PwC International Business Reorganisations Network – Monthly Legal Update

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Contents

Welcome

Welcome to the second edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2017.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues and developments relevant to multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our February 2017 issue:

- PricewaterhouseCoopers Legal AG Rechtsanwaltsgesellschaft (Germany) provides an update on German rules on codetermination of employees which are under dispute;
- PricewaterhouseCoopers Belastingadviseurs N.V. (Netherlands) reports the proposed revision of the Shareholders' Rights Directive (2007/36/EC); and
- PricewaterhouseCoopers LLP (UK) considers the implications of the Easynet Global decision on the use of non-trading, dormant or shell companies in EU cross-border mergers.

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PricewaterhouseCoopers Legal AG Rechtsanwaltsgesellschaft (Germany) – Update on German rules on codetermination of employees which are under dispute

At a glance

In third edition of the PwC IBR Network Monthly Legal Update for August 2015, we presented a decision of the Regional Court of Frankfurt concerning the German rules on codetermination of employees.

In the meantime, some further courts in Germany ruled on different codetermination matters. The Court of Appeal in Berlin decided to defer its proceedings on a respective matter and lodged a request to the Court of Justice of the European Union (the **European Court**) to make a preliminary ruling on a potential incompatibility of the German rules on codetermination of employees with Article 18 and/or Article 45 of the Treaty on the Functioning of the European Union (**TFEU**).

The decision of the European Court is eagerly anticipated, in particular in Germany.

After conclusion of the written procedure, a hearing took place on 24 January 2017 which we would like to use as an opportunity to give an update on this dispute.

In detail

A German corporation with more than 2,000 employees must set up a supervisory board whereby half of its members be composed of employees or their representatives. The employees of the subsidiaries of a group are deemed to be employees of the controlling company. For a long time, the following two principles were generally trusted:

a only employees working in Germany are considered when determining the threshold; and

b these participatory rights in supervisory boards are granted only to those employees of the group who are employed in establishments of the corporation or in affiliated companies within Germany.

In its 2015 decision, the Regional Court of Frankfurt rejected the first principle as employees of other European Union (**EU**) countries would have to be considered as well. Some other courts in Germany have decided similarly. Others are of the opinion that the German rules on codetermination of employees do not violate EU law. The Court of Appeal in Berlin lodged a request for a preliminary ruling to the European Court in November 2015; the case number is C-566/15 (*Erzberger v. Tui*).

In the proceedings pending at the Court of Appeal in Berlin the shareholder of a German stock corporation argues that the second principle (under (b) above) violates Articles 18 and 45 TFEU.

Question to be answered by the European Court

The question referred to in the request from the Court of Appeal is as follows:

"Is it compatible with Article 18 TFEU (non-discrimination) and Article 45 TFEU (freedom of movement for workers) for a Member State to grant the right to vote and stand as a candidate for the employees' representatives in the supervisory body of a company only to those workers who are employed in establishments of the company or in affiliated companies within the domestic territory?"

The issue decided by the Regional Court of Frankfurt in 2015 is not in question before the European Court. However, trial observers expect that the European Court will consider this matter when making its decision in the pending court case.

Outcome of the hearing

The European Court used the hearing to clarify some questions. It indicated a different view on the legal situation of employees working in foreign branches of a German company and those working in foreign subsidiaries.

One statement of the European Commission was taken with interest. While supporting the argumentation of the claimant in the written proceedings it was stated during the hearing:

"*Employee participation is an important public policy objective and any possible restriction on the free movement of workers resulting from such rules can be justified by the need to safeguard systems of employee participation and their social objective. As a result, the Commission considers that the German rules as they stand can be considered compatible with EU law.*"

Further impact of the court decision

It remains to be seen whether the European Court will share this view.

Should the European Court decide that there is an incompatibility with European freedoms, this would not mean that the supervisory boards of all German corporations with more than 2,000 employees will be recomposed automatically. A rule in the German Stock Corporation Act prevents such automatic impact. According to this rule, a special court procedure must be initiated in order to change the composition of a supervisory board (as it was done in the proceedings *Erzberger v. Tui*). But in any case, such decision will bring the issue of codetermination further along in Germany.

Outlook

The conclusions of the Advocate General are expected to be published in May 2017. Usually, these conclusions are a strong indication for the decision of the European Court as it often adopts the opinion of the Advocate General which is, however, not mandatory.

A decision of the European Court is expected before the end of 2017.

