**EXPLANATORY MEMORANDUM TO**

**THE COMPANIES (CROSS-BORDER MERGERS) REGULATIONS 2007**

**S.I. 2007 No. 2974**

**1.** This explanatory memorandum has been prepared by the Department for Business, Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the House of Lords Select Committee on the Merits of Statutory Instruments and the Joint Committee on Statutory Instruments.

## 2. Description

2.1 The Companies (Cross-Border Mergers) Regulations 2007 implement Directive 2005/56/EC of the European Parliament and of the Council on cross-border mergers of limited liability companies. The Directive lays down a framework of rules facilitating cross-border mergers between companies in the EU and requires the removal of obstacles in national laws to such mergers. It applies to public and private companies with limited liability, and to mergers involving at least two companies from different Member States.

2.2 The Regulations implement the Directive by:

- Establishing a facilitative framework for cross-border mergers to occur between UK companies and companies from other European Economic Area (EEA) Member States; and

- Establishing the process to be completed where employee participation arrangements exist in one or more of the companies wishing to merge.

## 3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

## 4. Legislative Background

4.1 These regulations are made under section 2(2) of the European Communities Act 1972 and will come into force on 15 December 2007.

4.2 A transposition note relating to the Directive is attached.

## 5. Territorial Extent and Application

5.1. These regulations extend to the United Kingdom. Company Law is a transferred matter for Northern Ireland and reserved for Scotland and Wales. We have consulted all the Devolved Administrations and they are content.

## 6. European Convention on Human Rights

6.1. The provisions of these regulations are compatible with the European Convention on Human Rights.

## 7. Policy background

7.1. The 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. In this way, the Cross-Border Mergers Directive is part of a wider range of mechanisms by which European companies may choose to restructure.

7.2. UK companies generally use takeover procedures rather than the type of merger procedures for company restructuring provided by this Directive. Very few domestic mergers[1] have occurred in the UK since 2003. It is not clear whether the demand for cross-border mergers will be significantly higher than this.

7.3. The present domestic legislative framework does not expressly provide for cross-border mergers between UK companies and companies elsewhere in the EEA. The Directive provides an infrastructure through which UK companies may confidently explore restructuring opportunities in the EEA and removes uncertainties and administrative and legal barriers to such restructuring. The measures are intended to protect the interests of shareholders and creditors during a merger.

7.4. The Regulations require specific procedures to be completed in order for a cross-border merger to be approved. Identical procedures will also be required throughout the EEA. The main procedures are as follows:

i.) each of the companies involved is required to circulate the merger proposal, a management report and an independent expert’s report to shareholders;

[1] This covers mergers under section 427 and 427A of the Companies Act 1985.

ii.) shareholders' approval of the proposal is required;

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).

7.5. The Directive provides for a competent authority which has the power to veto the merger unless the necessary steps have been taken. This provides a safeguard for shareholders, creditors and employees that may be affected as a result of a cross-border merger.

7.6. The Directive further aims to protect acquired employee participation rights where these exist in any of the merging companies. Employee participation is a system which gives employees a statutory or contractual right to involvement at Board level. Such statutory rights already exist in some Member States (such as Germany, Austria, the Netherlands and Sweden). In the UK and some other Member States, there are no statutory rights of this kind. These regulations therefore contain provisions governing a situation where a UK company opts to merge with one or more companies where employee participation rights exist.

7.7. In one significant respect the Regulations go beyond the Directive's requirements: they give a company's creditors the rights to demand a meeting, and if such a meeting is held, then the merger must be approved by a majority of the creditors at that meeting. This is consistent with the requirements for 'domestic' mergers in the Companies Act 2006.

7.8. Pre-consultation stakeholder discussions were held to work through the practicalities of implementation of the Directive. A 12-week public consultation[2] took place from 5 March to 1 June 2007. Ten written responses were received which gave overall support for the Government's light-touch approach to implement the minimum requirements of the Directive while aiming for consistency between domestic and cross-border merger procedures as far as possible. The employee participation provisions have been implemented on the same basis as analogous legislation (with suitable or necessary alteration), such as the European Company Statute.

7.9. The Government response to this consultation exercise was published on 31 August 2007[3].

[2] http://www.berr.gov.uk/files/file30267.pdf

[3] "DTI – Company Law – Implementation of the European Directive on Cross-Border Mergers - Government Response and Summary of Responses to the Consultative Document" together with draft clauses available on the BERR website
http://www.berr.gov.uk/consultations/closedwithresponse/index.html

7.10. Guidance notes accompanying these regulations will be published on 16 October 2007.

7.11. The Secretary of State for Business, Enterprise and Regulatory Reform has primary responsibility for the Companies (Cross-Border Mergers) Regulations 2007.

