

A NEW EU BUSINESS COMBINATION FORM TO FACILITATE CROSS-BORDER M&A: THE COMPULSORY SHARE EXCHANGE

LUCA ENRIQUES*

ABSTRACT

Facilitating cross-border mergers and acquisitions has long been one of the objectives of European company law directives and regulations. This short essay shows that the current European legal framework unnecessarily raises the transaction costs incurred when the acquirer aims both to obtain one hundred percent of a company's shares and to preserve the acquired company as a separate entity. Higher transaction costs result from the limited availability of the squeeze-out right. Instead of proposing to extend such right, which would be politically contentious, the solution proposed here is for a directive requiring member states to allow companies to execute acquisition transactions via a 'compulsory share exchange.' This is a transaction form in which the acquiring and the target companies agree that the target shareholders will receive shares in the acquiring company in exchange for their shares. This essay will show that a subset of the rules applying to cross-border mergers would be sufficient to regulate such transactions.

* Department of Law, LUISS (Rome), and ECGI. I wish to thank András Hanák, Vanessa Knapp, Jennifer Payne, and Michele Siri for their precious comments to an earlier draft and to Reinier Kraakman for a helpful discussion. Usual disclaimers apply.

1. INTRODUCTION

A long-standing and persistent aspiration of European law has been to facilitate cross-border mergers and acquisitions. Various European Union directives and regulations regarding companies and taxes have been adopted for this purpose in the last three decades, from the Merger Tax Directive of 1990 and its subsequent amendments¹ to the European Company Statute² and the Cross-Border Merger Directive.³

However, the process to be followed to execute a cross-border merger can be cumbersome and costly,⁴ discouraging at least some potential M&A transactions. This discouragement is especially the case with mergers between a company incorporated in a jurisdiction providing for worker representation on the Board of

¹ Council Directive 90/434, on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, 1990 O.J. (L 225) 1 (EC), as later amended and then codified in Council Directive 2009/133, on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE or SCE between Member States, 2009 O.J. (L 310) 34 (EC) [hereinafter Merger Tax Directive].

² Council Regulation 2157/2001, on the Statute for a European Company (SE), 2001 O.J. (L 294) 1 (EC); Council Directive 2001/86, Supplementing the Statute for a European Company with Regard to the Involvement of Employees, 2001 O.J. (L 294) 22 (EC).

³ Council Directive 2005/56, on Cross-Border Mergers of Limited Liability Companies, 2005 O.J. (L 310) 1 (EC) [hereinafter Cross-Border Merger Directive]. In addition, the European Commission and the European Court of Justice decisions on golden shares have lowered political obstacles to cross-border mergers. See, e.g., Wolf-Georg Ringe, *Company Law and Free Movement of Capital*, 69 CAMBRIDGE L.J. 378 (2010). Unfortunately, the same positive impact cannot be attributed to the Takeover Bids Directive, Council Directive 2004/25, on Takeover Bids, 2004 O.J. (L 142) 12 (EC) [hereinafter Takeover Bids Directive], which might have facilitated bids in the version originally proposed by the Commission, but ended up designing a framework less favorable to bidders than the pre-existing one. See Paul Davies et al., *The Takeover Directive as a Protectionist Tool?*, in COMPANY LAW AND ECONOMIC PROTECTIONISM: NEW CHALLENGES TO EUROPEAN INTEGRATION 105, *passim* (Ulf Bernitz & Wolf-Georg Ringe eds., 2010) (showing that, as an outcome of the Takeover Bids Directive, national takeover laws have become less favorable to takeovers than before); Luca Enriques, *European Takeover Law: The Case for a Neutral Approach*, 22 EUR. BUS. L. REV. 623, 627-31 (2011) (showing how the Takeover Bids Directive contains a number of provisions hindering takeovers and much fewer promoting them).

⁴ See, e.g., Paul Storm, *Scope and Limitations of the Cross-border Merger Directive*, in 1 CROSS-BORDER MERGERS IN EUROPE 54, 75 (Dirk Van Gerven ed., 2010) (describing the obstacles to executing cross-border mergers pursuant to the Cross-Border Merger Directive).

Directors and one incorporated in a jurisdiction that does not provide for the same level of employee participation. Such companies have to engage in potentially lengthy labor negotiations, with parties bargaining in the shadow of pro-labor rules that will govern if no deal can be struck.⁵ The justification for such worker protection measures is to ensure that cross-border mergers are not mechanisms used by companies to get rid of co-determination imposed by their jurisdictions.

Well aware that “a number of issues have been identified as a potential source of uncertainty and complexity,” the European Commission plans to consider “the appropriateness of amendments to the Directive on cross-border mergers.”⁶

The purpose of this essay is to show that, as a complement to well-advised efforts at simplifying the current regime for cross-border mergers, a business combination form well-known in U.S. corporate law, the compulsory share exchange, could be made available to all European companies to facilitate cross-border M&A activity.

