LAW AND ORDER IN MERGERS AND ACQUISITIONS. A THEORETICAL FRAMEWORK AND REFERENCE TO THE LEGISLATIVE PART

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ABSTRACT

Mergers and Acquisitions (M&A) have been a common phenomenon in the business world in recent decades. Many companies decide to follow the strategy of mergers or acquisitions in order to survive, or even to increase their market share and expand in the industry in which they operate. So it is obvious the necessity of a strong legal framework to avoid any problems for both bidder and target before, during and after the process of M&A. There are many scientific approaches in the legal literature on how commercial law is able to affect the economic development of a state and the field of M&A is no exception and especially when it comes to capital coming from another country for cross-border M&A that are very important in increasing a country's foreign direct investment. In every country's economy, M&A and so commercial law play an important role for growth by creating economies of scale and scope. So usually the commercial law in M&A is governed by commercial codes and other special laws to ensure their quality and integrity. For this purpose, governments have developed a special legislative framework of commercial in M&A before and after the completion of the procedures in order to expand the economies of the states and improve business performance, thus maintaining suitable competitive environments to improve business performance while ensuring the employee personnel indirectly involved in the whole process. The study aims to show the legal procedures of commercial law in the European Union and of its country and the characteristics for both domestic M&A and cross border M&A.

Keywords: Mergers & Acquisitions, European Law Framework

INTRODUCTION

M&A are a fascinating industry with so many possibilities. M&A is also a powerful tool that large companies can use to exponentially grow their businesses in a short amount of time. As it happens, M&A are probably the most complex and difficult of any other financial transaction exactly because they combine many financial, accounting and law procedures and of course demand so much strategic understanding for the board of both bidder and target. The reasons for M&A described by the diagram 1 below.

Diagram 1: Reasons for Mergers and Acquisitions

Source: https://firmroom.com/blog/reasons-for-mergers-acquisitions

M&A is a branch of corporate law that deals with companies purchasing and/or merging with other companies. Corporate law comprises all the legal issues corporations face in daily transactions, and some lawyers specialize in this field. M&A is more than just buying companies, it also includes joint ventures, partnerships, and minority investments (https://www.mascience.com/community-blog/mergers-and-acquisitions-m-a-law-a-complete-guide).

There are several legal procedures that apply to business and bank M&A that take place in developed countries. Each depending on the country has its own legal framework, and for this reason in the literature and laws of these countries they are found under different names, even if they often refer to the same things. So each efficient market as well as each emerging market has its own M&A legislation and tries to impose notification, control and intervention procedures if the transactions are likely to affect a particular industry or the market as a whole.

Of course, the markets are obliged to secure the money of both targets and bidders and for this reason they have a fair legal framework to protect both parties involved in the process of acquisitions and mergers, thus creating a safe business environment for growth and profits of capital.

In this study, we present a theoretical approach to the legal framework that exists in the European Union and must be applied before and after a M&A. Of course, in each European Union member country there are separate legal rules that are mandatory for all parties involved in M&A. This fact takes on significant importance and must be particularly taken into account when a cross-border M&A is to be carried out.

Companies, with headquarters in developed countries, had invested in the emerging economies regions using M&A operations being attracted by an insufficiently regulated market, a workforce not so well paid as in Western Europe and also by the numerous opportunities for development. Political changes in Eastern Europe that had led to the removal of communist regimes also led to the end of the state company, which, in many cases, were financed even if it did not recorded profits. In these conditions, the solution for a former state company was simple: privatization or bankruptcy. In 2000, after the East European states started negotiations with European Union, the M&A operations fall under regulations of the European Commission and EU laws. This had a positive effects, the success of the transaction is greater, which is shown by the growth of mergers and acquisitions market. This increase can also be due to the favorable economic situation, because the same trend was recorded in Western Europe where, in 2006 there were 30,000 transactions with a total annual value of more than 1000 billion dollars, most transactions had a small value, but the specific is that the majority stake was acquired. With the start of the global economic crisis, M&A had a downward trend until 2010 when it reached a total of only 15,000 transactions yearly and their total value is two times lower than in 2006. Currently we talk about an increase in M&A globally and in the national and international legislation governing this area (Ciobanu 2015).

