

CROSS FRONTIER MERGERS

BY PROFESSOR JOHN H FARRAR LL.M. (LOND), PH.D. (BRIST)

Harold Ford Professor of Commercial Law at the University of Melbourne and formerly Dean of the Faculty of Law at the University of Canterbury

I. THE CONCEPT OF A CROSS FRONTIER MERGER*

In spite of the globalisation of financial and other markets, domestic and international law do not greatly facilitate cross frontier co-operation. Each country has its own corporate laws, securities regulation, foreign ownership laws, antitrust laws, taxation law and system of industrial relations. Apart from limited regional integration, bilateral treaties and ad hoc contracting promoted or encouraged by governments, there has been little in the way of international co-operation. Within a particular state co-operation can usually take place. The form that particular co-operation takes will be determined by the domestic law, and particularly by its business organisations, antitrust and tax laws. Some states have been slow to facilitate co-operation in the form of mergers.

In economics and antitrust there are three general types of merger: horizontal, vertical and conglomerate.¹ A horizontal merger occurs when two firms in the same industry are merged. Both firms must have been rivals in the sense of selling the same product in the same geographic market. A vertical merger occurs when a firm merges with one of its suppliers or one of its customers. The first is called backward integration, the second forward integration. A conglomerate merger can be one of three types. A product extension merger occurs where a multiple product firm acquires a producer of a further commodity. A market extension merger involves firms in the same product but not the same market. A pure conglomerate merger involves two firms which are wholly unrelated. Merger, however, is an ambiguous legal term.² In British Commonwealth corporate laws it is used loosely to cover *reconstruction* which involves fusion of enterprise, *amalgamation* which involves the formation of a new holding company to take over the two original companies and a *takeover* whereby one company takes a controlling interest in the shares of another.³ Sometimes co-operation short of a full merger takes the form of a *joint venture* agreement,⁴ which is either a form of partnership or a looser agreement of co-operation, or a *consortium*⁵ where a number of companies join together to form a joint company for a particular, usually limited, purpose. In a consortium no single company has control.

* This article is based on a paper given to the International Trade Law class at the University of Toronto, Spring Term 1990 and forms the basis of a chapter in *Farrar's Company Law* 3rd edition, Butterworths, London. (Copyright Butterworths, 1991)

1 See Roger D Blair and David L Kaserman *Antitrust Economics* (1985) p. 227-228

2 Cf *Weinberg and Blank on Takeovers and Mergers* (5th edn, 1989) para 1-004.

3 *Ibid*, para 1-003 et seq.

4 See Jesse H Choper, John C Coffee Jr and C Robert Morris Jr *Cases and Materials on Corporations* (3rd edn, 1989) p. 50

5 See F Wooldridge 'Consortium and Related Operations in the United Kingdom' [1978] 3 LMCLQ 427; A H Boulton 'Construction Consortia — their Formation and Management' [1959] JBL 234; J T Brown 'International Joint Venture Contracts in English Law' (1979) 5 *Droit et Pratique du Commerce International* 193.

In US corporation and tax laws the following transactions are commonly referred to as mergers:⁶

- (i) A statutory merger or consolidation, known as an 'A' reorganisation under section 368(1)(a)(A) of the Internal Revenue Code. This involves one firm merging into another firm or a consolidation involving two firms merging into a newly created third firm.
- (ii) A stock for stock exchange (a B reorganisation). Here one corporation becomes the subsidiary of the other.
- (iii) An exchange of voting stock for substantially all of the assets of a target corporation (a C reorganisation).
- (iv) The purchase of assets of the target corporation for cash or non-voting securities.
- (v) The purchase of the stock of the target for cash or non-voting securities.

In most of the continental European member states of the EEC a merger is effected by either:

- (a) an absorption of one company by another and the transfer of all the assets of the absorbed company to the other. The latter issues shares to the shareholders of the absorbed company which is then dissolved (this resembles an A reorganisation in US laws and a reconstruction in English and New Zealand law); or
- (b) the formation of a new company which absorbs two other companies as in (1), with the latter companies being dissolved rather than becoming members of a group as they would in an English or New Zealand amalgamation. This resembles a consolidation in US laws.⁷

Most continental European countries have not hitherto recognised the hostile takeover as a means of achieving a merger.⁸ In most countries 100% approval is necessary and the company acquired needs to be wound up.⁹ Mergers there are thus essentially co-operative in nature.¹⁰ This is also the position which prevails in Japan where recent attempts by US corporations to take over Japanese companies by hostile tender offers have been frustrated.¹¹

The topic of corporations in general received fragmented treatment in private international law¹² and questions of merger are rarely (if ever) discussed.¹³ In Anglo-American systems a company is governed by the law of the place on incorporation¹⁴ and this law governs merger of the company with another company of the same domicile.¹⁵ The position is less clear with

6 See Bruce Wasserstein *Corporate Finance Law* (1978) Ch. 15. There are tax advantages in (i)-(iii).

7 See R R Pennington and F Wooldridge *Companies in the Common Market* (3rd edn): S N Frommel and J H Thompson *Company Law in Europe* (1975).

8 For the changing scene see Simon MacLachlan and William Mackesy, 'Acquisitions of Companies in Europe — Practicability, Disclosure and Regulation: An Overview' 23 *Int Law* 373 (1989).

9 See *Internal Market and Industrial Co-operation — Statute for the European Company* Internal Market White Paper, point 137, Commission of the European Communities Com (88) 320 final, Brussels, 15 July 1988 (hereinafter called 'EC White Paper'), p. 13.

10 See Deborah DeMott 'Comparative Dimensions of Takeover Regulation' 65 *Wash ULQ* (1987).

11 H Boone Pickens, the notorious US corporate raider, recently had this experience.

12 See Thomas C Drucker 'Companies in Private International Law' (1968) 17 *ICLQ* 28. The matter receives token treatment in most works on conflicts of laws. A valuable exception is C M Schmitthoff *The Conflict of Laws* (2nd edn) Ch XIII.

