

EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

GOVERNMENT RESPONSE TO THE CONSULTATION ON THE CROSS-BORDER MERGERS DIRECTIVE

Introduction

In March 2007, the government published a consultation seeking views on the implementation of the Cross-Border Mergers Directive (2005/56/EC). This consultation closed on 1 June 2007. A summary of responses is at annex 1.

Background

The Directive establishes a framework to facilitate cross-border mergers between UK companies and companies elsewhere in the EEA. In so doing, a platform for cross-border restructuring that did not exist previously, is introduced in the UK. Only companies which consider they would benefit from using such a procedure need use it. If they prefer, companies may still choose to restructure through the use of takeovers instead.

The Directive also removes legislative and administrative difficulties that UK limited liability companies encounter when merging cross-border in the EEA.

The Directive requires that any cross-border merger operation carried out must take into account employee participation arrangements where these exist in one or more of the merging companies. Employee participation is a system which gives employees a statutory right to involvement at Board level. Such systems already exist in certain EEA countries – e.g. Germany or Sweden. These Regulations do not introduce employee participation rights where these do not exist in any of the merging companies, but establish the procedures that need to be completed if there is an existing system of employee participation and Chapter 4 of the Regulations applies. Court approval of the cross-border merger can only be granted once a number of conditions have been determined; one of which is that the employee participation arrangements have been determined.

The Directive covers public and private companies with limited liability.

The full text of the Directive is available from:

http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_310/l_31020051125en00010009.pdf

A copy of the consultation document is available from:

<http://www.berr.gov.uk/consultations/page38069.html>

The Government Response

1. The consultation paper covered the key elements of the proposals; company law and employee participation issues. These are covered separately below.

Company Law Issues

2. The Government will implement the Directive in the UK by 15 December 2007. The Government believes that this framework contributes to the strengthening of the Single Market and UK companies' flexibility and accessibility to business in the European Economic Area (EEA). The Directive opens up the prospect of a more flexible approach to inter-EEA company activity for the future, enabling removal of the remaining cultural, legal and administrative barriers.

3. The Government will implement this Directive following the high level principles covered in the consultation paper. These included ensuring consistency between the domestic and cross-border merger procedures in the UK. The respondents to the consultation supported this approach. This legislation would apply to all of the UK. This is consistent with the approach of the Companies Act 2006.

4. The Government notes that UK companies rely more on takeovers than mergers and hence UK companies are less likely to use this framework in the immediate future.

5. In addition to legislation implementing the Directive, the Government intends to bring forward legislation extending the scope of the implementation to Limited Liability Partnerships (LLPs) by 1 October 2008¹. This retains consistency with domestic legislation under which LLPs are able to merge. Although there may be very few such mergers, it is appropriate to have a legal framework in place in case there is interest in such a merger.

6. We have not been able to identify any specific drawbacks to extending the implementing legislation to LLPs, provided that appropriate safeguards for members and creditors will be in place. As the legislation would be providing a new option for LLPs to re-structure, it would not be imposing any burdens on them if they elect not to make use of it.

7. The Government will not be extending the Directive's employee participation provisions to the LLPs as they fall outside the scope of the Directive.

8. BERR has consulted stakeholders of the mutual sector including building societies, friendly societies and industrial and provident societies about extending the provisions of this Directive to cover them. HM Treasury, which has policy responsibility for these types of organisations, will be

¹ To coincide with the relevant parts of the LLP regulations relating to the Companies Act 2006.

conducting a further public consultation on extending the cross-border mergers framework to these organisations separately.

9. As indicated in the consultation document published in March, the Government does not intend to extend the implementation to Open Ended Investment Companies (OEICS).

Employee Participation Issues

10. The Directive requires that any cross-border merger operation carried out must take into account employee participation arrangements where these exist in one or more of the merging companies. The UK Regulations only go as far as to implement the Directive's minimum requirements necessary to protect existing employee participation rights. In other words, the Regulations do not introduce employee participation rights for a company formed by a cross-border merger unless there is an existing system of employee participation in at least one of the merging companies, and Part 4 of the Regulations applies.

11. The consultation document in relation to the employee participation provisions posed four questions for respondents to answer. Question 6 and Question 7 particularly sought respondents' views in relation to two situations for which the Directive had made no provisions.