It is necessary that the company/bank have to hold every year an ordinary board and shareholders meeting for the approval of the company's/bank's financial statements, new business plan new investments and other administrative matters. Occasionally, the company/bank may hold extraordinary shareholders meetings to take certain decisions. Therefore, the Commercial Registry's file on each company/bank contains a historical record of the shareholders present at shareholders meetings; but only of those meetings which treat subjects that the law requires to be registered. And since there is no legal requirement to register the transfer of the shares, the Commercial Registry's file may show that a company/bank has certain shareholders when the ordinary shareholders meeting was held, and has other shareholders at the next registered shareholders meeting minutes; but there does not have to be evidence at the Commercial Registry of the transfers of shares which may have occurred in between, or after the last registered minutes.

LITERATURE REVIEW

In the European Union, the Community law governing M&A market is called the European Community Merger Regulation Law (ECMRL law). Here there are three main types of transactions, defined as "concentration", that require regulation. They occur only where there is change in control or change in ownership in that company and may result in mergers, acquisition of sole control or association of companies (joint venture). According to ECMRL law, a merger is the situation where two or more companies join, and at least one entity ceases to exist. However, EU law does not rule out the merger in which entities retain their legal personality, but, in this case, they are united in a single economic unit. When it comes to buying a company's control, the European law is relating this to any change in the existing control, whether is constituted by rights, contracts or other elements that confer a decisive influence on the company. A change of control is found in three cases: buying the majority stake which involves holding majority voting rights, buying a company's assets and in this case we speak of control over a company activities especially when the transaction object is a license or its brand and finally, the last way is the "acquisition by contract", a situation that occurs when there is a contractual economic dependence. In the joint company the decision power is divided under an agreement between partners or shareholders. So, in a joint venture, even if is not actually a transfer of control of a company, each party may limit or block decisions taken by the partner and so this must be regulated by law. This description is quite similar with that presented by the European Commission (European Community Merger Regulation Law - ECMRL, 2004).

In recent years more and more scientific works have studied the links between law and finance the starting point being the well-known scientific works of La Porta, et al. in 1997, 1998, 1999, 2000 & 2008. The theory of law and finance argues that the legal system is a direct cause of a state of financial development and it influences the economic growth of the country.

In their study Sherman, Hart (2006) defined M&A. A merger is a combination of two or more companies, where the assets and liabilities of a company are acquired by another company, and although the latter will have a totally different organization, it will not lose its original identity. Acquisition is the purchase of a division, a part or the whole company, especially to diversify product portfolio and customer service. Other authors make a clear distinction between the terms merger and acquisition (Sherman & Hart Milledge, 2006) and concluded that a merger is a combination of two or more companies, where the assets and liabilities of a company are acquired by another company, and although the latter will have a totally different organization, it will not lose its original identity. Acquisition is the purchase of a division, a part or the whole company, especially to diversify product portfolio and customer service.

Even if there is a diversity of ways to explain M&A in the financial literature, the general view supports the one from the law. For example, some authors (Damodaran, 2008) state that there are two categories of M&A: one when the company is acquired by another company, which is a foreign operation and one when it is acquired by an insider such as its managers, shareholders or investors. Interesting is the fact that the M&A legislation has a great contribution when it comes to the financial concept of the transaction involved. Even if there is a diversity of ways to explain them in the financial literature, the general view supports the one from the law. For example, some authors (Damodaran, 2008) state that there are two categories of M&A: one when the company is acquired by another company, which is a foreign operation and one when it is acquired by an insider such as its managers, shareholders or investors.

In other studies (Gaughan, 2010) the emphasis is more on the merger and less on the acquisition. A merger is a combination of two companies where only one will survive, the other ceases to exist and the capital and liabilities of the acquired enterprise is simply transferred.

Other authors were more interested in issues related to the causes underlying the M&A than explaining the terminology of merger and acquisition (DePamphilis, 2010).

Governments have developed M&A laws in order to expand the states economies and enhance business performances, thus maintaining proper competitive environments for improving business performances (Lin et al., 2011).