## 8. Impact

8.1. A Regulatory Impact Assessment (attached to this memorandum) has been prepared which concludes that the Regulation is likely to have minimal impact on business as it is optional and only those who would benefit from using the framework would choose to use it.

8.2. The impact on the public sector should be negligible as the instrument applies to companies.

## 9. Contact

9.1. Sudha Oza at the Department for Business, Enterprise and Regulatory Reform. (Tel: 0207 215 2529 or e-mail: Sudha.Oza@berr.gsi.gov.uk) can answer any queries regarding the Regulations**.**

**Annex C**

# Final Regulatory Impact Assessment September 2007

## The Companies (Cross-Border Mergers) Regulations 2007

(Implementing 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 the Cross-Border Merger Regulations:

1. These regulations 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 expressly 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 Companies (Cross-Border Mergers) Regulations 2007 put in place new legal provisions to allow UK companies to participate in cross-border merger opportunities, as set out in the Directive. These regulations will apply to Great Britain and Northern Ireland.

## The Objective

3. **These regulations:**

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.
d.) protect existing employee participation rights in any of the merging companies

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. These regulations support the facilitation of mergers through a 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.

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. These regulations provide for the court to have the power to block the merger unless the necessary steps have been taken;

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

5. **Employee Participation:**

a.) These regulations cover 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 States – 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 merging companies 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. **These regulations:**

a.) Recognise 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.) These regulations lay down standard procedures that need to be followed for every cross-border merger. The main procedures are listed below:

v.) each of the companies involved is required to circulate the merger proposal, a management report and an independent expert’s report to shareholders etc.;

vi.) approval of the proposal by shareholders;

vii.) Registrar of companies will be required to execute certain functions such as publishing merger particulars in the Gazette; and

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 usually 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. These regulations will also apply 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 are restated in Parts 26 and 27 of the Companies Act 2006, which will come into effect in April 2008. 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 these regulations ) 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 hazard[1] 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.

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 company[2].

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

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

[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://ssm.com/abstract=321101>

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 Renneboog[3] 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 -

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 value[4].

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[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
[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.

*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 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 Renneboog[5]. 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 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

[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

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. These regulations put 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. Delays in implementing this legislation are not anticipated and the UK is on track to implement this Directive via these regulations, by 15 December 2007. In the event that there is an unexpected delay in this implementation , 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 expressly provide a mechanism for UK companies to carry out cross-border mergers with companies elsewhere in the EEA.  These regulations provide a further choice.

29.  **Option 1: Do nothing:**

- There can be no benefits by not implementing these regulations.  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 non-implementation of 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:**

- To implement the Directive 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 the Companies (Cross-Border Mergers) Regulations 2007 in the UK, a framework of rules will be laid down that facilitates cross-border mergers involving UK companies and companies elsewhere in the EEA.
- By implementing these regulations, 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. The Government has decided to implement these regulations in the UK via option 3 as options 1 and 2 would not give legal effect to the Directive and could leave UK open to infraction procedures.

33. 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

34. These regulations provide for cross-border mergers involving UK companies. In the UK, the implementing legislation will apply to the following types of entity (approximately 2.3 million in total): -

| Type of Company | Numbers[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 -** | **1000** |
| 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). | Not known as not required to register but not expected to exceed the above figure |
| **Unlimited companies -** | **5,750** |
| There are a small number of unlimited companies in the UK registered under the relevant companies legislation. The implementing legislation covers such companies. | |

[6] Data Source for these figures: Companies House

**Potential `Take Up' of these Regulations:**

In our discussion with representatives of UK companies, we did not receive 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 which is using takeovers to restructure.

35. As presented in the Economic Rationale section of the RIA, forecasting future mergers and acquisition (M&A) activity with any degree of 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 sought views on the likely take up of the cross-border merger procedure. The majority of the consultation responses commented that UK companies were unlikely to use this framework to restructure cross-border.