In a compulsory share exchange,⁷ the acquiring company would offer to exchange its own shares for shares of the target that it does not already own. The difference between this transaction form and a share-for-share tender offer would be that the target and the acquiring companies’ shareholder meetings would vote on the transaction and, if approved, even the dissenting target’s shareholders would participate in the exchange. As a result of the transaction, the target company shareholders would become shareholders of the acquiring company (in a measure determined according to the exchange ratio approved by both companies) and the acquiring company would obtain one hundred percent of the acquired company’s shares.

⁵ See, e.g., Mathias M. Siems, *The European Directive on Cross-Border Mergers: An International Model?*, 11 COLUM. J. EUR. L. 167, 177-78 (2005) (showing that, in the case where no deal is struck with employee representatives, the applicable rules are favorable to labor).

⁶ *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, at 12-13, COM (2012) 740 final (Dec. 12, 2012), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF>.

⁷ For a more in-depth discussion of the mechanics of the compulsory share exchange, see *infra* Part 2.

Because a compulsory share exchange, as explained below, would leave worker (and creditor) rights unscathed, lawmakers may regulate this business combination form without requiring companies to undergo some of the cumbersome procedural steps that are currently mandated for cross-border mergers.

To understand why a similar business combination form would be useful, let us categorize M&A transactions into three categories depending on the degree of economic and legal integration between the combined entities that the acquiring party is interested in achieving.

If the acquiring party only intends to gain control over a company situated in another member state, all it has to do is acquire a majority of its shares, whether through private negotiations (followed by a mandatory bid if the acquired company is listed and the relevant ownership threshold is crossed⁸) or via a voluntary offer for all or a majority of the shares (again, in the latter case, followed by a mandatory bid for the remaining shares, if the mandatory bid threshold is crossed). We can call this first category of transactions partial acquisitions: though the acquirer, due to mandatory bid obligations in listed companies or tag-along clauses in the privately held company setting, may end up with one hundred percent of the shares, the acquirer's main goal is to achieve a majority (or even a working control) stake.

In other instances, the acquirer aims to gain complete control over the acquired company, i.e., to end up with one hundred percent of the shares. The acquirer may want total control for a variety of reasons. One hundred percent ownership at the subsidiary level rules out the possibility of conflicts of interest with minority shareholders, and therefore any kind of limitations to parent-subsidiary transactions arising from minority shareholder protection rules.⁹ It also rules out any other possibly costly

⁸ See Takeover Bids Directive, *supra* note 3, at art. 5 (providing that purchasers of a block of shares granting control of a listed company have to launch a tender offer for the remaining shares at the highest price paid for them).

⁹ See WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 468 (4th ed. 2012) ("To acquire a corporation in the full sense of obtaining complete dominion over its assets, an acquirer must purchase 100 percent of its target's stock, not merely a control block.").

intrusions in the subsidiary's management via the exercise of minority rights by a vociferous holding-out shareholder.¹⁰

In the same circumstances, it may also be the case that the acquirer cannot, or would rather not, achieve one hundred percent ownership via a merger of the acquirer company and the target. Such a merger might be too difficult to execute or excessively costly. For example, a strong creditor may have a covenant granting it a veto over change-of-control transactions and gaining its consent may be costlier in the event of a full-blown merger. The merger may also have negative tax consequences: in fact, the Merger Tax Directive has only partially achieved tax neutrality so far.¹¹ In addition, maintaining a wholly owned subsidiary may be politically sensitive; for instance, in a situation where nationalistic opposition mounts against the M&A transaction, preservation of the national entity would ease political concerns. Maintaining a

¹⁰ The acquirer may also aim to appropriate all the increased profits deriving from its improved management of the acquired entity (whether due to better managerial skills or to synergies with the acquirer's pre-existing business) to the exclusion of the pre-acquisition shareholders. This may be possible in jurisdictions allowing the squeeze-out of minorities at a price which does not incorporate the efficiency gains from the acquisition. For the U.S. debate on the issue, compare Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 322-40 (1974) (advocating equal distribution of synergy gains between acquirer and minority shareholders of the acquired corporation) with Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 729 (1982) (providing an efficiency rationale for a rule allowing the acquirer to appropriate all gains from the acquisition by squeezing out minorities at the pre-acquisition share price). The compulsory share exchange proposed here may allow the acquirer to attain such an objective, but this will depend on whether the valuation of the target's shares for the purposes of the exchange ratio incorporates the post-acquisition value of the combined entity. On this issue, EU corporate law is silent. In fact, Council Directive 2011/35, Concerning Mergers of Public Limited Liability Companies, 2011 O.J. (L 110) 1 (EU) [hereinafter the Merger Directive] only states that the exchange ratio must be "fair and reasonable," but does not specify what that implies in respect of synergy gains. *Id.* at art. 10(2). The Cross-Border Merger Directive also refers to Article 10(2) of the Merger Directive. *See* Cross-Border Merger Directive, *supra* note 3, at art. 8(3) (citing Article 10(2) of the Merger Directive as the guideline for requirements of independent expert reports for shareholders). To be clear, the Cross-Border Merger Directive refers to the Merger Directive's predecessor, the Third Council Directive 78/855, Based on Article 54(3)(g) of the Treaty Concerning Mergers of Public Limited Liability Companies, 1978 O.J. (L 295) 36 (EC).

