

The French SE: An Attractive Tool to Facilitate An International Merger?

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Introduction

With the development of the European economic cooperation and the consecutive increase of the intra-European business partnerships, the question of the European cross-border mergers has become crucial. However, the European legislator seemed to be absent of such debate for many years. As a matter of fact, European cross-border mergers remained very complex to achieve, mainly due to a lack of a clear and practical legislation.

In order to favour such cross-border transactions, the European legislator contemplated to enact specific cross-border mergers legislation. However, the latter encountered various difficulties and was consequently not adopted until 2005.

The 3rd Directive 78/855/EEC promulgated on 9 October 1978, on corporate law, more specifically on merger of companies, was merely referring to public limited companies incorporated in a same Member State which, as a matter of fact, excluded the private limited companies as well as any cross-border operation. The other directive, Directive 90/434/EEC adopted on 23 July 1990, on tax law, addressed the tax implications of cross-border mergers between companies incorporated in different Member States. However, the weakness of the 3rd Directive 78/855/EEC was, in fact, limiting the efficiency of the Directive of 23 July 1990.

Further, the European legislator envisaged the creation of a European Company Statute in order to consolidate European corporate law, and which Statute was

formally adopted, after lengthy negotiation process, in 2001 (*Regulation 2157/2001 of 8 October 2001* on the Statute for a European Company (the “Regulation”) and *Directive 2001/86/EC of October 2001* completing the

Statute for a European Company with regards to the incentive policy to the benefit of employees in the European Company).

The French legislator recently adopted provisions on the implementation of the Regulation in France in the *Loi n°2005-842* promulgated on 26 July 2005 (hereafter referred to as the “French Legislation”) and which has been incorporated in the French Commercial Code in its articles L.229-1 and following. The adoption of this legislation was the result of an intensive debate. Indeed, draft bills were proposed by some members of the French Parliament, and particularly by French Senator Philippe Marini, whose objective was to set up provisions as attractive as it could be in order to favour the incorporation of European Companies in France.¹

Upon their enactment, the Regulation and the French Legislation both raised questions amongst practitioners (lawyers, accountants, bankers, consultants) such as:

- What are the perspectives opened by the European Company Statute?
- Will it favour or facilitate the implementation of cross-border mergers?
- What is its contribution in comparison with the former European legislation pertaining to cross-border mergers?
- Is the French SE attractive to implement cross-border mergers?

These questions will be dealt with in this article. For the sake of clarity, this article will not cover the questions pertaining to listed companies as the latter are subject in

¹ See Professor M. Menjucq, *Implementation in France of the regulation on the European Company: a strategic interpretation*, in *European Company law*, n° 04/3. In this article, M. Menjucq studied in detail the draft bill proposed by French Senator Marini on 17 October 2003.

France to the *Code Monétaire et Financier* insofar as public issue is concerned.

1. Perspectives opened by the European Company Statute

The European Company Statute is a uniform system of rules which concerns every European Company regardless of its country of incorporation, in the European Union. Therefore, such statute clearly aims at streamlining and harmonizing European company law.

One of the most salient questions pertaining to this Statute is whether or not such Statute would open new perspectives in terms of European cross-border operations and, in particular, whether such European Company Statute would favour intra-European transactions, hence strengthening the comparative advantages of European companies.

However, it would be fair to acknowledge that before raising legal issues, intra-European concentrations, and particularly cross-border mergers, raise operational and financial concerns such as, amongst others, integration and reorganization of management teams, implementation of synergies (purchase and production process, strategy, commercial policy, distribution and development of an international network), financial and accounting synergies (cash pooling and more generally negotiation with banks of more favourable conditions of financing, integration of a standardized accounting policy), and finally tax integration (applicable tax regime and optimization).

Needless to say that these operational and financial concerns are of paramount importance in the decision making process of a contemplated cross-border merger. However, once overcome this first step, the decision makers should consider carefully the competitive advantages that they can derive from the legal regime of the said merger.

