PwC International Business Reorganisations Network – Monthly Legal Update

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Welcome

Welcome to the sixth 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, legal entity rationalisation and simplification and migration and re-domiciliation 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 June 2017 issue:

- PricewaterhouseCoopers LLP (UK) analyses the Easynet Global decision and the courts' approach to the use of non-trading, dormant or shell companies in EU cross-border mergers;
- PricewaterhouseCoopers Legal AG Rechtsanwaltsgesellschaft (Germany) considers cross-border conversions of companies between member states of the European Union; and
- PricewaterhouseCoopers (Australia) reports on recent reforms to Australia's foreign investment laws.

Contact us

For your global contact and more information on PwC's IBR services, please contact:

Richard Edmundson
Partner and Head of International Business Reorganisations, London
+44 (0) 20 7212 1512
richard.j.edmundson@pwc.com

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 European Economic Area (**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.

Who to contact

For more information, please contact:

Richard Edmundson

Partner and Head of International Business Reorganisations, London

+44 (0) 20 7212 1512

richard.j.edmundson@pwc.com

PricewaterhouseCoopers LLP (UK)

The Easynet Global decision on the use of non-trading, dormant or shell companies in EU cross-border mergers

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Cross-border conversions of companies: practical implementation in the absence of national provisions

PricewaterhouseCoopers (Australia)

FIRB – changes to approvals for land acquisitions, exemption certificates and fee regime

Cynthia Chan

Director, London

+44 (0) 207212 1918

cynthia.chan@pwc.com

PricewaterhouseCoopers Legal AG Rechtsanwaltsgesellschaft (Germany) – Cross-border conversion of companies: practical implementation in the absence of national provisions

At a glance

A string of judgements from the European Court of Justice (**ECJ**) has established the possibility of cross-border conversions of companies (migrations) between member states of the European Union (**Member States, EU**). The decisive judgements were ECJ C-210/06 in 2008 (**ECJ Cartesio**) and ECJ C-378/10 in 2012 (**ECJ VALE**).

In essence, cross-border conversions are possible between Member States, if the Destination Member State allows a conversion for domestic companies.

This article:

a summarises the problem the ECJ has left Members States with, namely what provisions apply to cross-border conversions;

b shows how German courts have handled this issue; and

c demonstrates how Member States should approach cross-border conversions in practice.

In detail

A cross-border conversion describes the change of legal form of a company of one jurisdiction into a legal form of another jurisdiction, without a change of legal identity or a transfer of assets occurring. The basic process for companies in Member States would be as follows:

a resolution to change the legal form of the company into a legal form of another Member State (**Destination Member State**);

b de-registration in the Member State where the company is currently registered and the laws of which were applicable to the company (**Member State of Origin**); and

c registration with the competent authority in the Destination Member State.

The binding result of ECJ Cartesio and ECJ VALE is that both, the Member State of Origin and the Destination Member State, must enable a cross-border conversion under the freedom of establishment, if the Destination Member State allows a conversion for domestic companies.

To execute a cross-border conversion, Member States regularly require some kind of review regarding the validity of the process by a court or other authority, both in the Member State of Origin and the Destination Member State. Both reviewing authorities as well as the lawyers planning to implement the cross-border conversion must answer the question, *which provisions should the validity of the cross-border conversion be measured against?*

Applicable provisions and procedures

The ECJ itself has noted that finding a practical procedure in the absence of national provisions might be an issue (see side no. 50 ECJ VALE), but it did not provide any specific insights into how to resolve this.

When considering sets of rules to draw upon, three come into mind:

a Art. 8 of the Regulation regarding the Societas Europeae (**SE Regulation**). Art. 8 SE Regulation regulates the cross-border conversion of the Societas Europeae. As such, it combines the advantages of both regulating company conversions and taking the challenges of cross-border situations into account. However, it is tailored to large and public companies and has extensive formal requirements;

b cross-border merger directive and the respective national implementations (**Merger Directive**). The Merger Directive provides for a procedure for cross-border reorganisations. It has been widely tested in practice. However, the challenges in process of a merger and of a conversion somewhat differ (e.g. creditor protection: In a merger creditors lose their debtor); and

c national company conversion provisions (in Germany, Sec. 190 et. seq. German Transformation Act).

The ECJ has pointed out that procedural provisions are a matter of Member States' domestic law, however they must abide to the following rules (see side no. 48 ECJ VALE):

a **Principle of equivalence:** domestic provisions that apply may not be less favourable for cross-border situations than for similar domestic situations; and

b **Principle of effectiveness:** Domestic provisions that apply, even if formally equivalent, may not render impossible in practice or excessively impede the exercise of rights conferred by the freedom of establishment.

