



## **FAQ on the cross-border mergers directive (2005/56/EC)**

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### **A: General**

#### **1. What is a merger within the meaning of the directive?**

According to Art. 2 II a merger is an operation whereby one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company (or to a company that they form), 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.

Alternatively, it is an operation whereby 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 is the scope of the directive?**

The directive applies to cross-border mergers of limited liability companies, formed in accordance with the law of a member state and having their registered office, central administration or principal place of business within the Community. Furthermore, the companies have to be subject to the law of two different member states (cross-border element).

#### **3. What is a limited liability company within the meaning of the merger directive?**

The directive is applicable to different types of limited liability company. Art. 2 I lit. a refers to the first Council directive on company law (68/151/EEC) which lists the relevant types of public limited liability company and private limited liability company in the different member states. Moreover, according to Art. 2 I lit. b the directive is applicable, in a more general sense, to companies which have legal personality, possess separate assets which alone serve to cover its debts and which are subject under the national law covering it to disclosure requirements.

**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 the directive provides for some important 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. The main argument in support of it is that it will make it easier for European companies to cooperate and restructure themselves across borders. This will make Europe more competitive and enable businesses to further reap the benefits of the Single Market. From a labour point of view, however, one is likely to come to another conclusion.

**6. Does the freedom of establishment in the EC Treaty provide a right to merge across borders?**

Since the outcome of the recent ECJ case *Sevic* C-411/03 it is clear that a cross-border merger into another member state is protected by freedom of establishment (Art. 43, 48 EC Treaty). However, there is still no legal certainty concerning whether a cross-border merger from a member state must be legally recognised by that (home) member state. There are some good counter-arguments in the legal literature.

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

The legal basis for the directive was Art. 44 EC Treaty. This provides for the co-decision procedure laid down in Art. 251 EC Treaty.

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

The directive has to be transposed into national law by 15 December 2007 (Art. 19 I).

## **B: Board-level participation**

**1. How does the directive deal with participation?**

The issue of participation is regulated in Art. 16, which refers repeatedly to the SE directive. The basic rule is that the applicable participation rules shall be those of the country in which the company resulting from the cross-border merger has its registered office. However, there are three important exceptions to this basic rule, to safeguard existing participation rights. If these exceptions apply, as a basic principle the SE procedure will be relevant. This

means there must be negotiations on the participation of employees between the management of the merging companies and the employee representatives in a Special Negotiating Body (SNB). If the parties fail to reach agreement on employee participation within a given time frame standard rules for participation may apply.

## 2. What are the exceptions to the basic rule which provide for substitution of the SE procedure?

According to **Art.16 II** the SE procedure will apply when:

- a) one of the merging companies has an average number of employees that exceeds 500 employees and is operating under an employee participation system (**Art. 16 II**);
- b) **or** if the national law of the member state in which the company resulting from the merger has its registered office provides for less participation than is operated in one of the merging companies (see **Art. 16 II lit. a**);
- c) **or** if there is not the same entitlement to exercise participation rights for employees of establishments in other member states as is enjoyed by those employees employed in the state in which the company resulting from the merger has its registered office (see **Art. 16 II lit. b**).

In these **three cases the SE procedure** will apply.

## 3. What does it mean if the SE procedure applies?

If the SE procedure applies the participation of the employees in the company resulting from the cross-border merger and their involvement in the definition of such rights shall be regulated in accordance with the SE provisions (Art. 16 III). That means that an SNB must be set up for negotiations between the employees and the management on the participation issue. If the negotiations fail the standard rules on participation may apply.

## 4. Could the management of the companies in the case of Art. 16 II prevent negotiations?

Yes. The relevant organs of the merging companies have the right to choose without any prior negotiations to be **directly subject to the standard rules** for participation, as laid down by the member state in which the company resulting from the merger will have its registered office (Art. 16 IV lit. a). This provision goes back to a British proposal and is meant to accelerate the whole procedure.

## 5. What is the special negotiating body (SNB)?

The SNB represents the employees in negotiations with the participating companies in order to reach a written agreement on employee participation in the company resulting from the merger. It is created after the companies' managements have announced their plans to merge and Art. 16 II applies (Art. 16 III lit. a and Art. 3 SE Directive). The SNB can request that experts of its

choice assist it in its work. In this context, the Directive explicitly mentions the **representatives of Community-level trade union** organisations.

## 6. Who sits on the special negotiating body (SNB)?

According to Art. 16 III lit. a and Art. 3 II SE Directive, the seats are allocated proportionally among the member states in which the participating companies 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 – if possible – all involved companies are represented in the SNB.