One of the major legal issues faced by managers is the fact that some Member States do not even recognize the existence of cross-border mergers. This concern was recently

addressed, as far as Germany is concerned, by the Court of Justice of the European Communities (CJEC) in the SEVIC Systems AG ruling². Indeed, the CJEC has been confronted to the fact that only legal entities incorporated in Germany may be subject to mergers. Provisions of the German law concerning the registration of mergers do not apply to cross-border mergers and there are no analogous rules for such operations. Internal and cross-border mergers are consequently treated differently in this Member State.

The CJEC has considered this difference of treatment between internal and cross-border mergers as contrary to the freedom of establishment provided by Articles 43 and 48 of the EC Treaty. The potential consequences of such decision and its potential influence on the future success of the SE will be treated below.

Besides this specific concern, the Preamble of the Regulation clearly highlights that the aim of the European Company Statute is to facilitate cross-border mergers and, more particularly, to give to managers positive solutions to overcome the operational and legal concerns usually engendered by the implementation of cross-border mergers.

As a matter of fact, the European Company Statute tends to provide a uniform system of rules covering all the steps of the company's life, starting from its incorporation all the way to its management and general operations.

1.1. Incorporation

The Regulation provides four ways to incorporate a European Company, which are as follows:

- cross-border merger of public limited liability companies;
- incorporation of a holding company by public or private limited liability companies;

² Court of Justice of the European Communities, Case C-411/03, Sevic Systems AG, 12-13-2005. See extensively about this landmark decision the articles of Thomas Rønfeldt/Erik Werlauff and Paul Storm in *ECL* 06/4.

- formation of a joint subsidiary; or
- conversion of a public limited company previously formed under national law.

With the adoption of such Regulation, practitioners may now refer to its Article 17 which provides that a European Company may be formed either (i) through a merger - amalgamation or (ii) through a merger by the incorporation of a new company (between, exclusively, public limited liability companies registered in two different Member States).

The incorporation of a European Company by a cross-border merger is the most striking contribution of the European Company Statute as it gives a legislative framework to companies of different nationality willing to merge.

Hence, at first glance, the European Company Statute seems to be a new and efficient tool to facilitate cross-border mergers.

It emerges though that a careful review of the European Company's features is necessary to assess its practical interest for managers.

In the premises, it would be important to define the legal regime of a "European Company".

In this respect, the European legislator has taken a pragmatic approach as:

- The European Company Statutes refers to public limited companies which is a very common type of entity, used all over Europe (e.g. a *société anonyme* in France)³.
- Moreover, a European Company is governed by the provisions of laws which would apply to a public limited-liability company when matters are not, or not entirely, regulated by the Regulation⁴.

³ Article 3, §1 of the Regulation : *For the purposes of Article 2(1), (2) and (3), a European Company shall be regarded as a public limited-liability company governed by the law of the Member State in which it has its registered office.*

⁴ Article 9, §1 of the Regulation:

An SE shall be governed:

(a) by this Regulation,

Regarding these provisions of the Regulation, Philippe Marini had proposed in his draft bill to improve and simplify the French *société anonyme* regime in order to make it more flexible⁵. As a European Company incorporated in France would be partly governed by the same rules as those which apply to the *sociétés anonymes*, his objective was to set up more attractive rules to favour the incorporation of European Companies and the implementation of cross-border mergers in this Member State. However, the legislator did not retain this part of the draft bill (simplification of the *société anonyme* regime) when the French Legislation on the European Company was adopted.

- Article 4 of the Regulation provides that the subscribed capital of a European Company shall not be less than € 120,000. It also gives Member States the option to adopt provisions requiring a greater subscribed capital for European Companies carrying on certain types of activities. The French legislator did not use this option. Indeed, the amount of € 120.000 is already likely to discourage a significant number of companies incorporated in France. One can even regret that the Regulation did not give Member States the possibility to decrease this minimum required capital for companies carrying on smaller businesses.