¹¹ *See, e.g.,* HARM VAN DEN BROEK, CROSS-BORDER MERGERS WITHIN THE EU: PROPOSALS TO REMOVE THE REMAINING TAX OBSTACLES 325 (2012) ("In other words, the Merger [Tax] Directive fails to neutralize all relevant tax burdens for cross-border mergers.").

separate subsidiary may have the advantage of leaving workers' rights untouched and therefore allow the acquirer to skip labor negotiations that, in the worst case scenario for the acquiring company's owners, may lead to extending labor participation rights to its own employees. Further, the acquirer may want to keep the acquired company's liabilities separate from its own.¹² And, finally, there may be national or EU rules requiring notification to customers or other stakeholders of any change in the identity of the supplier of goods or services, which is what happens when the acquired company is merged into the acquiring one or becomes part of a new entity via a merger.¹³ We can call this second category of transactions—in which the acquirer aims at total ownership but cannot, or would rather not, engage in a merger—'one hundred percent acquisitions.'

Finally, there may be instances in which the acquirer pursues not only one hundred percent ownership, but also complete integration, including from a legal entity point of view. The motivations may be tax-related, labor law-related,¹⁴ regulation-related,¹⁵ or more broadly business-related. These instances make up the third category: merger transactions.

This essay shows, first, that the current EU framework is ill-equipped to facilitate one hundred percent acquisitions. Acquirers are pushed to either buy out hold-out minority shareholders at a higher price or engage in a costlier cross-border merger. In either case, the legal framework may prevent some cross-border merger deals from going through. And it will impose higher transaction costs on those deals that will go through all the same.

¹² See ALLEN ET AL., *supra* note 9, at 471 (discussing the mechanics of a triangular merger, which allows an acquirer to limit its exposure to the target's liabilities "by merging the target into a wholly owned subsidiary of the acquirer").

¹³ For instance, under German law, following a merger between two insurance companies, policyholders of the merged entity have to be notified of the merger by the merging company. See *Versicherungsaufsichtsgesetz* [VAG] [Insurance Supervision Act], Dec. 5, 1901, RGBl at 139, repromulgated Dec. 17, 1992, BGBl. I at 2, last amended by § 6(13), of Act of Aug. 28, 2013, BGBl. I at 3395, §§ 14(7) & 14a (Ger.).

¹⁴ For instance, the participation rights of workers in the acquiring company may suffer dilution once they have to be exercised together with the acquired company's workers, who may be less unionized and/or represented by less confrontational unions. See Michael Stollt & Norbert Kluge, *The Potential of Employee Involvement in the SE to Foster the Europeanization of Labour Relations*, 17 *TRANSFER: EUR. REV. OF LAB. & RES.* 181, 184 (2011).

¹⁵ For example, a financial institution may prefer to conduct business in the target's jurisdiction via a branch rather than via a subsidiary.

A set of rules enabling companies to enter into a compulsory share exchange, a business combination form hitherto unavailable in most European jurisdictions, is thus proposed here to facilitate one hundred percent acquisitions.

Part 2 describes the practical problems with one hundred percent acquisitions and the compulsory share exchange solution to them. Part 3 explains what rules would be necessary and sufficient to ensure minority shareholders and other stakeholders protection in compulsory share exchanges. Part 4 sums the essay up.

2. THE PROBLEM AND THE SOLUTION

An acquirer interested in obtaining one hundred percent ownership of the acquired company may have a hard time achieving its goal.