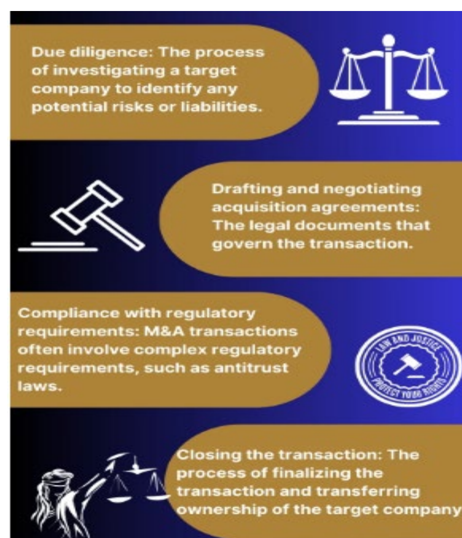
The study of Ciobanu (2015) analyzed 30 countries from 4 different legal systems: common law on one hand and French, German and Scandinavian civil law on the other hand. In order to analyze the relation between the characteristics of a country's M&A market and the legal origin of a country, the study conducted several regression models. So, the study analyzed business indicators that show how attractive was the legal system of a country for investors. The aim of this study was to analyze the influence of the law on the M&A market. In order to do this, it considered that some conceptual clarification of the terms M&A have to be made, to find the similarities and especially the differences between these two types of operations as they result from the finance literature and, more important, from the legislation. Different from other studies, the study of Ciobanu (2015) analyzed the M&A market not only related to the legal origin of the stat, but also to the country's business environment and also the legislation might strongly influence the investor's decision to place his capital in a foreign country business. For example, common law countries were considered to be business friendly, and thus a low number of tax payments and a low number of days required to start a business was recorded in these countries. There were an opposite situation in the French and German civil law. Interesting is the fact that the M&A legislation has a great contribution when it comes to the financial concept of the transaction involved Ciobanu (2015). The results show that a country's M&A market was influenced by the business environment that the law could create for investors who were likely to invest more in a well regulated markets which could protect the their capital, but also could provide an excellent environment for development and capital gains.

Especially in Greece as it is a country of European Union Mergers, divisions and conversions of undertakings are based on the provisions of Law 4601/19 (Government Gazette, Series I, No 44). There are no specific provisions for other legal types, and the above provisions describe transformations (mergers, divisions and conversions) that take place within Greece and concern companies subject to Greek law. (Last update 19/09/2022 https://www.gov.gr/en/sdg/starting-running-and-closing-business/mergers-of-companies-or-selling-business/general/business-transformations-and-cross-border-business-transformations-between-member-states)

METHODOLOGY

M&A lawyers are always on the lookout for red flags in every phase of a deal. A transaction of Mergers and Acquisitions typically involves a prospective buyer conducting due diligence on a target company, negotiating price and deal terms, and then executing a definitive purchase agreement. The entire process can take several months to complete. In the picture 1 we describe the standard advice of Law procedure framework for M&A:

Picture 1: Main Advice for Clients in Law Procedures of M&A



Source: http://elixirlegalservices.com

Whenever a purchaser is yet to be found, it is standard practice for an M&A transaction process to commence by means of an information memorandum. The Information Memorandum is generally drawn up by the vendor and published with a view to gauge market interest and ultimately sell the company/ group of companies/ their business or part thereof for maximum value. An Information Memorandum usually contains enough information to provide the potential purchaser with sufficient detail to understand whether it would like to pursue the acquisition of the target company/ business, without divulging any confidential or sensitive business information of the said target.

Here are the legal activities that occur during each deal stage:

1. Non-Disclosure Agreements (NDA):
   Should a purchaser be interested in acquiring the target company or its business, the interested purchaser or purchasers, if more than one, would generally enter into a Non-Disclosure Agreement (NDA) which is aimed at securing the confidentiality of the target company and the sensitive data concerning its business. NDAs are the first legal document that a buyer and seller will agree upon. An NDA serves as a protection that enables both parties to share sensitive information with one another. Non-disclosure agreements are an industry standard prior to due diligence.

2. Letter of Intent (LOI):
   A letter of intent is a non-binding contract that buyers hand out to sellers to show their interest and make a formal offer for a company. An LOI usually includes the exclusivity period, proposed deal structure, and initial price range.