(b) where expressly authorized by this Regulation, by the provisions of its statutes

or

(c) in the case of matters not regulated by this Regulation or, where matters are partly regulated by it, of those aspects not covered by it, by:

(i) the provisions of laws adopted by Member States in implementation of Community measures relating specifically to SEs;

(ii) the provisions of Member States' laws which would apply to a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office;

(iii) the provisions of its statutes, in the same way as for a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office.

⁵ See Professor M. Menjucq, *Implementation in France of the regulation on the European Company: a strategic interpretation*, in *European Company law*, n° 04/3.

- Article 17 of the Regulation allows cross-border mergers to be carried out in accordance with the procedure established for mergers of public limited companies which are incorporated in a same Member State.

What are the practical consequences of such provision? Pursuant to a debate existing within the French doctrine, a merger between two companies of different nationality could be analysed as incurring the transfer of the registered office of the absorbed company.

According to this view, even if not shared by all the French doctrine⁶, the transfer of the registered office incurs a change of the nationality of the absorbed company. Under French law, the change of nationality of a company requires the **unanimous consent of its shareholders**. Therefore, if we consider that a cross-border merger can be implemented pursuant to the European Company Statute (*i.e.* that it may follow the procedure established for mergers of companies incorporated in a same Member State pursuant to Article 17), it shall not be analysed as a transfer of the registered office (and hence as a change of nationality) of the absorbed company.

Hence, the practical consequence of such provision is that there is no requirement for the unanimous consent of the shareholders of companies that are involved in a cross-border merger. Needless to say that such flexibility can be strongly appreciated by international investors facing from time to time minority shareholders oppositions.

Moreover, Article 29, §1, c) of the Regulation confirms such assumption. Indeed, it provides that the absorbed company is automatically wound up by virtue of the implementation of the cross-border merger. As the absorbed company is dissolved, the question of its change of nationality can not be raised anymore. As a consequence, there is no doubt on the fact that the unanimity of the

shareholders is not required for cross-border mergers implemented pursuant to the European Company Statute.

- Concerning the protection of the minority shareholders, Article 24⁷ of the Regulation provides the option for a Member State to implement a procedure to ensure the protection of minority shareholders who have voted against the implementation of a cross-border merger. However, as the implementation of such protection of minority shareholders is merely an option at the sole discretion of the Member States, some countries (e.g. France) voluntarily decided not to implement it in order to make the European Company more attractive. As a matter of fact, the absence of such regime of protection of minority shareholders is of notable importance as it has a substantial impact on the financial cost of the merger. Indeed, the absence of right of the minority shareholders to veto the cross-border merger facilitates clearly its implementation as it avoids the extra cost linked to the purchase of the minority group's participation in the absorbed company.
- Finally, it is worthwhile noting that, French law (article L. 229-6 of the French Commercial Code) has used the option mentioned in Article 3 (2) of the Regulation, so that a European Company can be incorporated by just one shareholder, under the condition that this sole shareholder is a European Company itself.

⁷ Article 24:

1. The law of the Member State governing each merging company shall apply as in the case of a merger of public limited-liability companies, taking into account the cross-border nature of the merger, with regard to the protection of the interests of:

(a) creditors of the merging companies;

(b) holders of bonds of the merging companies;

(c) holders of securities, other than shares, which carry special rights in the merging companies.

2. A Member State may, in the case of the merging companies governed by its law, adopt provisions designed to ensure appropriate protection for minority shareholders who have opposed the merger.

⁶ See JP Bertrel, *La société européenne entre son passé et son avenir*, Droit & Patrimoine, 2004 n°125, p.59.

It is interesting to observe that this “sole shareholder rule” is derogatory to the French *société anonyme* regime (article L. 225-1 of the French Commercial Code) pursuant to which a *société anonyme* can not be incorporated with less than seven shareholders. Besides, in the part of his draft bill concerning the simplification of the French *société anonyme* regime, finally not retained in the French Legislation on the European Company as mentioned above, Senator Philippe Marini had suggested to create a *société anonyme* with only one shareholder.

1.2. Management of the European Company

- Modalities and consequences of the transfer of the registered office

The standardization of the regime of transfer of registered office is also an indirect way to facilitate cross-border mergers. Indeed, pursuant to Article 8, §1 of the Regulation, the registered office may be transferred to another Member State whilst such transfer shall not result in the winding up of the European Company or in the creation of a new legal entity.