## Table 1: Evaluation of Option 3

| **Option 3 – Implementation of the Companies (Cross-Border Mergers Regulations 2007) in UK . (Regulations made under Section 2(2) of the European Communities Act 1972).** | |
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| **Costs** | **Benefits** |
| **Policy Costs**<br><br>This implementing legislation affects private and public companies. However, there is no direct cost impact on these companies. These regulations provide a framework for when companies **choose** to merge cross-border. Therefore, companies do not have to use this route for restructuring should they not wish to.<br><br>By implementing these regulations, 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 | **Policy Benefits**<br><br>These regulations offer companies a new and additional choice in cross-border restructuring exercises.<br><br>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.<br><br>Offers shareholders and creditors protection and provides for companies a clearer understanding of what is required in terms of procedures and the costs involved.<br><br>Opportunities afforded to restructure under these regulations implementing the Directive will be open to a very wide range of corporate entities, covering all sectors of the economy and sizes of company.<br><br>Restructuring activity brings |

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| company.<br>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): -<br>a.) A senior employee would consider whether there was a case for a cross-border merger to take place. The cost of | opportunities to embrace innovation and creativity; both contribute to building competitive companies and a more dynamic economy. |
| a manager spending two days (16 hours) considering whether there was a case for a cross-border merger is estimated to be £430[7].<br>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.<br>c.) Legal advice would be sought. The cost of such legal advice would clearly | |

[7] Data Source: Annual Survey of Hours and Earnings (ASHE) 2006.
[8] Information obtained from Lawrence Graham, member of the QCA Legal Committee.

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| 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-£5,000[8].<br><br>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).<br><br>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);<br><br>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). | |

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| 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.<br><br>c.) Meeting of company members held to consider proposal; and<br><br>d.) Approval of merger by UK court (and or cross-border aspects by relevant EEA authority).<br><br>**<u>Administrative Burdens</u>**<br><br>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).<br><br>**<u>Comparison of costs with domestic merger procedure</u>**<br><br>The merger procedures under the implementing legislation closely follow those in relation to domestic mergers. The differences in terms of costs are as follows:-<br><br>a.) An expert's report must be prepared for cross-border mergers involving | **<u>Administrative benefits</u>**<br><br>There are considered to be no administrative benefits. |

| | |
|---|---|
| private companies (such reports are only required for domestic mergers which involve a public company).<br><br>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.<br><br>**Employee Participation**<br><br>Employee participation provisions of the Directive will apply only 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 participation[9] aspects of the regulations. The overriding principle is that the applicable employee participation provisions will be those which exist in the EEA State where the merged company will have its registered office.  However, the following exceptions to the principle apply:

a.) Where at least one of the merging companies has more than 500 employees in the last 6 months and is operating under an employee participation system which meets the definition set out in the regulations; or

b.) Where the EEA State's 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 circumstances above apply, 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 and agree with an employee representative body known as the Special Negotiation Body (SNB)  the type of employee participation which will exist in the newly formed 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 Statute[10]. The employee participation provisions contained in the Cross-border Mergers Directive are broadly based on those contained in ECS Directive, which was implemented in the UK by the European Public Limited-Liability Company Regulations 2004. The examples set out below follow those used in the Regulatory Impact Assessment for the European Public Limited-Liability Company Regulations although that assessment referred to provisions for informing and consulting employees, as well as participation. The Cross-Border Mergers Regulations do not include any rules on information and consultation, which are already

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[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

covered by other legislation. Costs have been adjusted to take into account latest available data and information. Full details of the costs relating to the European Public Limited-Liability Company Regulations can be found in the Regulatory Impact Assessment, published in October 2003 by the Department of Trade and Industry[4].

## 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 EEA States to employee participation issues. Some Member States do not impose mandatory employee participation provisions (such as Italy and the UK). In EEA 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 transactions[5].

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 EEA State 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 EEA 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.

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 must be established. Any expenses

[4] ("Implementation of the European Company Statute: The European Public Limited-Liability Company Regulations" URN 03/1279).
[5] 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

relating to the 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. There are two possible outcomes:

i) the SNB and the management draw up a voluntary agreement for employee participation; 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 rules of the EEA State 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 EEA State where the participating companies have employees although this will not always be the case. In some EEA 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 £14,855[6]. There would be no additional balloting cost in the EEA States where works councils are used to nominate SNB members.

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[6] This is the cost for a ballot in GB only, and is broadly indicative for UK costs. 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]

48. The rules for the composition of the Special Negotiating Body (SNB) depend on a variety of factors including the number of merging companies and in how many Member States the employees are located and in what proportion etc. The method of determining the number of SNB members in the regulations implies that there will always be a minimum of 10 SNB members and currently, with the 30 countries of the EEA required to implement the employee participation provisions, 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 £24,700[7].

### 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 an EEA State that does not impose statutory participation rules at the same level as existed in the merging company with the highest level of participation. For example, where a UK company merges with a Swedish company which 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, subject to a ceiling of 33.3%) 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.

[7] 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 costs £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 uprated 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 £197,600[8].