13 See *National Bank of Greece and Athens SA v Metliss* [1958] AC 509, HL. However, the corporations in this case were of the same domicile. See Drucker, op cit, p 33. For the position in US laws see *Restatement of the Law, 2d, Conflict of Laws* Ch 13, para 302, Comment.

14 Schmitthoff, op cit, p 336; Drucker, op cit, p 28.

15 See note 13, supra.

a cross frontier merger although a corporation validly incorporated in one jurisdiction will normally be recognised in other jurisdictions.¹⁶ It may, however, be subjected to special local formalities.¹⁷ With regard to mergers, US laws operate choice of law rules which are based on the law of the place of incorporation except in unusual cases where, with respect to a particular issue, another state has a more significant relationship to the event and the parties.¹⁸ The law of the place of incorporation normally governs the exercise of power within the corporation and the public issue of its securities¹⁹ except that in the case of the latter the requirements of the place of issue have also to be complied with.²⁰ Different rules may apply to debt financing.²¹ In Anglo-American laws a state may wind up the business of a corporation within its jurisdiction without necessarily terminating the existence of the foreign corporation.²² Dissolution otherwise is a matter for the law of the place of incorporation.²³

Within a federal system the law relating to mergers between corporations incorporated in different states within the federation is usually determined partly by the constitution²⁴ and partly by state laws. Most constitutions contain full faith and credit clauses in respect of state laws and legal acts but some require licensing of out-of-state corporations. Canada requires licensing but has provisions for continuance where a corporation wishes to shift residence between jurisdictions.²⁵ In the USA a liberal regime exists which has facilitated capital accumulation. Many of the leading corporations are registered in Delaware, a permissive state, whose Corporation Code expressly provides for a merger or consolidation of a Delaware corporation with a foreign corporation.²⁶ By contrast in the looser-knit union of the European Community many of the member states have put a number of obstacles in the way of cross frontier mergers. It is the attempts to overcome these obstacles against a background of different corporate law and even conflict of laws philosophies which makes the EC such an interesting case study of regional co-operation, which may provide a model for further international co-operation.

II. OBSTACLES TO CROSS FRONTIER MERGERS

A recent report by the EC Commission²⁷ has identified the following obstacles to transnational mergers.

- (a) The difficulty under present laws of carrying out cross frontier mergers.²⁸ At the moment within the EC mergers take the form of participation in capital by minority holdings and joint ventures. The European Economic Interest Grouping (EEIG) was introduced to facilitate certain aspects of cross frontier joint ventures but is not intended as the vehicle for the merger itself.

16 Schmitthoff, op cit, pp 334-335.

17 See eg Restatement, op cit, para 297, Comment.

18 Ibid, para 302.

19 *Banco de Bilbao v Sancho* [1938] 2 KB 176, 194-195, CA; Drucker, op cit, p 47.

20 Drucker, op cit, p 51.

21 Ibid (proper law of the contract of loan as well as country of issue — quare questions of security).

22 See Schmitthoff, op cit, pp 339 et seq.

23 *Lazard Bros & Co v Midland Bank Ltd* [1933] AC 289 at p 297, HL per Lord Wright.

24 See eg US Constitution, Act IV Section 1.

25 See for instance Ontario Business Corporations Act 1982, s 179; Canada Business Corporations Act 1985, s 187.

26 General Corporation Law of the State of Delaware, s 252.

27 EC White Paper, pp 7 et seq.

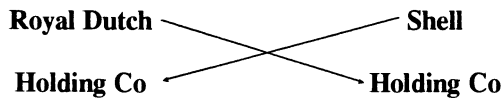
28 Ibid, pp 7-8.

- (b) Tax problems resulting from (a) taxation of hidden reserves, (b) double taxation of dividends, (c) economic double taxation which might arise from cross frontier transactions between associated companies if the profits of one of the companies have been adjusted upwards without a corresponding downward adjustment in the other country, (d) distortions arising because of the different corporation tax systems.²⁹
- (c) The differences in company laws and their administration between member states.³⁰
- (d) The difficulties under present laws of integrating a group of enterprises as a single economic unit. The law of most member states adopts a rather fragmented approach to the corporate group, except for disclosure purposes.³¹
- (e) Administrative difficulties surrounding the establishment of companies. This is exacerbated by the unfamiliarity of foreign businessmen with the requirements of a particular country.³²

Although the Commission does not discuss them in this context there are the additional complications of the different anti-trust regimes³³ and industrial relations systems³⁴ which are also very significant factors.

Faced with these obstacles, cross frontier co-operation in Europe has taken a variety of forms of which the most significant are as follows:

- (a) *Royal Dutch/Shell*. This was set up in 1907. Here Shell formed a wholly-owned English holding company. Royal Dutch formed a Dutch holding company. Each company transferred shares in subsidiaries to the respective holding companies then exchanged shares in the holding companies so that the picture was:



- (b) *The Unilever type of agreement*. This merger was set up in 1927 and involves complex agreements between the UK company and the Dutch company for a pooling of assets and profits, treatment of shareholders *pari passu* and identical boards.
- (c) *Agfa-Gevaert*. This was an example of intricate corporate structures between the German Agfa-Gevaert and the Belgian Gevaert NV set up to avoid the nationalist opposition which would have resulted if one company had been absorbed by the other.
- (d) *Dunlop-Pirelli*. This left the parties as they were but gave each partner a distinct stake in the operations of the other. In essence this involved both companies creating subsidiaries to which were transferred the operations and assets of the parent companies. Each then exchanged an interest in its subsidiary for a corresponding interest in the other's subsidiary. Thus

²⁹ *Ibid*, pp 8-9.

³⁰ *Ibid*, p 9.

³¹ *Ibid*.

³² *Ibid*.

³³ See Klaus J Hopt, *European Merger Control*, Vol 1 (1982), *passim*.

³⁴ See the *Green Paper on Employee Participation and Company Structure in the European Communities*, EEC Bull Supp 8/75: J Welch (1983) 8 ELR 83.

the structure is two headed. The merger experienced a number of difficulties, which are commercial and financial as much as structural.