12. The first of these is a situation which may arise as a result of a decision by the merging companies to be directly subject to the standard rules for employee participation, without prior negotiation with employee representatives. Choosing to do so would forego the need to establish a special negotiating body (SNB). However, where there exists more than one type of employee participation in the merging companies, the Directive is silent as to which type of employee participation should be adopted or how agreement could be reached in the absence of an SNB.

13. Question 6 presented three options to address this situation and five respondents answered this question. Four of these considered that option 2 should be adopted. This option suggested that the merging companies in question should be in a position to voice the most appropriate form of employee participation on behalf of their respective employees who either elected or recommended appointments to the Board.

14. One respondent, Unite Amicus, opted for Option 1 which suggested that an SNB should be established in order to decide the type of employee participation system. The Government notes this observation but considers that this would negate the provision established by the Directive which enables the merging companies to be directly subject to the standard rules should there be more than one type of employee participation system present.

15. The Government is therefore satisfied that option 2 provides the most effective approach for the merging companies to complete the merger process

in good time, whilst providing adequately for the employee voice to be taken into account.

On this basis, the Government will amend the Regulations to enable the merging companies to decide which type of employee participation shall be adopted in the newly formed company where the merging companies have decided to be directly subject to the standard rules.

16. Question 7 of the consultation document sought respondents' views to the situation where an SNB has been established but failed to reach agreement as to which type of employee participation should exist in the newly formed company where more than one type of employee participation existed in the merging companies.

17. Two respondents, the European Study Group and Unite Amicus, suggested that where there existed more than one form of employee participation and the SNB failed to reach a decision, the merging companies should decide which type of employee participation should be adopted in the newly formed company. Unite Amicus further added that the highest form of participation should apply, a view supported by one other respondent. Two responses suggested that the standard rules should be applied were this situation to arise.

18. The Government has noted and considered these views. In particular, where respondents stated that the highest level of participation should apply, it considered that this would not resolve a dispute where an equal number of employees are covered by each form of employee participation. As this could be one possible cause for failure of an SNB to make a decision and as the standard rules already apply in this situation, the Government proposes to enable the merging companies to decide which type of employee participation shall be adopted in the absence of an SNB decision. The merging companies should be in a position to voice the most appropriate form of employee participation on behalf of their respective employees who either elected or recommended appointments to the board.

19. The Government is satisfied that this approach affords the most effective approach for the merging companies to complete the merger process in good time, whilst providing adequately for the employee voice to be taken into account.

On this basis the Government will amend the Regulations to enable the merging companies to decide which type of employee participation shall be adopted in the newly formed company in the absence of a decision by the SNB.

20. The Government is grateful for the comments provided by the Law Society² which drew attention to an apparent anomaly brought about by draft regulation 25(1) [requiring a special negotiating body (SNB) to be set up in all

² See full title of respondent at annex 2

cases] and Regulation 38 [merging companies opting to be directly subject to the standard rules for employee participation]. The Government has noted this point and has amended Regulation 25 to make it clear that it is subject to regulation 38.

21. One respondent sought clarification whether the 3-year moratorium on employee participation systems at draft regulation 40 would apply to takeovers and business transfers. The Government confirms that this provision only applies to subsequent domestic mergers for a period of three years from the date of registration. One other respondent considered the three-year moratorium to be an inadequate safeguard for employee participation rights. The Government has noted this comment but considers this period to be consistent with the requirements of the Directive and the Government's approach of light touch implementation.

22. Although one respondent, Unite Amicus, welcomed the introduction of the SNB and the standard rules, it considered that the employee participation provisions were not robust enough and that these did not bring the UK fully in line with the Directive. The Government has considered this point and a number of suggestions made by Unite Amicus but remains satisfied that the Regulations fully meet the UK's obligations to implement the Directive.

Directive Implementation

23. We will implement this Directive in the UK by making regulations under section 2(2) of the European Communities Act 1972, which will consist of a single set of self-standing regulations covering both company law and the employee participation aspects of the Directive. The Regulations covering companies will be made in October 2007, along with a guidance note. They will come into force on 15 December 2007.