German court challenges

Several cases of rejections of cross-border conversions by the German commercial registers have been challenged in court. These rulings are of course not directly applicable in other member states. The arguments may however serve as template and comparative empirical evidence. The rulings are not based on German specific law, rather they are based on specification and interpretation of the rules established by the ECJ.

Case 1 (ice breaker)

In the Nuremberg High Court decision dated 19 June 2013 (12 W 520/13, **Case 1**), the court had to decide on a rejection of a conversion of a Luxembourgish S.à r.l. (limited liability company) into a German GmbH (limited liability company) by a lower court. The rejection by the lower court was based both on the fact that German law does not allow cross-border conversions and that the order of steps with the German commercial register had not been strictly followed.

The lower court was clearly overruled in Case 1. In accordance with ECJ VALE, a conversion into a Gesellschaft mit beschränkter Haftung (**GmbH**) which would have been allowed for a German company, had to be allowed for a Luxembourgish S.à r.l. as well (principle of equivalence). The decision stated that the converting company is required to fulfil the requirements under German conversion law that a German company would have to fulfil. In particular, the S.à r.l. could be required to fulfil all the requirements for the incorporation of a GmbH. However, provisions of German conversion law that were formally applicable both to German and foreign companies, but that a foreign company could not reasonably fulfil for reason of the cross-border nature of the transaction (i.e. the order of registration with the German commercial register) violate the principle effectiveness.

Case 2 (clarification and substantiation)

The Berlin High Court, (**Kammergericht**) ruled on 21 March 2016 (22 W 64/15, **Case 2**) on a French S.à r.l. intending to relocate to Berlin and change its legal form to a GmbH. Shareholders' decisions and draft articles of association fulfilling the requirements for domestic conversions were resolved. The company registered its plans for de-registration as S.à r.l. in France and applied for re-registration as GmbH with the commercial register in Berlin.

The commercial register in Berlin refused the registration for several reasons, primarily the two reasons described in more detail in the following. The appeal to the Kammergericht was successful, the decision was repealed and the commercial register instructed to reissue its decision, taking into account the ruling of the Kammergericht.

Applicability of Sec. 8 SE Regulation

The first reason of rejection by the commercial register was that the documentation provided was insufficient under the SE Regulation. Sec. 8 subsec. 2 and 6 SE Regulation requires the drawing up of a transfer proposal, which needs to be published for two months before the transfer. Sec 8 subsec. 3 SE Regulation requires the drawing up of a transfer report. The converting company had not complied with either of these requests. These documents are considerably more extensive than the deed of conversion required for domestic conversions.

The Kammergericht refuted this argument. Sec. 8 SE Regulation is tailored to cross-border conversions of SEs, i.e. to large multinational corporations. The SE Regulation requires a transfer proposal and transfer report not only because of the cross-border nature of the transaction. The extensive documentation is made mandatory because the only affected parties are large multinational corporations. Under German law, smaller companies do not have to draw up such extensive documentation for domestic conversions. Requiring smaller foreign companies to draw up documentation pursuant to Sec. 8 SE Regulation violates the principle of equivalence.

Minimum share capital

The second reason of rejection made by the commercial register was that no sufficient evaluation of the minimum share capital had been made. A German GmbH has to have a minimum share capital defined in its articles of association (not less than EUR 25,000). If this minimum share capital is contributed by contribution of a business, a competent accountant must certify that the value of this business is at least as high as the minimum share capital.

Whether this requirement applies to a conversion of a S.à r.l. into a GmbH is – obviously - not addressed by German conversion law. The requirement to prove sufficient capital exists for conversions into an Aktiengesellschaft (German stock corporation) and for conversion of a partnership into a GmbH. The requirement to prove sufficient capital also exists when newly establishing a GmbH. No such requirement to prove sufficient capital exists for a conversion of an Aktiengesellschaft into a GmbH.

The commercial register argued, that the proof of sufficient capital was a fundamental requirement for the establishment of a GmbH. So the requirements for the establishment of a GmbH could also be required of the cross-border converting company.

Against this, the converting company argued that German conversion law does not require a proof of sufficient capital in the case of a conversion of a company of already limited liability into a GmbH, as is evidenced by the missing requirement for an Aktiengesellschaften converting into a GmbH.