It is up to the member states to define how their SNB members are elected or appointed. Furthermore, the member states may provide that **representatives of trade unions** be allowed to become SNB members, even if they are not employees.

## 7. What may result from the negotiations?

The special negotiating body (SNB) decides not to open or to terminate negotiations (Art. 16 IV lit. 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 participating companies conclude an agreement according to Art. 4 SE Directive on the participation of employees in the company resulting from the merger. The partners in principle have autonomy with regard to the content of the agreement.

The SNB and the competent organs of the participating companies fail to come to an agreement within the time frame. In this case the standard rules on participation may apply. If no standard rules apply it depends on the national company (participation) law of the country where the registered office is located whether the company will operate under participation rights (**Art. 16 I**).

## 8. 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 and Art. 3 IV SE Directive).

However, if the decision would lead to a reduction of participation rights, a double two-thirds majority is required, that is, at least two-thirds of the SNB members representing two-thirds of the employees. Moreover, the votes must come from at least two different countries. This exacting requirement is needed only when participation covers 25% of the employees of the involved companies. (Reduction of participation rights means a proportion of board

members which is lower than the highest proportion existing within one of the participating companies; see Art. 16 III lit. a and Art. 3 IV SE Directive.)

**9. Could the SNB rely on 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, but a special majority is necessary, that is, the SNB has to decide by a majority of two-thirds of its members representing at least two-thirds of the employees in at least two different member states (Art. 16 IV lit. b). In this case, standard rules will not apply.

**10. 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 total of one year after the establishment of the special negotiating body (SNB), if both parties agree (Art. 16 III lit. c and Art. 5 SE Directive).

**11. When have the standard rules to be applied?**

The standard rules have to be applied if negotiations between the special negotiating body (SNB) and the competent organs of the participating companies fail within the time frame (6 or 12 months) and no decision according to Art. 16 IV lit. b has been taken. In this case they are automatically introduced when at least one-third of the employees previously had participation rights (Art. 16 III lit. e and Art. 7 II lit. 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 involved companies before the merger (Art. 16 III lit. e and Art. 7 II lit. b SE Directive). No special majority is necessary.

On the other hand, the two parties may decide to apply the standard rules on a voluntary basis.

Member states have the right to 'opt out' with regard to the application of the standard rules on participation (Art. 16 III lit. e, Art. 7 III SE Directive and Art. 12 III SE Regulation). In this case, the company cannot be registered in such a country unless an agreement on participation has been reached, or none of the companies previously had participation.

**12. What is the content of the standard rules?**

The standard rules regulate participation. The member states must lay down standard rules which are in line with the standard provisions defined in the Directive. According to the standard rules laid down in Art. 16 III lit. h and Annex Part 3 lit. b SE Directive, the employees are entitled to elect or appoint

a number of board members. Their number is equal to the highest proportion existing before the merger in one of the involved companies. In contrast to the SE the member states are free to determine the allocation of the seats within the administrative or supervisory board.

**13. Who has the last word regarding employee participation?**

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

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

The costs of the SNB must be borne by the companies. With regard to the SNB's right to call in experts to assist it with its work, member states have the right to limit funding to one expert (Art. 16 III lit. a and Art. 3 VII).

**15. What are the differences between the merger directive and the SE directive?**

There are some important differences between the merger directive and the SE directive. The first is the threshold for the application of the standard rules. This threshold applies in the SE directive (Art. 7 (2) lit. b) when at least 25% of the employees of the companies concerned had been covered by codetermination rules before the foundation of the SE. This threshold is raised in the merger directive to one-third (33.33%).

Moreover, there is the possibility for member states in the case of a merger in which the standard rules are applied to limit the number of employee representatives on the board if the country where the registered office is located provides the option of a one-tier board system in its company law and the company resulting from the merger applies this option (see Art. 16 IV lit. c). However, if one of the merging companies had more than one-third participation, the limitation may not result in a proportion of employee representatives lower than one-third. It must be stressed that this limitation applies only in the case of a merger between a dualistic and a monistic company in a country which provides only a monistic system: for example, the merger of a German company into a Swedish company.

