

New Rules for Cross-border Conversions, Mergers and Divisions. Scope and Main Sensitive Provisions



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On April 25, 2018, the European Commission published a proposal for a directive¹ amending directive 2017/1132² by introducing procedures governing the cross-border conversions^{3,4} and divisions⁵ of companies, modifying and extending its scope for cross-border mergers⁶. In April 2019 the perseverance of the EU institutions led to the approval of a compromise (the 'Directive')⁷. The scope of the Directive (I) and its main sensitive provisions, including the protection of stakeholders (II); the pre-operation assessment (III); and how these new rules will be implemented and applicable (IV) will be briefly studied.

The Scope of the Directive

The legal framework for cross-border conversions and divisions

The Directive only deals with limited liabilities companies (as listed in annex II of directive 2017/1132) having their registered office, central administration or principal place of business in the European Economic Area. It introduces a legal procedure for a limited liability company to convert the legal form in which it is incorporated in a Member State of departure – without being dissolved, liquidated or put into liquidation – into a legal form of a limited liability company of the Member State of destination by, at least, transferring its registered office to the Member State of destination while retaining its legal personality⁸.

The Directive also introduces a legal procedure for limited liability companies, with at least two of them being governed by the laws of different Member States, to operate a cross-border division⁹ – which covers full divisions, partial divisions and divisions by separation as described by the Directive.

The amendments and the extended scope for cross-border mergers

The Directive amends provisions of directive 2017/1132 on cross-border mergers. It extends its scope to the operation whereby one or more companies transfer, as a result of or at the time of its/their dissolution without liquidation, all its/their assets and liabilities to another pre-existing company (the ‘acquiring company’) with no new shares issued by the acquiring company – provided that a person holds, directly or indirectly, all the shares of the merging companies or that the members of the merging companies hold their shares in the same proportions in all the companies that merge¹⁰.

The Protection of Stakeholders

The Directive ensures the protection of stakeholders (mainly creditors and co-contractors, employees and shareholders) during a cross-border operation which falls under the scope of the Directive.

The protection of creditors and co-contractors

The creditors concerned are those whose claims antedate the publication of the draft terms of the cross-border operation and have not yet fallen due at the time of such publication. The protection rules provided for them mainly include

- a right of information on the safeguards proposed by the company;
- a right to make observations before the general meeting called to decide on the operation;
- in case of division, a right to benefit from the joint and several liabilities of the companies concerned; and
- a right to apply to the competent authority for adequate safeguards.

Legal certainty for third parties is also ensured by measures of traceability of the operation on the national registers. A cross-border operation which has taken effect in compliance with the procedures transposing the Directive may not be declared null and void¹¹. In addition, companies in the liquidation process or other winding-up proceedings should be excluded from the application of the Directive¹².

The protection of employees

The Directive ensures that employees are properly informed and consulted about the expected effects of the cross-border operation according to the national rules applicable.

Regarding the participation rights (i.e., the right to have the employee(s) representative at the management level¹³), mainly the same principles and procedures as those applicable for cross-border mergers¹⁴ apply for conversions and divisions.

The protection of shareholders

Minority shareholders disapproving of the cross-border operation have a right to dispose of their shares and receive adequate cash compensation (the 'exit right'). The cash compensation is examined by an independent expert who has to give its opinion on whether the cash compensation is adequate, except if the shareholders renounce to such report.

The shareholders should also benefit from

- extended information rights,
- the right to challenge the calculation and the adequacy of the cash compensation (in case of an exercise of the exit right) and
- in cross-border mergers or divisions, the right for members who have not exercised the exit right to contest the share exchange ratio.

The Pre-operation Assessment and the Anti-fraud/Anti-abuse Control

Two controls of the legality of the cross-border operation are introduced for cross-border conversions and divisions, quite similar to those already in force for cross-border mergers subject to the following modifications:

- a first control of legality operated by the competent authority (to be determined at the national level) in the State of departure (or of the merged or divided company) followed by – within no more than three months extendable once in case of serious doubts of abuse or fraud – the issuance, by the competent authority, of a pre-operation certificate of legality and
- a second control of legality carried out by the competent authority (to be determined at the national level) in the State of destination (or of the beneficiary company/companies) to ensure compliance with the provisions of national law on the incorporation and registration of companies and, where appropriate, arrangements for employee participation have been correctly determined.

The most sensitive provisions are those stating that the pre-operation certificate of legality will not be issued by the competent authority in the State of departure and the cross-border operation will be blocked 'if it is determined in accordance with the national legislation that the cross-border operation is carried out for abusive or fraudulent purposes with the aim or leading to evasion or circumvention of national law or EU law, or for criminal purposes'.

The competent authority should be able to consult not only the company but also any other relevant authorities and/or experts to obtain useful information and documents and conduct investigations.

If we refer to the situation currently in force in Luxembourg for cross-border mergers, the notary is the competent authority in Luxembourg to deliver the pre-merger certificate and perform the

second control of legality according to article 1021-12 of the Law of 10 August 1915 as modified. We could assume that the same competence could be allocated to the notary for cross-border conversions and divisions. But is the notary able to solely identify if the operation is based on abusive, fraudulent or criminal purposes? The answer mainly depends on the contents of the assessment as analysed in our second article below¹⁵.

