appointment of UK members of the SNB

5.23 Regulations 33 – 35 detail the methods for electing or appointing UK members to the SNB. The allocation of SNB members is per Member State, therefore where the employees of the merging companies are situated in both GB and Northern Ireland, ballots must be held on a UK basis.

5.24 Regulation 33 requires that the UK members of the SNB must be elected by ballot of the UK employees. The competent organs of the merging companies are under an obligation to arrange the ballot or ballots of employees. As has been pointed out (paragraph 5.17), there will not necessarily be any correspondence between the number of merging companies and concerned subsidiaries or establishments in a Member State, and the number of SNB members from that Member State.

5.25 If the number of UK members to be elected is greater than the number of merging companies with employees in the UK, the management of those merging companies should ensure that all the merging companies each have ballots to elect a representative and that the remaining members are allocated in proportion to the number of employees in each company. For example, if the number of members allocated is one more than the number of merging companies, the ballot for a second member should go to the merging company with the largest number of employees.

5.26 If the number of SNB members that the UK employees are entitled to elect is smaller than the number of merging companies that have employees in the UK, the number of ballots held in the UK must be equivalent to the number of UK SNB members that are to be elected. Separate ballots should be held in each of the merging companies with the highest number of employees but employees in merging companies where a ballot will not be held must also be entitled to vote in a ballot held in one of the other merging companies. The management of the UK merging companies must also ensure that the UK based employees, of the concerned subsidiaries or establishments of non-UK merging companies, are entitled to vote in the UK ballots. The additional members that may be appointed under regulation 26(2) should be elected by a separate ballot in each of the merging companies that are entitled to elect them.

5.27 Employees of concerned subsidiaries of participating companies, as well as the employees of merging companies themselves, are entitled to be represented on the SNB. UK employees of a merging company and its concerned subsidiaries are therefore entitled to vote in ballots in respect of that merging company. Any of these employees or, if the management of that merging company permits, a representative of a trades union who is not an employee of that merging company, is eligible to stand as a candidate for election to the SNB in that ballot.

5.28 The management must ensure that an independent supervisor, in accordance with regulation 33(7) supervises each ballot. Where there is more

than one ballot, the management may appoint more than one independent ballot supervisor. The management must publish the final arrangements for the ballots of UK employees and consult on them through UK employees' representatives. If any UK employee or UK employees' representative believes that the ballot arrangements are defective under regulation 33(4), they may present a complaint to the CAC within a period of 21 days from the publication of the final arrangements. If the complaint is upheld, the CAC can make an order requiring the arrangements to be modified.

5.29 Regulation 34 refers to the appointment of the ballot supervisor and his duties with regards to the ballots of UK employees to elect the UK members of the SNB. As soon as practicable after the ballot has been held, the supervisor should publish the results of the ballot and ensure that the results are available to the management, the UK employees that were entitled to vote and the candidates that stood for election. If the ballot supervisor considers the ballot to have been defective he must publish an "ineffective ballot report" within a month of publishing the results. The defective ballot or ballots must then be held again (the previous results having no effect). All costs relating to the ballot must be borne by the management.

5.30 Regulation 35 prevents the composition of the SNB from entailing a double representation of employees. It also ensures a clear link between an SNB member and the employees he is representing for the purpose of taking decisions by the requisite majority (see regulation 30). SNB members are deemed to represent the employees of the merging company that were entitled to vote in the ballot to elect the member. If, under regulation 26, an additional member has been appointed, that additional member alone is deemed to represent the employees that were entitled to vote in the ballot to elect that additional member – i.e. the other SNB member that would otherwise have been representing these employees will not be representing the same employees.

Chapter 5 – Standard Rules On Employee Participation

5.31 Regulations 36 to 40 outline the circumstances under which the standard rules on employee participation apply. This can occur where the parties have agreed that they will apply; the SNB has agreed that they will apply; or no such decision or agreement has been made, the negotiating period has elapsed and participation applied to at least one third of the total number of employees of the merging companies.

5.32 The standard rules that apply where there is no agreement, will give the employees of the merged company and/or their representative body the right to elect, appoint, recommend or oppose the appointment of a number of members of the administrative or supervisory body of the merged company. The merged company may limit the level of employee participation rights to the maximum level in any of the merging companies, subject to a ceiling of 33.3%.

5.33 Regulation 40 ensures that the employee participation rights enjoyed by the employees of a company resulting from a cross border merger shall extend to any subsequent domestic mergers for a period of three years from the date of registration.

Chapter 6 – Confidential Information

5.34 Regulation 41 applies to anyone who is, or was, an SNB member or a member of an employee representative body or any expert assisting the SNB or representative body. Confidential information relating to the merger and entrusted to these persons may not be disclosed to third parties. Anyone to whom information has been provided in confidence may apply to the CAC for a declaration as to whether it was reasonable for the company to have imposed a confidentiality restriction. Where the CAC considers that the company's action was not reasonable, on the grounds that disclosure would not prejudice or cause serious harm to the company, it may make a declaration to that effect. Thereafter the information will not be considered confidential.

5.35 Regulation 42 provides that a merging company need not disclose information where to do so would, according to objective criteria, seriously harm the functioning of the company or be prejudicial to it. An application can be made to the CAC for a declaration whether the company was justified in withholding the information. Where the CAC considers that disclosing the information would not prejudice or seriously harm the functioning of the company, it may order disclosure of the information by a specific date. CAC decisions are appealable to the EAT on a point of law.

Chapter 7 – Protection for Members of the SNB, etc

5.36 Regulations 43 to 52 provide that employees who are members of the SNB are entitled to reasonable time off to perform their functions as such, and to be paid remuneration for the time taken off. These rights may be enforced through an employment tribunal.

5.37 An employee is protected in respect of unfair dismissal or detriment when acting as a representative of employees or standing as a candidate for election. The protections do not apply where the reason or principle reason for dismissal or detriment was that the employee had disclosed confidential information. A claim for unfair dismissal or a complaint of detriment may be brought before an employment tribunal.

Chapter 8 – Compliance and Enforcement

5.38 Regulation 53 outlines that a complaint may be brought to the CAC where it is considered that the company has failed to comply with the terms of the employee participation agreement. The complaint must be brought within a period of three months commencing from the date of the alleged failure.

5.39 Regulations 54 to 56 set out the maximum level of penalty that can be set and that a complaint may be brought to the CAC where a company is believed to be misusing or intending to misuse these procedures or these Regulations.

Chapter 9 – Miscellaneous

5.40 Regulations 57 to 60 concern various miscellaneous provisions such as the formalities to CAC proceedings, the Appeal Tribunal and the role of ACAS during any dispute.

5.41 Regulations 61 to 62 set out restrictions on contracting out, the arrangements and conduct of ballots and the representation of employees.

5.42 Regulation 63 amends Schedules 3, 4 and 5 of the Employment Act 2002 in order to maintain consistent treatment of employment rights relating to detriment.

Q8: Do you agree with the Government's intended approach in relation to Employee Participation?

Q9: If not, how do you think the Government should implement the Employee Participation provisions?

6. Other Issues

Costs, Savings and Benefits

6.1 A draft regulatory impact assessment (RIA) is attached at Annex C. This contains an overview of the merger procedure together with estimates of the costs and benefits of using the merger framework set down in the implementing legislation to facilitate a cross-border merger.

Q10: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed provisions implementing the Directive. Comments are also invited on any unintended consequences or other implications.

What Happens next?

6.2 We look forward to receiving your views on the issues set out in this consultation document. We would also be grateful for any supporting evidence that you are able to supply that would assist us in reaching our final views on the approach to implementation of the Directive.

6.3 This consultation will close on 1 June 2007. We shall subsequently publish the Government's response to this consultation within 3 months of the closing date. A copy of this response will also be available on the DTI website at: <http://www.dti.gov.uk/consultations/index.html>

6.4 The draft implementing legislation will be revised in the light of consultees' comments to come into force on 15 December 2007, by when Member States are required to have implemented the Directive.

SUMMARY OF QUESTIONS

Q1: Would you/your company consider using the merger framework laid down by the Directive to undertake a cross-border merger in the EEA?

Q2: Have you any comments on the high level principles that we propose to follow in implementing the Directive?

Q3: Do you consider that the legislation facilitating cross-border mergers should be extended to:-

- a.) Industrial and provident societies (including community benefit societies and credit unions)?**
- b.) Friendly societies?**
- c.) Building societies?**
- d.) Limited liability partnerships?**

Q4: Do you have any comments, as regards the merger procedures, on the implementing measures described to give legal effect to the Directive?

Q5: Do you have any comments on the draft Regulations (Parts 1 to 3) proposed to give legal effect to the merger procedures provisions of the Directive?

Q6: The Government proposes the following options to address the situation at paragraph 5.12, and invites respondent's views accordingly:

Option 1: To set up an SNB whose sole purpose will be to determine which type of employee participation system shall be adopted in the newly formed company; or

Option 2: The management boards of the merging companies decide which type of employee participation shall be adopted in the newly formed company. The management boards in question would be in a position to voice the most appropriate form of employee participation on behalf of their respective employees who either elected or recommended their appointment to the board; or

Option 3: Another form of consultation – direct or indirect – with employees. If so, which method do you think the Government should adopt, and how?

Q7: With reference to paragraph 5.13 and where draft Regulation 36(4)(i) applies, how do you think the form of participation should be decided?

Q8: Do you agree with the Government's intended approach in relation to Employee Participation?

Q9: If not, how do you think the Government should implement the Employee Participation provisions?

Q10: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed provisions implementing the Directive. Comments are also invited on any unintended consequences or other implications.

Annex B

Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005

on cross-border mergers of limited liability companies (Text with EEA relevance)

THE EUROPEAN PARLIAMENT
AND THE COUNCIL OF THE
EUROPEAN UNION,

Having regard to the Treaty
establishing the European
Community, and in particular Article
44 thereof,

Having regard to the proposal from
the Commission,

Having regard to the opinion of the
European Economic and Social
Committee ¹,

Acting in accordance with the
procedure laid down in Article 251
of the Treaty ²,

Whereas:

(1) There is a need for cooperation
and consolidation between limited
liability companies from different
Member States. However, as
regards cross-border mergers of
limited liability companies, they
encounter many legislative and
administrative difficulties in the
Community. It is therefore

necessary, with a view to the
completion and functioning of the
single market, to lay down
Community provisions to facilitate
the carrying-out of cross-border
mergers between various types of
limited liability company governed
by the laws of different Member
States.