- (e) *Variations on the theme of joint ventures.* There has been an increasing number of joint venture agreements, particularly in the automobile industry. In the automobile industry these frequently provide for pooling of research and design and patents etc; rationalisation of production; common specifications for sub-contractors and suppliers; common machine tools; and joint financing. Examples are Renault-Peugeot, Ford, Chrysler, and BAC and Sub-Aviation on Concorde. An example in 1990 was the announcement by Volvo and Renault that they intend to make sizeable investments (20-25%) in each other in the hopes of making both companies more competitive. In addition to the equity investments the two companies intend to enter into an extensive co-operation agreement to co-ordinate elements of product development, purchasing and investment plans. However, each company will retain its separate identity, trademarks and distribution organisations and will continue assembling and marketing its own cars, trucks and buses. The co-operation structure is described by Pehr Gyllenhammar, the Volvo president, as 'an alliance, not a merger or an acquisition'.

A successful joint venture outside the automobile and aircraft industries is Polygram, jointly run by Siemens and Philips.

All of these five methods are essentially horizontal contractual arrangements which are attempts to cope with the absence of a truly international structure. At the same time the flexibility of ad hoc contracting is not without advantages.

III. EC STEPS TO FACILITATE CROSS FRONTIER MERGERS

A number of proposals to facilitate cross frontier co-operation has been put forward within the EC although the proposals have been marked with lack of success at the stage of implementation. Apart from the Right of Establishment of agencies, branches and subsidiaries without discrimination on grounds of nationality, there are no specific provisions in the Treaty of Rome on this but the Treaty provides for law making in the form of regulations, directives and decisions. Under art 189, a regulation takes immediate internal effect in the member states. A directive is binding on the member states but leaves it to them to choose the method of implementation. A decision is only binding on the parties to whom it is addressed.

Initial efforts to facilitate cross frontier mergers within the EC were concentrated on a convention. This project was eventually dropped. The *European Economic Interest Grouping*³⁵ (EEIG) was created as a new legal form of co-operation between individuals, companies, firms, and other legal bodies from different member states by a EC regulation of 25 July 1985. The EEIG has a limited purpose, namely to facilitate or develop the economic activities of its members and to improve the results of these activities. It is not in itself a profit making venture. Its activities are only ancillary to the economic activities of its members. It has no power of management over its members' activities and can only hold shares in their undertakings, to the extent necessary to achieve its objectives. It must not employ more than 500 people and it must not be a member of another EEIG. It cannot be used by a

35 Regulation No 2137/85, 25 July 1985 (OIL 199/31 July 1985); S Israel (1988) 9 Co Law 14; 25th Report of the LLSC 1984.

company to make a loan to a director or transfer property between a company and a director except as allowed by national law. An EEIG is formed by contract between the members of the grouping. There are various registration and disclosure requirements and an EEIG has basically two organs, the members and the managers. Each member has to have the power to vote. If profits are made, they are to be apportioned to the members in accordance with the contract or, in the absence of any express provision, in equal shares. The members of the EEIG have unlimited joint and several liability for all its debts and other liabilities. Admission of new members is allowed by unanimous decision. In these latter respects an EEIG resembles a partnership under English or New Zealand law. Although an EEIG looks a somewhat limited innovation, its existence has been welcomed by some EC businessmen and this probably indicates the inadequacy of current EC laws to facilitate cross frontier co-operation.³⁶ It is significant that in a recent discussion of the topic the point was also made that there is a real need for a simplified European company statute.

Following the adoption of the Third Directive of 9 October 1978³⁷ on mergers of companies within the same member state, the intention was to build on this and to adopt *a directive on cross frontier mergers*.³⁸ This is now the Draft Tenth Directive. Since the mechanics of national and cross frontier mergers are identical the proposed Tenth Directive of the EC refers to the Third Directive extensively and is itself limited to additional requirements for cross border mergers and to those aspects of cross borders mergers which differ from national mergers. The justification of this was that all mergers, both national and cross frontier, involved the following steps:

- (a) the drawing up of joint draft terms of merger;
- (b) the approval of the merger by the appropriate organs of each of the companies involves.
- (c) the drawing up of a report by the administrative or management bodies of each of the companies;
- (d) the drawing up of an expert's report for each of the companies involved;
- (e) either the judicial or administrative supervision of the legality of the merger and completion of the formalities.

The special feature of cross frontier mergers is that the merging companies are governed by the laws of different member states. However, the significance of this should not be exaggerated since a number of the preparatory acts are taken individually by the companies involved and are conducted in accordance with the law of each member state. Nevertheless it is necessary to synchronise certain steps in the procedure. This is the case with the supervision of the drawing up and completion of the formalities of the merger and the publicity surrounding the completion of the merger. In addition certain rules in connection with cross frontier mergers have to be harmonised to a greater degree than is necessary for national mergers. These are in respect of (a) the contents of the draft terms of merger, (b) the protection of creditors

36 See Janet Dine, 'The Community Company Law Harmonisation Programme' (1988) 13 ELR 322 at 323.

37 OJ 1978, L295/36. See Pierre van Ommerslaghe, 'La Proposition de Troisième Directive sur L'Harmonisation des Fusions des Sociétés' in P Zonderland, *Quo Vadis, Jus Societatum* (1972), p. 123.

38 Proposal for a Tenth Directive submitted by the Commission to the Council 14 January 1985 (OJ 1985 C23 28/11).

of acquired companies, (c) the date on which the merger takes place and (d) the causes of nullity of mergers.

