FAQ on the 10th company law directive with regard to the cross-border merger of limited liability companies (2005/56/EC)[1]

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General

1. What is a merger within the meaning of the Directive? (Art. 2 II)

According to the Directive, a merger is an operation whereby

(a) one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to an already existing company – the 'acquiring company' – in exchange for the issue to their members of securities or shares representing the capital of that company (or of the newly formed company) and, if applicable, a cash payment not exceeding 10% of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities or shares;

(b) two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form – the new company – in exchange for the issue to their members of securities or shares representing the capital of that new company and, if applicable, a cash payment not exceeding 10% of the nominal value, or in the absence of a nominal value, of the accounting par value of those securities or shares; or

(c) a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities or shares representing its capital.

2. What kinds of merger are covered by the Directive? (Art. 1)

The Directive applies to cross-border mergers of limited liability companies, that is, if at least two of the companies are subject to the law of two different member states and have their head office or seat within the EU.

3. What forms of company are covered by the Directive? (Art. 2 I)

The Directive applies only to limited liability companies. In Germany, this includes, for example, *Aktiengesellschaften* (AGs) [company limited by shares], *Gesellschaften mit beschränkter Haftung* (GmbHs) [limited liability company] and *Kommanditgesellschaften auf Aktien* (KG a.A) [association limited by shares].[2] Apart from that, the Mergers Directive applies to the mergers of already established SEs

[1] Directive 2005/56/EC on cross-border mergers of limited liability companies.

2 A list of all the affected forms of company is available at:
http://ec.europa.eu/internal_market/company/docs/mergers/scope_en.pdf

with limited liability companies. The foundation of an SE, in contrast, shall comply with the provisions of the SE Regulation.

4. **Which company law shall apply to the company resulting from the merger?**

   Basically, the law of the state in which the company's registered office is located shall be applicable after the merger. This is also the standard rule for participation, but with some significant exceptions (see below).

5. **Why was a directive needed? What are the expected advantages?**

   From the Commission's point of view the most pressing consideration appears to have been the strong demand from the business sector, for the purpose of making it easier for European companies to cooperate and restructure across borders. This should make Europe more competitive and enable businesses to better reap the benefits of the Single Market. The trade unions and workers could easily come to another conclusion, however.

6. **Does freedom of establishment provide a right to merge across borders?**

   According to the ECJ (in Sevic C-411/03), cross-border mergers into another member state ('inbound' mergers) are protected by freedom of establishment (Art. 43, 48 EC Treaty). However, it has not been finally clarified whether cross-border mergers from a member state ('outbound' mergers) are also protected by freedom of establishment.

7. **What is the legal basis for the directive?**

   The legal basis for the Directive was Art. 44 EC Treaty and, therefore, required the Parliament's co-decision, as laid down in Art. 251 EC Treaty.

8. **When was the transposition deadline?**

   The Directive had to be transposed into national law by 15 December 2007.

Board-level participation

1. **What is 'participation' within the meaning of the Directive?**

   'Participation' is defined as the exertion of influence by employee representatives on a company's affairs through the election/appointment of a portion of the members of the supervisory board/administrative body or the recommendation/rejection of a portion or all members of these organs (Art. 16 II Mergers Directive in conjunction with Art. 2 k SE Directive). It concerns only participation in the management organs of the company, therefore, and not establishment-level participation.

2. **What rules does the Mergers Directive contain concerning participation in company boards?**

   Basically, the rules on participation of the country in which the company resulting from the merger has its registered seat shall apply (Art. 16 Mergers Directive).
   In order to ensure that existing participation rights in the companies involved in the cross-border merger are not reduced or cancelled, the Directive foresees three important exceptions to this principle (Art. 16 II Mergers Directive).

In these exceptional cases, the procedure familiar from the SE legislation shall be applied. To that extent, arrangements on participation will be negotiated between the management of the merging companies and a special negotiating body (SNB) of employee representatives.

