

Creditor protection in cross-border mergers; unfinished business

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1. Introduction

The purpose of the Directive on cross-border mergers¹ is facilitating cooperation and consolidation between limited liability companies from different Member States in the European Union by taking away legislative and administrative difficulties they encounter when executing a cross-border merger. In view of the completion and functioning of the single market, the Directive lays down provisions to facilitate such mergers and, considering the famous *Sevic* judgement,² such provisions are welcome in Europe. The Directive was preceded by lengthy debates. The first steps go back to 1965 when a committee was installed to draft a treaty on international mergers by public companies.³ In the final deliberations much attention was committed to the protection of minority shareholders and employee rights. The solutions reached on that front may be debatable,⁴ but in any case some provisions to that effect have been adopted in the final text of the Directive. This is barely the case for creditor protection. That has been left to the Member States to determine, albeit that the Third Directive⁵ provides a certain minimum framework.

As all assets and liabilities are being transferred, legal mergers may give rise to risks for creditors of the disappearing company when the liabilities of the acquiring company exceed the assets of the disappearing company or for creditors of the acquiring company when the liabilities of the disappearing company exceed the assets of the acquiring company. Therefore, creditor protection needs to be safeguarded in legal mergers. 'Because the corporate form defines the pool of assets that bond all corporate contracts, *all* parties who contract with corporations benefit from creditor protection', as Hertig and Kanda have rightfully stated.⁶ Different national systems of creditor protection may be an impediment for a smooth merger process and may create uncertainties. The question therefore is whether creditor protection can indeed best be left to the Member States.

Before addressing this question, we will in this article first describe the current position on creditor protection in national mergers in the Netherlands and subsequently go into specific cross-border issues concerning creditor protection in legal mergers.

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1 Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies, *OJL* 310/1.

2 ECJ 13 December 2005, Case C-411/03.

3 G. van Solinge, *Grensoverschrijdende juridische fusie* (dissertation VU), 1994, p. 24.

4 See the other contributions in this issue.

5 Directive 78/855/EEC of 9 October 1978 concerning mergers of public limited liability companies, *OJL* 295/35.

6 G. Hertig & H. Kanda, in Kraakman *et al.*, *The Anatomy of Corporate Law*, Oxford 2004, p. 71.

2. The position of creditors under current Dutch law

Under the Third Directive there are two types of legal mergers: a merger by acquisition and a merger by the formation of a new company. The merger by acquisition is the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.⁷ In a merger by the formation of a new company, this new company acts as the acquiring company.⁸ Thus, as implemented in Dutch legislation, a legal merger has three legal consequences: i) all assets and liabilities will automatically transfer to the acquiring company; ii) the disappearing company will cease to exist when the merger becomes effective, without any liquidation procedure being required; and iii) the shareholders of the disappearing company will become shareholders of the acquiring company.⁹

In a legal merger there is an inherent risk that the liabilities of the acquiring company will exceed the assets, bringing creditors of the disappearing company in a worse financial position than they were before the merger took place. To prevent that the position of creditors will be jeopardized in this respect, the Dutch and other legislators in the European Union have taken measures and implemented safeguards in their legislation on legal mergers. In short a distinction can be made between a system of *ex ante* and a system of *ex post* protection. In the first, creditors can object to the merger before it will become effective. In an *ex post* system they can only do so afterwards.¹⁰

Articles 13 and 14 of the Third Directive provide some guidelines on creditor protection. These are broad and vague, however. It is provided that the laws of the Member States must provide for an adequate system of protection of creditor interests of the merging companies whose claims antedate the publication of the draft terms of merger and have not fallen due at the time of such publication. The laws of the Member States shall at least provide that such creditors shall be entitled to obtain adequate safeguards where the financial situation of the merging companies makes such protection necessary and where those creditors do not already have such safeguards. There is no further guidance, however, on how these safeguards must be adopted in the law.