The Implementation and Application of the New Rules

It will be necessary to wait for the publication of the final versions of the Directive in the language of each of the Member States after legal-linguistic revision. The Directive will become effective 20 days after its publication and Member States will have to transpose it into national law¹⁶ within 36 months of its effective entry into force.

But what will be the situation between the publication of the Directive and the publication of the implementation rules by the Member States?

In principle, the Directive only takes effect once transposed¹⁷. However, the Court of Justice of the European Union considers that a directive that is not transposed can directly produce certain effects when

- the transposition into national law has not taken place or has been done incorrectly,
- the terms of the Directive are unconditional and sufficiently clear and precise and
- the terms of the Directive give rights to individuals. For example, this could refer to stakeholders such as individual creditors, co-contractors, shareholders or employees.

When these conditions are met, individuals may rely on the Directive against an EU Member State in court¹⁸. However, an individual may not rely on making a claim against another individual with respect to the direct effect of a directive if it has not been transposed¹⁹. The CJEU also allows, under certain conditions, individuals the possibility of obtaining compensation for directives whose transposition is poor or delayed²⁰.

In conclusion, the Directive has the merit of filling the absence of European provisions on cross-border transfers of corporate seats – other than those adopted for the European Company (SE) – and cross-border divisions. Nevertheless, the Directive incorporates constraints for companies in their operations within Europe; there are, at several levels, the risk of lengthening deadlines and legal uncertainty because of possible divergent interpretations within the Member States. It is therefore to be welcomed that there is the status of the SE – which, still too often ignored by companies, should be examined by companies contemplating to perform a cross-border transfer of their registered office and head office to another Member State or to perform a cross-border merger with the creation of an SE, as these two operations do not fall under the scope of the Directive.

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1. COM (2018) 241 final, 2018/0114 (COD). For comments on the proposal for a directive of 25 April 2018, see C. Cathiard, 'Proposition de directive de la Commission européenne en matière de mobilité transfrontalière des entreprises: une harmonisation des procédures mais de nombreuses contraintes pour les entreprises', *Droit des Sociétés*, LexisNexis, Oct. 2018, n° 10 and P. H. Conac, B. Lecourt, M. Menjucq and G. Parleani, 'Le paquet européen « droit des sociétés » de 2018: mobilité transfrontalière and digitalisation', *Revue des Sociétés*, Jan. 2019, n° 1.
2. Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law JO L 169, 30.06.2017, p. 46.
3. The term 'cross-border conversions' is used to designate, as does the Court of Justice of the European Union, the cross-border transfers of the seat of a company without dissolution and without loss of legal personality.
4. Inserted in directive (EU) 2017/1132 Title II Chapter I.
5. Inserted in directive (EU) 2017/1132 Title II Chapter IV.
6. Amending Title II Chapter II of directive (EU) 2017/1132.
7. For additional comments on the Directive, see inter alia: C. Cathiard, 'Directive on Cross-Border Mobility of Companies: Presentation Of The Main Provisions', *ACE Luxembourg*, Sept. 2019, to be published. *Actes du colloque 'La mobilité des sociétés dans l'Union européenne. Aspects juridiques et fiscaux'*, Joly, Pratique des Affaires, 2019, to be published; S. M. Bartman, 'The Adopted Proposal for an EU Directive on Cross-Border Operations: A Realistic Compromise', *ECL* 2019, editorial, issue n° 5. J. Schmidt, 'The Mobility Aspects of the EU Commission's Company Law Package: The Good, the Bad and the Ugly', *ECL* 2019, volume 16, issue 1, p. 13–17; I. Corbisier and F. Bernard, 'Cross-Border Mobility within the EU and Specifically in Luxembourg and Belgium: Same Destination, Different Roads', *ECL* 2019, volume 16, issue 1, p. 17–29; S. Binard and L. Schummer, 'The Case for Further Flexibility in Matters of Cross-Border Corporate Mobility', *ECL* 2019, volume 16, issue 1, p. 31–37.
8. Directive, art. 86 ter and exceptions art. 86 quater.
9. Directive, art. 160 bis.
10. Directive, art. 119 as modified.
11. Directive, art. 86 duovicies for the cross-border conversions and art. 160 quatervicies for the cross-border divisions.

12. Directive, art. 86 quater for the cross-border conversions, art. 160 quater for the cross-border divisions and art. 210 as modified for the cross-border mergers.
13. Within the meaning of point (k) of Article 2 of directive 2001/86/EC.
14. Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, OJ L 310, 25.11.2005, p. 1–9 replaced by art. 118 to 134 of directive 2017/1132. Directive 2017/1132, art. 133 § 2.
15. C. Cathiard and D. Maria, 'The new anti-fraud and anti-abuse assessment for cross-border conversions, mergers and divisions', AGEFI, Sept. 2019.
16. CJCE, case 41-74, 4 December 1974, Yvonne van Duyn v Home Office.
17. Article 288 of the Treaty on the Functioning of the European Union.
18. However, it can only have a direct vertical effect; EU Member States are obliged to implement directives, but directives may not be cited by an EU Member State against an individual (CJCE, case 148/78, 5 April 1979, Tullio Ratti).
19. CJCE, case C-91/92, Paola Faccini Dori v Recreb Srl.
20. CJCE, cases C-6/90 and C-9/90, Francovich and Bonifaci.