(2) This Directive facilitates the
cross-border merger of limited
liability companies as defined
herein. The laws of the Member
States are to allow the cross-border
merger of a national limited liability
company with a limited liability
company from another Member
State if the national law of the
relevant Member States permits
mergers between such types of
company.

(3) In order to facilitate cross-
border merger operations, it should
be laid down that, unless this
Directive provides otherwise, each
company taking part in a cross-
border merger, and each third party
concerned, remains subject to the
provisions and formalities of the
national law which would be
applicable in the case of a national
merger. None of the provisions and
formalities of national law, to which
reference is made in this Directive,
should introduce restrictions on

¹ OJ C 117, 30.4.2004, p. 43.

² Opinion of the European Parliament of 10
May 2005 (not yet published in the Official
Journal) and Council Decision of 19
September 2005.

freedom of establishment or on the free movement of capital save where these can be justified in accordance with the case-law of the Court of Justice and in particular by requirements of the general interest and are both necessary for, and proportionate to, the attainment of such overriding requirements.

(4) The common draft terms of the cross-border merger are to be drawn up in the same terms for each of the companies concerned in the various Member States. The minimum content of such common draft terms should therefore be specified, while leaving the companies free to agree on other items.

(5) In order to protect the interests of members and others, both the common draft terms of cross-border mergers and the completion of the cross-border merger are to be publicised for each merging company via an entry in the appropriate public register.

(6) The laws of all the Member States should provide for the drawing-up at national level of a report on the common draft terms of the cross-border merger by one or more experts on behalf of each of the companies that are merging. In order to limit experts' costs connected with cross-border mergers, provision should be made for the possibility of drawing up a single report intended for all members of companies taking part in a cross-border merger operation. The common draft terms of the cross-border merger are to be

approved by the general meeting of each of those companies.

(7) In order to facilitate cross-border merger operations, it should be provided that monitoring of the completion and legality of the decision-making process in each merging company should be carried out by the national authority having jurisdiction over each of those companies, whereas monitoring of the completion and legality of the cross-border merger should be carried out by the national authority having jurisdiction over the company resulting from the cross-border merger. The national authority in question may be a court, a notary or any other competent authority appointed by the Member State concerned. The national law determining the date on which the cross-border merger takes effect, this being the law to which the company resulting from the cross-border merger is subject, should also be specified.

(8) In order to protect the interests of members and others, the legal effects of the cross-border merger, distinguishing as to whether the company resulting from the cross-border merger is an acquiring company or a new company, should be specified. In the interests of legal certainty, it should no longer be possible, after the date on which a cross-border merger takes effect, to declare the merger null and void.

(9) This Directive is without prejudice to the application of the legislation on the control of concentrations between undertakings, both at Community level, by Regulation (EC) No

139/2004³, and at the level of Member States.

(10) This Directive does not affect Community legislation regulating credit intermediaries and other financial undertakings and national rules made or introduced pursuant to such Community legislation.

(11) This Directive is without prejudice to a Member State's legislation demanding information on the place of central administration or the principal place of business proposed for the company resulting from the cross-border merger.

(12) Employees' rights other than rights of participation should remain subject to the national provisions referred to in Council Directive 98/59/EC of 20 July 1998 on collective redundancies⁴, Council Directive 2001/23/EC of 12 March 2001 on the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses⁵ Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community⁶ and Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of

undertakings for the purposes of informing and consulting employees⁷.

(13) If employees have participation rights in one of the merging companies under the circumstances set out in this Directive and, if the national law of the Member State in which the company resulting from the cross-border merger has its registered office does not provide for the same level of participation as operated in the relevant merging companies, including in committees of the supervisory board that have decision-making powers, or does not provide for the same entitlement to exercise rights for employees of establishments resulting from the cross-border merger, the participation of employees in the company resulting from the cross-border merger and their involvement in the definition of such rights are to be regulated. To that end, the principles and procedures provided for in Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)⁸ and in Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees⁹, are to be taken as a basis, subject, however, to modifications that are deemed necessary because the resulting company will be subject to the national laws of the Member State where it has its registered

³ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (OJ L 24, 29.1.2004, p. 1).

⁴ OJ L 225, 12.8.1998, p. 16

⁵ OJ L 82, 22.3.2001, p. 16

⁶ OJ L 80, 23.3.2002, p. 29.

⁷ OJ L 254, 30.9.1994, p. 64. Directive as amended by Directive 97/74/EC (OJ L 10, 16.1.1998, p. 22).

⁸ OJ L 294, 10.11.2001, p. 1. Regulation as amended by Regulation (EC) No 885/2004 (OJ L 168, 1.5.2004, p. 1).

⁹ OJ L 294, 10.11.2001, p. 22.

office. A prompt start to negotiations under Article 16 of this Directive, with a view to not unnecessarily delaying mergers, may be ensured by Member States in accordance with Article 3(2)(b) of Directive 2001/86/EC.

(14) For the purpose of determining the level of employee participation operated in the relevant merging companies, account should also be taken of the proportion of employee representatives amongst the members of the management group, which covers the profit units of the companies, subject to employee participation.

(15) Since the objective of the proposed action, namely laying down rules with common features applicable at transnational level, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and impact of the proposed action, be better achieved at Community level, the Community may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality as set out in that Article, this Directive does not go beyond what is necessary to achieve that objective.

(16) In accordance with paragraph 34 of the Interinstitutional Agreement on better law-making¹⁰, Member States should be encouraged to draw up, for themselves and in the interest of the Community, their own tables which will, as far as possible, illustrate the correlation between this Directive and the transposition

¹⁰ OJ C 321, 31.12.2003, p. 1.

measures and to make them public,

HAVE ADOPTED THIS
DIRECTIVE:

Article 1

Scope

This 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 (hereinafter referred to as cross-border mergers).

Article 2

Definitions

For the purposes of this Directive:

1) "limited liability company", hereinafter referred to as "company", means:

(a) a company as referred to in Article 1 of Directive 68/151/EEC¹¹, or

¹¹ First Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ L 65, 14.3.1968, p. 8). Directive as last amended by the 2003 Act of Accession.

(b) 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 Directive 68/151/EEC for the protection of the interests of members and others;

absence of a nominal value, of the accounting par value of those securities or shares; or

(c) 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.

2. "merger" means an operation whereby:

(a) 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

(b) 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

Article 3

Further provisions concerning the scope

1. Notwithstanding Article 2(2), this Directive shall also apply to cross-border mergers where the law of at least one of the Member States concerned allows the cash payment referred to in points (a) and (b) of Article 2(2) to exceed 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of the securities or shares representing the capital of the company resulting from the cross-border merger.

2. Member States may decide not to apply this Directive to cross-border mergers involving a cooperative society even in the cases where the latter would fall within the definition of "limited liability company" as laid down in Article 2(1).

3. This Directive shall not apply to cross-border mergers involving a company the object of which is the collective investment of capital provided by the public, which operates on the principle of risk-

spreading and the units of which are, at the holders' request, repurchased or redeemed, directly or indirectly, out of the assets of that company. Action taken by such a company to ensure that the stock exchange value of its units does not vary significantly from its net asset value shall be regarded as equivalent to such repurchase or redemption.

Article 4

Conditions relating to cross-border mergers

1. Save as otherwise provided in this Directive,

(a) cross-border mergers shall only be possible between types of companies which may merge under the national law of the relevant Member States, and

(b) 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 Article 21 of Regulation (EC) No 139/2004 is applicable.

2. The provisions and formalities referred to in paragraph 1(b) 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 Article 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.

Article 5

Common draft terms of cross-border mergers

The management or administrative organ of each of the merging companies shall draw up the common draft terms of cross-border merger. The common draft terms of cross-border merger shall include at least the following particulars:

(a) the form, name and registered office of the merging companies and those proposed for the company resulting from the cross-border merger;

(b) the ratio applicable to the exchange of securities or shares representing the company capital and the

amount of any cash payment;

(c) the terms for the allotment of securities or shares representing the capital of the company resulting from the cross-border merger;

(d) the likely repercussions of the cross-border merger on employment;

(e) 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;

(f) 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;

(g) 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;

(h) 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;

(i) the statutes of the company resulting from the cross-border merger;

(j) 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 Article 16;

(k) information on the evaluation of the assets and liabilities which are transferred to the company resulting from the cross-border merger;

(l) dates of the merging companies' accounts used to establish the conditions of the cross-border merger.

Article 6

Publication

1. The common draft terms of the cross-border merger shall be published in the manner prescribed by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC for each of the merging companies at least one month before the date of the general meeting which is to decide thereon.

2. For each of the merging companies and subject to the additional requirements imposed by the Member State to which the company concerned is subject, the following particulars shall be

published in the national gazette of that Member State:

(a) the type, name and registered office of every merging company;

(b) the register in which the documents referred to in Article 3(2) of Directive 68/151/EEC are filed in respect of each merging company, and the number of the entry in that register;

(c) an indication, for each of the merging companies, of the arrangements made for the exercise of the rights of creditors and of any minority members of the merging companies and the address at which complete information on those arrangements may be obtained free of charge.

Article 7

Report of the management or administrative organ

The management or administrative organ of each of the merging companies shall draw up a report intended for the members explaining and justifying the legal and economic aspects of the cross-border merger and explaining the implications of the cross-border merger for members, creditors and employees.

The report shall be made available to the members and to the representatives of the employees or, where there are no such representatives, to the employees themselves, not less than one month before the date of the

general meeting referred to in Article 9.

Where the management or administrative organ of any of the merging companies receives, in good time, an opinion from the representatives of their employees, as provided for under national law, that opinion shall be appended to the report.

Article 8

Independent expert report

1. An independent expert report intended for members and made available not less than one month before the date of the general meeting referred to in Article 9 shall be drawn up for each merging company. Depending on the law of each Member State, such experts may be natural persons or legal persons.

2. As an alternative to experts operating on behalf of each of the merging companies, one or more independent experts, appointed for that purpose at the joint request of the companies by a judicial or administrative authority in the Member State of one of the merging companies or of the company resulting from the cross-border merger or approved by such an authority, may examine the common draft terms of cross-border merger and draw up a single written report to all the members.