The Dutch legislator has chosen to implement an *ex ante* system of creditor protection. This has resulted in the following protective measures:

- Creditors can request security or similar safeguards (2:316 section 1 Dutch Civil Code);
- Creditors can object to a merger within 1 month of publication of the merger proposal, mentioning the requested safeguards (2:316 section 2 Dutch Civil Code);
- The Court can allow the merging companies to provide alternative safeguards before it decides on the objection by the creditor(s) (2:316 sections 3 and 5 Dutch Civil Code);
- The Court can nullify a merger when it is effected in case timely filed objections have not yet been addressed (2:316 section 4 and 2:323 section 1(b) Dutch Civil Code);

7 Art. 3, Sect. 1 of the Third Directive.

8 Art. 4, Sect. 1 of the Third Directive.

9 See Arts. 309 and 311 Sects. 1 and 2 of Book 2 of the Dutch Civil Code.

10 Van Solinge 1994, *supra* note 3, p. 277; M.A. Verbrugh, *Structuurwijzigingen bij kapitaalvennootschappen en de positie van schuldeisers: een rechtsvergelijkend onderzoek naar juridische fusie, splitsing en omzetting* (dissertation Rotterdam), 2007, p. 3.

- Parties to a contract can under circumstances request amendment or rescission of the contract, up to 6 months after the merger proposal has been filed (2:322 Dutch Civil Code).

Creditors cannot claim security or other safeguards if they already have adequate safeguards or if the financial position of the acquiring company provides similar or better safeguards than before.

In Dutch law, there are more specific provisions for pledge and usufruct. By law these are vested on the replacing receivables.¹¹ For pledges on shares in the capital of the disappearing company, these are vested on the replacing shares in the acquiring company. If there are no replacing shares, the acquiring company must provide an equivalent alternative.¹² Parties with a special right (not being a shareholder) towards the disappearing company, should be rewarded an equivalent alternative towards the acquiring company or damages, in order to compensate for rights which will terminate following the merger and cannot be converted, such as options, share profit rights or convertible bonds.¹³ If no agreement can be reached on the amount of damages, these can be determined by an independent expert.

3. The Dutch implementation of the Directive

According to the Directive, the Member States had to implement the Directive into their own law by 15 December 2007. On the date of publication of this paper, the Act implementing the Directive into Dutch law has not come into force yet. The legislative proposal to implement the Directive in Dutch law was submitted to the Dutch House of Representatives on 15 January 2007.¹⁴ The House of Representatives has adopted the legislative proposal and it has been submitted to the Upper House for written consideration.¹⁵

The Dutch legislator has no intention to introduce stricter rules in Dutch law than required under the Directive. With respect to creditor protection, the legislative proposal follows the existing creditor protection measures for Dutch national mergers as referred to paragraph 2 above, *i.e.* creditor protection *ex ante*. Further, in conformity with the Directive, the legislative proposal contains a provision that a cross border merger which became effective cannot be pronounced null or void.¹⁶

The only provision proposed by the Dutch legislator stricter than Dutch legislation on legal mergers and which is not compulsory under the Directive¹⁷ is the right to resign for minority shareholders of the disappearing company (*uittreedrecht*).¹⁸ Article 333h of the legislative proposal provides that minority shareholders of the disappearing company who voted against the cross border merger can file a request for compensation with the acquiring company within one month after the decision to merge. If the parties cannot agree, one or more independent third experts shall determine the compensation. This right of compensation is not available in a Dutch

11 Art. 3:229 Dutch Civil Code. See in more detail D.F.M.M. Zaman, *Juridische fusie & splitsing*, 2000, pp. 66 *et seq.*

12 Art. 2:319 Dutch Civil Code.

13 Art. 2:320 Dutch Civil Code.

14 *Kamerstuk* (Parliamentary Paper), 30 929: a new part 3A on cross border mergers shall be inserted in Title 7 of Book 2 of the Dutch Civil Code.

15 State of affairs: on 15 February 2008 the Minister of Justice published his answers to questions raised by the Upper House.

16 Art. 333l of the legislative proposal.

17 Art. 4 of the Directive leaves the option open for Member States to introduce fitting measures to protect minority shareholders who opposed to the merger.

18 See in this respect also W. J.M. van Veen, 'Het wetsvoorstel grensoverschrijdende fusies', 2007 *Tijdschrift voor Ondernemingsbestuur*, pp. 81 *et seq.* and the paper by Wyckaert and Geens in this issue.

national merger.¹⁹ Following the Parliamentary Papers, the most important reason for the introduction of this provision seems to be that shareholders who become shareholders of a non-Dutch company due to the cross-border merger no longer have the right to institute an inquiry (*enquêterecht*).²⁰ Also, other than with a Dutch national merger, the shareholders of the acquiring company cannot nullify the merger.