3. What is the connection between the Cross-Border Mergers Directive and the European legislation on the SE?

Art. 16 III of the Mergers Directive refers extensively to the negotiating procedure of the SE Directive. Consequently, the arrangements for negotiations on participation in the SE and in the cross-border merger of limited liability companies are similar.

4. What do these SE regulations provide for?

In the three exceptional cases, participation is organised in accordance with the SE regulations by means of a negotiation procedure (Art. 16 III Mergers Directive). Consequently, a special negotiating committee must be established for employee representatives in order to conduct negotiations with the management on participation arrangements. Should no agreement be reached, under certain circumstances the standard rules can apply.

5. What are the exceptional cases in which negotiations are conducted in accordance with the SE regulations?

Art. 16 II of the Mergers Directive mentions three exceptional cases in which the SE regulations shall apply:

a) If at least one of the merging companies had more than 500 employees previous to the merger and was covered by participation rights;
b) or if the company law of the member state in which the company resulting from the merger has its registered office provides for a lower degree of participation rights than provided for in any of the merging companies;
c) or if the company law of the member state in which the company resulting from the merger has its registered office does not grant employees in enterprises located in another member state the same participation rights as employees from the country of incorporation.

6. Could a company management prevent negotiations?

Yes. The relevant organs of the merging companies can decide to apply the standard rules directly, as transposed by the member state in which the company resulting from the merger has its registered office (Art. 16 IV lit. a).

7. What is the special negotiating body (SNB)?

The SNB represents the employees in negotiations with the managements of the companies involved in the merger in order to reach a written agreement on employee participation in the company resulting from the merger. In principle, the SNB should be established if one of the three exceptional cases under Art. 16 II Mergers Directive applies. Timewise, the SNB must be established as soon as the enterprise managements have made known their intention to merge. The SNB can request that experts of its choice assist it in its work. In this context, the Directive explicitly mentions the possibility of calling in **representatives of Community-level trade union** organisations (Art. 16 III lit. a Mergers Directive in conjunction with Art. 3 IV SE Directive).

8. What is the composition of the special negotiating body (SNB)?

According to Art. 16 III a Mergers Directive and Art. 3 II SE Directive, the seats in the SNB are allocated proportionally among the member states in which the companies involved in the merger have employees: for every 10% (or fraction thereof) of the total number of employees of the companies involved in the merger, the country has the right to send one member to the SNB. Thereby, all countries concerned will have at least one representative on the SNB. There could be additional seats (but not more than 20% of the total number) to ensure that all involved companies are represented in the SNB.
It was up to the individual member states to define how their SNB members are elected or appointed in their national transposition laws related to the SE Directive. Furthermore, the member states could provide that **trade union representatives** be allowed to become SNB members, even if they are not employees (Art. 16 III a Mergers Directive in conjunction with Art. 3 II b SE Directive). In Germany, for example, in the case of an SNB with more than two members from the home country, every third member must a trade union representative (§8 III MgVG [*Mitbestimmung Verschmelzungsgesetz* – Participation Merger Law]).

9. How long will the negotiations on participation take?

Negotiations are expected to start as soon as possible after the companies embark on plans to merge. They may take up to six months and can be extended up to a maximum of one year after the establishment of the special negotiating body (SNB), if both parties agree (Art. 16 III a Mergers Directive in conjunction with Art. 5 SE Directive).

10. What decision-taking majorities shall apply within the special negotiating body (SNB)?

In general, the SNB takes its decisions (for example, to conclude an agreement) by an absolute majority of its members, which must also represent the majority of the employees. Each member has one vote (Art. 16 III lit. a Mergers Directive in conjunction with Art. 3 IV SE Directive).

However, if the resolution would lead to a reduction of participation rights, it can be passed only with a qualified majority, that is, at least two-thirds of the SNB members representing two-thirds of the employees must pronounce in favour of it. Moreover, the votes must come from at least two different member states. These exacting requirements are applied only when participation covers 25% of the employees of the involved companies before the merger. A reduction of participation rights means a proportion of supervisory or administrative board members of the company resulting from the merger which is lower than the highest proportion previously existing within one of the companies involved; see Art. 16 III a Mergers Directive in conjunction with Art. 3 IV SE Directive.