3. The expert report shall include at least the particulars provided for by Article 10(2) of Council Directive 78/855/EEC of 9 October 1978

concerning mergers of public limited liability companies¹². The experts shall be entitled to secure from each of the merging companies all information they consider necessary for the discharge of their duties.

4. Neither an examination of the common draft terms of cross-border merger by independent experts nor an expert report shall be required if all the members of each of the companies involved in the cross-border merger have so agreed.

Article 9

Approval by the general meeting

1. After taking note of the reports referred to in Articles 7 and 8, the general meeting of each of the merging companies shall decide on the approval of the common draft terms of cross-border merger.

2. 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. The laws of a Member State need not require approval of the merger by the general meeting of the acquiring company if the conditions laid down in Article 8 of Directive 78/855/EEC are fulfilled.

¹² OJ L 295, 20.10.1978, p. 36. Directive as last amended by the 2003 Act of Accession.

Article 10

Pre-merger certificate

1. Each Member State shall designate the court, notary or other authority competent to scrutinise the legality of the cross-border merger as regards that part of the procedure which concerns each merging company subject to its national law.

2. In each Member State concerned the authority referred to in paragraph 1 shall issue, without delay to each merging company subject to that State's national law, a certificate conclusively attesting to the proper completion of the pre-merger acts and formalities.

3. If the law of a Member State to which a merging company is subject provides for a procedure to scrutinise and amend the ratio applicable to the exchange of securities or shares, or a procedure to compensate minority members, without preventing the registration of the cross-border merger, such procedure shall only apply if the other merging companies situated in Member States which do not provide for such procedure explicitly accept, when approving the draft terms of the cross-border merger in accordance with Article 9(1), the possibility for the members of that merging company to have recourse to such procedure, to be initiated before the court having jurisdiction over that merging company. In such cases, the authority referred to in paragraph 1 may issue the certificate referred to in paragraph 2 even if such procedure has commenced. The certificate must, however, indicate that the

procedure is pending. The decision in the procedure shall be binding on the company resulting from the cross-border merger and all its members.

Article 11

Scrutiny of the legality of the cross-border merger

1. Each Member State shall designate the court, notary or other authority competent to scrutinise the legality of the cross-border merger as regards that part of the procedure which concerns the completion of the cross-border merger and, where appropriate, the formation of a new company resulting from the cross-border merger where the company created by the cross-border merger is subject to its national law. The said authority shall in particular ensure that the merging companies have approved the common draft terms of cross-border merger in the same terms and, where appropriate, that arrangements for employee participation have been determined in accordance with Article 16.

2. To that end each merging company shall submit to the authority referred to in paragraph 1 the certificate referred to in Article 10(2) within six months of its issue together with the common draft terms of cross-border merger approved by the general meeting referred to in Article 9.

Article 12

Entry into effect of the cross-border merger

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. That date must be after the scrutiny referred to in Article 11 has been carried out.

Article 13

Registration

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 Article 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.

Article 14

Consequences of the cross-border merger

1. A cross-border merger carried out as laid down in points (a) and (c) of Article 2(2) shall, from the date referred to in Article 12, have the following consequences:

(a) all the assets and liabilities of the company

being acquired shall be transferred to the acquiring company;

(b) the members of the company being acquired shall become members of the acquiring company;

(c) the company being acquired shall cease to exist.

2. A cross-border merger carried out as laid down in point (b) of Article 2(2) shall, from the date referred to in Article 12, have the following consequences:

(a) all the assets and liabilities of the merging companies shall be transferred to the new company;

(b) the members of the merging companies shall become members of the new company;

(c) the merging companies shall cease to exist.

3. Where, in the case of a cross-border merger of companies covered by this Directive, the laws of the Member States require the completion of special formalities before the transfer of certain assets, rights and obligations by the merging companies becomes effective against third parties, those formalities shall be carried out by the company resulting from the cross-border merger.

4. The rights and obligations of the merging companies arising from contracts of employment or from employment relationships and existing at the date on which the

cross-border merger takes effect shall, by reason of that cross-border merger taking effect, be transferred to the company resulting from the cross-border merger on the date on which the cross-border merger takes effect.

5. No shares in the acquiring company shall be exchanged for shares in the company being acquired held either:

(a) by the acquiring company itself or through a person acting in his or her own name but on its behalf;

(b) by the company being acquired itself or through a person acting in his or her own name but on its behalf.

Article 15

Simplified formalities

1. Where a cross-border merger by acquisition is carried out by a company which holds all the shares and other securities conferring the right to vote at general meetings of the company or companies being acquired:

- Articles 5, points (b), (c) and (e), 8 and 14(1), point (b) shall not apply,

- Article 9(1) shall not apply to the company or companies being acquired.

2. Where a cross-border merger by acquisition is carried out by a company which holds 90 % or more but not all of the shares and other securities conferring the right to vote at general meetings of the company or companies being

acquired, reports by an independent expert or experts and the documents necessary for scrutiny shall be required only to the extent that the national law governing either the acquiring company or the company being acquired so requires.

Article 16

Employee participation

1. Without prejudice to paragraph 2, the company resulting from the cross-border merger shall be subject to the rules in force concerning employee participation, if any, in the Member State where it has its registered office.

2. However, the rules in force concerning employee participation, if any, in the Member State where the company resulting from the cross-border merger has its registered office shall not apply, where at least one of the merging companies has, in the six months before the publication of the draft terms of the cross-border merger as referred to in Article 6, an average number of employees that exceeds 500 and is operating under an employee participation system within the meaning of Article 2(k) of Directive 2001/86/EC, or where the national law applicable to the company resulting from the cross-border merger does not

(a) provide for at least the same level of employee participation as operated in the relevant merging companies, measured by

reference to the proportion of employee representatives amongst the members of the administrative or supervisory organ or their committees or of the management group which covers the profit units of the company, subject to employee representation, or

(b) provide for employees of establishments of the company resulting from the cross-border merger that are situated in other Member States the same entitlement to exercise participation rights as is enjoyed by those employees employed in the Member State where the company resulting from the cross-border merger has its registered office.

3. In the cases referred to in paragraph 2, the participation of employees in the company resulting from the cross-border merger and their involvement in the definition of such rights shall be regulated by the Member States, *mutatis mutandis* and subject to paragraphs 4 to 7 below, in accordance with the principles and procedures laid down in Article 12(2), (3) and (4) of Regulation (EC) No 2157/2001 and the following provisions of Directive 2001/86/EC:

(a) Article 3(1), (2) and (3), (4) first subparagraph, first indent, and second subparagraph, (5) and (7);

(b) Article 4(1), (2), points (a), (g) and (h), and (3);

(c) Article 5;

- (d) Article 6;
- (e) Article 7(1), (2) first subparagraph, point (b), and second subparagraph, and (3). However, for the purposes of this Directive, the percentages required by Article 7(2), first subparagraph, point (b) of Directive 2001/86/EC for the application of the standard rules contained in part 3 of the Annex to that Directive shall be raised from 25 to 33 1/3 %;
- (f) Articles 8, 10 and 12;
- (g) Article 13(4);
- (h) part 3 of the Annex, point (b).

4. When regulating the principles and procedures referred to in paragraph 3, Member States:

- (a) shall confer on the relevant organs of the merging companies the right to choose without any prior negotiation to be directly subject to the standard rules for participation referred to in paragraph 3(h), as laid down by the legislation of the Member State in which the company resulting from the cross-border merger is to have its registered office, and to abide by those rules from the date of registration;
- (b) shall confer on the special negotiating body the right to decide, by a majority of two thirds of its members representing at least two thirds of the employees,

including the votes of members representing employees in at least two different Member States, not to open negotiations or to terminate negotiations already opened and to rely on the rules on participation in force in the Member State where the registered office of the company resulting from the cross-border merger will be situated;

(c) may, in the case where, following prior negotiations, standard rules for participation apply and notwithstanding these rules, determine to limit the proportion of employee representatives in the administrative organ of the company resulting from the cross-border merger. However, if in one of the merging companies employee representatives constituted at least one third of the administrative or supervisory board, the limitation may never result in a lower proportion of employee representatives in the administrative organ than one third.

5. The extension of participation rights to employees of the company resulting from the cross-border merger employed in other Member States, referred to in paragraph 2(b), shall not entail any obligation for Member States which choose to do so to take those employees into account when calculating the size of workforce thresholds giving rise to participation rights under national law.

6. When at least one of the merging companies is operating under an employee participation system and the company resulting from the cross-border merger is to be governed by such a system in accordance with the rules referred to in paragraph 2, that company shall be obliged to take a legal form allowing for the exercise of participation rights.

7. When the company resulting from the cross-border merger is operating under an employee participation system, that company shall be obliged to take measures to ensure that employees' participation rights are protected in the event of subsequent domestic mergers for a period of three years after the cross-border merger has taken effect, by applying *mutatis mutandis* the rules laid down in this Article.

Article 17

Validity

A cross-border merger which has taken effect as provided for in Article 12 may not be declared null and void.

Article 18

Review

Five years after the date laid down in the first paragraph of Article 19, the Commission shall review this Directive in the light of the experience acquired in applying it and, if necessary, propose its amendment.

Article 19

Transposition

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 15 December 2007.

When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.

Article 20

Entry into force

This Directive shall enter into force on the 20th day following its publication in the Official Journal of the European Union.

Article 21

Addressees

This Directive is addressed to the Member States.

Done at Strasbourg, 26 October 2005.

For the European Parliament	For the Council
The President	The President
J. Borrell Fontelles	D. Alexander

Annex C

Draft Regulatory Impact Assessment – March 2007

Implementation of the Cross-Border Mergers Directive

EU Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross border mergers of limited liability companies.

Purpose and intended effect of measure

1. The measure is designed to implement the Cross-Border Mergers Directive (“the Directive”). The Directive lays down, for the first time, a framework of rules within the European Economic Area (EEA) to facilitate cross-border mergers between companies. The UK supported the Directive in Single Market terms. It was adopted on 26 October and published in the Official Journal on 25 November 2005. The Directive must be implemented by 15 December 2007.
2. The present domestic legislative framework does not provide for **cross-border** mergers between UK companies and companies elsewhere in the EEA. The Directive provides an infrastructure for companies looking for such restructuring opportunities. The UK will put in place new legal provisions to provide for cross-border merger opportunities as set out in this Directive. This change will apply to Great Britain and Northern Ireland.