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PricewaterhouseCoopers Belastingadviseurs N.V. (Netherlands) – Revision of the Shareholders' Rights Directive (2007/36/EC)

At a glance

On 9 April 2014, the European Commission published a proposal for the revision of the Shareholders' Rights Directive (2007/36/EC) (the **Directive**).

The revised Directive aims to promote long-term shareholder engagement and more transparent listed companies.

On 12 May 2015, the European Parliament's Committee on Legal Affairs gave its view on the proposal and put forward a few adjustments to achieve more transparency, higher accountability for companies and better corporate governance.

On 9 December 2016, the European Council, the European Commission and the European Parliament reached a compromise on the revision of the Directive.

In detail

What is new?

The revision of the Directive aims to promote long-term shareholder engagement and more transparent listed companies. Further, the European Commission is of the view that companies with a stock exchange listing will benefit from identifiable shareholders who are committed to the company. The commitment of the shareholders to the company includes supervision of the shareholders on strategy, performance, risks, capital structure and corporate governance. Finally, it is likely that the companies will benefit from the fact that shareholders are better informed when they exercise their voting rights.

The major changes to the revised Directive are as follows.

Shareholders get a "say on pay"

Shareholders will get a larger say in the reward of directors (the so-called "say on pay"). According to the Directive, shareholders can enforce a vote in the shareholders' meeting about the remuneration policy of the company.

At least every four years, the remuneration policy of the company should be on the agenda of (and put to a vote) at a shareholders' meeting. Each Member State of the European Union is allowed to decide whether this vote on the remuneration policy is binding or non-binding. A few Member States, including the Netherlands, already have such a right for shareholders. If the voting is binding and the Shareholders resolve to disapprove the remuneration policy, the company is obliged to adjust its remuneration policy. If the voting is advisory and the shareholders resolve to disapprove the policy, then the company must at least have a dialogue with the shareholders on this subject.

In addition, the revised Directive provides that Member States must ensure that companies draws up a remuneration report, providing a comprehensive overview of the remuneration of the directors. Member States must ensure that the annual general meeting has the right to hold an advisory vote on the remuneration report on the remuneration report of the past financial year. If the shareholders vote against the remuneration report, the company should explain in the next remuneration report how the vote of the shareholders has been taken into account.

Further, the value of the shares in the capital of the company may not be decisive in determining the amount of the remuneration of the directors. The remuneration policy must contribute to the strategy, the long-term interests and the sustainability of the company. The explanatory note to the remuneration policy should indicate the financial and non-financial performance criteria of directors, including criteria relating to corporate social responsibility.

Transparency for institutional investors, asset managers and proxy advisors

Under the revised Directive, institutional investors and asset managers will have to either develop and publicly disclose a policy on shareholder engagement or explain why they have chosen not to do so. The policy must describe how they integrate shareholder engagement in their investment strategy and the engagement activities they carry out. Annually, institutional investors and asset managers should publish how their commitment policy has been implemented, explanations of the most important votes and their use of proxy advisors' services.

Many institutional investors and asset managers use the services of proxy advisors, who provide research, advice and recommendations how to vote in general meetings of listed companies. Proxy advisors may have significant impact on voting behaviour of investors. Therefore, the revised Directive aims to ensure more transparency in this respect, by introducing more transparency requirements for proxy advisors and a code of conduct to which the proxy advisors will be subject.

Transactions with related parties

To protect the corporate interest of the company, the revised Directive determines that certain related party transactions could be subject to approval by the shareholders or the board of directors. The original wording of the revised Directive, before the adjustments of the European Parliament's Committee on Legal Affairs, provided that transactions between a company with a stock listing and a related party that represent five percent of the assets of the company or transactions that have significant impact on the profit or turnover of the company need to be approved by the shareholders. In addition, it was determined that smaller transactions that represent one percent of the assets of the company need to be made publicly available.

The final wording of the revised Directive does not define "related party transactions" and therefore the Member States are allowed to keep their current definitions. Further, companies will have to make material transactions public not later than at the time of the closing of the transaction, with all necessary information to assess the fairness of the transaction.

Improved identification of shareholders and the role of intermediaries

Another adjustment aims to improve the exchange of information between companies and their shareholders. The new Directive will ensure that companies are able to identify their shareholders and to obtain information on shareholders' identity from any intermediary in the chain that has this information available. The Member States can decide whether companies are only allowed to request identification of shareholders holding more than 0.5 percent of the shares (or voting rights) in the capital of the company.

Next steps

The revised Directive will be put to a vote in the European Parliament in March 2017. If the revised Directive is be adopted by the European Parliament, the Council will need to approve the revised Directive. After the publication of the revised European Union's official Journal, the Member States will have up to two years to incorporate the new provisions of the Directive into national law.