**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.

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[8] 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** | **£79,255 – £227,455** |

**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 Public Limited-Liability Company Regulations 2004and 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 2005-06[9]. The average cost of appearing at an Employment Tribunal is £4,900 for the employer and £910 for the Employment Tribunal Service (ETS)[10]. These estimates include the amount awarded if the claimant is successful.

[9] http:/www.cac.gov.uk/cac_2_annual_report/Reports/FinalCACAnnualReport2005-2006.pdf
[10] DTI Employment Relations Research Series No.33:`Findings from the Survey of Employment Tribunal Applications 2003',http://www.dti.gov.uk/files/file11455.pdf

## Other Costs

61. **Charities and voluntary sector –** Some charities and voluntary sector organisations are also registered in the UK as companies within the scope of these regulations. 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 these regulations 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 originally laid down by the Directive and being implemented by these regulations, it is difficult to analyse the possible unintended consequences that may be faced as a result of implementing these regulations. Over time, it may be that UK companies do begin to merge cross-border using this facility. It is assumed that UK companies will only seek to avail themselves of the merger procedures under the regulations 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 aiming to lay final regulations for the Tax Mergers Directive before Parliament by end October/early November 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. These regulations provide 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.

- These regulations do 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, there is a concern that this framework could create an imbalance in terms of the options available to companies in third countries seeking to restructure with UK companies. However, as the present available restructuring mechanisms do not appear to have prevented non-EEA companies from entering into restructuring transactions with UK companies, the capacity for this framework to distort the corporate restructuring environment is very limited.

## Issues of Equity and Fairness

65. In working to facilitate the Single Market, these regulations apply 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 these regulations, 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.

## Race, Disability and Gender Equality Issues:

67. These regulations do not have a disproportionate impact on any particular sector of the community.

## Distributional Impacts

68. The distributional impact of any particular cross-border merger transaction will differ greatly depending on the circumstances of the transaction involved. These regulations apply across all business sectors and to companies of all sizes. Factors that will affect the distributional impact of these regulations 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 EEA 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.

69. As part of the safeguards required by the Directive and provided by these regulations, 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

70. These regulations apply 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, these regulations 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 these regulations on small companies alone. It is important to view such impact in the overall context of implementation of the Directive.

71. 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).

72. 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:**

73. 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 being implemented by these regulations.

**Competition Assessment:**

74. The competition filter has been applied. It has been concluded that the implementing regulations have 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 these regulations 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. It is not anticipated that these regulations would restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.

75. These regulations 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. These regulations would not affect competition, either positively or negatively. It is possible that these regulations could 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

76. As regards the merger procedure provisions of these regulations, 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.

77. 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.

78. 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 for Business, Enterprise and Regulatory Reform and the Department for Enterprise, Trade and Investment for Northern Ireland).

## Monitoring And Review

79. The Department will keep these regulations 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.

## Consultation

80. <u>Within government</u>
Before issuing the consultation document in March 2007, we consulted widely. This included the Ministry of Justice(formerly the 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.

81. <u>Public consultation</u>

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. Generally, consultees were supportive of the principle underlying the Directive. Interest in the Directive was however, relatively low.

82. 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.

83. The Government consulted on the implementation of the draft Cross-Border Merger Regulations between the period 5 March 2007 - 1 June 2007. Ten responses were received. The Government's response to the consultation was published on 31 August 2007. (http://www.berr.gov.uk/files/file41185.pdf).

## 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 our consultations have guided us in determining the Government's approach to this implementation.

## Declaration

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

**Signed Stephen Timms, Minister of State for Competitveness** **Date 15th October 2007**

Department for Business, Enterprise and Regulatory Reform

Contact

Sudha Oza, Department for Business, Enterprise and Regulatory Reform, Corporate Law and Governance Directorate, Bay 565, 1 Victoria Street, London. SW1H 0ET, Telephone: 0207 215 2529, e-mail: sudha.oza@berr.gsi.gov.uk

Marleen Jannink, Department for Business, Enterprise and Regulatory Reform, Employment Relations Directorate, Bay 462, 1 Victoria St, London.SW1H 0ET. Telephone: 020 7215 3135, E-mail: marleen.jannink@berr.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 |
| **TotalM&A** | **33 424** | **3223** | **7 034** | | **43681** |
| **Tota 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.** | | | | | |