The Objective

3. **This proposal aims to:**
 - a.) Establish a facilitative framework for cross-border mergers to occur between UK companies and companies elsewhere in the EEA where such companies **choose** to merge. It thereby introduces a system for cross-border restructuring that did not exist previously. It is assumed that only companies which consider they would benefit from using such a cross-border merger procedure would choose to participate in it;
 - b.) remove legislative and administrative difficulties that UK limited liability companies encounter when merging cross-border in the EEA; and
 - c.) contribute to the development of the Single Market.

4. **Therefore providing:**

a.) An increase in choice available for companies considering restructuring in the EEA area and, in particular as regards the UK implementing legislation, contributing to the choice of procedures available in the UK. In the long term, this Directive, and the implementing measures under it, could lead to the facilitation of mergers through a simpler and more legally certain legislative framework within the EEA;

b.) A consistent cross-border merger framework throughout the EEA creating a platform through which cross-border mergers may be pursued. As it is understood that the merger procedures laid down by the Directive are more commonly used elsewhere in the EEA than in the UK, UK companies may find this of value as it can reduce legal and administrative uncertainties and the costs associated with these during cross-border restructuring;

c.) Access for UK private and public limited liability companies to clear and transparent procedures with specific rules through which cross-border mergers and restructuring opportunities may be pursued with other EEA companies;

d.) Safeguards for shareholders and creditors affected as a result of any cross-border merger activity. The Directive provides for a competent authority (in the UK, this will be the Court) which has the power to veto the merger unless the necessary steps have been taken;

e.) Safeguards for employee rights following a cross-border merger.

5. **Employee Participation:**

a.) The Directive also covers employee participation rights in certain circumstances. Employee participation is the practice of mandatory representation of employees on the board of companies over a certain size in certain EEA companies – e.g. Germany and Sweden. Participation also covers employees' rights to recommend and/or oppose the appointment of board members (as in the Netherlands). These employee participation provisions will only apply if one or more of the merging companies already has some employee participation or the law of the Member State in which the company resulting from the merger is to be registered provides for such participation rights. The UK presently has no tradition of employee participation rights and will, accordingly, need to make specific provisions for employee participation, as we do not have any UK legislation in this arena.

b.) Where employee participation exists in any of the merging companies, the management have two options. The management can agree to adopt the “standard rules” which contain a default standard of employee participation

and may do this without reference to the employees, and without setting up a Special Negotiating Body (SNB). Alternatively, the companies can agree to set up an SNB with a view to agreeing employee participation arrangements. The management and the SNB can negotiate for up to 6 months to agree the employee participation arrangements (including the board structure) that will exist in the merged company, although this period can be extended by mutual agreement to 12 months. Where no agreement has been reached at the end of the period, the standard rules will apply.

6. **The main features of the Directive:**

a.) The Directive recognises three forms of mergers. These are:

- i.) merger by absorption (an existing company absorbs one or more other merging companies).
- ii.) merger by formation of a new company (two or more companies merge to form a new company); and
- iii.) merger by absorption of a wholly owned subsidiary.

b.) The Directive lays down some standard procedures that need to be followed for every cross-border merger. The main procedures are listed below:

- i.) each of the companies involved is required to circulate the merger proposal, a management report and an independent expert's report to shareholders etc.;
- ii.) approval of the proposal by shareholders;
- iii.) company registries (throughout the EEA) will be required to execute certain functions such as publishing merger particulars in the National Gazette; and
- iv.) merger process to be certified by a competent authority (in the UK, the court).

Background

7. A merger is a form of corporate restructuring involving dissolution of one or all of the participating companies (without liquidation). It is relatively little used within the UK. Due to cultural and structural conditions in the UK economy, corporate restructuring practice has seen greater use of takeovers rather than mergers. Takeovers do not lead to the dissolution of the acquired company, but simply involve the transfer of share ownership. Companies listed on the Stock Exchange in the UK usually have shares which are widely held and

traded, share owners are readily identified and the market operates against practices which facilitate minority shareholders or a board of directors maintaining control against the interests of shareholders generally. Consequently, market forces can determine the outcome of a takeover bid. In addition, there are few constraints on cross-border investment in equities within the EU and investors, both institutional and individual, are free to invest in those countries where they wish. The procedures under the implementing legislation will also apply, however, to small private companies in which capital may be more closely controlled.

8. Part 13 of the Companies Act 1985 (and Part XIV of the Companies (Northern Ireland) Order 1986) governs domestic mergers of public and private companies in the UK. These provisions have been restated by Parts 26 and 27 of the Companies Act 2006. This presents the relevant merger provisions in a more user-friendly and accessible format. Once these provisions are brought into force, they will replace the existing law. These provisions do not, however, lay down a framework for cross-border mergers involving UK companies.

9. It has been sought to quantify the level of merger and acquisition activity in which UK companies have been involved in the absence of a uniform legal cross-border merger framework at the EEA level. It has not been possible to provide specific data on mergers (within the meaning of the Directive) involving UK companies. UK companies have traditionally used 'takeovers' and other methods of reorganisation to restructure with companies both within and outside the UK. The figures in the Appendix provide a general overview of merger and acquisition activity by UK companies (both domestically, with other EEA companies and with companies in "third countries" (outside the EEA)).

Economic Rationale and Context

10. Traditional economics and finance literature on the issue of corporate governance views the "firm" as an economic profit-maximising entity where managers maximise value for shareholders. Rational (in the economic sense) risk-neutral shareholders (principals) rely on risk-averse managers (agents) to maximise shareholder value. This separation of ownership and control can give rise to a principal-agent problem, which becomes the reason for being of corporate governance. Principals need to effectively monitor and to some extent control their agents to ensure that managers are acting in the best interests of the company's owners and that the scope for moral hazard¹ is minimised. In doing so principals incur agency costs related to efforts they make by which agents can be monitored and influenced in the interests of owners.

¹ Moral hazard – the perverse incentive whereby agents are not held responsible for their actions which encourages them to engage in risky behaviour

11. In addition to these internal mechanisms to align interests between principals and agents, the managers of companies are also subject to the discipline of two external mechanisms. Firstly, efficient markets can assist in ensuring managers behave appropriately to use scarce resources efficiently and maximise shareholder value. For example if managers underperform, shareholders, by selling their shares send a signal, through lower share prices, about the quality of this company's management and prospects. Secondly, incumbent managers faced with the credible threat of take-over or merger would endeavour to deliver value to shareholders; otherwise these underperforming managers would be required to change or be replaced by more allocative efficient agents.

12. Evidence does suggest that companies with a low quality of governance and weaker protection of shareholder rights can improve their value if they merge or are taken over by companies with better governance and stronger shareholder rights. Similarly, and in recognition of the commercial reality associated with merger and takeover activity, companies with weaker governance and lower shareholder protection do merge and take over companies with stronger governance and shareholder protection, without an adverse affect on the value of the target company².

13. To understand the challenge involved with assessing the costs and benefits related to implementation of the Directive, it is useful to understand the history of merger and acquisition activity and the factors that drive corporate restructuring. In UK, mergers as defined by the Directive are almost non-existent and takeovers are the more common form of restructuring. Given that UK welcomes globalisation (and that most UK restructuring activity occurs between UK and non-EU entities by volume), it is essential to view merger and acquisition activity from a global perspective. Equally important is the need to understand that merger and acquisition activity is heterogeneous and that every restructuring is different and so there is no typical event that can be used to reflect the entire range of activity. Similarly merger and acquisition activity is driven by a variety of reasons that often rely on commercial and strategic motives and not always economic ones.

Evidence

14. Based on work by Martynova and Renneboog³ the history of merger and acquisition is characterised by waves. The authors have identified five major merger and acquisition waves, the earliest covering the period from 1890s, and the 1910s – 1920s; to the current wave which the authors state began in the middle of 2003. Each wave does have its own set of underlying drivers although they do share the following features -

² Bris, Arturo and Cabolis, Christos, "Corporate Governance Convergence by Contract: Evidence from Cross-Border Mergers" (September 2002). Yale ICF Working Paper No. 02-32. Available at SSRN: <<http://ssrn.com/abstract=321101>>

³ Martynova, Marina and Renneboog, Luc, "The History of M&A Activity Around the World: A Survey of Literature". ECGI – Finance Working Paper No. 97/2005 Available at SSRN: <http://ssrn.com/abstract=820984>

- a.) Merger and acquisition waves occur in a period of economic recovery;
- b.) Merger and acquisition waves coincide with rising stock markets and credit expansion. All waves end with the collapse of stock markets;
- c.) Waves are preceded by various types of economic, political, industrial and other shocks (e.g. oil prices); and
- d.) Waves also occur in periods of regulatory change e.g. anti-trust.

15. Takeover activity and merger and acquisition activity cannot be explained by a single theory and this has resulted in three main approaches to explain corporate restructuring

a.) *Neoclassical* – merger and acquisition waves arise as a result of rational economic factors that motivate many firms to restructure.

b.) *Hubris, herding and agency problem models* – this set of literature presents the view that merger and acquisition waves arise as a result of irrational managerial decision-making or managerial self-dealing. This literature concludes that a significant proportion of merger and acquisition destroys value⁴.

c.) *Market timing models* - This approach proposes that managers of overvalued companies exploit this to use their shares as cheap currency to takeover the companies that are less overvalued. An alternative approach within the same category of models is that during booming financial markets, when the uncertainty of the true value is more pronounced, better informed bidders can exploit their informational advantage over less informed targets.

16. The evidence that merger and acquisition activity occurs in waves and why they do so further demonstrates how challenging it would be to anticipate the next wave and where we are in any current wave. From an impact assessment perspective, it makes it even more challenging to estimate what proportion of mergers in the future will exercise the restructuring option provided by the Directive.

17. Before presenting the high level findings from the empirical evidence relating to merger and acquisition activity, it is useful to understand the challenges and caveats inherent in such studies. The results from such studies are influenced by a variety of factors and need to be interpreted within the context associated with caveats for the methods used to evaluate the economic impact of merger and acquisition activity. In addition, given the large body of empirical work in this area it would be inappropriate to aggregate these studies to provide a high level indicator about the contribution of merger

⁴ Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave SARA B. MOELLER, FREDERIK P. SCHLINGEMANN, and RENÉ M STULZ* The Journal of Finance Volume 60 Page 757 – April 2005 doi: 10.1111/j.1540-6261.2005.00745.x Volume 60 Issue 2.

and acquisition activity to economic efficiency. For example, there are likely to be differences between the time periods chosen for each, and the methods used. Studies that use share prices metrics have results that differ from those studies using accounting metrics.