Article 1 of the draft states that the directive is limited to public limited companies and does not apply to companies in insolvency proceedings. Article 2 states that the aim is to require member states to provide for cross frontier mergers both by the acquisition of one or more companies by another and by the formation of a new company. Articles 3 and 4 provide the definition of a cross frontier merger either by acquisition or by the creation of a new company and this is identical with that of the national merger under the Third Directive with the exception that two or more of the companies involved must be governed by the laws of different member states. Article 5 provides that the draft terms of merger must be drawn up in writing in the appropriate form required by the laws of the member states. Article 6 requires the draft terms to be published in the same way as the national merger but in addition the cross frontier aspects must be emphasised. Article 7 provides that member states may not impose stricter requirements as regards general meetings approving a cross frontier merger than they impose on a national merger. Article 8 provides that the report of an expert or experts is required for each of the merging companies. Article 9 provides that the protection of creditors provisions of the Third Directive also apply. Article 10 deals with the examination of the legality of mergers and again applies the provisions of the Third Directive but contains additional provisions for synchronisation of the judicial or administrative supervision of the drawing up of the terms of merger. Article 11 deals with the date on which the merger take effect. This is to be determined according to the law of the member state governing the acquiring company. Articles 12 and 13 deal with publicity and special formalities. Article 14 deals with the civil liability of the members of the administrative bodies and the experts involved. Article 15 sets out nullity rules.

In January 1989, the Commission adopted a proposal for a Thirteenth Directive on Takeovers and Other General Bids.³⁹ The need for harmonisation in the area of takeovers was recognised in the Commission's White Paper on completion of the internal market and is also supported by the European Parliament. The Commission takes the view that the economic climate supports the Directive. There is an increasing number of takeovers, especially cross frontier takeovers, and the legal arrangements (if any) in member states are very varied. It is inconsistent that there should be EC controls on certain types of mergers and divisions but not on takeover bids. The principal aims of the draft Directive are the protection of shareholders and the regulation of disclosure requirements.

The main features of the draft are the rules relating to the timetable for offers, the content of offer and defence documents, the obligation on a bidder to bid for the remainder of the shares when he has acquired a certain percentage, the prohibition of certain types of defences and the independent supervision of the takeover process. The proposals are less flexible than the City of London takeover code in that they rely more on rules than principles.

39 Proposal for a Thirteenth Directive on Company Law Governing Takeover and other General Bids (OJ 1989, c 64/8). Department of Trade and Industry (UK) *EC Proposal for a Thirteenth Company Law Directive Concerning Takeovers: A Consultative Document* August 1989 ('the Consultative Document'). See MacLachlan and Mackesy, *op cit* (footnote 8, *supra*); Jeffrey P Greenbaum, 'Tender Offers in the European Community: The Playing Field Shrinks' 22 *Vanderbilt Jo of Transnational Law* 923 (1989).

Article 3 sets out the fundamental axiom of the draft Directive. This is that 'shareholders who are in the same position shall be treated equally'. Article 3 deals with the obligation to make a bid. This imposes an obligation to make a bid for all the voting shares and convertible securities of a company when a person (and those acting in concert) aims to bring his or her holdings above a specified percentage. The percentage is to be set by the member state concerned but it must not be any higher than one-third (33⅓%). The obligation only applies to public listed companies and it does not apply to bids for small and medium-sized enterprises which are not listed.

Articles 7, 10, 11, 14 and 19 set out the provisions dealing with contents and publication of offer and defence documents. These lay down the procedure prior to the publication of documents, the information that must be included in them and the means of publication. Article 14 requires the report of the board of the target company to be accompanied by an expert's valuation of any consideration consisting of unlisted securities. Article 19 requires the offer documents to be communicated to employee representatives of the target company.

Article 8 prohibits the target company from issuing new voting shares and convertible securities and from engaging in exceptional transactions during the period of an offer unless approval to do so is given in a general meeting of shareholders. This is aimed at regulating takeover defences by the management of target companies.

Articles 10, 12, 13, 15 and 20 deal with the period of an offer which must be between 4 and 10 weeks. They also deal with the circumstances where a bid may be withdrawn, the circumstances for revision of a bid, and the treatment of competing bids.

Article 16 provides for the price of the offer to be the highest price paid for shares in the target company during the offer period by the offerors or those acting in concert with them.

Article 6 requires member states to designate a supervisory authority which must have the necessary powers to ensure compliance with the directive. It is, however, left to member states to determine whether the authority should be a public and private body. In certain circumstances, the supervisory authority will have discretion to modify some of the requirements of the Directive.

The United Kingdom Government has several major concerns over the draft directive.⁴⁰ These relate to the method of implementation and its apparent lack of flexibility and the increased risk of litigation which it may occasion. It argues that the Directive should be based on a wider range of general principles than are currently provided by Article 3 and for the supervisory authority to be given adequate flexibility to waive or adapt the more specific rules, provided that it operates within those general principles. The wider general principles for which the UK delegation argue are:

- a. holders of securities who for all practical purposes are in the same position should be treated similarly;
- b. holders of securities should be given adequate time, information and advice to enable them to reach a properly informed decision on the offer;
- c. the Board of a target company must not, after it has reason to believe that an offer might be imminent, take any action without the approval of the holders of its securities which could result in the offer being frustrated or those holders of securities being denied an opportunity to consider it on its merits;

⁴⁰ The Consultative Document, pp 7 et seq.

- d. all parties to an offer must use every endeavour to prevent the creation of a false market in relevant securities of the target or bidding company;
- e. target companies should not remain under siege from an unwanted bidder beyond a reasonable time.⁴¹

The UK delegation also argues for the Directive to be framed in a way which reduces the scope for litigation or some other form of outside review during the course of a bid. Such delay would create a powerful barrier to takeovers at a time when it is vital to the development of more open capital markets that existing barriers should be eliminated.

As a result of UK initiative the Commission is currently making a comprehensive study of various takeovers in the EC.⁴² The UK delegation thinks more needs to be done than the regulation of certain takeover defences to remove barriers in other members states in the interest of achieving a single, open and efficient market.

It is understood that some member states are objecting to the idea of a threshold and a compulsory bid. The UK delegation is arguing that the threshold should be retained and that there should be a requirement for a full bid in order that minority shareholders should not be locked into a company under new managerial control without the opportunity to realise their share bid premium.⁴³

Takeovers are becoming an increasing widely-used technique in the EC and one whose importance is growing with the gradual liberalisation of capital markets.