If the target company is privately owned, a minority shareholder may hold out and refuse to sell his or her shares to the acquirer unless he or she receives a higher price than that offered to other shareholders (which may lead all of them to hold out for a higher price). The problem can be solved by entering into a merger agreement with the target company, in which case a majority of shareholders will force the minority shareholders to become shareholders of the combined entity under the same conditions as the majority.¹⁶ But, for the reasons explained in Part 1, a full-blown merger transaction may not be an attractive, or even viable, route for the acquirer.¹⁷

If the target company is listed, a minority shareholder or a group of minority shareholders coordinating among themselves may refrain from tendering their shares to the bidder. If the hold-out shareholders own more than a given percentage of shares, the acquiring company will not be able to squeeze them out, i.e., to force them to sell their shares at a price usually equal to or not much higher than the bid price. The threshold above which an acquirer can force a squeeze-out is in fact very high: ninety or

¹⁶ This is assuming that the majority did not enter into any side deals with the acquiring company. But that's another story.

¹⁷ See *supra* notes 11–13 and accompanying text (explaining why a merger transaction may not be a practicable solution for an acquirer aiming at one-hundred percent of the target's shares).

ninety-five percent of the shares,¹⁸ depending on how member states have implemented the Takeover Bids Directive.¹⁹

The only way to get rid of minority shareholders, other than through a merger, would be to reach an agreement at a sufficiently high price for the remaining shares. Whenever the situation is such that the market knows that a merger is not a practical solution, e.g., for political reasons, the likelihood of hold-outs by shareholders aggregating more than five or ten percent of the shares will be high. Anticipating this hold-out, the acquiring company may make the bid conditional upon acceptance by shareholders representing at least ninety or ninety-five percent of the shares. But, even in that case, it may not be prohibitively costly for a hedge fund to build a stake higher than five or ten percent and negotiate better terms for all shareholders or (when this does not violate the best price rule²⁰) for itself alone.

Of course, an easy way to solve the problem outlined here would be to make the squeeze-out remedy more easily available in cases of acquisitions via a takeover bid. This could be done either by lowering the ninety percent minimal threshold in the Takeover Bids Directive, or by amending the Merger Directive²¹ and the Cross-Border Merger Directive so as to make cash-out mergers available under EU law, similar to the United States.²² The

¹⁸ For a more precise analysis of the thresholds in Article 15 of the Takeover Bids Directive, see Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals*, 50 VA. J. INT'L L. 841, 888-89 (2010).

¹⁹ A study covering twenty-one member states and all major EU jurisdictions reports that the threshold is ninety percent in thirteen countries (including the United Kingdom, Spain, Poland, and Sweden) and ninety-five percent in seven (including Germany, France, Italy, and the Netherlands), with Romania having a dual threshold based on both voting rights (ninety-five percent) and share capital (ninety percent). See CHRISTOPHE CLERC ET AL., A LEGAL AND ECONOMIC ASSESSMENT OF EUROPEAN TAKEOVER REGULATION 90 (2012). Note that Article 15 of the Takeover Bids Directive prevents member states from setting a threshold lower than ninety percent. See Takeover Bids Directive, *supra* note 3, at art. 15.

²⁰ See Takeover Bids Directive, *supra* note 3, at art. 5(4) (requiring bidders to extend to all offerees any price higher than the bid price paid during the offer).

²¹ See Merger Directive, *supra* note 10, at pmb. (1) (stating that the Merger Directive in its current form is the result of several amendments to prior Council Directive 78/855).

²² See DEL. CODE ANN. tit. 8, § 251(b), (c) (1974) (providing mechanics of corporate mergers under Delaware law). To be sure, following a cash-out merger, the target company would not survive as a separate entity; it would either be merged into another entity or the other entity would have to merge into it. Often, a wholly owned subsidiary is created for the purpose of executing a so-called triangular merger so as not to expose the acquirer to the liabilities of the target.

problem with this alternative solution is that, in Europe, the squeeze-out remedy is highly controversial, with legal scholars on the continent even doubting its consistency with constitutional principles on takings of private property.²³ A proposal to amend the Takeover Bids Directive to lower the threshold for the squeeze-out remedy, say, to seventy-five percent of the outstanding shares, even if it went together with rules aimed to effectively rule out pressure to tender in takeover bids,²⁴ would hardly fly.²⁵ Similarly,

See ALLEN ET AL., *supra* note 9, at 471 (“[M]aintenance of the liability shield is the premise for the *triangular merger* form.”). A separate entity is also retained if the “share exchange” transaction form under the Revised Model Business Corporation Act is used. See REV. MODEL BUS. CORP. ACT § 11.02 (1983) (defining the share exchange as a transaction with the same features as the compulsory share exchange proposed here); *id.* at ch. 11 (regulating share exchanges the same way as mergers). On the other side of the Atlantic, a more complex alternative, which would only be available for companies incorporated in some European jurisdictions (basically, the United Kingdom and the Netherlands), is the “dual-listed structure,” of which Unilever and Reed Elsevier are examples. See PAUL L. DAVIES & SARAH WORTHINGTON, *GOWER AND DAVIES’ PRINCIPLES OF MODERN COMPANY LAW* 1123 (9th ed. 2012) (explaining the complex arrangement of managerial and shareholder bodies in “dual-listed structure” companies).