18. It is important to note that Martynova and Renneboog (MR) highlight the caveats associated with the methods that are used and that these may also have a bearing on the results.

Studies using share prices

19. In the short-term, announcement of merger and acquisitions favours the target's shareholders, although the magnitude of the net gains will be deal specific and related to the manner by which the transaction is financed. Deals funded by equity compare less favourably with those funded by cash. However over the longer-term (five years after the restructuring event), the evidence indicates a marked decline in the acquiror's share prices.

Operating Performance

20. Here too, the choice of method chosen can influence the results and conclusions of studies. MR state that when earnings are used as a profitability metric, 14 of the 25 studies they cite show a decline in post-merger profitability, 6 papers show insignificant changes in firm profitability and 5 papers show evidence of a significant increase in profitability.

21. Studies that use cash flow based metrics demonstrate that post merger gains do arise. The results vary depending on which merger wave is being examined as well as which geographic regions are being analysed. However in relation to studies related to the fourth merger and acquisition wave there does appear to be greater consistency in the results across regions. In these studies, there were no significant changes in the growth rate of these companies following the event and this was shared by merger and acquisition activity in U.S, Europe and Japan.

Merger and acquisition activity in Europe

22. Insights into the impacts of merger and acquisition activity in Europe can be provided from a paper by Martynova and Renneboog⁵. The paper focuses on a shorter period of 1993-2001 and uses share prices as the metric of choice. It should also be noted that the period chosen also includes the most recent stock market bubble.

23. It is noticeable that although the volume of intra-EU deals in this period picked up sharply during the 1990s compared to the middle of 1980s; the total volume of deals peaked at about 10,000 in 2000 compared to 2,000 in 1990. The value of these deals increased markedly between 1998-2001. 1999 saw

⁵ Martynova, Marina and Renneboog, Luc, "Mergers and Acquisitions in Europe" (January 2006). ECGI – Finance Working Paper No. 114/2006 Available at SSRN: <http://ssrn.com/abstract=880379>

the peak in the value of deals which reached \$1,200 billion compared to about \$200 billion in 1990.

24. The majority of merger and acquisition deals in Europe were expected to result in efficiency gains and this was reflected in the share prices once the announcement was made. The bulk of the gains were enjoyed by the shareholders of target firms. Similar to the global analysis, all-cash offers generated higher short-term returns than equity financed offers. Equity financed deals experienced larger declines in the bidders' share price in the three months following the event than those funded by cash.

25. Target shareholders enjoyed higher wealth effects from domestic merger and acquisitions compared to cross-border mergers and acquisitions although these impacts also depended upon the level of stock market development, corporate governance regulation and the legal origin. For example, target shareholders in companies of French, German and EU accession legal origins earn the lowest abnormal returns on announcement while targets of UK and Scandinavian legal origin earn the highest.

26. Like the study by Moeller et al (2005) of U.S merger and acquisition activity, many mergers and acquisitions undertaken in Europe destroyed bidders' value. This supports the view that merger and acquisition waves tend to pass their "optimal stopping point." Furthermore the prominence of unprofitable mergers and acquisitions at the latter stages of the merger and acquisition wave are likely to be attributed to limited information processing by agents, managerial self-interest and hubris.

Risk assessment

27. The Directive puts in place a framework enabling cross-border merger activity across the EEA. It thus addresses risks created in the absence of such a structure through the existence of barriers to increased corporate restructuring activity in the EEA. Additionally, should the UK fail to implement this Directive by 15 December 2007, the UK could face infraction proceedings from the Commission or, equally, challenges may arise from UK companies seeking to merge with companies in other EEA countries.

Options

28. The present domestic legislative framework does not provide a mechanism for UK companies to carry out cross-border mergers with companies elsewhere in the EEA. Through implementation of this Directive, therefore, a further choice will be provided for companies wishing to restructure cross-border.

29. Option 1: Do nothing:

- There will be no benefits by not implementing the Directive. A status quo would be maintained whereby UK companies would not

have to consider or evaluate using an alternative option (“mergers”) when restructuring cross-border.

- This is not a realistic option. By not implementing the Directive, the Government could face infraction proceedings before the European Court of Justice since, under Community law, the provisions of the Directive have to be implemented by rules that have legally binding effect.

30. **Option 2: Voluntary Code of practice:**

- It might be possible to work with appropriate organisations to establish and apply a voluntary code of practice or self-regulation for cross-border mergers. This would require intensive time from the stakeholders involved in developing something of this order and would also create considerable legal uncertainties. Ultimately it would not be possible to enforce a voluntary code.
- This could also raise further issues such as funding, control and liability of the body setting up such voluntary codes.
- Furthermore, it would not be proper implementation as the UK is obliged to deliver appropriate legally enforceable measures in the UK. This option, therefore, only offers limited benefit in terms of additional certainty when compared with Option 1 above (Do Nothing).

31. **Option 3: Implementation of the Directive in UK by legislative provision:**

- The Directive could be implemented in the UK via secondary legislation through regulations made under section 2(2) of the European Communities Act 1972 for both company law and employee participation aspects. Through implementation of this Directive in the UK, a framework of rules will be laid down that facilitate cross-border mergers involving UK companies and companies elsewhere in the EEA.
- By implementing this Directive, UK companies will have an alternative choice for restructuring, thereby increasing their competitiveness and enhancing innovation by embracing new practices and ideas.

Summary of options

32. Only option 3 is further considered. Options 1 and 2 would not give legal effect to the Directive. The costs and benefits associated with option 3 are further described below. It would be reasonable to assume that, in the event that a company chooses to merge via this framework, the resulting benefits would outweigh the costs incurred e.g. costs of initial research and subsequent legal and commercial costs (including any costs of setting up employee participation structures).

Scope/Business Sectors Affected

33. The Directive provides for cross-border mergers involving “limited liability companies”. In the UK, the implementing legislation will apply to the following types of entity (approximately 2.3 million in total): -

<u>Type of Company</u>	<u>Numbers</u> ⁶
Public and private limited companies – These companies that are limited by shares or guarantee and are incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986. This includes most UK registered companies.	2.3million
Unregistered Companies – For the purposes of certainty and for implementing purposes, it is intended to rely upon definition of unregistered company contained at section 718 of the Companies Act 1985 (or Article 667 of the Companies (Northern Ireland) Order 1986).	1000 Not known as not required to register but not expected to exceed the above figure
Unlimited companies - There are a small number of unlimited companies in the UK registered under the relevant companies legislation. It is intended that such companies would also be included in the implementing legislation.	5,750

Potential `Take Up' of this Directive:

34. In our discussion with representatives of UK companies, we have not received a significant expression of preference to use the cross-border merger facility for restructuring purposes in the future. UK businesses view this as an alternative secondary option through which restructuring may be explored but not their preferred route.

35. As presented in the Economic Rationale section of the RIA, forecasting future mergers and acquisition (M&A) activity with any degree of

⁶ Data Source for these figures: Companies House

confidence is very challenging. Therefore, it is even more difficult to estimate take-up of the Cross-Border Mergers Directive by UK companies. The degree of difficulty is demonstrated by the volume of M&A activity between 1985 and 2006; during which period, there were a total of 3,223 UK - EEA M&A deals, which ranged from a minimum of 12 in 1985, to 360 during the peak period of 2000 and 182 in 2006. (Data Source: Thomson Financial). In percentage terms, these UK-EEA deals accounted for 8.1% in 1985, 10.5% in 2000 and 8.45% in 2006 of the overall annual M&A activity in the UK.

36. Therefore we anticipate take-up to be very low, probably representing only a fraction of 1% of all companies in the UK. The consultation document specifically seeks views on the likely take up of the cross-border merger procedure.

Table 1: Evaluation of Option 3

<u>Option 3 – Implementation of the Directive in UK through Regulations made under Section 2(2) of the European Communities Act 1972</u>	
Costs	Benefits
<p><u>Policy Costs</u></p> <p>This implementing legislation affects private and public companies with limited liability. However, there is no direct cost impact on these companies. The Directive simply provides a framework should companies choose to merge cross-border. Therefore, companies do not have to use this route for restructuring should they not wish to.</p> <p>By implementing the Directive, some one-off costs will be incurred as a result of training or familiarisation workshops being required to train staff on this framework. Companies would not generally have to train their staff on an ongoing basis or invest in new equipment but it would be necessary for staff in relevant companies to understand the systems and processes that are required to be followed. These costs will apply across the board to all companies – small, medium and large - that wish to use this route to enter into a cross-border merger with another EEA company.</p> <p>The principal costs incurred by a company where there would not be any benefits would be in a case where a company investigated the possibility of a cross-border merger, but ultimately decided against such a proposal. There would appear to be three stages (cost estimates are set out against each, although these would vary considerably dependent on the circumstances and the size and type of the company concerned): -</p> <p>a.) A senior employee would consider whether there was a case for a cross-border merger to take place. The cost of</p>	<p><u>Policy Benefits</u></p> <p>The Directive offers companies a new and additional choice in cross-border restructuring exercises.</p> <p>Reduces legal uncertainties about merging cross-border. Lays down a framework of rules that aim to remove administrative and financial burdens and various other obstacles to such mergers caused by national laws.</p> <p>Offers shareholders and creditors protection and provides for companies a clearer understanding of what is required in terms of procedures and the costs involved.</p> <p>Opportunities afforded to restructure under the legislation implementing the Directive will be open to a very wide range of corporate entities, covering all sectors of the economy and sizes of company.</p> <p>Restructuring activity brings opportunities to embrace innovation and creativity; both contribute to building competitive companies and a more dynamic economy.</p>

a manager spending two days (16 hours) considering whether there was a case for a cross-border merger is estimated to be £430⁷.

b.) The question of whether or not to enter into a cross-border merger would be put to the board of the company. A company board of 12 members considering the issue for two hours would represent a further 24 hours of costs with an estimated total cost of £650.

c.) Legal advice would be sought. The cost of such legal advice would clearly vary on a case by case basis and be determined, at least initially, on the type and extent of the advice sought by the company. The cost of a senior solicitor in the City of London, spending one day (eight hours) considering whether a company might benefit from entering into a cross-border merger transaction is estimated to be an average of £3,000-£5,000⁸.