Other proposals now under consideration include three directives on tax⁴⁴ which deal with the tax treatment of mergers in similar operations; the tax treatment of parents and subsidiaries; and an arbitration procedure to eliminate double taxation arising from transactions between associated companies. In addition to the latter, the Commission proposed as far back as 1975 the harmonisation of corporation tax systems on the basis of the 'partial imputation system' and it is also considering another proposal for harmonisation of the determination of taxable profits. The object of these proposals is to reduce tax distortions on commercial transactions.

Mergers may lead to economies of scale and increased efficiency but they also have the capacity to impede effective competition. The international perspective arises in two main ways. The first is in the definition of the concept of the market in question and the second is in the international application of domestic antitrust laws. Most antitrust regimes concentrate on their own domestic markets and restrict horizontal mergers, are mixed in their reaction to vertical mergers, but are generally permissive in respect of conglomerate mergers. In the EC the main concern in the present period of low growth is to achieve faster growth through dynamic competition.⁴⁵ Anti-competitive forces may result from market dominance or the creation of a cartel. Dominance occurs where one company gains control of a competitor thus reducing the number of independent competitors and increasing concentration in the particular industry. A cartel typically occurs where two independent competitors create an arrangement likely to reduce competition or enter into a consortium to make a takeover bid which has the effect of an auction ring for the target

41 Ibid, p 9.

42 Ibid, pp 10-11.

43 Ibid, p 11.

44 EC White Paper pp 10-11.

45 See Ingo L L Schmidt and Jan B Rittaler *A Critical Evaluation of the Chicago School of Antitrust Analysis* (1989) P XIV.

company's shares or an arrangement to divide up its assets or which leads to a joint venture which restricts competition.⁴⁶ In all these cases everything depends on the structure of the particular market. There has been an increasing feeling in the Commission that the provisions in Articles 85 and 86 of the Treaty of Rome are inadequate to deal with mergers.⁴⁷ There has consequently been a growing recognition of the need for a specific merger regulation. A regulation⁴⁸ has been proposed which defines concentration widely as occurring when two or more undertakings merge or when one or more persons or undertakings acquire direct or indirect control of the whole or part of another undertaking. The definition of control is wide. It encompasses not only de jure control, i.e. more than 50% of voting rights, and de facto control, but also the power to influence the composition, voting or decisions of the board or general meeting. The regulation only applies to concentrations having a 'community dimension', in other words, involving cross frontier concentration within the EC. There are financial tests which are to be applied: the aggregate world-wide turnover of all the undertakings concerned must be not less than 1 billion ECUs. Acquisitions will escape control if (a) the aggregate world-wide turnover of the target is less than 50 million ECUs, or (b) each of the undertakings effecting the concentration have more than 75% of the aggregate community-wide turnover within one and the same member state. Thus small acquisitions by large companies will escape control as will mergers of substantial companies whose business remains confined to one member state. In the latter case they will, of course, be subject to the individual member states antitrust laws.

Under the regulation concentrations are regarded as incompatible with the common market when they create or strengthen a dominant position in the common market or a substantial part of the common market. On the other hand such concentrations will be allowed if they improve production or distribution or promote technical or economic progress. There is a rebuttable presumption that concentrations are compatible with the common market when the aggregate market share of the undertakings concerned in the common market, or a substantial part of the common market, is less than 20%.

The Commission has sought exclusive jurisdiction to apply the regulation, subject only to review by the Court of Justice, and that such matters should be governed by the regulation alone and not by national laws. This reduces the risk of double jeopardy and ensures uniformity of application. States are reluctant to enforce antitrust laws which work to the detriment of local firms while at the same time paying lip service to the principle of world free trade.

Industrial relations differ considerably in the member states ranging from adversarial collective bargaining on the one hand to worker participation on the other. Negotiations on these topics have been long and controversial especially since the United Kingdom joined the EC.

The most elaborate proposal to date is that of the European company⁴⁹ project. The European company is sometimes called *societas europae* (SE) and we will

46 Stanley Berwin & Co, *Company Law and Competition*, Mercury Books, London (1989), Ch. 9.

47 Clifford Chance, *1992 An Introductory Guide*, 1988, paras 5.7, 5.8.

48 Regulation on the Control of Concentration between Undertakings OJ C 22/89. Adopted 21 December 1989.

49 EC White Paper, *passim*; *European Stock Corporation Text of Draft Statute with Commentary* by Prof. P Sanders, CCH Inc, New York (1969); Yvon Loussouarn 'La Proposition d'un Status des Sociétés Apunyme Européennes et le Droit International Privé' (1971) *Rev Critique DIP* 383; Jean Van Ryn 'Le Projet de Statut des Sociétés Européennes' (1971) *Rev Trim de Droit Europ* 563; see generally P Zonderland (editor) *Quo Vadis, Jus Societatum*, Kluwer (1972), which is a festschrift for Prof Sanders, especially the papers by Dabin, Rotondi, Vasseur and Vogelaar; Guy

use that abbreviation. This would be a genuine transnational corporation which would provide a suitable vehicle for cross frontier mergers within the EC.

There are four possible legal bases for the SE project.⁵⁰ These are a uniform statute, an international convention, and regulation under two separate provisions of the Treaty of Rome.

A uniform statute

The problem is to ensure uniform interpretation since uniform statutes such as the 1930 Geneva Convention on Bills of Exchange leave interpretation entirely to the national courts. There are two possible ways of overcoming this difficulty. The first is a provision along the lines of 'Questions concerning matters regulated by the present law that are not expressly decided by it shall be governed by the general principles on which it is based' such as is found in art 17 of The Hague Convention relating to a Uniform Law on the International Sale of Goods. The second is the provision for interpretation by a single court as the French Government advocated on 15 March 1965. The main disadvantage with a uniform statute is that it is enacted in each state as a domestic law and can be amended or repealed as such.

An international convention

This was the basis for the SE project as originally conceived. Precedents include the Warsaw Convention on International Transportation by Air and the Convention Relating to Contracting for the International Transport of Goods by Road. Here the problem is the differing approaches to international treaties in the members states — in some member states treaties have internal effect and take precedence over national law. This is not of course the case in English or New Zealand law.