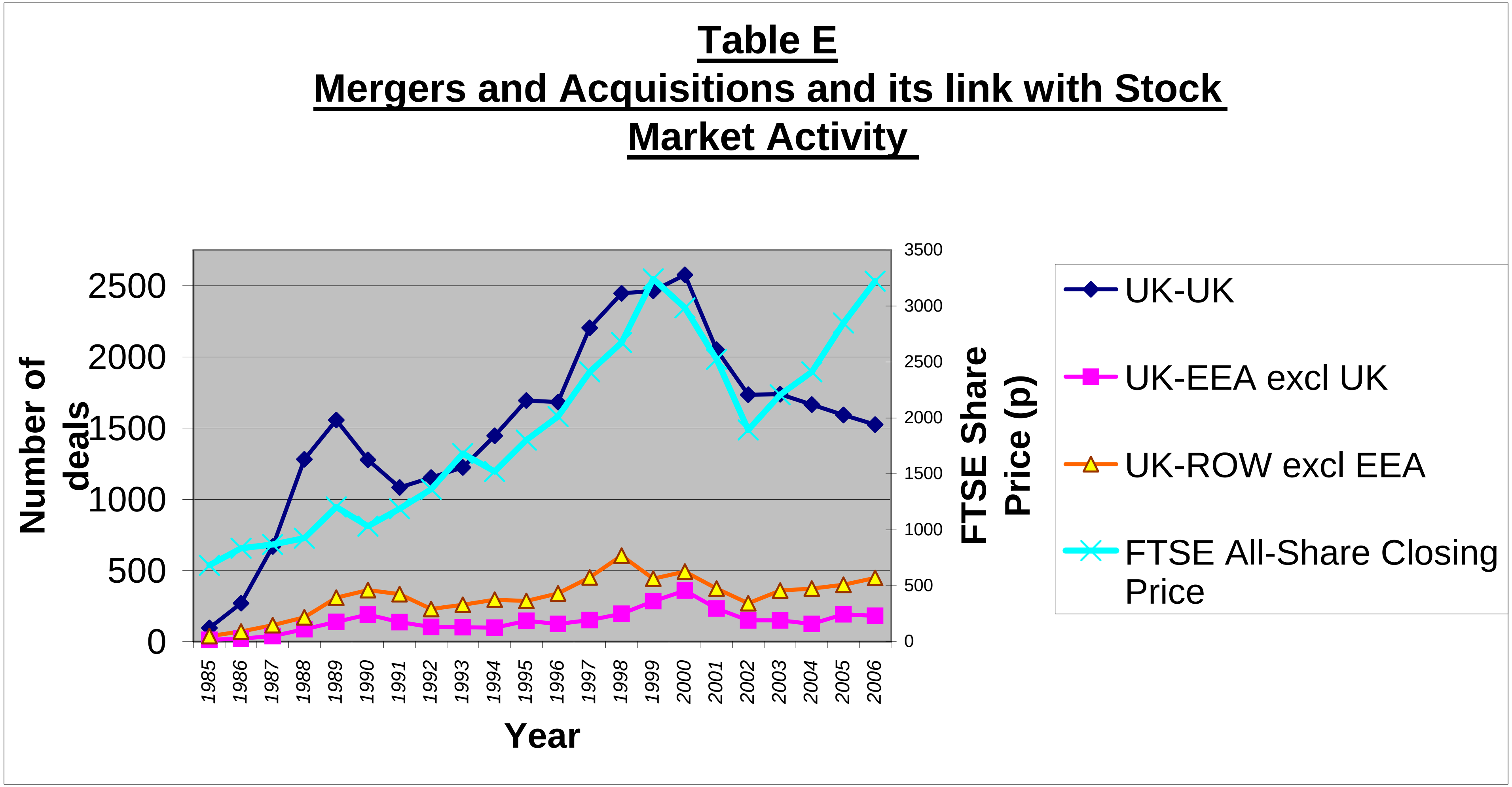

Table E
Mergers and Acquisitions and its link with Stock Market Activity
Number of deals
2500
2000
1500
1000
500
0
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Year
3500
3000
2500
2000
1500
1000
500
0
FTSE Share Price (p)
UK-UK
UK-EEA excl UK
UK-ROW excl EEA
FTSE All-Share Closing Price

TRANSPOSITION NOTE

DIRECTIVE 2005/56/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 26 OCTOBER 2005 ON CROSS-BORDER MERGERS OF LIMITED LIABILITY COMPANIES

The Companies (Cross-Border Mergers) Regulations 2007

The Companies (Cross-Border Mergers) Regulations 2007 implement in the UK 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 L310, 25.11.2005, p.1). The Directive must be implemented by 15 December 2007.

