First EU reverse cross-border merger: the first of many?

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Cross-border mergers

For the first time in English legal history, the High Court has approved a reverse cross-border merger under the Companies (Cross-Border Mergers) Regulations 2007 (*SI 2007/2974*). In this case, an English limited company, Formenta Ltd, was absorbed by its Italian subsidiary, Newco Immobiliare SRL. This newly permitted reverse cross-border merger has the potential to play an important role in allowing UK parent companies to move their headquarters to EU member states.

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As businesses respond to the legal and commercial uncertainties of Brexit, cross-border mergers may increase. This newly permitted reverse cross-border merger has the potential to play an important role in allowing UK parent companies to move their headquarters to EU member states.

What is a reverse merger?

Under the 2007 Regulations, a cross-border merger by absorption of a wholly-owned subsidiary involves a company transferring all of its assets and liabilities to another company, which holds all the shares or other securities representing its capital (*see box "Cross-border mergers"*). At the final stage of the merger, the transferor subsidiary company is dissolved without going into liquidation.

In a reverse cross-border merger, rather than the transferor being the subsidiary that is merged into the parent company, the transferor is the parent company that is merged into the subsidiary.

The Formenta merger

The Formenta merger involved the absorption of an English limited parent company by its Italian subsidiary company. It was motivated, among other things, by a desire to restructure, slim down and streamline the administration and operation of the corporate group. Before the decision in *Formenta*, the 2007 Regulations had never been used to permit a reverse cross-border merger under English law, although it had been permitted under the equivalent Italian law.

In Italy, the competent body to administer cross-border mergers are Italian Notaries Public, who are organised through the National Association of Notaries. The Italian National Association of Notaries regularly guides the Italian Notaries Public to carry out reverse cross-border merger procedures under its direction statement No 204-2009/1, linking it to section 2505 of the Italian Civil Code for domestic mergers involving wholly owned subsidiaries.

The underlying argument for why the cross-border merger procedure should be available for both reverse and forward cross-border mergers is that where the merger takes place between wholly owned entities, it is effectively a matter of internal reorganisation, with no material impact on shareholders, therefore removing the need for external supervision and protection.

High Court decision

Formenta applied to the High Court, which appreciated the commercial reasons for the merger and accepted that it was effectively an internal matter for the corporate group. It is a well-established principle of English law that the courts will not interfere with the administration of a company where the shareholders can validly express and act on their wishes themselves. Accordingly, the court indicated that it saw no problem with the concept of a reverse cross-border merger and approved the application.

Market conditions

Following the UK’s decision to leave the EU, this type of merger has significantly gained in importance when it comes to considering the future of pan-European corporate structures.

While large entities have used the 2007 Regulations to restructure their European operations, for example in *Honda Motor Europe Ltd*, the 2007 Regulations are principally geared to small and mid-sized businesses that are often still family run (*[2013] EWHC 2842 (Ch)*).

At present, cross-border mergers seem to be dominated by two distinguishable scenarios: shoring up for Brexit; and repatriation ahead of Brexit.

In respect of shoring up for Brexit, English limited companies are being converted into European limited companies, such as Italian SRLs or German GmbHs, to continue trading in the UK and exercise their European rights in the UK in a situation that enables them to “hop over the English Channel” at short notice, should the need arise as a result of Brexit.

Repatriation takes account of the fact that the English limited company model was, and to a lesser extent still is, a bestseller in continental Europe, where it is often used by entrepreneurs to avoid much more onerous capital requirements for local limited company structures. Where a business venture has turned out to be a success, the initial advantage is quickly consumed by the fact that reporting has to occur abroad, that is, at Companies House, and in a foreign language: English. The 2007 Regulations are frequently employed to repatriate the legal structure to where the operative business is. Brexit has prompted entrepreneurs to employ the 2007 Regulations now, while their existence and applicability is still certain.

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Cross-border mergers

A cross-border merger is a procedure introduced by the Directive on Cross-Border Mergers of Limited Liability Companies (*2005/56/EC*) (the Directive). It is a process by which a company from an EEA state can be absorbed into a company from another EEA state without needing to be liquidised, therefore ensuring corporate continuity. The Companies (Cross-Border Mergers) Regulations 2007 (*SI 2007/2974*) implement the Directive in the UK.

There are three different types of cross-border merger:

- Merger by absorption, where an existing company absorbs one or more other merging companies.
- Merger by absorption of a wholly-owned subsidiary.
- Merger by formation of a new company; that is, two or more companies merge to form a new company.

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