²³ See Ventoruzzo, *supra* note 18, at 911 (“Most continental European systems emphasize the property rights of the single shareholder over the shares she owns and consider most forced acquisitions an infringement of the right to own property. In some Member States, freeze-out statutory rights have even raised constitutional law challenges on the grounds that they might be considered unconstitutional takings based on private, rather than public, interests.”).

²⁴ Pressure to tender is the collective action problem that target shareholders face in the event of a coercive bid, i.e., a bid so structured that shareholders, being unable to act collectively, may individually decide to tender their shares even when they would rather see the bid fail. Shareholders do this for fear of ending up holding minority shares that are worth even less than the pre-acquisition share price, should the bid succeed despite their not tendering their shares. See, e.g., Lucian Arye Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911, 911 (1987) (“In the face of a takeover bid, shareholders’ tender decisions are subject to substantial distortions.”). At present, the mandatory bid rule as designed in the Takeover Bids Directive does not work effectively to release shareholders from pressure to tender, due to its unavailability in the event of a voluntary bid for one hundred percent of the shares. See Luca Enriques, *The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?*, 1 EUR. COMP. & FIN. L. REV. 440, 446–47 (2004).

²⁵ See Christoph Van der Elst & Lientje Van den Steen, *Opportunities in the Merger and Acquisition Aftermarket: Squeezing Out and Selling Out*, in CORPORATE GOVERNANCE AND REGULATORY IMPACT ON MERGERS AND ACQUISITIONS: RESEARCH AND ANALYSIS ON ACTIVITY WORLDWIDE SINCE 1990 191, 207 (Greg N. Gregoriou & Luc Renneboog eds., 2007) (“[D]eviating from high thresholds could be judged as contrary to the constitutional right of property protection.”). This position echoes the influential view of the High Level Group (a group of company law experts set up by the European Commission in 2001 to make recommendations on a modern regulatory framework in the EU) in its Report on takeover bids. According to this

the idea of cash-out mergers would raise the same kind of opposition.

A compulsory share exchange would have the advantage of putting the dissenting shareholders, once the transaction is executed, in exactly the same position as shareholders dissenting from a merger proposal.²⁶ In other words, its effects (and, as proposed below, its safeguards for minority shareholders) would be the same as found in a merger, a business combination form that is traditionally accepted and regulated within European jurisdictions and by the EU itself.

Further, strictly as a matter of European law, simply lowering the squeeze-out threshold in the Takeover Bids Directive would not cover situations in which the acquiring company only becomes interested in obtaining one hundred percent ownership well after having gained partial control (for instance, because it would make sense initially, if only for political reasons, to retain a local shareholder base). In fact, the squeeze-out remedy in the Takeover Bids Directive is limited to situations in which someone has launched a bid to obtain control of the company; if a bid is launched by someone already holding a majority of the shares, that bid does not qualify as a takeover bid as defined by Article 1 in the Directive, and hence Article 15 does not apply.²⁷ The only alternative in such a case would be to execute a full-blown merger.

Group, the squeeze-out right would be proportionate (i.e. legitimate), “[s]o long as [it] applies only when the minority is fairly small” See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, at 61 (Jan. 10, 2002), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf. A recent European Commission report on the Takeover Bids Directive has not included the squeeze-out right among the areas to be considered in a review of the Directive. See *Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Application of Directive 2004/25/EC on Takeover Bids*, at 9–11, COM (2012) 347 final (June 28, 2012), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/COM2012_347_en.pdf.

²⁶ See *infra* note 35 and accompanying text (explaining why dissenting shareholders in a compulsory share exchange are in the same position as dissenting shareholders in a merger).

²⁷ To be sure, member states have usually extended the squeeze-out right (or an equivalent tool) either to all shareholders with a stake higher than the relevant threshold or to all kinds of public offers (i.e., even those launched by someone already controlling the company). See Christoph Van der Elst & Lientje Van den Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights*, 6 EUR. COMP. & FIN. L. REV. 391, 394–99 (2009) (describing the applicable law in Belgium, France, the Netherlands, Germany, and the United Kingdom).

As anticipated, a different, and more politically palatable, way to facilitate one hundred percent acquisitions would be for the EU to make the compulsory share exchange available as a cross-border M&A transaction form. At present, among European jurisdictions, a similar business combination form is only available in the United Kingdom and Ireland²⁸ and limited to transactions involving domestic companies.²⁹ In the United Kingdom, what we call the compulsory share exchange is known as a “transfer scheme”³⁰ and is regulated as a scheme of arrangement. This means it is subject to rules that, according to British commentators, are overall less cumbersome than those imposed by the Cross-Border Merger and the Merger Directives.³¹

A compulsory share exchange can be described as a transaction in which the acquiring company (A) and the target company (T)³² agree that all the shares in T that A does not already own will be transferred to A, while T shareholders will receive shares in A in an amount determined according to an agreed upon exchange ratio.³³ Other than in a tender offer, T shareholders would not

²⁸ CLERC ET AL., *supra* note 19, at 92.