The Directive aims to increase company mobility in the Single Market by laying down a framework of rules facilitating cross-border mergers between companies in the EU and requiring the removal of obstacles in national laws to such mergers. It applies in relation to public and private companies with limited liability, and to mergers involving at least two companies from different Member States. The Directive extends to companies in the European Economic Area by virtue of Decision of the EEA Joint Committee No. 127/2006 of 22 September 2006 amending Annex XXII (Company law) to the EEA Agreement (OJ L 333, 30.11.2006, p.59).

The Directive sets down a number of requirements which must be met before a cross-border merger can be completed. In particular, there are safeguards for shareholders: they must approve the merger and must have the right to inspect a number of documents, including the draft terms of the merger and a report prepared by an independent expert. In certain circumstances, the companies involved must also ensure that there are adequate employee participation arrangements. The merger must be approved by a national authority designated for this purpose, and must be publicised in the relevant national register of companies.

To date, there is nothing in UK law which expressly provides for cross-border mergers of companies. Parts 26 and 27 of the Companies Act 2006 (which restate Part 13 of the Companies Act 1985) provide for ‘domestic’ mergers of UK companies (i.e. mergers with other UK companies). A number of those provisions implement the Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies (OJ L 295, 20.10.1978, p. 36), which is similar in many ways to Directive 2005/56/EC.

The Regulations implement the Directive’s framework of rules, enabling UK companies to engage in cross-border mergers if specified conditions are met. In one significant respect they go beyond the Directive’s requirements: they give a company’s creditors the rights to demand a meeting, and if such a meeting is held, then the merger must be approved by a majority of the creditors at that meeting. This is consistent with the requirements for ‘domestic’ mergers in the Companies Act 2006.

Responsibility for the measures, described in this transposition note, taken to implement the Directive lies with the Secretary of State for Business, Enterprise and Regulatory Reform.

The table below describes how the substantive provisions of the Directive are implemented.

| **Directive 2005/56/EC on cross-border mergers: Transposition Measures** | | |
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| **Article** | **Objective** | **Implementation in Companies (Cross-Border Mergers) Regulations 2007** |
| 1 | Defines the scope of the Directive in terms of the companies to which it applies. | Scope is reflected in definition of “cross-border merger” in regulation 2. |
| 2.1 | Defines ‘limited liability company’ to which Directive applies. | Directive definition reflected in definitions of “UK company” and “EEA company” in regulation 3(1). |
| 2.2 | Defines cross-border merger as mergers by absorption, merger by formation of new company, or merger by absorption of wholly-owned subsidiary. | Directive definitions reflected in definition of “cross-border merger” in regulation 2. |
| 3.1 | Provides option for applying Directive to merger by absorption or merger by formation of new company where cash payment made in excess of 10% of value of transferee company’s shares. | Option implemented in regulation 2(2)(f)(ii) and 2(4)(c)(ii). |
| 3.2 | Provides option for not applying Directive to mergers involving cooperative societies. | Option exercised: no provisions for cooperative societies. |
| 3.3 | Provides option for not applying Directive to mergers involving open-ended investment companies. | Option exercised: no provisions for open-ended investment companies. |
| 4 | Provides that: | |

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| | • cross-border mergers only possible between types of company which may merger under national law;<br>• a merging company must comply with the national law to which it is subject, and national law may contain measures for the protection of creditors and others; and<br>• national laws may allow a merger to be opposed on grounds of public interest. | Reflected in definitions of "UK company" and "EEA company" in regulation 3(1).<br><br>Reflected in application of regulations 6(1) and 16(1)(a) to UK companies. Regulation 14 (creditors' meeting) included for the protection of creditors.<br><br>No specific implementation required. |
| 5 | Sets out the particulars which must be contained in the draft terms of merger. | Implemented in regulation 7(1) and (2). |
| 6 | Requires the publication in a specified format of the draft terms of merger. | Implemented in regulation 12. |
| 7 | Requires management organ of a merging company to draw up a report explaining aspects and implications of the merger; requires employees' representatives to be consulted and their opinion appended to the report. | Implemented in regulations 8 and 10. |
| 8.1 | Requires an independent expert's report to be drawn up for each merging company. | Implemented in regulations 9 and 10. |
| 8.2 | Allows independent expert to be appointed jointly for merging companies. | Implemented in regulation 9(2)(b) and (c). |
| 8.3 | Specifies particulars to be included in expert's report, and gives expert the right to secure information from merging companies. | Implemented in regulation 9(5) and (6). |
| 8.4 | Provides that expert's report not required if members of all merging companies agree. | Implemented in regulation 9(1)(c). |