In other words, the transfer of the registered office of a company to another Member State shall not incur, in principle, the winding up of the said entity and the tax consequences attached (taxation of all outstanding taxes due until the date of such winding up. Such outstanding taxes shall, amongst others, include corporate tax, business tax, etc).

There is no doubt that the tax neutrality of such transfer may have a direct impact on the decision making process of some investors as to whether completing the contemplated cross-border operation or not.

However, the legal advisor confronted to such question will have to verify whether, in practice, these provisions conflict with internal rules of the concerned European Member State.

For example, the French legislator has adopted a taxation law in order to comply with the requirements of the European regulation pertaining to the transfer of the registered office of a European Company. Article 34 of the *Loi de finances for 2005* provides the tax neutrality of the transfer of the registered office of a company (private or public limited share company, European Company, etc.) incorporated in France, to another Member State. It is however important to note that this tax neutrality is applicable provided that the assets of the company do remain in France⁸.

The French Legislator has also adopted provisions concerning the minority shareholders whom oppose the transfer of the registered office of a European Company. Indeed, the said minority shareholders may obtain the repurchase of their participation in the transferred company (article L. 229-2 of the French Commercial Code). As a matter of fact, the French legislator implemented a more protective procedure than the one, which is described above, adopted for the minority shareholders who vote against a cross-border merger

Given the current legislation on the transfer of registered offices (the proposition of 14th *Directive* on transfer of cross-border registered offices has never entered into force), the provisions of the Regulation in this respect are undoubtedly an essential contribution to improve the European companies’ mobility and hence to facilitate cross-border mergers.

It is finally significant to note that the French legislator has found important to provide in the article L.229-1 of the French Commercial Code (and as mentioned in Article 7 of the Regulation) that the registered office and the principal place of management (*administration centrale*) of a European Company can not be separated. This specific provision has certainly a tax reason hidden behind it.

- The traditional alternative between the dual and the single management corporate body

⁸ See Revue de Droit Fiscal, n°1-2, 2005, p.61.

Article 38 of the Regulation provides that a European Company may comprise either a supervisory body and a management body (the so-called “two-tier system”) or a single administrative/management body (the so-called “one-tier system”) depending on the form adopted in the Memorandum and Articles of Association. In fact, the European legislator, taking into account the various internal legislations, has not imposed a single system of corporate management body.

The choice between the one-tier system and the two-tier system has practical consequences on the management of the European Company as it determines its decision making process. Besides, the modalities of each system’s decision making process are specified in Articles 39 to 51 of the Regulation.

As a matter of fact, the provisions mentioned above were adopted by the European legislator in order to respect the specificities of national corporate laws. Indeed, in some Member States (e.g. France) the one-tier system is the most common corporate body organisation whereas in others, the two-tier system turns out to be the standard.

It would be fair to say that the approach of the European legislator tends to be pragmatic as it provides a certain level of flexibility to managers. Indeed, as mentioned earlier, cross-border mergers may create issues at the management level of the merging companies. A choice of management corporate bodies (one-tier system or two-tier system) may provide a fairly satisfactory response to specific concerns pertaining to the allocation of the management and operational positions (executive and non executive chairman, supervisory board vs. directory or management board).

Besides of these considerations, the provisions of Article 38 may also raise questions concerning the long-term efficiency of the European Company Statute. Indeed, as the Regulation does not impose a uniform corporate body system, practitioners will be undoubtedly involved in a near future in operations between European Companies organised under different systems. Then, they might encounter the same operational hindrances as before as far as the integration of management teams is concerned.