Regulation under the Treaty of Rome

The two possibilities are articles 235 and 100a of the Treaty of Rome. Article 235 is couched in very general germs and provides that if action by the Community proves necessary to attain one of the objectives of the Community and the Treaty of Rome has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures. Article 100a provides inter alia that:

1. The Council shall, acting by a qualified majority on a proposal from the Commission in co-operation with the European Parliament and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in member states which have as their object the establishment and functioning of the internal market.
2. Paragraph 1 shall not apply to fiscal provisions, to those relating to the free movement of persons nor to those relating to the rights and interests of employed persons.

The Commission favoured Article 235 in its 1975 report but now favours Article 100a. The UK Government considers that this is inappropriate and that the only possible legal basis is Article 235. In its Consultative Document of December 1989 the UK Government states:

Keutgen *Le Droit des Groupes de Sociétés dans la CEE*, Bruylant Bruxelles 1973, Titre II Chapitre II; F A Mann 'The European Company' (1970) 19 ICLQ 468; D Ranier 'The Proposed Statute for a European Company' 10 Texas Int LJ 90 (1975). For the latest text of the draft see OJ C263/41. *Proposal for a Council Regulation on the Statute for a European Company* (16 October 1989). For comment see J Dines (1990) 11 Co Law 208.

⁵⁰ European Stock Corporation Text (supra note 49) pp 8 et seq.

The Government consider that Article 100a does not provide an appropriate basis for the regulation because that Article is concerned with measures to approximate provisions of law in Member States whereas the ECS proposal is not about approximation of national laws but about the creation of a Community-wide legal framework for a new supranational entity. Further, even if this were not the case, Article 100a would be an inappropriate treaty basis because, by virtue of Article 100a(2), it cannot be used for provisions on fiscal or worker participation matters. Provisions on both matters are included in the proposed regulation. The Government also consider that Article 54 is an inappropriate Treaty basis for the provisions contained in the proposed directive. Those provisions are regarded as an integral part of the ECS proposal and, just as Article 54 could not provide a basis for the proposal as a whole, so it cannot be used for a part of that proposal.

The original SE concept was put forward by French legal practitioners in 1959 and the idea was developed by Professor Pieter Sanders of the University of Rotterdam in the same year.⁵¹ Professor Sanders advocated a new corporate form, a European limited liability company registered on a European Commercial Register and incorporated under an alternative EC company regime, uniform in each member state and interpreted by the European Court of Justice. By this means he hoped to solve the conflict of laws problems such as the transfer of the seat of an enterprise across frontiers, which generally involved a change of nationality, liquidation and reconstitution under the other law, and the problem of mergers of companies incorporated under different legal systems. The Commission set up a committee of experts which assisted Professor Sanders in elaborating the concept. This led to a Commission proposal in 1970 which followed its complex EC path ending before the Council in 1975.⁵² There it languished before an ad hoc working party and got bogged down in the discussion of the proposals on groups. It was shelved in 1982. However, as part of the 1992 programme, the proposal was resurrected in 1988 and is now being pursued in earnest in spite of lukewarm support from the UK Government and business community.⁵³

IV THE PROPOSED EUROPEAN COMPANY

The European company proposal is ambitious. It has to overcome the current legal difficulties inherent in the domestic laws and constitute a valid alternative to the present techniques. The Internal Market White Paper Internal Market and Industrial Co-operation — Statute for the European Company gives the following example to show how it will work:⁵⁴

- (a) Let us imagine that two groups merge their activities because they complement each other and on account of the economies of scale secured by merging together their three respective subsidiaries which pursue the same activities:



⁵¹ *Ibid.*, p vii.

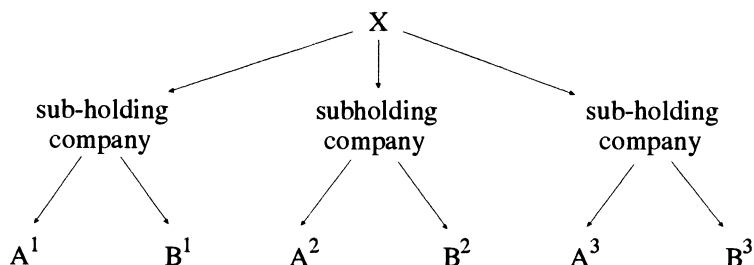
⁵² See generally EC White Paper, p 11.

⁵³ *Ibid.*, p 22.

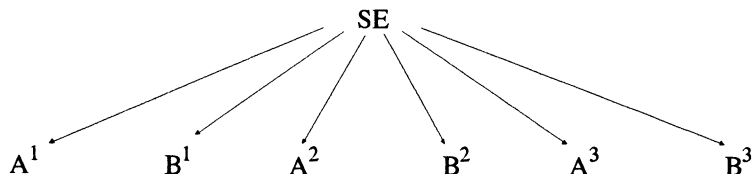
⁵⁴ *Ibid.*, pp 12-13 (this is set out verbatim).

- (b) because of the current impossibility from a legal standpoint (consent of 100% of shareholders under most national laws) and from the standpoint of taxation (the companies which are acquired have to be wound up), of cross frontier mergers between companies, the simplest organisation plan which meets the wishes of those directing or managing the companies is, at present, the following:

Holding company made up of shareholders of A and B



- (c) The alternative of the European Company would afford considerable simplifications:



While the company law aspects are important and the European Company Statute will itself provide a code of law for the operation for the company which will serve as a blueprint for the harmonisation programme, the question of the tax status of the SE is also vital and the tax regime will have to be consistent with the logic underlying the concept of the SE.

Specific issues which have to be addressed in the European company project are, (1) co-existence with national systems of company law, (2) worker participation, (3) the question of disclosure of information and consultation of workers, (4) the problem of groups and (5) tax treatment. The latest proposals consist of two documents:

- (a) a proposal for a Council regulation on the statute for a European Company, and
 (B) a proposal for a Council directive complementing the statute with regard to the involvement of employees in the SE. It is intended that the two will operate as an integrated whole.

