Deloitte.

URL: http://mobile.deloitte-tax-news.de/german-tax-legal-news/european-court-of-justice-liability-for-administrative-offenses-and-fines-by-the-company-being-acquired-in-the-event-of-mergers-by-acquisition.html

13.07.2015

German Tax and Legal News

European Court of Justice: Liability for Administrative Offenses and Fines by the Company Being Acquired in the Event of Mergers by Acquisition

The ECJ made an important ruling which also affects the interpretation of national provisions concerning mergers and leads to a higher risk of the absorbing entity.

A merger by acquisition which is regulated in the German Reorganization Act (Umwandlungsgesetz – UmwG) allows all the assets of a company to be transferred to another company without having to name and transfer every individual asset separately as long as the respective form requirements are observed. However, the transfer is not limited to assets: the assets of the legal entity being acquired are transferred to the acquiring legal entity "including the liabilities" (§ 20 Subsection 1 No. 1 UmwG). A recent decision by the European Court of Justice (ECJ ruling dated March 5, 2015 – Case No.: C 343/13) specifies the extent of the transfer of liabilities within a merger by acquisition and again makes it clear that the question of interpreting national law in accordance with European directives is of considerable importance – not only for cross-border issues.

Decision by the European Court of Justice
The ECJ decision stemmed from a legal dispute before a Portuguese labor court. A Portuguese company (hereinafter also referred to as the "Acquiring Company") was defending itself against a fine which the Portuguese authority for working conditions had imposed. The fine was to punish infringements of labor law which had been committed not by the Acquiring Company but by a different Portuguese company (hereinafter also referred to as the "Company Being Acquired"). The Company Being Acquired merged into the Acquiring Company before the authority for working conditions imposed the fine. Since the Company Being Acquired ceased to exist as a consequence of the merger, the authority for working conditions turned to the Acquiring Company which argued that the liability of the Company Being Acquired based on the infringements did not yet exist at the time of the merger since the fine had not yet been imposed at that time. The Acquiring Company continued that this legal item regarding the infringements had therefore not been transferred to the Acquiring Company through the merger.

The Portuguese labor court referred the matter to the ECJ to review how to interpret the extent of the transfer regulated in Portuguese conversion law of all "rights and obligations" of the legal entity being acquired to the acquiring legal entity in this case in the light of the relevant EU merger directive. The relevant regulation, Art. 112 of the Portuguese Commercial Companies Code, served to transpose Art. 19 Subsection 1 of the EU merger directive (58/855/EEC Directive, now replaced by the – insofar identical – 2011/35/EU Directive). Art. 19 Subsection 1 of the EU merger directive foresees "the transfer to the acquiring company of all the assets and liabilities of the company being acquired".

The ECJ decided in favor of the authority for working conditions and came to the conclusion that a "transfer [exists] to the acquiring company of the obligation to pay a fine imposed by final decision adopted after the merger by acquisition for employment law offenses committed by the acquired company prior to that merger".

Practical Effects for the German Law Regulating the Conversion of Companies
Although the merger in the legal dispute was a national matter, the question of interpreting national conversion law in accordance with European law was of decisive importance for the instant case. Although it involved a national merger in Portugal, the ECJ decision is also relevant for mergers in Germany: the interpretation by the ECJ of Art. 19 Subsection 1 of the EU merger directive has an effect on the interpretation of all national regulations which were passed to transpose said regulation – including the German § 20 Subsection 1 No. 1 UmwG.

It should be stated that in contrast to the legal situation in Portugal there was already a risk before the ECJ decision for regulatory authorities to make a claim against the acquiring

company of a national merger in Germany for infringements of the company being acquired: since 2013 § 30 Subsection 2a German Act on Administrative Offenses (Gesetz über Ordnungswidrigkeiten – OwiG) explicitly foresees that fines can be transferred to the legal successor of the party liable to pay the fine. This also covers the legal succession in a merger. However, the amount of the fine is limited here to the value of the acquired assets and the amount of the fine which was appropriate for the legal predecessor.

The ECJ decision has now generally cleared the way to circumvent such limits of the amount since conversion law can now also provide the grounds for imposing fines on the legal successor of the actual party liable to pay the fine – without referring to § 30 Subsection 2a OWiG. This is not uncontroversial; cf. Haspl, European Periodical for Business Law (Europäische Zeitschrift für Wirtschaftsrecht – EuZW) 2013, 888.

The ECJ also offers important general hints on its understanding of the transfer of "assets and liabilities" in a merger by acquisition. The ECJ explains its decision with the deliberation, among other things, that apart from the creditors of the company being acquired the EU merger directive should also protect third parties "which though not yet creditors … at the date of the acquisition may become such post-acquisition as a result of situations antedating the acquisition". In the past German courts have sometimes decided against the transfer of certain legal items of the legal entity being acquired to the acquiring legal entity; cf. the Higher Regional Court (Oberlandesgericht – OLG) in Cologne (ruling dated October 14, 2008 – Case No.: 6 W 104/08) on imposing execution measures in the sense of § 890 German Code of Civil Procedure (Zivilprozessordnung – ZPO). It remains to be seen whether such decisions will/can be made in a similar vein in the future against the background of the ECJ deliberations. It should be particularly closely followed how the ECJ decision affects the succession of liability in anti-trust fines which, as we are all fully aware, can reach considerable amounts.

Conclusion
The ECJ decision will tend to lead to a higher risk of the acquiring legal entity in a merger by acquisition accepting unidentified latent liabilities or other detrimental legal items of the legal entity being acquired. This will often cause a higher requirement to review the situation thoroughly before the merger. The ECJ points out accurately that "in addition to the documents and information available in accordance with the relevant legislative provisions [the acquiring legal entity is at liberty to conduct] a detailed audit of the economic and legal situation of the company to be acquired before the merger by acquisition in order to obtain a more complete picture of that company's liabilities". There will often already be an interest in being able to evaluate the economic scope of the merger for the acquiring company accurately and in advance even for mergers within a corporate group. Attention should particularly be paid to the ECJ decision with respect to the preparatory legal review for incorporations of – newly acquired – external companies.

www.deloitte-tax-news.de