The Kammergericht, in essence, followed the argument of the commercial register, while giving the converting company a procedural remedy. The provision of sufficient capital serves primarily to protect creditors. Aktiengesellschaften, when converting into a GmbH, are exempt from this requirement, as they are subject to even stricter capital protection provisions than a GmbH. The same cannot be said of foreign companies. To ensure effectiveness of the German creditor protection regime, foreign companies could be required to go through the same verification process any limited liability company in Germany would have to go through at some point in the course of its establishment. The commercial register was, however, reprimanded for rejecting the application outright. Under German register law, remediable mistakes must be communicated and a chance for remedy be granted before an application may be rejected.

Case 3 (out-bound conversions)

In the Frankfurt High Court decision dated 3 January 2017 (20 W 88/15, **Case 3**), the court overruled a lower court decision preventing a German GmbH from converting into an Italian societá a responsabilita limitata (limited liability company). The conversion had been registered in Italy.

After Case 1 and Case 2 had confirmed that an inbound cross-border conversion had to be practically possible, in this case the reversed procedure of an outbound cross-border conversion was confirmed. The court clarified that while the ECJ VALE case formally only referred to inbound cross-border conversions, out-bound cross-border conversions are under equal protection of the freedom of establishment, as stated in ECJ Cartesio.

The lower court had also based its rejection on the correct observation that the documentation for the conversion did not meet the requirements of German domestic conversion law. However, German conversion law states that once a conversion has been registered with the commercial register at the registered office of the converted (i.e. migrated) company, insufficient documentation is remedied, i.e. effects the conversion. Under the principle of equivalence according to the opinion of the Frankfurt High Court, the power to remedy insufficient documentation rests with foreign registers as well as with domestic ones. Thus, the fact that the conversion had been registered in Italy meant that the German commercial register could not reject the application for reason of insufficient documentation.

In practice

For inbound cross-border conversions, Member States without specific laws have to undergo a two-step process.

Step 1: Apply domestic law to converting company

a. When comparing the converting company to a domestic company to establish potential applicable provisions, the EU lists of comparable legal forms (see e.g. Annex II of Regulation 2157/2001/EC) should be consulted.

b. If no provisions exist that enable comparable domestic companies a domestic conversion, such a right does not need to be granted to a foreign company.

c. If provisions exist that enable comparable domestic companies to convert, they must be applied on the foreign converting company, even if this directly contradicts the wording of the domestic provisions (principle of equivalence).

d. If the provisions under lit. c above refer to national specifics that a foreign company cannot reasonably comply with (e.g. domestic registration obligations with a domestic authority prior to the conversion), such provisions may not be applied (principle of effectiveness).

Step 2: Handling of missing provisions

Where procedural rules had to be disregarded under Step 1, lit. d above, the procedure must be substituted with an essentially comparable procedure, which the converting company is capable of complying with. There is no established procedure for this as of now. If possible, the procedure should be discussed with the reviewing authority. Both the SE Regulation and the Merger Directive can serve as guidelines, always keeping in mind that the converting company may not be unreasonably burdened in comparison to a domestic company.

Out-bound conversion

To cite ECJ Cartesio (side no. 112):

"*[A Member state may not require] winding-up or liquidation of the company, in preventing that company from converting itself into a company governed by the law of the other Member State, to the extent that it is permitted under that law to do so.*"

Who to contact

For more information, please contact:

Robert Dorr
Local Partner, Stuttgart/Munich
+49 711 25034 1505
robert.dorr@de.pwc.com

PricewaterhouseCoopers LLP (UK)

The Easynet Global decision on the use of non-trading, dormant or shell companies in EU cross-border mergers

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Axel Rinnert

Senior Consultant, Stuttgart

+49 711 25034 1015

axel.rinnert@de.pwc.com

PricewaterhouseCoopers (Australia) – FIRB – changes to approvals for land acquisitions, exemption certificates and fee regime

At a glance

The Foreign Investment Review Board (**FIRB**) has recently announced details concerning changes to aspects of Australia's foreign investment screening process. The changes flow from proposals contained in the 2017-18 Federal Budget and include changes to exemptions certificates, streamlining of some foreign investment applications and modifications to the fee regime. Outlined in this article is a summary of the changes which came into effect from 9 May 2017 and the proposed changes which are expected to take effect from 1 July 2017 subject to the passage of legislation.

In detail

Measures which took effect on and from 9 May 2017

1. New Dwelling Exemption Certificates now subject to 50 per cent foreign ownership cap

Under the FIRB regime it is possible for property developers to seek a New Dwelling Exemption Certificate (**NDEC**) to enable the sale of new units in a development to foreign purchasers without those foreign purchasers needing to obtain their own FIRB approval. With a NDEC in place, a developer is likely to achieve pre-sales and lock in the necessary funding for projects more quickly. Developers can apply for NDECs where the development consists of at least 50 dwellings and development approval has been obtained.