This qualified majority is necessary when the SNB wishes to resolve not to enter into negotiations or to break them off (Art. 16 IV b Mergers Directive).

11. What are the possible outcomes of the negotiations?

Three cases are possible:

- The SNB decides not to open or to terminate negotiations (Art. 16 IV b). In this case, the **national rules on participation** enter into force of the member state where the registered office of the company resulting from the merger will be situated.
- The SNB and the competent organs of the companies involved conclude an agreement **according to Art. 4 SE Directive on the form of the participation of employees**. The negotiating parties in principle have autonomy with regard to the content of the agreement.
- The negotiating parties fail to come to an agreement within the time frame. In this case, or if the parties agree voluntarily, the standard rules on participation may apply (Art. 16 III e in conjunction with Art. 7 l SE Directive). If the conditions for application of the standard rules do not apply, the national participation rules shall apply.

12. Can the SNB decide in favour of the participation rules in force in the member state in which the registered office of the company resulting from the cross-border merger is situated?

Yes, this is possible, if the SNB decides by a qualified majority not to open negotiations or to terminate them and thereby introduce the national participation rules (Art. 16 IV b).

13. What is the content of the participation agreement?

The two parties have considerable autonomy with regard to the content of the agreement. Nevertheless, the Directive lays down a number of minimum requirements concerning the points on which there must be agreement within the framework of the participation agreement (Art. 16 III b Mergers Directive in conjunction with Art. 4 I, II SE Directive). These are as follows:

- The scope of the agreement.
- The content of the participation regulation, including the number of members of the administrative/supervisory body which the employees can /elect/appoint/recommend/reject and the rights of the members.
- When the agreement will come into force; cases giving rise to new negotiations; procedure for new negotiations.

There are no minimum requirements with regard to participation arrangements. Merely the abovementioned majorities have to apply in voting.

14. When are the standard rules applied?

The standard rules have to be applied if negotiations between the special negotiating body (SNB) and the managements of the companies involved fail to reach agreement within the time frame and the negotiations are not terminated in accordance with Art.

16 IV b. In this case, the standard rules are automatically introduced when at least one-third of the employees previously had participation rights (Art. 16 III e Mergers Directive in conjunction with Art. 7 II b SE Directive).

If this threshold is not met, the SNB can decide to apply them anyway if a system of participation existed in at least one of the companies involved before the merger.

In any case, the two parties may decide to apply the standard rules on a voluntary basis.

15. What rights do the standard rules contain?

The standard rules regulate participation in accordance with Art. 16 III h Mergers Directive, in conjunction with Appendix Part 3 b of the SE Directive. The member states were obliged to adopt national standard rules which are in line with the provisions of the SE Directive. The standard rules of the country in which the company resulting from the merger has its registered seat shall apply.

The standard rules entitle employees to elect, appoint, recommend or reject a certain number of members of the supervisory or administrative organ. The number of employee representatives in the management body of the company resulting from the merger is calculated on the basis of the highest number of employee representatives of the companies involved in the merger. The employee representatives have the same rights and duties as the members of the supervisory/administrative organs appointed by the shareholders.

In accordance with Art. 16 IV c Mergers Directive, the proportion of employee representatives in the administrative organ (monistic system) of the company resulting from the merger can be limited. However, if employee representatives had at least one-third of the seats in the administrative or supervisory organ in one of the companies involved in the merger, then the employee representatives in the administrative organ must receive at least one-third.

16. Who has the last word regarding employee participation?

The general (shareholders') meeting of each of the companies can reserve the right to make implementation of the cross-border merger conditional on its express ratification of the agreement on employee involvement (Art. 9 II Mergers Directive).

17. Who bears the costs of the special negotiating body (SNB)?

According to Art. 16 III a in conjunction with Art. 3 VII SE Directive, the costs of the SNB must be borne by the companies involved. With regard to the costs of external experts, funding can be limited to one person.