4. Specific cross-border issues

As indicated, the European legislator has left the specific protection of creditor rights to the Member States. The European Council and the European Parliament have indicated that the Directive should not contain further obligations vis-à-vis the Member States than is necessary to realize its goal. The starting point is that the Directive should fit the legislation of the Member States on legal mergers, instead of vice versa. In this respect article 4, section 1 (b) of the Directive provides that, save as otherwise provided in the Directive, 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. To avoid any misunderstanding, section 2 of that same article provides that these provisions and formalities include the protection of creditors of the merging companies. The only other provision of the Directive on creditor protection is in article 6, section 2 (c), where it is stated that for each of the merging companies and subject to the additional requirements imposed by the Member State to which the company concerned is subject, an indication, for each of the merging companies, needs to be published in the national gazette of the relevant Member State of arrangements made for the exercise of the rights of creditors.

This approach by the European legislator results in different and sometimes contradicting systems of creditor protection in cross-border legal mergers within the European Union. As indicated earlier, the Third Directive provides only minimal guidelines on creditor protection in legal mergers and leaves ample flexibility to Member States on how to arrange for protection on a more detailed level. As a result there is within the European Union a wide diversity in practice. It is argued for example that creditors of the disappearing company as a rule have greater need for protection than the creditors of the acquiring company. The Netherlands, France and Belgium have not used the possibility to make this distinction in their own national legislation. At first Germany did make such a distinction, but finally changed its law so that such a distinction is no longer there.

Another prominent example is the difference in *ex ante* and *ex post* systems, as mentioned earlier.²¹ In an *ex ante* system, protection for creditors is provided before the date the merger becomes effective. This system is adopted, for example, by the Netherlands and France. The advantage of this system is that there is certainty concerning the position of the creditors at the time the merger is being executed. As a result, there is less uncertainty that the execution of this legal merger may be affected by creditors afterwards. The downside, however, is that creditor protection proceedings before the merger is being executed may delay the process of the merger itself. An *ex post* system is, for example, adopted by Germany. In this system, creditors can only invoke their rights after the merger has become effective. This way the completion of the merger

19 It is already suggested that this distinction will not hold in a preliminary procedure for the European Court, see G. van Solinge, 'Een nieuwe rechtsfiguur met oude wortels', 2007 *Weekblad voor Privaatrecht, Notariaat en Registratie* 6271, p. 679, and A.F.J.A. Leijten, 'Het uittreedrecht voor aandeelhouders volgens het wetsvoorstel grensoverschrijdende fusies (30 929)', 2007 *Ondernemingsrecht* 8, p. 307.

20 *Kamerstukken II* (Parliamentary Papers II) 2006-2007, 30 929, no. 7, p. 15.

21 See P. Vlas, 'De bescherming van schuldeisers bij een internationale juridische fusie in het licht van de Tiende Richtlijn', in J.H. Christiaanse (ed.), *Tot vermaak van Slagter*, 1988, p. 351 *et seq.*; Van Solinge 1994, *supra* note 3, pp. 276 *et seq.*

cannot be delayed. Only the acquiring company can be addressed with a claim, as obviously the disappearing company has already disappeared. Whereas this system avoids the merger process being delayed by creditor protection proceedings, it provides no certainty regarding the position of creditors at the time the merger is being executed.

As long as legal mergers concern national companies only, these differences in legal systems across the European Union do not create any difficulty. This may change, however, now that legislation for cross-border mergers is being introduced without harmonizing these rules of creditor protection. In practice, there may be various scenarios where there will be problems as a result of this, *e.g.* creditors of a disappearing company in an *ex ante* jurisdiction may be confronted after the merger with an acquiring company in an *ex post* jurisdiction, with surprising safeguards being awarded to the ‘local creditors’, which may adversely affect their position. These and other discrepancies may, in our view, form an impediment in facilitating cross-border mergers. Currently we have no clear and transparent system of creditor protection throughout the European Union. Although there are good arguments for example for both the system of *ex ante* protection and the system of *ex post* protection, the fact that these differences remain will create unjustifiable differences in the position of various groups of creditors involved in one single merger.