- Modalities of transfer of shares

The European Company Statute authorises, under French law, the standard provisions to be inserted in the Memorandum and Articles of Association relating to the limitation of transfer of shares such as:

- a. Inalienability Clause: this clause can be inserted provided that the inalienability does not exceed ten years (Article L. 229-11 al 2 of the French Commercial Code);
- b. Pre-emptive Right, which has been extensively used in all types of legal entities and which principle does not require further explanation;
- c. Drag and Tag along Rights: these specific provisions have proven very useful whether as a minority shareholder (where the exercise of the tag along right offers the opportunity to sell its participation together with the majority shareholders’ one) or as a majority shareholder (where the exercise of the drag along right permits to “drag” the minority shareholders to the sale to a potential purchaser).

Others provisions may also be inserted such as the exclusion and suspension of non-financial rights clause in the case of a change of control (e.g merger) of the European Company.

According to Senator Philippe Marini, this flexibility provided to non-listed European Companies is inspired by the attractive *sociétés par actions simplifiées* regime and benefits from the provisions of Article 9 of the Regulation⁹.

Last but not least, the *Ordonnance* adopted by the French legislator on 24 June 2004 created the Preference Shares (generally similar to the US regime of the Preferred Shares). The Preference Share is a specific type of shares which aim is to replace progressively the former notion under French law of *valeurs mobilières composées*

⁹ See M. Menjuçq, L’introduction de la société européenne en droit français, JCP G n°38, 21 September 2005, p. 1668.

(structured securities) by creating a uniform and simplified set of rules applicable to such type of securities.

The Preference Shares offer specific rights (financial, voting) to their holders, it being understood that such rights can be determined by the shareholders pursuant to the general principle of contractual freedom (save the respect of any public order requirement). The Preference Shares can be issued in companies with a share capital (such as a public limited liability company). Hence, although not expressly specified, one can assume that the Preference Shares could be issued in the context of a European Company. Needless to say that this right shall increase substantially the attractive power of the European Company (at least in countries where Preference Shares do exist) particularly for private equity investors whom have been instrumental in the adoption of the Preference Shares regime in France.

The French legislator is one of the first national legislators that has provided a sanction in the event of a breach of the above provision. Indeed, Article L. 229-11 *alinea* 2 of the French Commercial Code (which refers specifically to the European Company) provides that any transfer of shares made in violation of the above contractual restrictions shall be deemed null and void.

The necessary implication of the European countries in the enactment, under each national legislation, of the potential sanctions in the event of a breach of the provision of the Regulation is typical of the limits of the said Regulation.

As a preliminary conclusion, we can assert, from the above review of the European Company's most salient features, that it clearly provides a new tool to facilitate cross-border mergers and that the implementation of this tool in French law gives particularly attractive solutions to managers.

On the other hand, it is certainly too early to draw definitive conclusions on the efficiency of such new type of legal entity, specifically on its impact on cross-border mergers. It is however thinkable to identify certain limits that may restrict the efficiency of the European Company.

2. Limits and perspectives of evolution

Practitioners as well as managers have shown legitimate expectations on the favourable impact that the European Company may have on European cross-border transactions.

However, it would be fair to say that we can already foresee, in the text of the Regulation itself, the potential limits of the development of the European Company as a new tool to facilitate cross-border mergers.

First, Article 17 of the Regulation addresses only public limited liability companies, excluding hence (and principally) private limited companies. This legal exclusion undeniably reduces the scope of application of the European Company Statute as a tool to favour cross-border mergers given that a significant number of companies incorporated in Europe are not eligible to such operations.

Secondly, the absence of taxation provisions in the Regulation can also be seen as a hindrance to its development as a tool to facilitate such international operations, in particular since the tax consequences of such operations are always put under strict scrutiny by the initiators of such operations¹⁰. As of today, the tax regime applicable to a European cross-border merger is the one applicable to each Member State concerned by the said operation.

However, we could foresee an attempt by the European legislator to improve such tax deficiency by adopting the *Directive 2005/19/CE* on 17 February 2005. Indeed, this Directive improves and updates the *Directive 90/434/EEC* adopted on 23 July 1990 concerning the tax consequences of cross-border mergers. In practice, the provisions pertaining to tax neutrality regime applicable to such operations can now apply to the mergers involving European Companies.