The main cost elements a company would face where it decided to proceed with a cross-border merger proposal under the implementing legislation are described in the steps set out below (most of these costs are already required in the current UK domestic merger regime).

a.) Professional advice to be sought (and to deal with application to court for approval of the merger proposal). The cost of fees paid to financial advisors for mergers/takeovers on average amount to 0.01% per merger deal but given that the size of mergers can be so varied, these fees can range from a minimum of 0.001% of the deal to 0.03% of the deal. (Source: Thomson Financial);

b.) Expert's report to be prepared (this is the principal additional cost for private companies when compared with the domestic merger regime where such a report is only necessary for domestic mergers involving public companies).

⁷ Data Source: Annual Survey of Hours and Earnings (ASHE) 2006.

⁸ Information obtained from Martin Mankabady, Lawrence Graham, member of the QCA Legal Committee.

The approximate cost for an independent experts report may be between £50,000 - £100,000 for a valuation report. Costs may increase for determining a 'fair value' report.

c.) Meeting of company members held to consider proposal; and

d.) Approval of merger by UK court (and or cross-border aspects by relevant EEA authority).

Administrative Burdens

The majority of the administrative cost would be classed as Business as Usual activities and so we consider that this only imposes a nominal additional administrative burden, requiring as it does provision of basic information or documents by merging companies to the Registrar of Companies (such as copies of any cross-border merger proposal made and of court orders in relation to any such proposal).

Comparison of costs with domestic merger procedure

The merger procedures under the Directive and the implementing legislation closely follow those in relation to domestic mergers. The differences in terms of costs are as follows:-

a.) An expert's report must be prepared for cross-border mergers involving private companies (such reports are only required for domestic mergers which involve a public company).

b.) Further additional costs associated with a cross-border merger compared to a domestic merger are considered to be nominal. They principally relate to obtaining the final ratification for the cross-border merger once it has been approved in each of the Member States of the companies involved and notification of, or by, the respective company registries concerned.

Administrative benefits

There are considered to be no administrative benefits.

Employee Participation	
-------------------------------	--

Employee participation provisions of the Directive will apply in certain circumstances. Further detail on these and the costs and benefits associated with them are set out in the Employee Participation overview starting at Paragraph 37.	
--	--

Table 2: Costs Of Implementing This Policy:

The cost of implementing this policy will be in the region of £110,000.	
---	--

Employee Participation – An overview

37. There may also be additional costs involved with the employee participation⁹ aspects of the Directive. The general presumption is that the employee participation provisions will be those which exist in the Member State where the merged company will have its registered office. However, this presumption will not apply in two circumstances:

- a.) Where at least one of the merging companies has more than 500 employees and is operating under an employee participation system; or
- b.) Where the Member State law does not provide for at least the same level of employee participation as measured by reference to the proportion of employee representatives amongst the members of the administrative or supervisory organ of the merging company subject to employee participation.

38. Should either of the two circumstances above apply, the respective management of the merging companies will have two options.

- a.) Firstly, they can choose to adopt, without reference to their employees, the standard or fallback rules which are contained in the Directive and which impose minimum standards of employee participation; or
- b.) Secondly, they will need to negotiate with an employee representative body known as the Special Negotiation Body (SNB) to resolve how employee participation arrangements should be dealt with in the newly formed or acquiring company. After negotiation, there may be additional costs in relation to employee participation at board level (see discussion below).

39. The cost implications of employee participation were dealt with in the context of the implementation of the European Company Statute¹⁰. The employee participation provisions contained in Article 16 of the Cross-border Mergers Directive are broadly based on those contained in ECS Directive. The examples set out below follow those used in the Regulatory Impact Assessment for the ECS although that assessment referred to provisions for informing and consulting employees, as well as participation. Costs have been adjusted to take into account latest available data and information. The Cross-border Mergers Directive does not include any rules on information and consultation, which are already covered by other legislation. Full details of the costs relating to the ECS Directive can be found in the Regulatory Impact

⁹ “Participation” means the influence of the body representative of the employees and/or the employees’ representatives in the affairs of a company by way of:

- The right to elect or appoint members of the company’s supervisory or administrative organ; or
- The right to recommend and/or oppose the appointment of some or all of the members of the company’s supervisory or administrative organ.

¹⁰ Council Directive 2001/86/EC supplementing the Statute for the European Company with regard to the involvement of employees

Assessment that was included in the European Company Statute consultation document published in October 2003 by the Department of Trade and Industry¹¹.

Employee participation costs

40. In the event that companies decided to use the cross-border merger procedure, it is likely that, where applicable, the principal additional costs would come from any employee participation arrangements. However, the voluntary nature of cross-border merging, as well as the many different circumstances of the companies involved, make it very difficult to come up with an estimate of the overall costs. It must be stressed that the employee participation provisions would only apply where one of the merging companies already had existing participation arrangements.

41. There are a variety of approaches amongst Member States to employee participation issues. Some Member States do not impose mandatory employee participation provisions (such as Italy, Ireland and the UK). In Member States that do have statutory participation rights, the application of such provisions is, in general, either limited to certain types of company and/or only applies where the number of employees reaches a particular threshold (for example, employee participation rules apply in German companies if there are more than 500 employees). Employee participation provisions will only apply where participation already existed in one of the merging companies, the costs associated with the employee participation provisions may only apply in a minority of cross-border merger transactions¹².

42. Some illustrative costs are set out below, based on two companies of a similar size that intend to merge and register as a UK company. In this example, one is a UK company with no employee participation and the other is based in another EU country and is subject to participation. Costs may be higher if there are more than two companies involved. The examples used below assume that there are no subsidiaries and the employees of each company are located in each of their two respective Member States. The example also assumes that the respective management of the merging companies have not taken up the option to adopt the Standard Rules without reference to the SNB. Specific provisions from the ECS Directive are applied directly to Article 16 of the cross-border mergers directive and are referred to in the directive, and in the examples below, as provisions of the ECS Directive.

43. For the purpose of agreeing the arrangements for employee participation that will apply to the merged company, a Special Negotiating Body (SNB), made up of employee representatives from the merging companies and any “concerned” subsidiaries, must be established. Any expenses relating to the

¹¹ (“Implementation of the European Company Statute: The European Public Limited-Liability Company Regulations” URN 03/1279).

¹² See SEEurope for more information on employee participation rules in the EU25 Member States <http://www.seeurope-network.org/homepages/seeurope/countries/cross-borderaspects.html>

functioning of the SNB, and to the negotiations in general, must be borne by the merging companies (this may include the cost of up to one “expert” to assist the SNB). The SNB and management have 6 months, extendable to 12 months, in which to reach a voluntary agreement on employee participation (pursuant to Article 4 of the ECS Directive). There are two possible outcomes:

- i) the SNB and the management draw up a voluntary agreement for employee participation, under Article 4 of the ECS Directive; or
- ii) no voluntary agreement is reached by the end of the negotiating period but the merging companies still wish to merge. In such a case, the standard “fallback” rules of the Member State in which the merged organisation wishes to register¹³ will apply, provided that at least 25% of the employees of the merging companies had participation rights.

Costs related to employee participation

44. The principal costs associated with employee participation relate to:

- a.) Ballots to elect SNB members
- b.) SNB meetings
- c.) Participation at board level.

45. Each of these costs is discussed in turn and are summarised further below in Table 3.

a.) Ballots to elect SNB members and number of SNB representatives.

46. A ballot should be conducted to elect SNB representatives for the UK employees. Separate ballots may need to be conducted in each Member State where the participating companies or subsidiaries have employees although this will not always be the case. In some Member States (such as Germany), existing works council members may simply be appointed as SNB members and no ballots would be held.

47. The cost of conducting a ballot to elect the UK SNB members is estimated to be around £14,855¹⁴. There would be no additional balloting cost in the other Member States where the works council is used to nominate its SNB members.

48. The rules for the composition of the Special Negotiating Body (SNB) depend on a variety of factors including the number of merging companies or “concerned” subsidiaries and in how many Member States the employees are

¹³ Contained in Part 3 of the Annex to the ECS Directive.

¹⁴ This is the cost for a ballot in GB only. For full details of a breakdown of this figure, see the annex of “Implementation of the Regulations on European Works Councils – Regulatory Impact Assessment”. Source: <http://www.dti.gov.uk/er/emp-ria.pdf>. Costs have been updated to 2007 prices]

located and in what proportion etc. The method of determining the number of SNB members in the Directive implies that there will always be a minimum of 10 SNB members and currently, with the 30 countries of the EEA covered by the Directive on employee involvement, an absolute maximum of 39.

b.) Costs of a special negotiating body meeting

49. Assuming that the merging companies have a total of 50,000 employees, an SNB might have 10 employee representatives and 6 management representatives. The costs of this meeting would include the opportunity cost of the workers' and employers' time, travel costs, the cost of the venue and interpreter costs. It is estimated that the costs for one meeting would be about £24,700¹⁵.

Illustrative costs

50. UK companies will only need to enter into negotiations for employee participation arrangements if they intend to merge with a company that is subject to employee participation and then register in a Member State that does not impose statutory participation rules. For example, where a UK company merges with a Swedish company that has employee participation and intends to register in UK. As mentioned, there are two possible outcomes - either a negotiated agreement or, where negotiations fail, the application of the standard rules (which extend the highest level of participation that existed in any of the merging companies to all of the merged company) provided that the relevant conditions are met.

51. Where negotiations are relatively straightforward, only two SNB meetings may be necessary for the representatives to agree employee participation arrangements for the merged company. This would cost about £49,400.

52. Where it takes 4 SNB meetings to come to a voluntary agreement on employee participation, there would be a cost of £98,800.

¹⁵ Rounded to the nearest £100. The cost of worker time is taken to be £132 per day and the cost of management time is £224. This has been estimated in 2007 prices and is based on earnings information multiplied by 1.3 to take into account non-wage costs. Source: Table 2.5a, Hourly pay – Gross (£) – For all employee jobs: United Kingdom, 2006 Annual Survey on Hours and Earnings (ASHE) 2006 http://www.statistics.gov.uk/downloads/theme_labour/ASHE_2006/2006_occupation.pdf. It is assumed that each worker and each manager needs to dedicate two days per meeting. It is estimated that travel will cost £10,769, interpretation £5,384 and the venue £3,231. This is based on the findings of the study by T Weber, P Foster and K Levent Egriboz entitled “Costs and Benefits of European Works Councils Directive” Employment Relations Research Series No 9 <http://www.dti.gov.uk/er/emar/camp.pdf>. The original costs from this study have been updated to 2007 prices. It is assumed that the costs are evenly distributed between the companies (ie in the two company example, the GB company would therefore pay half of this cost).