24. The regulations covering Limited Liability Partnerships will be prepared and implemented separately and will come into effect on 1 October 2008, coinciding with the other regulations for LLPs related to the Companies Act 2006.

25. The draft regulations will be available from the BERR website at: <http://www.berr.gov.uk/bbf/eu-company-law/directives/page19528.html>

26. Additional copies of this document are available from the BERR website at: <http://www.berr.gov.uk/consultations/closedwithresponse/index.html>

Summary of Responses to the Consultation

We received 10 responses to the consultation. A list of consultees is included at annex 2.

Copies of the original responses are available for inspection on request. Please contact Sudha Oza on 020 7215 2529 or via e-mail at Sudha.oz@berr.gsi.gov.uk, should you wish to see these responses.

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

The general response to this question was that there was a very low demand for such restructuring in the UK and that it was unlikely to have a wide appeal. This is because the majority of UK company restructuring is carried out through takeovers (which involve the exchange or transfer of shares) rather than mergers (which involve the dissolution of the company being merged).

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

The majority of those who responded supported our implementation through light touch principles to meet only the minimum requirements of the Directive. KPMG, for example, supported a minimalist approach to implementation and the replication of existing matters from the implementation of the European Company Statute. Unite Amicus welcomed the introduction of the SNB and the standard rules but considered that these did not bring the UK fully in line with the Directive on worker involvement.

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?**

Of those who responded on this point, several preferred the Directive not to be extended to include all of the above entities. In discussion with representatives of these organisations, they were content for us to include them within the scope of the Directive if the safeguards were as stringent for Cross-Border mergers as they were for domestic restructuring purposes. This was mainly due to the optional nature of the framework.

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

There were no substantive comments on this question.

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?

There were few substantive comments on this question. Two respondents provided detailed comments on the draft Regulations which have been taken into account. One respondent sought clarification whether the 3-year moratorium on employee participation systems at draft regulation 40 would apply to takeovers and business transfers.

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?

Five respondents answered this question. All but one respondent suggested that the Government adopts Option 2, to which the Institute of Chartered Secretaries added that there should be a default to Option 1 in the absence of such a decision. Unite Amicus recommended that Option 1 should be adopted so that full participation is given to the workers' representatives. The Law Society brought to the Government's attention an apparent inconsistency brought about by regulation 25(1) [requiring an SNB to be set up in all cases] and regulation 38 [merging companies opting to be directly subject to the standard rules for employee participation].

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?

Five responses were received. Two respondents, the European Study Group and Unite Amicus, suggested that the managements of the merging companies must make a decision. Unite Amicus further added that the highest

form of participation should apply, a view supported by one other respondent. Two respondents pointed to the standard rules to indicate that these should govern the form of employee participation, whilst another respondent stated that the SNB is required to make a choice and therefore must do so.

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

There were five responses to this question. Two respondents, the European Study Group and the Institute of Chartered Secretaries, agreed with the Government's intended approach. Two other respondents indicated support, subject to the points made in response to Questions 5, 6 and 7. One respondent, Unite Amicus, felt that the Government's approach to employee participation was not rigorous enough.

Q9: If not, how do you think the Government should implement the employee participation provisions?

Two respondents replied to this. One of these referred back to comments on its implementation made under Question 6 and 7, but agreed otherwise. The other respondent, Unite Amicus, called for provisions to enable Trade Union representatives and European Works Councils members' participation in the SNB without prior permission from management. It also proposed penalties for non-compliance to represent a proportion of the company turnover and considered the 3-year moratorium to protect employee participation during subsequent domestic mergers inadequate.

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.

One respondent provided information on the different market conditions in UK from that of the EEA and outlined that UK markets would make an assessment of this framework once the regulations had been fully settled.

Cross-Border Mergers Consultation: List of Respondents

1. Takeovers Joint Working Party of the City of London Law Society Company Law Sub - Committee and the Law Society of the England and Wales' Standing Committee on Company Law.
2. Quoted Companies Alliance (QCA).
3. KPMG
4. The Institute of Chartered Accountant (ICA).
5. PWC
6. Building Societies Association
7. Institute of Chartered Secretaries Association
8. Unite (Amicus Section).
9. European Study Group
10. Confidential response

End

Department for Business, Enterprise and Regulatory Reform (BERR)
August 2007