The regulation relies heavily on previous directives or proposed directives and at the same time refers a number of things back to the member state in which the SE is registered. Article 7 provides that matters within its scope not expressly mentioned are to be determined by the general principles of the Regulation or, failing that, by the law applying to public limited companies in the state of registration. This will give scope to differences between SEs. Matters outside the scope of the regulation such as antitrust, employment law and intellectual property law are to be governed by existing national and community law.⁵⁵

55 This is based on the EC White Paper, pp 14 et seq.

The essential structure is that of commercial public limited company which will have a minimum capital of 100,000 ECUs (approximately £70,000) which is higher than the £50,000 required for a public limited company in the UK. The SE's capital will be in ECUs. The SE will have its registered office in the place of central administration and will have either a two-tier board (management and supervisory boards) or a one-tier board (an administrative board).

1. *Co-existence with national systems of company law*

The Commission argues that the statute will have to establish a single system of company law, totally independent of national systems. It will have to contain provisions which deal with legal problems which differ from those arising in national law or which do not exist in any member state's legislation. Since the statute will be entirely optional, the arguments against its inconsistency with national law are of less weight. This goal has not been completely realised by the latest draft.

2. *Worker participation*

The Commission takes a strong view that it is necessary to lay down rules governing worker participation in the structure and decision-making process of the European company. This is for a variety of reasons. It will be necessary to be compatible with national systems and the statute should not provide a means for contracting out of more rigorous obligations in individual member states. The Commission's argument is that worker participation is essential, not simply as a matter of social rights, but as an instrument of promoting the smooth running and success of the enterprise through promoting stable relationships between managers and employees in the workplace.

There are three main approaches for dealing with worker participation in the European Company Statute.

- (a) The model laid down in the 1975 version of the statute which consisted of a supervisory board made up of equal numbers of shareholder representatives, worker representatives, and members co-opted by these two groups representing general interests.
- (b) The rule of the country of establishment.
- (c) A choice from the principal schemes provided in the Fifth Company Law Directive which are (i) the workers elect no less than one-third and no more than one-half of the members of the supervisory board which is the German system; (ii) worker participation through a body representing the employees quite separate from the company organs; (iii) worker participation through collectively agreed systems to be determined within the company.⁵⁶

Approach (a) represents the most ambitious form of participation but it has not yet been applied in any member state and is likely to meet with considerable resistance from companies. Approach (b) runs contrary to the basic idea of the SE being independent of national systems. For these reasons (c) has been the option chosen and the option of co-option by the board has been added. The Commission considers that the provisions must be based on principles governing systems in the states that have so far developed them yet be flexible enough to allow for a consensus. It is thought that the system need not be uniform. It would be appropriate to allow companies a choice between

⁵⁶ OJ 1983, C240/2; see J Welch (1983) 8 ELR 83.

different schemes which reflect accepted practices in most member states, such being subject to consultation with the workers affected. Nevertheless there should be a provision that member states can restrict the choice. In this way the fear that the Germans have that companies might be inclined to use an SE to evade the provisions of the national law regarding worker participation is addressed.

3. *Disclosure and consultation with workers*

The Commission takes the view that the employees of the SE should benefit from the same disclosure and consultation rights which are enjoyed in other firms in the EC. The inclusion of more stringent rules in the statute is not thought to be desirable at this stage.

4. *The group problem*

In many systems within the EC the group is simply recognised *de facto* and not *de jure*. Except in Germany and Portugal the laws of member states are based on the principles of the economic and legal independence of each company which is a member of the group — which is an idea which is not always easy to reconcile with a degree of concentration. In England the courts have already been faced with the conflict between the interest of the company and the interests of the group. This was in the context of *ultra vires* and gratuitous payments.

The problem arises within the context of the European Company Statute because two of the means of creating a European community — the creation of a holding company or a joint subsidiary — automatically entail the formation of a group. The aim of the original draft was to enable those setting up the SE to opt for a special group status facilitating management of the company as a single economic unit while at the same time protecting the interests of third parties such as minority shareholders and creditors. The Commission now takes the view that it is open to question whether the European Company Statute is the proper place to create a body of rules governing groups. Under Article 114 where an undertaking controls an SE, that undertaking, rights and obligations relating to minority shareholders and third parties are to be governed by the law of public limited companies of the state where the SE has its registered office. This does not, however, affect the obligations imposed on the controlling undertaking by the legal system which governs it.

5. *Tax treatment*

The European company will be subject to the tax regime of the state in which it is domiciled in the same way as any other company. In this way it will also be subject to any bi-lateral agreements against double taxation made between that state and other member states. In addition there will be certain favourable provisions for enterprises which differ from normal tax treatment. There will be provisions whereby losses suffered by permanent establishments of the European company situated in another member state or by foreign subsidiaries can be deducted from the profits in the member state of domicile. At the same time the Commission takes the view that it would not be desirable to lay down any other tax provisions favourable to the European company which derogate from the normal tax treatment of companies. To do so would create a distortion in its favour which is detrimental to small or medium-sized enterprises which are unlikely to opt for this method of incorporation. The UK Government favours a system of tax neutrality for SEs.

The UK Department of Trade and Industry was sceptical whether the SE would provide any real assistance in helping companies in the community to restructure in response to changing market forces in the developing single market. There were three main reasons for their scepticism. First, the proposal as drafted will still be closely identified with the member state in which the SE was registered. Second, the proposal would not result in a single body of European Company Law and the law applicable to an SE would vary according to the member state in which it was based. Third, there was no real evidence that companies wanted to adopt the new form proposed, particularly if it involves compulsory employee participation.

