

Cross-Border Conversions within the EU are bound for Change: Main Takeaways

Executive Summary

- Due to the absence of harmonized rules, cross-border migrations have a long history of jurisprudence within the EU. **Directive 2019/2121** aims at creating a common legal framework for **EU cross-border conversions and divisions**.
- The new legal framework, to be implemented into national laws by **31 January 2023**, will increase legal certainty within the EU and benefit employees, shareholders and creditors. However, for the companies and intragroup re-structurings, the new regime could be more burdensome than the **current legal solutions**.
- Migrations with a non-EU country will continue to be challenging.
- As a consequence of **Brexit**, the UK will likely fall out of the scope of the European jurisprudence after 31 December 2020.

Directive (EU) 2019/2121 of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (the **Directive**) shall be transposed into national laws by 31 January 2023. Following in the footsteps of Directive 2017/1132, which introduced a legal framework for cross-border mergers, the Directive marks the end of a long history of fundamental jurisprudence by the Court of Justice of the European Union concerning cross-border migrations of limited liability companies within the EU.

I. What are Cross-Border Conversions?

The term “**cross-border conversion**” covers a wide range of corporate transformations whereby a limited liability company transfers its legal form from one country to

another without losing its legal personality. A conversion can entail the transfer of the company’s registered seat, central administration and principal place of business from one jurisdiction to another. A successful conversion requires that the company will not be dissolved, wound up or liquidated as a result of the transfer, will be fully recognized by the destination state and retain its assets, liabilities, rights and obligations.

II. Key Components of the Directive

1. Scope

The Directive applies to limited liability companies which are not subject to liquidation, insolvency proceedings or preventive restructuring measures.

The Directive covers only cross-border conversions within the European Union. Cross-border conversions originating in or destined for a location **outside of the EU** will need to rely on national regimes. Certain jurisdictions, such as Germany, do not recognize extra-EU conversions. Luxembourg, however, allows the transfer from and into non-EU countries and can act as a suitable EU hub for entities wishing to access or leave the EU market.

2. Procedure

The conversion procedure introduced by the Directive largely replicates the regime governing cross-border mergers on the basis of Directive 2017/1132. It entails the following main steps:

- (1) The administrative or management body of the company draws up the **draft terms of conversion** outlining the particulars of the transfer. These draft



- terms shall be published together with a notice to stakeholders.
- (2) The administrative or management body further provides a **report to the members and employees**, where applicable, explaining and justifying the legal and economic aspects of the conversion and its implications for future business. The members may agree to waive the report.
 - (3) The company is required to comply with employee information, consultation and participation rights, where applicable.
 - (4) An **independent expert** examines and reports on the draft terms of conversion, unless such report is waived by the members.
 - (5) Not earlier than **one month** following the publication of the draft conversion terms, the **general meeting** of the company resolves on the transfer. The required majority to be determined by the departure Member State may range between two thirds and 90 % of the represented voting rights and may not be higher than the majority required for cross-border mergers in that Member State.
 - (6) The completion of the conversion steps in the departure Member State will be certified by a **pre-conversion certificate**. The competent authority to be designated by the Member States shall not issue the certificate if it determines that the conversion is set up for abusive, fraudulent or criminal purposes. The authority may generally take up to three months for its assessment. In exceptional cases, this period may be prolonged.
 - (7) The pre-conversion certificate will be automatically transmitted to the competent authority of the destination Member State.
 - (8) The competent authority in the destination Member State shall ensure that the relevant provisions of national law concerning the incorporation and registration of companies are complied with.
 - (9) Following the approval by the competent authority of the destination Member State, the company will be **registered** in the destination Member State and de-registered in the departure Member State.
 - (10) The law of the destination Member State determines the date of effectiveness. For a period of three months since the publication of the draft conversion terms, creditors may apply for adequate safeguards. Additionally, creditors whose claims pre-date the draft terms may continue to instigate proceedings in the departure Member State for two years since the effective date.

III. Current Market Practice

Despite the lack of a legal framework, the European Court of Justice confirmed intra-EU conversions in several landmark cases on the basis of the freedom of establishment. However, the procedure was not harmonized and strongly dependent on the varying requirements of the Member States.

The Directive only applies within the EU. International conversions remain challenging.

As an international financial market, Luxembourg has seen many cross-border conversions and currently provides a reliable practice for cross-border conversions which is not limited to EU member states.

Inbound conversions to Luxembourg mainly require that

- (i) the departure state allows the cross-border conversion without loss of the company's legal personality; and
- (ii) the shareholders approve the transfer.

On a case by case basis, the Luxembourg notary might require further assurances, such as a legal opinion concerning the laws of the departure state or confirmations concerning the equity and stakeholders of the company. While there are no formal steps to consider from a Luxembourg perspective concerning



employees' or creditors' rights, the inbound company shall of course ensure that all applicable laws in this respect are complied with and all relevant stakeholders are adequately informed.

IV. Main Takeaways

Fostering legal certainty within the EU, the Directive will mainly benefit those stakeholders who were most at risk of being marginalized by fraudulent or abusive intent.

- **Employees** have the right to be informed and consulted and the participation of their representatives to negotiations and to the board of their company must be ensured.
- **Creditors** who are not satisfied with the protection offered by the company benefit from harmonized rights of recourse.
- **Members** who voted against the approval of the draft terms have a right to exit and receive cash compensation. Member States may decide to extend this right also to other members.

In addition, the Directive clarifies the scope of the required majority and ensures smoother registration processes within the EU.

Brexit: Cross-border transfers of UK companies into and out of the EU will be more complex after 31 December 2020.

On the other hand, the Directive will significantly prolong standard conversions by imposing a minimum deadline of one month. Simple and non-controversial conversions will face an increased burden of documentation.

Finally, the Directive will not provide any solutions for non-EU companies wishing to access or leave the EU market. In the context of **Brexit**, UK companies will face particular challenges: UK entities will not benefit from the harmonization by the Directive. In addition, they risk losing the market access currently only guaranteed by

the jurisprudence of the European Court of Justice after the end of the transition period on 31 December 2020.

V. Conclusion

The Directive marks a great step towards the creation of an internal market within the EU, fostering the freedom of establishment, legal certainty and improving stakeholder protection. The Directive tries to balance the legitimate right and interest of migrating companies to enhance competitiveness against the interest of creditors and employees' protection. While we welcome the common legal framework to end legal fragmentation and partial legal uncertainty, we also note that the current established market practice might be more advantageous for

- (i) simple and non-controversial conversions, such as intragroup restructurings, and
- (ii) UK entities who risk losing their access to the EU conversion regime as of 1 January 2021.

International entities wishing to convert into the EU market will need to rely on the current market practices of the Member States. In this context, Luxembourg might be a suitable hub as it allows inbound migrations of non-EU entities.

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