53. It is assumed that failure to reach a voluntary agreement is time consuming and could take 6 to 8 SNB meetings, with a cost of about £148,200 to £197,600¹⁶.

c) Participation at board level

54. If one of the merging companies already has worker participation on a company board, there will need to be at least the same level of participation on the new company board (unless the SNB take a two-thirds majority decision to reduce, or even abolish, employee participation in the new company). Since there is no tradition of employee participation in the UK, the possible costs involved have been estimated using the German model as an example.

55. The maximum percentage of representatives is likely to be 50% of the board as this is the maximum that applies in Germany; it is doubtful that this percentage would be exceeded. In this example it is assumed that there are two worker representatives on the board of the company in the non-UK company and that the SNB decides that there should be four - two from each country. This would mean an extra two worker representatives attending maybe 12 meetings per year, which take up one day of each representative's time. The cost of travel has been included, but not interpreter and venue costs (since these costs will already have been included). It is estimated that this will cost about £15,000 per year.

56. In Germany, a proportion of the employee representatives on the boards of companies may be full time union representatives who are paid by the company for this purpose. If this model were followed for the boards of companies that participate in a cross-border merger, there would be no opportunity costs to companies of employee time for these representatives.

57. It is sometimes argued that worker participation on boards can slow down decision-making and hence reduce companies' competitive edge. However, evidence from Japanese companies with works councils in Germany does not show this to be the case. Accordingly, no costs have been factored in for longer decision-making processes.

58. A summary of the costs associated with employee participation are presented in table 3 below. Total costs are based on estimated volume of EEA-wide merger activity involving UK organisations and adjusted according to the presence of existing employee participation rules in the merger organisation country.

¹⁶ Figures have been rounded to nearest £100.

Table 3: Summary of Costs of Employee Participation

	Unit Cost per merger
Ballot to elect SNB members	£14,855
SNB Meetings	£49,400 - £197,600
Participation at board level	£15,000
Total Cost	

Cost Of Compliance

59. Once the employee participation arrangements have been put into place, compliance follow similar rules and procedures to those set out in other employee involvement legislation such as the European Company Statute Regulations and the existing Transnational Information and Consultation of Employees (TICE) Regulations, which implement the European Works Council Directive. There will therefore be costs to employers if a complaint is brought before the Central Arbitration Committee (CAC) or an Employment Tribunal (or in Northern Ireland, the Industrial Court or an Industrial Tribunal).

60. The average cost of administering the CAC's jurisdictions was £5,800 per case in 2005-06¹⁷. The average cost of appearing at an Employment Tribunal are £4,900 for the employer and £910 for the Employment Tribunal Service (ETS)¹⁸. These estimates also include amount awarded if claimant is successful.

Other Costs

61. **Charities and voluntary sector** – Charities and voluntary sector organisations are also registered in the UK as companies captured by the scope of the implementing legislation. They will be affected in the same way as other types of company detailed in Table 1. It is assumed that charities or the voluntary sector would not enter into any arrangements to merge cross-border, unless it was considered to be of material benefit to them.

62. **Costs on Society and the environment** - Implementation of the Directive would appear not to impose any environmental or social costs.

63. **Unintended consequences** - As there has historically been little use domestically of the types of merger procedures laid down by the Directive and the implementing legislation, it is difficult to analyse the possible unintended consequences that may be faced as a result of implementation of this Directive. Over time, it may be UK companies do begin to merge cross-border

¹⁷ http://www.cac.gov.uk/cac_2_annual_report/Reports/FinalCACAnnualReport2005-2006.pdf

¹⁸ DTI Employment Relations Research Series No.33: 'Findings from the Survey of Employment Tribunal Applications 2003', <http://www.dti.gov.uk/files/file11455.pdf>

using this facility. It is assumed that UK companies will only seek to avail themselves of the merger procedures under the Directive when they see clear benefits in doing so. They will not, therefore, be exposed to new risks in terms of restructuring procedures that they are obliged to follow.

64. Possible unintended consequences identified are as follows: -

- It is believed that a key concern that arises in considering possible restructuring opportunities is the question of the potential tax consequences, benefits or disadvantages. This issue is not being addressed by this implementing legislation. HM Treasury are in the process of implementing provisions of the Tax Mergers Directive. HM Treasury intends that the necessary amendments to tax legislation will be made via secondary legislation through the insertion of a power enabling it to do so in Finance Bill 2007;
- Suppliers and other creditors may be providing goods/services to a UK company, which then merges cross-border. They may then find themselves a creditor of a company registered elsewhere in the EEA. Creditors will face initial uncertainties in such situations. The proposed implementing legislation provides an important safeguard in that it requires final approval of any cross-border merger by the Court;
- It is possible that suppliers of UK companies may be affected by the newly formed companies resulting from the cross-border merger looking to re-appoint suppliers from their original territories or hire new suppliers. This is considered to be a fairly small risk and one that suppliers face even now during UK companies' cross-border restructuring.
- The implementing legislation does not provide for mergers between UK companies and companies in "third countries" (i.e. non-EEA countries) as such mergers do not fall within the scope of the Directive. Between 1 January 1991 and end December 2006, UK companies entered into over 3000 mergers and acquisitions transactions with EEA companies and just over 7000 such transactions with companies outside the EEA (see figures in the Appendix, table D).
- In the light of this level of restructuring activity involving UK and third country companies, the legislation implementing the Directive could create an imbalance in terms of the options available to companies in third countries seeking to restructure with UK companies compared with companies elsewhere in the EEA seeking to undertake similar restructuring activity. However, as the present available restructuring mechanisms do not appear to have prevented non-EEA companies from entering into restructuring transactions with UK companies, it is considered that the extent to which this will result in a real distortion in restructuring transactions between third country and other EEA companies with UK companies will be limited.

Issues Of Equity And Fairness

65. In working to facilitate the Single Market, the Directive applies to all sizes of companies and sectors throughout the EEA. The implementing legislation is similarly extended.

66. However, it is necessary to consider whether, in implementing this Directive, an invisible barrier is being raised against mergers between UK companies and companies in third countries (such as USA or in Asia). It might be the case that companies in such countries that regularly explore merger opportunities with UK companies will be disadvantaged by the lack of a similar merger framework to facilitate cross-border company restructuring involving non-EEA companies. However, as noted above, the absence of such a merger facility does not presently seem to inhibit restructuring activity involving UK companies and non-EEA companies.

Distributional Impacts

67. The distributional impact of any particular cross-border merger transaction will differ greatly depending on the circumstances of the transaction involved. The implementing legislation applies across all business sectors and a wide variety of different types of companies. The implementing legislation similarly applies to all sizes of company. Factors that will affect the distributional impact of the legislation have been identified as follows:-

- Nationality of the companies involved and the final place of registration of the merged company. A number of possible distributional impacts arise from this, covering matters as diverse as fees paid to advisors dependent on the legal and business infrastructures concerned to possible change of suppliers and market shares;
- The motivation behind the merger proposal. For instance, the merger may be merely seeking to take advantage of a more flexible corporate form available in another Member State without substantive restructuring of the underlying business. Alternatively, the aim of the merger may be to achieve wider synergies, through consolidation of manufacturing or management functions in one location; and
- Impacts on employment levels. Jobs, and income of the employees affected, may be lost if a merger is designed to, for instance, reduce duplication of administrative or manufacturing staff. Equally, a merger may protect jobs, such as when it strengthens the viability of the business of the merging companies as part of a rescue package.

68. As part of the safeguards required by the Directive and provided by the implementing legislation, the management of the merging companies is required to produce a report intended for the shareholders explaining and justifying the legal and economic aspects of the cross-border merger for members, creditors and employees.

CONSULTATION WITH SMALL BUSINESS

THE SMALL FIRMS' IMPACT TEST

69. The implementing legislation applies to small business as it includes both public and private limited liability companies. The legislation imposes no size barrier on those companies which may avail themselves of the merger procedures prescribed under it. Consequently, the legislation would affect small UK companies that wish to enter into cross-border mergers with a company in another EEA State. Similarly, there is no restriction on the size of company that a small company may merge with (it may, for instance, merge with another small company or a large listed company). It is, therefore, impossible to quantify the impact of the Directive on small companies alone. It is important to view such impact in the overall context of implementation of the Directive.

70. No costs will be imposed on any small company. It would be reasonable to assume that, in the event that a small company chooses, voluntarily, to merge via this framework, the resulting benefits would outweigh the costs incurred (e.g. costs of initial research and the preparation of an independent expert's report and any costs involved in addressing employee participation provisions).

71. The principal additional cost for private limited liability companies wishing to use the cross-border merger procedure would be the requirement that an independent expert's report be prepared. We understand that there are variations in the form of reports available. We do not have a specific cost for such reports yet but we understand that reports providing valuation may cost in the region of £50,000 - £100,000 and that further costs may be associated when determining 'fair value' reports. These reports are not required for domestic merger procedures involving private companies.

Summary Of Discussions With Small Business:

72. We have had discussions with representatives of small business. The key message we have received was that small businesses in UK do not frequently engage in cross-border restructuring activity and hence are expected to have little interest in the merger framework laid down by this Directive.

Competition Assessment

73. The competition filter has been applied. It has been concluded that the implementing legislation has a potential effect on all UK companies, all market sectors and that the distribution of market shares within those sectors could be affected by the new procedure if companies choose to use it. It is considered that the implementing legislation will not give rise to disproportionate costs of entry or administrative costs for either small or large

business. As the merger procedure provided for by the Directive is voluntary, it is assumed that only companies which perceive real business advantage will elect to use the procedures. The implementing legislation is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.

74. The implementing legislation will affect all markets since the companies that may participate in a cross-border merger are not restricted to any particular sector. This will not impose additional costs – either set-up or ongoing – on any companies nor restrict the ability of companies to choose the price, quality, range or location of their products. It is anticipated that the legislation will not affect competition, either positively or negatively. It is possible that the legislation will have an effect on market structure since the companies formed by cross-border merger could (but not necessarily would) lead to a smaller number of companies registered in the United Kingdom.