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| 9.1 | Requires approval of draft terms of merger by general meeting of each merging company. | Implemented in regulation 13. |
| 9.2 | Allows general meeting to make merger condition on ratification of employee participation arrangements. | Implemented in regulation 13(2)(a). |
| 9.3 | Permits option for national law not to require general meeting approval if specified conditions are met. | Implemented in regulation 13(4). |
| 10.1 | Requires designation of court or competent authority to scrutinise pre-merger procedure. | Implemented in regulation 6(1). |
| 10.2 | Requires designated authority to issue a certificate attesting to completion of pre-merger formalities. | Implemented in regulation 6(2). |
| 10.3 | Permits procedure for amending the ratio applicable to the exchange of shares in specified circumstances, if members of merging companies in other Member States agree. | Implemented in regulation 13(2)(b). |
| 11.1 | Requires designation of court or competent authority to scrutinise completion of merger procedure. | Implemented in regulation 16(1). |
| 11.2 | Requires pre-merger certificate granted under Article 10.2 to be submitted to designated authority within 6 months. | Implemented in regulation 16(1)(b), (c) and (d). |
| 12 | Requires national law applicable to transferee company to determine the date when merger takes effect. The date must be after the scrutiny under Article 11. | Implemented in regulation 16(2). |

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| 13 | Requires completion of merger to be publicised in a specified form in register of companies. | Implemented in regulation 19. |
| 14.1 | Specifies consequences of a merger by absorption or a merger by absorption of a wholly-owned subsidiary. | Implemented in regulation 17. |
| 14.2 | Specifies consequences of a merger by formation of a new company. | Implemented in regulation 17. |
| 14.3 | Provides that, where national law requires further formalities for the transfer of assets, rights or obligations of the merging companies to be effective, these shall be carried out by the transferee company. | Implemented in regulation 17(3). |
| 14.4 | Provides that employment rights and obligations of the merging companies shall be transferred as a result of the merger. | Implemented in regulation 17(1)(b). |
| 14.5 | Provides that:<br>(a) the transferee company may not receive its own shares in exchange for any shares it held in the transferor company; and<br>(b) the transferor company may not receive any of the transferee company's shares in exchange for any of its own shares which it was holding. | Implemented in regulation 7(4)(a)(ii).<br>Implemented in regulation 7(4)(a)(i). |
| 15.1 | Allows simplified merger formalities for a merger by absorption of a wholly-owned subsidiary. | Implemented in regulations 7(3), 9(1)(a) and 13(3). |
| 15.2 | Allows simplified merger formalities for a merger by absorption of a 90%-owned | Implemented in regulation 9(1)(b). |

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| | subsidiary. | |
| 16.1 | Provides that 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. | Implemented in regulation 22(1) and (2). |
| 16.2 | Provides that Article 16.1 shall not apply where resultant national law would not provide at least the same level of employee participation as operated in the merging companies. | Implemented in regulation 22(1) and (2). |
| 16.3 | Provides that 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, mutatis mutandis, in accordance with the principles and procedures laid down in Article 12(2), (3) and (4) of Regulation (EC) No 2157/2001 (Council Regulation on the Statute for a European Company) and specified provisions of Directive 2001/86/EC (Council Directive supplementing the Statute for a European Company with regard to the involvement of employees). | The applicable provisions and their transposition are set out below. |
| 16.4(a) | Provides that the merging companies may choose, without any prior negotiation, to be subject to the standard rules on participation | Implemented by regulation 36. |
| 16.4(b) | Provides that the SNB may choose by a 2/3 majority to be subject to the rules on participation in force in the Member State where the transferee company is registered. | Implemented by regulation 31. |
| 16.4(c) | Provides that Member States may provide that | Implemented by regulation 39. |

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| | where the standard rules apply following negotiations, the proportion of employee representatives in the transferee company should be limited; where a merging company had had employee representation of at least on third, the limitation may be no lower than one third. | |
| 16.5 | Provides that employees in Member States other than where the transferee is registered need not be taken into account when calculating the size of workforce thresholds giving rise to participation rights under national law | Reflected in definition of “UK company” in regulation 3(1). |
| 16.6 | Provides that the transferee should be in such a form as to allow exercise of participation rights, where the exercise of participation rights is provided for by the Directive. | Implemented throughout the regulations. |
| 16.7 | Provides that where a transferee company operating under an employee participation system engages in a domestic merger, employee participation rights should continue for three years after the merger. | Implemented by regulation 40. |
| 17 | Provides that a merger may not be declared null and void after it has taken effect. | Implemented in regulation 16(3). |
| 18 | Requires the Commission to review the Directive in 2012. | No implementation required. |
| 19 | Requires that the provisions of the Directive be transposed no later than 15 December 2007. | Regulation 1(2) provides that the Regulations come into force on 15 December 2007. |
| 20 | Provides that the Directive enters into force on the 20th day after publication in the Official | No implementation required. |