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PricewaterhouseCoopers LLP (UK) – The Easynet Global decision on the use of non-trading, dormant or shell companies in EU cross-border mergers

At a glance

In this case, the UK High Court considered whether a UK company could effect a merger pursuant to the Cross-Border Merger Regulations 2007, SI 2007/2974 as amended by SI 2008/583 and SI 2011/1606 (**Regulations**) where the only non-UK EEA company involved in the transaction was a dormant entity.

The merger involved 22 companies being merged into Easynet Global Services Limited (**Easynet**). The cross-border element was provided by the inclusion in the proposed transaction of only one non-UK EEA company (the others all being UK companies) which was dormant, had never traded, and had no assets. The courts refused to make an order convening a meeting of the shareholder to approve the proposed merger on the grounds that the proposed transaction was not within the scope of the Regulations.

In detail

The UK High Court considered an application by Easynet for permission under the Regulations to convene a meeting of its sole shareholder. This was intended to be the first step in a series of procedural steps under the Regulations resulting in the merger of 22 companies into Easynet.

21 of the companies were UK companies and the only non-UK EEA company directly involved in the proposed transaction was a non-trading Dutch B.V. whose only asset was a low value inter-company receivable. The parties did not deny that the only purpose of the Dutch B.V. (although it was not created for the purposes of applying the Regulations) was to enable the proposed transaction by allowing the group to utilise the process set out in the Regulations and argued that this was irrelevant to the question of whether the transaction fell within their scope.

The Regulations

The Regulations set out the meaning of a cross-border merger as being '*a merger by absorption, a merger by absorption of a wholly-owned subsidiary, or a merger by formation of a new company*'. '*Merger by absorption*' is further expanded and one of the necessary features is that '*at least one of those companies is an EEA company*'.

The decision

The High Court stated that in considering whether or not the Regulations were applicable, the reason for introducing Directive 2005/56/EC on cross-border mergers of limited liability companies (on which the Regulations were based) should be taken into account. The High Court considered such reason to be the facilitation of movement across borders.

On a literal interpretation of the rules, the transaction appeared to satisfy the criteria in the Regulations. However, the Courts held that the proposed transaction was not able to take advantage of the process set out in the Regulations because while it was a merger, it was not a *cross-border* merger. It was the opinion of the Courts that the Regulations were not put in place to facilitate transactions such as this, as it considered that the sole purpose of including the non-UK company was as a device to attempt to make the transaction appear to have a cross-border element.

Implications of the decision

The decision could have implications for the use of cross-border mergers which often have had dormant, non-trading or effectively shell companies used in the structure as part of, or to provide, the cross-border element, which is very often the case. The decision shows that the courts will look beyond the strict letter of the law and consider whether the transaction is of a kind which the Regulations intended to facilitate particularly where a proposed merger only satisfies the jurisdiction requirements as a result of the inclusion of a dormant company. The courts will therefore look to see whether this is a 'device' to bring the transaction within the framework of the Regulations.

Much will depend upon what subsequent cases conclude was the actual basis of the decision. It could be interpreted as meaning that the use of a dormant or shell company in order to activate the Regulations is now not permitted. On another view, the use of a dormant or shell company is not the real vice the court was concerned with, but the fact that in reality and substance the transaction was an attempt at a wholly domestic merger dressed up as a cross-border merger, which appeared to be the emphasis of the Court's decision. The impact of this decision is therefore more unique to the UK as most other EEA states have in place a regime allowing for domestic mergers as part of their national legislation.

The more accepted view appears to be that the merger before the High Court was in truth a domestic merger and could not be treated differently simply by using the device of inserting a non-UK, EEA company.

In Easynet, permission to appeal has been given. Consideration of this judgment by the Court of Appeal (if it is in fact appealed) as well as the decisions that the courts will take in the next few applications involving dormant, non-trading and shell companies, should provide further clarity on the implications of the decision.

More recently in Re Portman Insurance plc, the High Court had to decide, in the context of a merger to form a Societas Europaea (SE), whether certification conclusively attesting to the completion of pre-merger acts and formalities under the SE Regulations should be refused where one company was a non-trading dormant company.

The claim concerned a proposed merger by absorption of a wholly owned subsidiary incorporated in France, and the simultaneous formation of an SE.

The court in this instance held that the merger could not be considered a device in the sense defined and identified by the court in Easynet suggesting that the main factor leading to the Easynet decision was the attempt to bypass the lack of domestic merger regime as opposed to the non-trading status of the Dutch entity.

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