18. What are the differences between the Cross-Border Mergers Directive and the SE Directive?

There are some differences between the two Directives:

- The SE Directive, alongside the regulations on participation, provides for regulations on information and consultation rights. Consequently, the SE Directive also contains standard rules on information and consultation and the founding of a representative body. The Directive on Cross-border Mergers, in contrast, only contains regulations on participation in the management organ.
- The threshold for application of the standard rules is at least 25% for the founding of an SE and was raised in the case of cross-border mergers to one-third (33.33%). These thresholds indicate what percentage of the employees of the companies concerned had to have possessed participation rights before the founding of the SE or the merger in order that the standard rules would apply automatically.
- Companies which after the merger choose a monistic governance system (only possible in member states with the relevant company law) can reduce the number of employee representatives in the administrative organ, if the standard rules are applied (Art. 16 IV c Mergers Directive).

  If the employees in one of the companies involved had at least one-third of the seats in the administrative or supervisory organ, however, employee representatives must be allocated at least one-third of the seats in the administrative organ of the company resulting from the merger.

19. Is there a right of continuation of participation rights in the case of subsequent domestic mergers?

For a period of three years the company resulting from the merger shall be obliged to take measures to ensure that participation rights are protected in the case of subsequent domestic mergers (Art. 16 VII Mergers Directive).

20. Examples[3]

- **Example 1**: A German company with more than 2000 employees (50% participation in the supervisory board) merges with a Swedish company (one-third participation in the one-tier administrative board). The registered office of the new company is in Sweden. The German company employs more than one-third of the employees. **Outcome:** The SE regulation (negotiations with the SNB) must be applied (Art. 16 II, a and b Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If the parties cannot reach agreement in time, the standard rules will apply (Art. 16 III Mergers Directive). If there is a limitation on participation in Sweden to one-third of the board, which is allowed in the directive, the new board will contain only one-third employee representatives.

- **Example 2**: A German company with more than 2000 employees (50% participation in the supervisory board) merges with a British company (no participation). The German company employs 25% of the employees. The

[3] Information on enterprise participation in all EU member states is available in several languages on the following website: http://www.worker-participation.eu/national_industrial_relations/

registered office of the company resulting from the merger is in Germany. **Outcome**: The SE regulation (negotiations with the SNB) is applied (Art. 16 II Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If the parties cannot reach agreement in time, the SE standard rules will not apply automatically because the one-third threshold has not been reached. If there is no SNB decision to apply the standard rules, German law shall apply, which in this case provides for 50% representation in the management organ (Art. 16 I Mergers Directive).

- **Example 3**: A German company with more than 2000 employees (50% participation in the supervisory board) merges with a Swedish company (one-third participation in the one-tier administrative board). The registered office of the new company is in Germany. The German company employs more than one-third of the employees. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If they cannot reach agreement in time, the standard rules will apply automatically (Art. 16 III e and h Mergers Directive), in this case 50% participation.

- **Example 4**: A German company with more than 2000 employees (50% participation in the supervisory board) merges with an Austrian company (one-third participation in the supervisory board). The German company employs more than one-third of the employees. The registered office of the company resulting from the merger is in Austria. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II Mergers Directive). The management decides to adopt the standard rules to prevent long negotiations (Art.16 IV lit. a Mergers Directive). In this case the company resulting from the merger will have 50% participation in the supervisory board. In the absence of such a decision on the part of the management, the standard rules would apply automatically after the negotiation period, which means 50% participation.

- **Example 5**: A Dutch company (one-third of the supervisory board members are nominated by the works council) merges with a British one (no participation). The registered office of the new company is in the Netherlands. The Dutch company employs more than one-third of the employees. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II, and b Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If there is no agreement the standard rules will apply automatically (Art. 16 III e and h). This means that one-third of the supervisory board members will be nominated by the works council.