²⁹ See Jennifer Payne, *Cross-Border Schemes of Arrangement and Forum Shopping* 5 (University of Oxford, Legal Research Paper No. 68, 2013), available at <http://papers.ssrn.com/abstract=2277451> (stating that “schemes of arrangement” affecting shareholder—as opposed to creditor—rights may only be used by companies incorporated under UK law).

³⁰ See LOUISE GULLIFER & JENNIFER PAYNE, *CORPORATE FINANCE LAW: PRINCIPLES AND POLICY* 621 (2011) (explaining alternative schemes, including the “transfer scheme”).

³¹ Schemes of arrangement need to be approved by a very high majority (three quarters of the shares and a majority in number of shareholders) and are subject to court approval. However, the disclosure requirements are less broad and there is no need for an independent expert report. See DAVIES & WORTHINGTON, *supra* note 22, at 1108–15.

³² Of course, a compulsory share exchange may also be used to execute what is known as a ‘(non)merger of equals.’ In other words, it would also work for combinations involving two companies of similar size with dispersed shareholders, where the two companies survive as separate entities. In this situation, it makes little sense, when looking at substance, to talk about an acquiring and a target company.

³³ One may also imagine a triangular transaction in which A offers shares in one of its affiliates in exchange, while acquiring T shares itself. Of course, in such a case the rules protecting shareholders identified in Part 3 will apply to protect the interests of minority shareholders in A’s subsidiary in the unlikely case that any exist. Also, following the British experience with schemes of arrangement, the transaction may also be executed by cancelling the T shares A does not already own, issuing an equal amount of shares in favor of A, and having T shareholders other than A receive shares in A, which may have tax advantages if

have a choice on whether to accept A's offer; acceptance or rejection would in fact be collective, in the form of an approval by the shareholder meeting of T (and A). Other than in a merger, once the transaction is executed, T would survive as a newly one hundred percent-owned subsidiary of A.

In friendly acquisition settings, the compulsory share exchange can work as a single-step transaction, where the acquiring company approaches the target management (or controlling shareholders) and a business combination of this kind is agreed upon. In hostile acquisition settings, the acquirer may use the compulsory share exchange, duly anticipated in the offering document, as a second-step transaction to be executed once control is obtained via a takeover. In either case, minority shareholders have no choice but to become shareholders of the acquiring company, unless of course company law either grants them the power to block the transaction via special quorum requirements for business combinations and/or for related party transactions, or protects them via appraisal/withdrawal rights.

Part 3 explains why a subset of the rules applicable to (cross-border) mergers would be sufficient to protect all of the relevant stakeholders of T and A in the event of a compulsory share exchange.

3. WHAT A COMPULSORY SHARE EXCHANGE DIRECTIVE WOULD LOOK LIKE

The EU may facilitate one hundred percent cross-border acquisitions by making the compulsory share exchange an available tool for European companies engaging in cross-border M&A. Due to the limited objective of this essay, we assume in the following that all rules in the Takeover Bids and the Cross-Border Merger Directives are necessary and sufficient to protect the interests of the relevant stakeholders in the given circumstances.³⁴

a stamp duty (or possibly a financial transaction tax) applies. See GULLIFER & PAYNE, *supra* note 30, at 621.

³⁴ Of course, this is not the case. One may indeed question the usefulness of some of the rules on mergers and raise doubts about their effectiveness in protecting minority shareholders' interests, especially in the case of parent-subsidiary mergers. See Marieke Wyckaert & Koen Geens, *Cross-Border Mergers and Minority Protection: An Open-Ended Harmonization*, 4 *UTRECHT L. REV.* 40 (2008). What matters here is that, first, if the European Union simplified the rules on mergers, such simplifications should extend to compulsory share exchanges. Second, if member states may impose stricter requirements to protect (minority)

A European directive on compulsory share exchanges would be very simple to devise. As articulated below, it would be enough to identify the rules among those applicable to cross-border mergers (and takeover bids) that, given the analogies, should apply to compulsory share exchanges as well.