   Whenever there is more than one potential purchaser involved, this second phase is usually preceded by the due diligence exercise which is outlined below. However, if there is only one potential purchaser in the fray, before or simultaneously with the commencement of the due diligence exercise, it is common for the parties to start considering certain matters which should precede the contractual phase of the sale. Such matters, include the following:

- Competition/antitrust law implications, and whether such transaction necessitates pre-clearance from the Office for Competition;
- Employment law considerations;
- Licensing matters; and
- Fiscal implications, among others.

It is also common for the potential purchaser and vendor to outline the proposed terms and conditions underlying such acquisition in a letter of intent, which in most cases is (or for the most part is) not legally binding.

3. Due Diligence:
   Due diligence is one of the most tedious tasks for M&A lawyers. Due diligence is the process of investigating and analyzing everything there is to know about a target company in order to validate the purchase. Normally, due diligence requires a massive number of teams such as finance, law, and HR. The relevant lawyers have primary objective to discern and highlight potential risks or liabilities that could impact the transaction, ensuring that no stone is left unturned, and crucially, to flag any concerns that might lead to future litigation.

4. Deal Structure:
   Contrary to popular belief, the deal structure is not just a financial activity. Every deal structure will have different legal ramifications, such as tax consequences, transferability of liability, and regulatory issues. For instance, a stock deal and an asset deal will have massive differences from a legal standpoint. The term "deal structure" tends to make people think of financial structures, earn outs and divisions between cash and equity. The reality is, a deal structure is as much legal as it is financial. For example, whatever structure is agreed to in the deal, important legal issues need to be considered, including shareholder approval, the tax consequences of the structure agreed to, transferability of liability, third-party contractual consent requirements, and foreign regulatory issues (if applicable). Deciding whether to buy the company or just its assets (thus, not taking on any of its liabilities) is another consideration that corporate M&A lawyers will advise on.

5. Representations and Warranties:
   Due to high competition which promotes a faster transaction speed, reps and warranties have become extremely popular in M&A. Reps and warranties are statements of facts made by the seller, that the buyer relies on, to make the purchase. Any breach in reps and warranties can result in indemnification claims from the acquirer and can destroy deal value. It is now standard for acquirers to include several representations and warranties in the terms of their transaction. These typically aim to avoid the threat of litigation for the acquiring firm in issues such as:

   - compliance,
   - tax,
   - authority,
   - capitalization,
   - and material contracts.

This is no small matter - generally, breaches in any of these representations and warranties can result in indemnification claims from the acquirer - destroying value in the deal. This can be a complex gray area, where even the most honest target company owner may leave themselves vulnerable on issues that they might not always have full awareness of. Lawyers on the sell side will often try to push back against many of the representations and warranties on this basis.

6. Non-Competes and Non-Solicits:
Non-competes and non-solicits are important legal clauses in practically all transactions, particularly in the services industries.

7. Target Indemnification:
Target indemnification are hotly contested clauses in the closing conditions of M&A transactions. Again, these are essentially clauses which seek to protect the acquiring company on the downside. Say, in the case of fraud or material misrepresentation on the part of the seller, the acquirer could include an indemnification clause that annuls the transaction and/or forces the seller to pay back a pre-agreed amount up to the value of the closing price.

8. Joint and Several Liability:
Joint or several liability is an extension of the target indemnification issue.
It asks: Which of the target's shareholders does indemnification apply to, and to what extent. In the case of joint liability, each of the target's shareholders is fully liable for any future damages. In the case of several liability, each of the target's shareholders can be liable only to the extent that they are seen to have contributed to the damages (for example, the CFO would be responsible for misstatements in the company's financial results, but not the CTO).

9. Negotiations and Closing Conditions:
Once the due diligence exercise is finalised, the prospective purchaser will typically go over and consider the findings and their materiality to the transaction together with its advisors. Should the purchaser be still interested in proceeding with the acquisition, the parties would typically engage in negotiating the details of their transaction, and all terms and conditions thereto. This may also involve negotiating the final price or agreeing on a mechanism that would determine the sale price and the details of the warranties, the indemnities and any limitations which will then be included in Share Purchase Agreement (SPA) or an Assets Purchase Agreement (APA), depending on whether the transaction will involve the acquisition of shares or of the business.