- **Example 6**: A Dutch company (one-third of the supervisory board are nominated by the works council) merges with a British one (no participation). The registered office of the new company is the UK. The Dutch company employs 25% of the workforce and more than 500 employees. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If the parties cannot reach agreement in time, the standard rules will not apply automatically because the threshold of one-third of the employees has not been met (Art. 16 III e and h Mergers Directive). If the company resulting from the merger was an SE the

standard rules would apply because of the lower threshold. However, the **SNB could decide to apply the standard rules** anyway (Art. 16 III e Mergers Directive and Art. 7 II b SE Directive).

- **Example 7**: An Italian company merges with a Spanish company. The registered office of the company is in Spain. There is no participation in either Italy or Spain. **Outcome:** There will be no participation in the company resulting from the merger.

- **Example 8**: A Hungarian Company (one-third participation in the supervisory board) merges with an Austrian one (one-third participation in the supervisory board). The registered office of the new company is in Hungary. The Hungarian company employs more than one-third of the employees. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II b Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If the parties cannot reach agreement in time, the standard rules will apply automatically, which means one-third of the supervisory board will consist of employees. On the other hand, the SNB could decide to apply the participation rules of Hungary (Art. 16 IV b Mergers Directive).

- **Example 9**: A Czech company (one-third participation in the supervisory board) merges with a British company (no participation). The registered office of the company is in the Czech Republic. The Czech company employs more than one-third of the employees. **Outcome**: The SE regulation (negotiations with the SNB) is applied (Art. 16 II b Mergers Directive). An exception is the case in which the relevant organs of the merging companies decide to adopt the standard rules without prior negotiations. If the parties cannot reach agreement in time, the standard rules will apply automatically, which means the employees will have one-third participation in the supervisory board.

- **Example 10**: A Spanish company (no participation) merges with a German company (one-third participation in the supervisory board). The registered office of the company resulting from the merger is in Germany. The German company employs less than one-third of the employees. **Outcome:** The SE regulation (negotiations with the SNB) is applied (Art. 16 II, and b Mergers Directive). If the parties fail to reach agreement the standard rules will not apply automatically. However, the SNB can decide that they should apply. In addition, the SNB can decide by a qualified majority to adopt the participation rules in force in Germany (Art. 16 IV b Mergers Directive), namely one-third participation in the supervisory board of the company resulting from the merger.

Other labour law aspects

1. **What rights does the Mergers Directive provide besides board-level participation rights for employees?**

   The Directive grants the employees some special information and consultation rights during the merger process and obliges the central management to take into account in good time the likely repercussions of the cross-border merger for employment:

- The merger plan, which is drawn up jointly by the managements of the companies involved, must contain information on the probable effects of the merger on employment (Art. 5 d Mergers Directive).
- The managements of each of the merging companies must draw up a report for their employees on the legal and economic aspects of the merger, including its implications for employment (Art. 7 I Mergers Directive). This report must be made available to the employees' representatives or to the employees themselves (if there is no representation) no less than one month before the general meeting.
- If national law (for example, the German Works Constitution Act) provides such a right, the employee representatives have the right to append an opinion to this report.

2. What is the relationship between the Mergers Directive and the EWC Directive?

The Mergers Directive shall be without prejudice to the rights provided in the EWC Directive. European works councils can also be established in addition. In contrast to the SE legislation the Mergers Directive does not provide for the establishment of a transnational representative organ with information and consultation rights. These rights can, therefore, be exercised only through the establishment of a European works council.

3. What effects does the merger have on the rights and obligations arising from the employment contract?

The rights and obligations arising from contracts of employment shall be transferred to the company resulting from the cross-border merger (Art. 14 IV Mergers Directive). To the extent that these rights and duties are regulated by a collective agreement or company agreements they shall form part of the employment relationship subject to the Directive on the transfer of an undertaking (2001/23/EC).

4. Will the merger affect the employees' relevant national labour rights?

As long as the employee remains at the same establishment of the company in the same member state, nothing will change (see Art. 6 of the Rome Convention; from December 2009, the so-called Rome I Regulation shall apply, Art. 8). If the employee is permanently transferred to an establishment of the company in another member state the relevant national law could change, depending on the individual circumstances.