Enforcement And Sanctions

75. As regards the merger procedure provisions of the implementing legislation, ultimately decisions as to whether or not to proceed with a cross-border merger proposal, irrespective of the size or type of company involved, will be for shareholders (a 75% majority in each class being required for a proposal to proceed). This is a key element of the enforcement process. Shareholders not satisfied that the cross-border merger proposal is in the best interests of the company can vote against it. Additionally, there is a specific requirement for an independent expert's report to be prepared in respect of each merger proposal. An independent expert in the UK must be a qualified auditor.

76. A cross-border merger cannot be concluded until the Court approves the merger. The Court will issue an order certifying that the pre-merger acts and formalities have been properly completed.

77. A small number of new criminal penalties have been included to replicate penalties under the domestic merger provisions (such as in relation to the duty upon companies and their officers to file copies of any court order sanctioning a merger with the Registrar of Companies). These offences will be enforced by the Department of Trade and Industry (or the Department of Enterprise, Trade and Investment for Northern Ireland).

Monitoring And Review

78. The Department will keep the cross-border merger implementing legislation under review. Additionally, a review by the EU Commission of the Directive must be undertaken by December 2012. If, in the light of experience, it proves necessary to amend the domestic legislation, this could be done by making further regulations under section 2(2) of the European Communities

Act 1972. The consultation exercise will give interested parties the opportunity to comment on the draft legislation.

Consultation

79. Within government – Before issuing the present consultation document, DTI consultation within Government included Department for Constitutional Affairs, HM Treasury, Her Majesty's Revenue and Customs, the Department of Trade and Investment (Northern Ireland) and Department for Employment and Learning (Northern Ireland) as well as Companies House and the Small Business Service.

80. Public consultation - In June 2004, a public consultation was published by the DTI on the original Commission proposal for a Cross-Border Mergers Directive. The Government formally responded to consultees' comments on the document in November 2004 and issued a summary of responses. Both of these documents are available on the DTI website at:

<http://www.dti.gov.uk/bbf/eu-company-law/directives/page19528.html>.

Generally, consultees were supportive of the principle underlying the Directive. Interest in the Directive was, however, relatively low (only 10 parties responded to this consultation exercise).

81. We have also consulted on an informal basis a number of organisations that were considered to have an interest in the Cross-Border Mergers Directive both during the earlier consultation on the draft Directive and its negotiations and before issuing this consultation document. These have included representatives of small business, the merchant banking community, the Law Society, Confederation of British Industry, the Institute of Directors and the Trades Union Congress.

Summary and recommendation

I recommend that we implement via regulations made under section 2(2) of the European Communities Act 1972, through which UK companies could restructure throughout the EEA, using the framework of rules that aim to remove administrative and financial burdens, and other obstacles to such mergers caused by national laws.

UK companies would then have an alternative choice for restructuring their company if they so desired and an increased possibility of participating in cross border mergers. Mergers across national borders increase competitiveness, foster innovation and allow consumers to benefit from increasing choice and the economics of integrating in an expanding EU.

The responses to this consultation document will guide us in determining which method of implementation the Government adopts.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed **Date**
Minister's name, title, Department of Trade and Industry
Contact point

Sudha Oza, Department of Trade and Industry, Corporate Law and Governance, Area 565, 1 Victoria Street, London SW1H 0ET, telephone: 0207 215 2529, e-mail: sudha.oza@dti.gsi.gov.uk

Appendix

Range of Merger & Acquisition Fees Per Deal Size For Mergers between UK Companies and other EEA (non-UK) Companies (For Period 1998 – 2005). These figures may be over-inflated as this was in the midst of a stock market peak.

**Data source: Thomson Financial
Table A:**

	Value of Transaction (\$mil)	Freeman - Acquiror Financial Advisor Imputed Fees (\$Mil)	%
Maximum	74,558.58	78.00	0.03
Minimum	0.67	0.462	0.0001
Median	136.39	6.36	0.01
Average	1,444.98	11.35	0.01

Range of Merger & Acquisition Fees Per Deal Size For Mergers Between UK Companies Only (For Period 1998 – 2005). These figures may be over-inflated as this was in the midst of a stock market peak.

**Data source: Thomson Financial
Table B:**

	Value of Transaction (\$mil)	Freeman - Acquiror Financial Advisor Imputed Fees (\$Mil)	%
Total	775,481.67	1,348.59	49.64
Maximum	75,960.85	50.64	0.04
Minimum	0.03	0.002	0.0005
Median	30.87	1.01	0.02
Average	263.05	2.64	0.02

Freeman - Acquiror Financial Advisor Imputed Fees refers to the fees for the acquiror advisers. Freeman fees are calculated for each adviser on the deal taking into consideration various elements such as the number of advisers involved, assignments, deal value, deal attitude etc.

Value of Merger & Acquisition Activity (1998 – 2005).
Data source: Thomson Financial

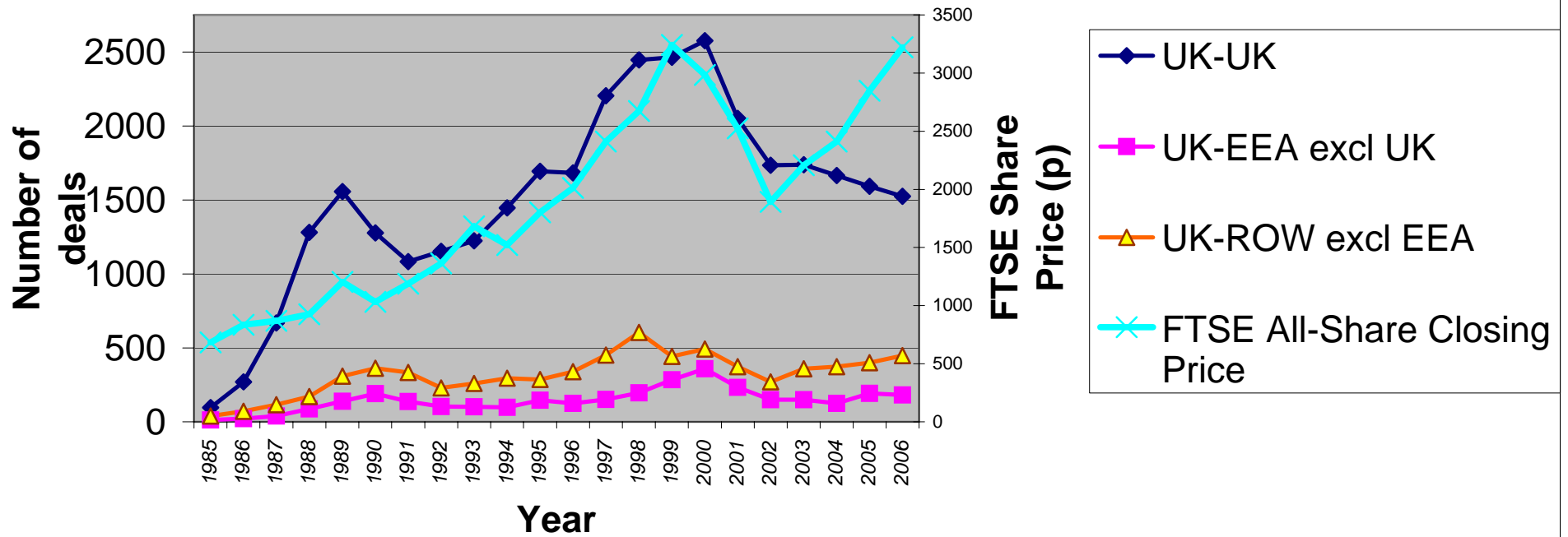
Table C:

UK –UK mergers	\$m775,481.67
UK-EEA (excl UK-UK mergers)	\$m374,838.016
UK – Rest of world (excluding UK-EEA Mergers)	\$m352,282.04
UK-Rest of world Mergers (inc UK-EEA mergers)	\$m722,052.45

Table D: Volume of Merger & Acquisition Activity (Number of Deals - 1985 – 2006)

Year	UK-UK	UK-EEA excl UK	UK-ROW excl EEA	FTSE All Share: Closing Price at year end	Total deals per year
1985	96	12	40	682.94	148
1986	270	22	72	835.48	364
1987	669	40	116	870.22	825
1988	1280	88	170	926.59	1538
1989	1557	138	310	1204.7	2005
1990	1277	191	362	1032.25	1830
1991	1083	137	335	1187.7	1555
1992	1152	103	230	1363.79	1485
1993	1224	102	260	1682.17	1586
1994	1447	98	295	1521.44	1840
1995	1693	146	286	1803.09	2125
1996	1683	125	340	2013.66	2148
1997	2204	151	452	2411	2807
1998	2446	196	605	2673.92	3247
1999	2464	284	443	3242.06	3191
2000	2575	360	493	2983.81	3428
2001	2051	233	373	2523.88	2657
2002	1735	149	271	1893.73	2155
2003	1737	149	359	2207.38	2245
2004	1665	125	373	2410.75	2163
2005	1592	192	401	2847.02	2185
2006	1524	182	448	3221.42	2154
Total M&A	33 424	3223	7 034		43681
Total M&A %	76.5%	7.4%	16.1%		100%
Average no of deals over the last 20 years:	1519	146	320		1985
Highest Proportion of M&A deals take place within the UK, i.e. domestic M&A activity.					
This is followed by UK M&A activity with the Rest of the World, excluding the EEA.					
UK - EEA M&A activity is the lowest in proportion to the other M&A activity over the last 20 years.					
Data Source: Thomson Financial.					

Table E
Mergers and Acquisitions and its link with Stock
Market Activity



CODE OF PRACTICE ON CONSULTATION

The Consultation Code of Practice Criteria:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinetoffice.gov.uk/regulation/consultation/index.asp>

Comments or complaints:

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Nick Cooper
DTI Consultation Co-ordinator
1 Victoria Street
London
SW1H 0ET
Telephone Nick on 020 7215 0346
or e-mail to: nick.cooper@dti.gsi.gov.uk



Printed in the UK on recycled paper containing a minimum of 75% post consumer waste.
First published March 2007. Department of Trade and Industry. www.dti.gov.uk
© Crown copyright. DTI/03/07/NP. URN 07/605