Note, first, that the position of shareholders dissenting from the proposal to make the compulsory share exchange offer (in the case of company A) or accept the offer (in the case of company T) would be no different from that of shareholders dissenting from a merger resolution.³⁵ The outcome would be practically the same; the fact that T survives after the transaction as a wholly-owned subsidiary is of little or no relevance to the cash-flow rights and voting rights of the shareholders involved. As a matter of fact, even immediately after a merger is complete, nothing prevents management from separating out T's assets into a wholly-owned subsidiary. It would be costly to do, of course, and never necessary if the compulsory share exchange tool was available. But, the fact that management might do so without triggering any kind of EU corporate law protection for minority shareholders shows that this situation, by assumption,³⁶ is of no concern to minority shareholders.³⁷

shareholders in mergers, they should be able to do so with regard to compulsory share exchanges as well. See Cross-Border Merger Directive, *supra* note 3, at art. 4(2).

³⁵ In fact, much like dissenting shareholders in a merger have no choice but to become shareholders of the combined entity, shareholders dissenting from the compulsory exchange resolution will similarly be forced to become shareholders of the acquiring company. It follows that member states that grant shareholders dissenting from a merger proposal withdrawal or appraisal rights should extend such protections also to shareholders dissenting from a compulsory share exchange proposal.

³⁶ See *supra* note 34 and accompanying text (discussing how, despite the assumptions made in this essay, stakeholders are in fact not adequately protected by current EU laws).

³⁷ In fact, there might be instances in which creating a new subsidiary may be just a preparatory step for the execution of related party transactions harming minority shareholders. Separating assets in a different subsidiary may in fact facilitate tunneling by making it harder for independent directors to police it, also depending on domestic rules on related party transactions. The point here, however, is only that a compulsory share exchange is no more dangerous than a merger from this point of view. While in the former the assets remain segregated, in the latter case, segregation could take place immediately after the merger and be subject to no EU rule aimed to protect minority shareholders.

Hence, the Cross-Border Merger Directive (and the Merger Directive)³⁸ rules aimed to protect shareholders would be—again, presumptively³⁹—necessary and sufficient to protect shareholders in compulsory share exchanges. More precisely, the disclosure obligations in the Cross-Border Merger Directive's Articles 5 and 6, because they also serve the purpose of informing shareholders prior to the meeting,⁴⁰ would also apply to compulsory share exchanges.⁴¹ And the Cross-Border Merger Directive's Articles 7 to 9, on the management report, the independent expert report, and approval by the general meeting, respectively, would of course apply.⁴²

What about creditor interests? Because T would survive as a separate entity following the transaction's execution, there would be no reason to extend merger creditor protection rules⁴³ to compulsory share exchanges. Existing creditors would retain their right to seize T's assets on a priority basis vis-à-vis A's creditors. The analogy here is with takeover bids. If the relevant directive provides for no creditor protection tools in the event of a takeover bid, then there is no reason to provide for such tools in a compulsory share exchange.

More generally, because executing a compulsory share exchange would not alter third party claims on T's assets, there

³⁸ See Cross-Border Merger Directive, *supra* note 3, at art. 4(2) (declaring domestic rules concerning the decision-making process relating to the merger applicable to cross-border mergers, and hence, implicitly referring to the additional protections contained in the Merger Directive).

³⁹ See *supra* note 34 and accompanying text (discussing how, despite the assumptions made in this essay, stakeholders are in fact not adequately protected by current EU laws).

⁴⁰ Cross-Border Merger Directive, *supra* note 3, at arts. 5–6. See *id.* at pmbl (5) (clarifying the procedural publication requirements of Cross-Border Merger Directive Article 6).

⁴¹ Of course not all items would be relevant in the case of a compulsory share exchange. In Article 5, sub-sections (f), (i), and (k) presuppose a merger of the relevant companies, while sub-section (j) presupposes the application of Article 16 on worker participation, which, as argued below, would not apply to compulsory share exchanges. See Cross-Border Merger Directive, *supra* note 3, at art. 5. On sub-section (d), see *infra* note 49 and accompanying text.

⁴² Cross-Border Merger Directive, *supra* note 3, at arts. 7–9. On the provisions requiring that information be also given to workers' representatives, see *infra* note 48 and accompanying text.

⁴³ See Cross-Border Merger Directive, *supra* note 3, at art. 4(2) (declaring domestic rules concerning the protection of creditors of the merging companies applicable to cross-border mergers, and hence implicitly referring to the additional protections contained in the Merger Directive).

would be no need to apply the Cross-Border Merger Directive rules aimed at making third parties aware of and able to assess the consequences of the merger on the relevant companies' assets and liabilities. Hence, Article 6, on publication of the draft terms of the merger, and Article 13, on registration, should not be extended to compulsory share exchanges.⁴⁴ And those provisions providing for legality control over the merger (Articles 10 and 11)⁴⁵ should only apply if it is held that such control is also undertaken in the interests of shareholders.