The UK Department of Trade and Industry and the Department of Employment carried out consultations and received 41 responses. Three of the responses were favourable: 26 were opposed to the company law aspects of the current draft; 9 were opposed to the whole idea of a European company; and 10 were in favour of the general idea but opposed the detailed proposals. Only 31 of the 41 responses commented on the worker participation question and of these only 3 favoured compulsory worker participation or did not see difficulties in the present proposal. The Minister of State for Employment said that the Government did not believe that the draft directive was necessary and this view was shared by British industry generally. His Department rejected the forms of worker participation proposed in the European Company Statute as being in no way superior to the UK voluntary system. The Confederation of British Industry said that they were unable to identify the problem for which the European company statute was a solution. It did not think that the European company statute would enhance business activity nor facilitate cross border investment. The statute would not help the single European market in relation to the free movement of capital, goods, services and people. Far from simplifying matters the statute presented a more complicated situation. It would not make life easier for British companies wishing to merge with European companies nor would it lead towards the harmonisation of European company law.

The Select Committee on the European Communities reporting on the European company statute said that in its present form proposal would not be attractive. It would be unfortunate if this attempt failed for lack of adequate consideration of all the factors involved. The Committee made a number of proposals with a view to making the statute acceptable in the UK and in the EC.⁵⁷

V. CROSS FRONTIER MERGERS, INTERNATIONAL COMPETITION AND INTERNATIONAL CO-OPERATION

In the 1960s the main argument advanced for co-operation within the EC was economic integration under a policy of planned growth⁵⁸ and this, of course, remains valid today but in a time of slower growth and increasing international competition. Today, a more pressing reason and that which is the basis of the 1992 programme and the advancement of the cause of the European Company Statute is to improve the EC's competitive position in world markets characterised by ever-increasing global capitalism.⁵⁹ Such co-operation is regarded as absolutely vital, especially in high technology

⁵⁷ See Select Committee on the European Communities — *European Company Statute Report* (House of Lords Session 1989-90, 19th Report, HL, Paper 71-1).

⁵⁸ EC White Paper, p 5; Schmidt and Rittaler, n 45 *supra*, p XIV.

⁵⁹ EC White Paper, p 5.

industries and for companies which are highly specialised in financial services. Only by means of EC level co-operation will it be possible to bring together the large amounts of capital and technical know-how required to ensure competitiveness in world markets. Without such competitiveness there will be an erosion of living standards and a diminution of social and economic status.⁶⁰ In the lead-up to 1992 many EC companies are looking for merger partners and many US corporations are seeking a European partner.⁶¹ This is a tendency which is likely to increase and the progress of the European Company Statute as the means of facilitating cross frontier mergers is, therefore, important on a European level.

Although we have referred to the position in private international law and have concentrated on the EC position as an interesting case study of regional co-operation, the question of cross frontier mergers is also a topic of public international law. Some of the earliest examples of cross frontier co-operation in Europe involved the creation of corporate bodies by international treaty. Thus the 'Société Internationale de la Moselle' was created in 1956 by an international convention between France, Germany and Luxembourg to make the Moselle River navigable between Thionville and Koblenz, and EUROFIMA was set up to assist railways in the financing of purchase of rolling stock.⁶² Such bodies were created by treaty and mainly regulated by by-laws or 'statutes' accompanying the treaties. In matters not covered by the treaty and by-laws, the treaties provide for them to be governed by the law of the country of registration or by rules common to the countries involved. However, where there is an inconsistency between the treaties and by-laws and the latter treaties and by-laws prevail.⁶³ The Euratom Treaty provides rules for the creation of 'common enterprises' but the EC treaty does not contain such a provision with the exception of articles 129 and 130 which create the European Investment Bank. Foreign investment laws have been the subject of a number of international treaties, of a bi-lateral nature.⁶⁴ Thus the USA has entered into numerous treaties, imbued with the spirit of international co-operation under GATT but largely in pursuit of its own self-interest. Similarly, there are even more numerous double taxation agreements between different countries.

Each country is concerned with such international issues as the mutual recognition of the decisions of courts and administrative agencies of other countries. Within the British Commonwealth⁶⁵ and within the EC⁶⁶ the question of the mutual recognition of judgments and orders has been the subject of international co-operation. Elsewhere it is the subject of bi-lateral treaties or often nothing at all. Recently since the stock market crash of 1987, there has been an increase in informal co-operation between national securities regulators, future markets and financial institutions. Legislation has been passed in a number of jurisdictions to allow international co-operation.⁶⁷

60 See Robert I. Heilbroner *The Nature and Logic of Capitalism* (1985) p. 58.

61 See Tim Hingle 'Cross-border Takeovers — Proof That the Single Market is Here' (1990) 2 *Euro Business* 13.

62 See Hans Smith and Peter Herzog *The Law of the European Economic Community*, Vol 2.

63 *Ibid.*

64 *Bilateral Trade Treaties* (UN).

65 See K W Patchett *Recognition of Commercial Judgments and Awards in the Commonwealth* (1984).

66 L Collins *The Civil Jurisdiction and Judgments Act 1982* (1983).

67 See H Williams and L Spencer, 'Regulation of International Securities Markets: Towards a Greater Co-operation', 4 *J Comp Corp L & Sec*, Reg 55 (1982); P Merloe 'Internationalisation of Securities Markets: a Critical Survey of US and EEC Disclosure Requirements', 8 *J Comp Bus*

IOSCO is working actively in this field with its annual conferences and various committees.⁶⁸ The question of comprehensive regulation of multi-national enterprises is being considered by the United Nations at great length as well as by various regional bodies. Cross frontier mergers, like multi-national securities and financing operations in general, present a complex range of issues. At the present time international co-operation is still in its infancy but, in fostering extensive and varied debate and regional co-operation within its borders, one hopes that the EC will ultimately provide a model or series of models for international co-operation, rather than an impregnable Fortress Europe.

and Cap Market L 249 (1986); Daniel L Goelzer, Robert Mills, Katherine Gresham and Anne H Sullivan. 'The Role of the US Securities and Exchange Commission in Transnational Acquisitions' 22 *Int Law* 615 (1988) pp 635 et seq.

⁶⁸ IOSCO is based in Montreal. It hosts a number of specialised committees and an annual conference. The recent conferences in Melbourne, Venice and Washington have been important gatherings of securities and financial regulators.