5. Future ambitions and unfinished business

On 10 July 2007, the Commission adopted its communication on a simplified business environment for companies in the areas of company law, accounting and auditing. In this communication, the Commission set out its proposals for reducing administrative burdens and adapting the *acquis* in these areas to the needs of today’s business which were adopted by the Competitiveness Council on 22 November 2007.²² The Competitiveness Council indicated that it prefers that before the end of 2008, proposals based on impact assessments are brought forward.²³

The communication from the Commission proposed two options for future European company law. The first option regarded the repeal of directives such as the Third, the Sixth, the Twelfth directives, and, subject to the outcome of an outside study on the current capital maintenance system, the Second Directive. The second option consisted in the proposal to simplify at least part of the Third, the Sixth and probably also the Second Directive as these directives, in their current form, leave the Member States little flexibility to adapt their respective national systems to the evolving needs of business and stakeholders in general. A clear majority of the respondents to the communication of the Commission were in favour of the second option. However, with respect to the Second Directive, the majority of the respondents commented that they would like to await the results of an outside study on the evaluation of the feasibility of an alternative to the current regime of legal capital established by the Second Directive. This study was completed and recently published.²⁴ It contains an overview of the capital maintenance in

22 Council document 15222/07 DRS 48.

23 Synthesis of the reactions received to the Commission Communication on a simplified business environment for companies in the areas of company law, accounting and auditing (COM(2007) 394), report from the Internal Market and Services Directorate-General dated December 2007.

24 Contract ETD/2006/IM/F2/71, Feasibility study on an alternative to the capital maintenance regime established by the Second Company Law Directive 77/91/EEC of 13 December 1976 and an examination of the impact on profit distribution of the new EU-accounting regime, KPMG 2008, http://ec.europa.eu/internal_market/company/docs/capital/feasibility/study_en.pdf.

five Member States and in four non-Member States. It further discusses the various proposals with regard to capital maintenance, such as the Winter report.²⁵

This report already stated that there is a wide diversity of practices in Member States in relation to creditor protection in restructuring transactions, while the policy considerations were the same implying that there is no real reason justifying this wide diversity. Following the report, the Commission issued an action plan with as primary goals i) the enhancement of the rights of shareholders and protection for employees, creditors and other parties involved with companies whereby the rules with respect to corporate governance will be amended and ii) increase of the efficiency and the competitiveness of the business world whereby especially certain cross-border issues have to be addressed.

On 6 September 2006, the Commission adopted a Directive on the amendment to some articles of the Second Directive which has to be complied with by 15 April 2008.²⁶ This Directive establishes the conditions that must be satisfied in order to ensure that the capital of the company is maintained in the interest of creditors and follows a number of recommendations made by the High Level Group, including the acquisition of shares through contributions in kind and the acquisition by a company of its own shares. Also, the current rules on financial assistance that a company can give for the acquisition of its shares by a third party will be relaxed.

Following the above, it seems the case for leaving creditor protection to the Member States is weakening. Although there are arguments in favour of various systems of creditor protection, ultimately the way safeguards in this respect are being implemented in national law is a matter of technical nature which should in our view not impede the efficient functioning of the single market.

There are strong arguments, in other words, to adopt the same provisions for all transactions for the sake of simplicity. It is promising that the European Commission intends to adopt uniform creditor protection rules modelled after Article 32 of the amended Second Directive. In the event of a reduction of the subscribed capital, at least the creditors whose claims antedate the publication of the decision on the reduction shall at least have the right to obtain security for claims which have not fallen due by the date of that publication. Member States may not set aside such a right unless the creditor has adequate safeguards, or unless such safeguards are not necessary having regard to the assets of the company. We have some doubt whether this approach will solve the entire problem, as it still leaves room for differences in national legislation. What is important, in any case, is the ambition to come to a harmonized system of creditor protection.

For now, however, the disappointing conclusion is that the goal of the Directive has not yet been accomplished. In cross-border mergers, creditor protection, in our view, is important to facilitate a smooth, efficient and transparent process necessary to equally facilitate the single market. Differences in national legislation on creditor protection, defensible as they may be, are ultimately of a technical nature and create unnecessary and unjustifiable impediments. The ambition formulated by the Winter Group to come to uniform rules for 'all restructuring transactions' is attractive, but can lead to undesired delay. However, amending the Directive at this point in time seems equally unfeasible. We would conclude therefore that this stresses the need to at least make haste with further harmonization of creditor protection in the Third Directive.

25 Report of the High Level Group of Company Law Experts on a modern regulatory framework for company law in Europe, Brussels, 4 November 2002.

26 Directive 2006/68/EC.