Similarly, there would be no need to extend rules on worker participation rights to such transactions (Article 16).⁴⁶ If co-determination rules applied to T before the transaction, they would continue to apply once the transaction was executed. If they applied to A, but not to T, there would be no reason to extend them to T because the rationale underlying Article 16 is to protect existing co-determination rights rather than to increase the number of employees who enjoy them.⁴⁷

Under the initial assumption that existing European rules on mergers and acquisitions are necessary to protect stakeholders' interests, however, one may ask whether the (fairly innocuous) labor-related disclosure obligations contained in the Takeover Bids

⁴⁴ Cross-Border Merger Directive, *supra* note 3, at arts. 6 & 13. Of course, companies will have to comply with the EU's legal formalities and publication requirements regarding corporate statute amendments whenever issuance of shares in favor of target shareholders requires amending the acquiring company's statute. See Directive 2012/30, on Coordination of Safeguards Which, for the Protection of the Interests of Members and Others, Are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 54 of the Treaty on the Functioning of the European Union, in Respect of the Formation of Public Limited Liability Companies and the Maintenance and Alteration of Their Capital, with a View to Making Such Safeguards Equivalent, art. 3, 2012 O.J. (L 315) 74, 76 (EU) (setting forth information requirements for corporate documents); Directive 2009/101, on Coordination of Safeguards Which, for the Protection of the Interests of Members and Third Parties, Are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 48 of the Treaty, with a View to Making Such Safeguards Equivalent, art. 11, 2009 O.J. (L 258) 11, 16 (EC) (requiring that any amendments to corporate documents "be drawn up and certified in due legal form").

⁴⁵ Cross-Border Merger Directive, *supra* note 3, at arts. 10 & 11.

⁴⁶ *Id.* at art. 16.

⁴⁷ See, e.g., ADRIAAN DORRESTEIJN ET AL., EUROPEAN CORPORATE LAW 206 (2d ed. 2009) (explaining how rules dealing with employee participation rights in the Cross-Border Merger Directive "protect existing participation rights when . . . a cross-border merger takes place").

Directive,⁴⁸ as partly reproduced in the Cross-Border Merger Directive,⁴⁹ will have to be extended to compulsory share exchanges. This question highlights how arbitrary in their scope such takeover bid provisions are: if workers need special information rights in the event of a (prospective) change of control, then they would also need such rights whether or not the target shares are listed on a regulated market. However, for political reasons alone, it may be wise to extend the relevant Cross-Border Merger Directive rules to compulsory share exchanges as well.

Finally, there would be no need to extend the Takeover Bids Directive rules on tender offers to compulsory share exchanges. Structurally, the latter transactions are equivalent to a merger transaction. The collective action problems arising in the context of tender offers⁵⁰ are by definition not an issue with a compulsory share exchange; shareholders can either collectively reject the transaction or collectively accept it.⁵¹

4. SUMMING UP

This essay makes the case for the introduction, at the EU level, of a new business combination form to facilitate cross-border acquisitions – what we have called the compulsory share exchange. If this business combination form was available, transactions aimed to obtain one hundred percent control over another company, while still preserving it as a separate legal entity, would be facilitated, as the transaction costs arising from hold-out behavior would be reduced (we cannot say eliminated, because there might be cases in which, no differently than with mergers, and depending on national rules on shareholder meeting quorums,

⁴⁸ See Takeover Bids Directive, *supra* note 3, at arts. 6(1), 6(2), 6(3)(i), 8(2), & 9(5) (governing the procedural and substantive requirements concerning disclosures that must be made to employees of the offeror and offeree companies when a takeover bid is made).

⁴⁹ See Cross-Border Merger Directive, *supra* note 3, at art. 5(d) (reproducing in part Article 6(3)(i) of the Takeover Bids Directive, and Article 7, second paragraph, corresponding, *mutatis mutandis*, to Articles 6(1), 6(2), 8(2), and 9(5) of the Takeover Bids Directive).

⁵⁰ See *supra* note 24 and accompanying text (discussing the pressure to tender in takeover bids).

⁵¹ See Jennifer Payne, *Minority Shareholder Protection in Takeovers: A UK Perspective*, 8 EUR. COMP. & FIN. L. REV. 145, 158 (2011) (discussing the lack of collective action problems under a scheme of arrangement since there is “no opportunity for the bidder to divide and conquer”).

2013] *COMPULSORY SHARE EXCHANGE* 557

a blocking minority may extract a higher price by using its veto power over the transaction).

A directive on cross-border compulsory share exchanges could be easily drafted by extending to such transactions the rules in the Cross-Border Merger Directive that aim to protect shareholders. For political reasons alone, it might be expedient to apply the labor-oriented disclosure requirements found in the Takeover Bids Directive to such transactions.