**16. 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.

## 17. Examples:

- **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 board). The registered office of the new company will be in Sweden. Before the merger the German company employed more than one-third of the employees. **Outcome:** The SE procedure (negotiations) must be started (Art. 16 II, as well as lit. a and lit. b). 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, the standard rules will apply (Art. 16 III). 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 before the merger employed 25% of the employees. The registered office of the company will be in Germany. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II). 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, 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, there are good reasons for applying German company law – as the **default rule** – with 50% participation (**Art. 16 I**).
- **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 board). The registered office of the new company will be in Germany. The German company before the merger employed more than one-third of the employees. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II). 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 the standard rules will apply (Art. 16 III lit. e and lit. h), 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 before the merger employed more than one-third of the employees. The registered office of the company will be in Austria. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II). The management decides to adopt the standard rules to prevent long negotiations (Art.16 IV lit. a). In this case the company 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 will be in the Netherlands. The Dutch company before the merger employed more than one-third of the employees. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II, as well as lit. b). 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 lit. e and lit. h). This means that one-third of the supervisory board members will be nominated by the employees.
  
- **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 will be the UK. The Dutch company before the merger employed 25% of the employees of all involved companies. The Dutch company has more than 500 employees. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II). There has been no decision on the part of the relevant organs of the merging companies to adopt the standard rules without prior negotiations. If the parties cannot find an agreement the standard rules will not apply automatically because the threshold (one-third) for the automatic application of the standard rules has not been met (Art. 16 III lit. e and lit. h). If the company was an SE the standard rules would apply because in that case the threshold is only 25%. However, the **SNB could decide to apply the standard rules** anyway (Art. 16 III lit. e and Art. 7 II lit. b SE directive).
  
- **Example 7:** An Italian company merges with a Spanish company. The registered office of the company will be in Spain. **Outcome:** The basic rule will apply (Art. 16 I). There will be no participation.
  
- **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 will be in Hungary. Prior to the merger the Hungarian company employed more than one-third of the employees. **Outcome:** The SE procedure (negotiations) must be initiated (**Art. 16 II lit. b**). 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 the standard rules will apply, 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 lit. b).
  
- **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 will be in the Czech Republic. The Czech company employed more than one-third of the employees of the involved companies prior to the merger. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II lit. b). 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 the standard rules will apply automatically, which means the company will have one-third participation in its 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 will be in Germany. The German company employed less than one-third of the employees of all involved companies prior to the merger. **Outcome:** The SE procedure (negotiations) must be initiated (Art. 16 II and Art. 16 II lit. b). 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 lit. b), namely one-third participation in the supervisory board of the company resulting from the merger.

## C: Miscellaneous Labor Law

### 1. What rights does the merger directive provide besides board-level participation rights for employees?

There are some special information rights. The management or administrative organ of each of the merging companies must draw up a common draft plan on the cross-border merger. This draft must include information on the likely repercussions of the cross-border merger for employment (Art. 5 lit. d).

Moreover, the management or administrative organ of each of the merging companies must draw up a report explaining and justifying the legal and economic aspects of the cross-border merger, including the implications of the cross-border merger for the employees (Art. 7 I). This report must be made available to the employees' representatives or to the employees themselves not less than one month before the general meeting which approves the merger (Art. 7 II). These provisions force the management to take into account the employment consequences of the merger at an early stage.

Furthermore, the employees' representatives have the right to append an opinion to the merger report of the management or the administrative organ, if national law (for example, the Works constitution act) provides such a right (Art. 7 II). This provision is borrowed from the Takeover Directive (2004/25/EC).

### 2. What is the relation of the merger directive to EWC rights?

The rights arising from the merger directive shall be without prejudice to the rights provided in the EWC directive.

**3. What happens to the rights and obligations arising from the employment contract?**

The rights and obligations of the merging companies arising from contracts of employment or from employment relationships shall be transferred to the company resulting from the cross-border merger (Art. 14 IV). In addition, directive 2001/23/EC (Directive on the transfer of an undertaking) shall apply.

**4. Will the merger affect the law applicable to individual employment contracts?**

As long as the employee remains at the same establishment of the company in a particular member state usually nothing will change (see Art. 6 of the convention on the law applicable to contractual obligations, signed in Rome on 19 June 1980). If the employee is transferred to an establishment of the company in another member state the law applying to the individual employment contract could change, but this depends on the individual circumstances.

**5. What impact will the merger have on collective agreements?**

Following the merger, the company resulting from the merger must continue to observe the terms and conditions laid down in any collective agreement on the same terms as those which previously applied until the date of termination or expiry of the collective agreement or the entry into force or application of another collective agreement. The period may be limited by member states, but not to less than one year (Art.3 III Directive 2001/23/EC).