FIRB will now impose a new condition on all NDECs limiting the total amount of dwellings a developer can sell to foreign persons to 50 per cent. This new condition applies for all NDEC requests received by FIRB from 7:30pm (AEST) on 9 May 2017.

2. Annual vacancy charge on residential property and CGT exemption

Foreigner purchasers of residential property will now be subject to an annual charge for any vacant properties they hold in Australia. The charge will only apply to foreigners who have lodged a foreign investment application for residential property from 7.30pm (AEST) on 9 May 2017. The charge will apply if the property is not occupied or genuinely available on the rental market for at least six months each year. The annual vacancy charge will equal the relevant FIRB application fee that applied when the foreign purchaser applied for FIRB approval for the acquisition.

The annual vacancy charge will be assessed yearly on the date of settlement and foreign investors will be subject to ongoing reporting obligations relating to the use of their property over the course of the previous 12-month period. Foreign and temporary tax residents will also be unable to claim the capital gain tax main residence exemption from 7.30pm (AEST) on 9 May 2017, except for any currently owned properties which will be grandfathered until 30 June 2019.

Measures which will take effect from 1 July 2017

1. Changes to the commercial fee structure and increase in residential investment fees

As of 1 July 2017, FIRB will introduce a new three-tiered fee framework relating to commercial land, actions relating to entities and businesses and agricultural land. The new framework will, for some acquisitions, result in higher fees and, for other acquisitions, result in lower fees than what is otherwise payable under the current regime. A summary of the proposed new fee regime is as follows:

a Commercial land (vacant and developed) or actions relating to entities and businesses

Consideration for acquisition:

a $10 million or less = $2,000

b Above $10 million = $25,300

c Above $1 billion = $101,500

b Agricultural land

Consideration for acquisition:

a $2 million or less = $2,000

b Above $2 million = $25,300

c Above $10 million = $101,500

Exemption certificates will be subject to a flat fee of $35,000 regardless of the value of the acquisition whilst fees for internal reorganisations will remain at $10,100. Application fees for foreign purchases of residential properties valued at less than $10 million will also be increased by 10 per cent from 1 July 2017.

2. New business exemption certificate

Foreign investors (including foreign government investors) that wish to acquire securities in an Australian entity will be able to seek an exemption certificate allowing pre-approval for multiple investments in one application rather than applying separately for each investment. We expect this to assist large acquisitive groups and investment companies that are planning a program of acquisitions in different Australian companies and businesses.

3. New residential exemption certificates

From 1 July 2017, FIRB will introduce two new residential exemption certificates. The first will enable developers to re-sell off-the-plan dwellings that failed to settle without needing to re-apply for FIRB approval. The second will allow a foreigner to obtain one FIRB approval to cover the possible purchase of one new dwelling out of multiple new dwellings that the foreigner is interested in acquiring.

4. Treatment of residential land used for commercial purposes

Currently, the FIRB definition of ‘commercial residential premises’ excludes certain properties which, whilst providing a form of domestic private accommodation, are inherently commercial in nature. For example, student accommodation and aged care facilities which are typically managed and operated on a professional basis for commercial gain. The changes will treat such properties as commercial residential premises which means foreign purchasers will benefit from the higher monetary thresholds.

5. 'Low Threshold' non-vacant commercial land definition

Presently, the FIRB rules impose a lower screening threshold of $55 million for acquisitions of 'sensitive land'. However, the concept of sensitive land covers most land in many major cities as it is partly defined with reference to land below 'prescribed airspace' which, for example, covers most of Sydney. It is proposed that amendments will be made to reduce the scope of what is treated as sensitive land meaning foreigner investors will potentially have access to a higher monetary threshold before needing to seek FIRB approval.

6. Other changes

Further minor changes will be introduced so that developed solar and wind farms are treated as commercial non-vacant land rather than vacant land or agricultural land and reducing or removing FIRB notification requirements for companies that have significant foreign custodian holdings, that is, only legal foreign holders rather than equitable interest holders.

The takeaway

Since the wholesale changes made in December 2015, the FIRB regime is continuing to evolve and change so it is critical that foreign investors obtain timely advice before planning or structuring an acquisition in Australia. Foreign investors need to carefully analyse the rules so that the necessary FIRB approvals are sought, application fees are appropriately budgeted for and timing is considered in the context of any transaction or group restructure.

Who to contact

For more information, please contact:

Andrew Wheeler
Partner, Sydney
+61 (2) 8266 6401
andrew.wheeler@pwc.com

Nathan Greenfield
Senior Associate, Sydney
+61 (2) 8266 0706
nathan.greenfield@pwc.com

www.pwc.com

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