In addition to the *Directive 2005/19/CE*, the European legislator has recently implemented specific cross-border mergers legislation through the adoption of the *Directive 2005/56/EC* of 26 October 2005. Indeed, the entry into force of the European Company Statute has indirectly given a second breath

¹⁰ See JP Bertrel, *La société européenne entre son passé et son avenir*, Droit & Patrimoine, 2004 n°125, p. 53.

to the negotiation process of the said legislation, which has been ongoing for years.

Insofar as cross-border mergers are concerned, the *Directive 2005/56/EC* has a wider scope than the European Company Statute as it refers to cross-border mergers between all companies with share capital and not only between public limited liability companies. Moreover, such legislation allows managers to carry out cross-border mergers without incorporating a new legal entity, which undeniably simplifies and reduces the costs of such operations

The SEVIC ruling of the CJEC also impacts on the implementation of cross-border mergers as Member States should now adapt their legislation in order to treat similarly internal and cross-border mergers to respect the freedom of establishment provided by the EC Treaty.

Due to these new texts adopted by the European legislator and this recent CJEC ruling, the recourse to the European Company Statute may decrease. Although the regulation on cross-border mergers and the one on the SE both can be used to implement cross-border mergers, it is important to note that the SE benefits of a much wider scope than merely cross-border operations. It is therefore certainly too restrictive to envisage the future of the SE only through the spectrum of its use in the context of cross-border mergers.

It is important to note that Member States have until 15 December 2007 to bring into force laws and regulations necessary to comply with the *Directive 2005/56/EC* on cross-border mergers of companies with share capital. Until this date, the European Company shall therefore remain undeniably the sole efficient tool to merge companies incorporated under different national laws in Europe¹¹. Though, one cannot predict that practitioners and managers will not abandon the recourse to the European Company after the SEVIC ruling and as soon as the specific cross-border mergers legislation will become effective.

Furthermore, the coexistence of the above two legislations may favour the recourse by the decision makers to Law-shopping practices¹².

As a matter of fact, each Member State will, in all likelihood, attempt to transpose in the internal legislation the *Directive 2005/56/EC* in the most attractive way. These new transposed legislations will coexist with the other more or less attractive internal provisions adopted by Member States to implement the European Company Statute.

In this context, electing the legal regime which provides the most competitive advantages may become an uneasy task, especially as practitioners do not know, as of today, how European corporate law will evolve. In particular, it is too early to know how Member States will articulate the two legal frameworks proposed to decision makers to complete cross-border mergers: the European Company Statute and the *Directive 2005/56/EC*.

Conclusion

Given the relatively recent entry into force of the European Company Statute, it is difficult to draw definitive conclusions on its impact on European cross-border mergers.

However, one would say that the characteristics of the European Company retained by the European legislator and the ongoing process of incorporation into the various National Laws of the Regulation may give practitioners and managers fairly satisfactory legal tools to implement such cross-border operations, principally in Europe.

Moreover, through this specific cross-border legislation, the European legislator aims at consolidating companies incorporated in Europe, reducing the costs of cross-border mergers and increasing legal security.

In fact, we could certainly assert that the implementation of the European Company Statute will offer optimistic perspectives to

¹¹ See V. Magnier, *La société européenne en question*, Doctrine et Chroniques, Rev. Crit. DIP, 93 (3), 2004, p.577.

¹² See JP Dom, *La société européenne – Aspects de droit des sociétés*, Droit & patrimoine, 2004 n°125, p.84.

develop the European internal market whilst making it more competitive.

It can be assumed though that a “Premium” will be given to those Member States having incorporated promptly in their internal set of rules an attractive regulation in this respect (particularly on Tax legislation). It could be the case for France. Indeed, the French Legislation on European Company provides attractive tools to managers. However, one can regret that the French legislator has not gone further with regards to the flexibility of the French SE, as it had been proposed by Senator Marini.

Finally, in order to conclude with an optimistic perspective, we could assume that this uniform set of rules (yet to be further refined and completed at each Member State’s level) shall favour the return of international investors (i.e. non-European) on the European economic market. Time solely shall address this anticipation.

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