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| | Journal of the EU. | |
| 21 | Addresses the Directive to the Member States. | No implementation required. |
| **Provisions of Regulation (EC) No 2157/2001 (Council Regulation on the Statute for a European Company) applied by Article 16.3 of Directive 2005/56/EC** | | |
| 12.2 | Provides that a transferee company may not be registered unless an agreement on employee participation has been concluded or the period for negotiations has concluded. | Implemented by regulation 16(1)(f). |
| 12.3 | Provides that where Member States exercise the option that the standard rules on employee participation shall not apply (as provided for by Article 7(3) of Directive 2001/86), an employee participation agreement must be negotiated between the SNB and the merging companies where a merging company operated a system of employee participation. | Option in Article 7.3 of Directive 2001/86 not exercised by UK and therefore this paragraph is not applicable. |
| 12.4 | Provides that the statutes of the transferee company must not conflict with the arrangements for employee participation. | Implemented through Part 4 (since company will not be able to agree to employee participation arrangements under Part 4 if its articles are in conflict). |
| **Provisions of Directive 2001/86/EC (Council Directive supplementing the Statute for a European Company with regard to the involvement of employees) applied by Article 16.3 of Directive 2005/56/EC** | | |
| 3.1 | Provides that the merging companies shall start negotiations with employee representatives on arrangements for their involvement in the transferee company as soon as possible after publishing the draft terms of merger. | Implemented in regulation 23(1) and (2) and regulation 25. |

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| 3.2 | Regulates the composition of the Special Negotiating Body (“SNB”). | Implemented in regulation 26. |
| 3.3 | Provides that the SNB shall determine written arrangements for the involvement of employees within the transferee company. | Implemented in regulation 25(2) and 29(1) |
| 3.4 | Regulates the voting procedures of the SNB. | Implemented by regulation 30(1) to (4). |
| 3.5 | Provides that the SNB may be assisted by experts. | Implemented by regulation 30(6). |
| 3.7 | Provides that the expenses of the SNB shall be borne by the participating company, although funding of experts may be limited by national law to one. | Implemented by regulation 30(7). |
| 4.1 | Provides that the merging companies and SNB shall negotiate in a spirit of cooperation with a view to reaching an agreement on employee participation. | Implemented by regulation 28(2) |
| 4.2 | Regulates the content of an employee participation agreement | Implemented by regulation 29(2). |
| 4.3 | Provides that the agreement shall not be subject to the standard rule sunless specified. | Implemented by regulation 29(3). |
| 5 | Regulates the duration of negotiations | Implemented by regulation 28(3). |
| 6 | Provides that the legislation applicable to the negotiation procedure shall be that of the member state where the transferee company will be situated. | Implemented by Part 4. |
| 7.1 | Provides that MS shall provide a system of standard rules on participation. | Implemented by regulation 38. |

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| 7.2 | Limits the circumstances in which the standard rules may apply. Provides that where more than one form of employee participation existed in the participating companies, the SNB shall decide which of those forms should apply in the transferee company. | Implemented by regulation 37(2) and (3). |
| 7.3 | Provides that Member States may provide that the standard rules shall not apply. | Option not exercised by UK. |
| 8.1 | Provides that the SNB and others who receive confidential information shall hold it in confidence. | Implemented by regulation 41. |
| 8.2 | Provides that a merging or transferee company is not required to disclose information where its disclosure would seriously harm the company. | Implemented by regulation 42. |
| 8.3 | Provides that Member States may make provision for information sharing and expression of opinion by transferee | Option not exercised by UK |
| 8.4 | Provides for judicial supervision of Article 8 rights and obligations. | Implemented by regulation 41 and 42. |
| 10 | Provides that members of the SNB and those chosen to represent employees in the transferee company shall enjoy the same protections as national legislation confers on employee representatives | Implemented by regulation 43, 44, 45, 46, 47, 48, 49. 50, 51 and 52 |
| 12 | Provides that a UK company, subsidiary to an EEA transferee company, and its employees, shall be subject to the provision of the Directive. | Reflected in definition of “UK company” in regulation 3(1). |

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| 13.4 | Provides that Member States may take measures to guarantee that existing structures of employee representation in merging companies should continue in the transferee company. | Option not exercised by the UK |
| Annex: Part 3(b) | Sets out the standard rules on employee participation | Implemented by regulation 38 |

*Department for Business, Enterprise and Regulatory Reform*
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