The conditions set out in the definitive agreement are themselves subject to closing conditions. As the name suggests, these are conditions that must be met in order for the transaction to close. These tend to be the same across transactions and typically include board approval for the deal, the absence of any material changes to the company's trading conditions, and of course, shareholder approval. In the case of shareholder approval, acquirer's often seek shareholder approval in excess of 80%, to avoid the complications that arise with hostile acquisitions (such as appraisal claims, for example). It is common for the SPA/ APA to include clauses that come into effect post-closing, such as further obligations that are to be undertaken by the parties, finalising the transfer of additional assets; obtaining consents, issuing notifications, affecting a price adjustment mechanism or entering into other ancillary contracts. Besides implementing such post-closing matters, the parties may consider undergoing a post-closing integration exercise in order to bring the two companies or businesses together with the aim of maximising synergies to ensure the success of the deal.

10. Definitive Purchase Agreement:
A definitive purchase agreement is the final agreement that supersedes any other prior agreement made by both parties. A definitive purchase agreement finalizes all terms and conditions and is often referred to as the "signing" phase. M&A lawyers from both sides must carefully examine and draft this agreement, because once it's been finalized, neither side can turn back, except in special circumstances.

According to Brett Shawn, Senior Vice President, Assistant General Counsel at Warburg Pincus, the most common risks that M&A lawyers are looking for that can immediately stop a deal are:

1. Diligence Risks
Verifying everything about the target company during diligence is one of the main roles of M&A lawyers. This process is also called legal due diligence.

The purpose of legal due diligence is to gain a legal perspective of the target company. The ultimate goal is to ensure everything is in order and determine if there are any legal reasons why the acquisition shouldn't proceed. Most companies use a legal due diligence checklist to ensure efficiency and speed. Having a checklist helps keep everyone organized and on-task during due diligence.

M&A lawyers also draft representations and warranties, that serve as extra protection, for buyers.

2. Financial Risks
There are instances where the buyer is securing a loan from a bank to fund the acquisition, but the bank wants to assess the target company. M&A lawyers put covenants in place to ensure that the seller cooperates with the deal's funding. There is also a risk around consummating the deal itself. If a buyer, is trying to get a loan from a bank to

fund the deal of M&A, the bank will ask to assess the seller. The buyer need to put a covenant with the seller in place to cooperate with the bank to get your funding. Otherwise, the deal might fall off.

3. Antitrust Risks
Antitrust is a governing body that ensures market competition and prevents monopolies. Strategic acquirers often trigger antitrust since they buy competitors from the same market. M&A lawyers prepare the necessary documents and remedies to ensure the deal goes through without violating antitrust laws. The private equity acquirer, usually don't have much antitrust risk.

4. Deal Jump Risk
A deal jump risk is quite common if the seller is a public company. Board members have a fiduciary duty to get the highest price for their stakeholders, often resulting in deal jumping. M&A lawyers mitigate this risk by placing a termination fee on the contract or matching rights

5. Red Flags
Be on the lookout for red flags. For example, if basic information is difficult to access. They might be hiding something, and receiving inconsistent information can also create credibility and trust issues. Also, private companies can sometimes be too informal with their processes which can cause a problem in the long run.

6. PE Firms vs Public Companies Acquirers
If you are a seller, choosing between a PE firm and a public company depends on your deal rationale. PE firms will generally keep the management team, so if you want to continue growing the company and looking for help, expertise, and money, a PE firm might be the better option for you. Oftentimes, public companies can pay a lot more money due to their lower cost of capital synergies. If you are looking to retire and want a bigger payout, public companies may be the way to go.

CONCLUSION

In conclusion, we can say that the more complex and bureaucratic the legal framework of mergers and acquisitions of a country, the more deterrent it works for the realization of domestic mergers and acquisitions as well as cross-border ones which bring about decisive effects on the increase of foreign direct investments of this country. Investors are most likely to be willing to invest in a well legally regulated efficient or emerging market, even if each legal system has its own peculiarities but without complexities and bureaucratic procedures.

Moreover as Kison Patel (2022) said in M&A, time is the enemy. The longer a deal takes to close, the more risks it poses for both parties. Both the buyer and the seller need to understand the deal risks and how to mitigate them.

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