Dissenting Shareholders and Creditor Rights in Corporate Mergers

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A corporate merger is capable of significantly amending the position of shareholders in the two or more companies embraced by such a transformation. Additionally, creditors as third parties, might also be affected by their debtor's transformation. This article discusses the position of dissenting shareholders and corporate creditors and explains what legal rights and remedies they enjoy. On the other hand, the existence of a certain level of minority and creditor protection imposes a legal risk on the transaction which also needs to be taken into account as a cost factor.

M&A transactions connected with stock market trading are the most spectacular. The solutions indicated below aim at presenting a general picture of protecting minority shareholders, or capital company creditors, i.e., limited liability companies and joint-stock companies, that want to search for court protection in the event of conducting M&A transactions, as such situations are more common.

In Poland, the practice of concluding detailed agreements protecting against takeovers, or allowing their estimated cost to be indicated, is not common. Therefore, a margin of uncertainty exists in the scope of the planned costs of M&A transactions, which should try to be limited. In general, the institutions serving the protection of the minority also find, although on somewhat more modified terms, their application in the situation of conducting M&A transactions. The law also foresees detailed entitlements for shareholders, and also third parties not being

shareholders, but connected with the takeover of the company. The position of the company's creditor is also protected, so as not to worsen the possibilities of their satisfaction from the debtor's assets after the merger.

In practice, significant M&A transactions usually cannot occur without approval by the shareholders meeting. This is explicitly mandated by law in mergers and it is common in acquisitions, at least on the part of the company which disposes of its organised assets (seller) or which pays with its shares (acquirer). Whenever there is a need of shareholders' approval, such an additional legal requirement entails further transaction costs and risks associated with the preventive measures by the dissenting minority. Namely, the resolution might be challenged and an action brought to the Court. The Polish company law provides for two types of actions aimed at challenging shareholder's decisions: (i) the reversal of the resolution; or (ii) the declaration of nullity. A fundamental difference comes down to indicating the premises, when the statement of claims will be effective and in what situation, as a result of the judgment of the court, would lead to eliminating the resolution and thus to hindering the transaction.

In the event of a statement of claims on the reversal of the resolution, it will be eliminated from transactions when the Plaintiff proves, before the court, that a given resolution on the merger or the takeover, although formally in accordance with the law, is in contradiction with the company's articles of association, or is in contradiction with good practices and at the same time aims at violating the interests of the company itself, or it violates the substantiated interests of the shareholder. The action of nullity aims at eliminating defective resolutions, which violate the provisions of the law. This is referring to defectiveness of a procedural nature, connected with the manner of adopting the resolutions, as well as on the violation of the provisions regulating the manner of conducting M&A transactions. In the case of resolutions on the merger of companies, the dissenting shareholder cannot try to render the resolutions invalid by basing the foundation of the statement of claims on the fact that the ratio of exchanging the stocks, indicated in the resolution, is not favourable for them. In such a case, the shareholder dissatisfied with the number of received shares may demand payment if they prove damages, but the merger itself will remain unaffected.

Poland is not an exception, in terms of the occurrence of such phenomena as statements of claims, the objective of which is rather an attempt at obtaining incidental benefits, and not a realistic protection of the conducted investment by a small, in principle, shareholder. The indication that usually such statements of claims present a very formal approach to a given transaction and try to focus on picking up potential, sometimes, from the business point of view, very small procedural transgressions, will not be a malfeasance. Hence, well prepared transactions may have such an effect that they will discourage the lodgement of such types of claims. The case law of the Supreme Court exists, which gives a basis to protect the effectiveness of the resolution, in a situation in which the transgressions were small and did not influence the content of the decision taken by the shareholders. It is certainly not worth risking, especially since the courts in Poland, specifically those that rule in cases as courts of first instance, have a tendency to take a strongly formalised approach to the issue of the procedure of adopting resolutions.

In Poland, a thorough reform of the system of challenging resolutions has been implemented since 2001. This was connected with the adoption of the Code of Commercial Companies, which, in this matter, replaced the Commercial Code, dating back to the 1930s. The Code was amended in later years, specifically adjusting it to the requirements of the community law. In the scope of the issue of challenging resolutions, the legislator's aim was to strengthen the company's position in disputes with potential corporate blackmailers, especially in M&A transactions which, as a rule, are linked with the need to incur significant costs for the preparation of the

entire undertaking. Such an objective was partially achieved, it seems. Just the challenging of the appeal alone does not automatically withhold the registration process. In the case of the rules, introduced in 2008, regarding the merging of a Polish company with a company from a different member state, the registration of the merger is possible despite challenging the resolution on the merger. Moreover, the resolution foresees the possibility of increasing the substantiated refund of the costs of the proceedings to the benefit of the company from the opponent, in a situation in which the statement of claims would prove to be groundless, in an obvious manner.

In the scope of M&A, the possibility of challenging is strongly limited in time and is possible up to one month from the date of adopting the resolution on the merger. The circle of persons who may lodge a statement of claims on rendering the resolution invalid is also limited. In general, only shareholders and company functionaries may lodge statements of claims. Creditors, in terms of principle, are not entitled to such a right.

Company law protects the creditors in such a way that it allows them to submit an objection. It is submitted with the maintenance of relevant deadlines, counting from the date of announcing the merger of the companies. The creditor's claim is not of such significance that it legally renders the conducting of the merger itself impossible, but it causes the need of separate asset management of each of the merged companies until the payment of a given creditor or granting additional security on his behalf has taken place. In practice, such a division of management is not convenient for merged companies, which want to take advantage of the economic effects connected with the deduction and to reduce the costs of their activities as quickly as possible. Additionally, the rights of the creditors are protected in such a way that they gain priority, on specified terms, in satisfaction before other creditors of the merged company.

From the point of view of persons possessing specific entitlements in the company, which may refer to other persons, not only shareholders, or possessing securities other than shares, what is significant is the fact that the Code of Commercial Companies ensures that their rights are to be equivalent to their hitherto rights. The entitlements of these persons may be changed or abolished by means of an agreement concluded between them, the acquiring company or the new company created after the merger. If an individual shareholder's rights or specific entitlements of any given shareholder towards the company were to be limited or suppressed as a result of the merger, such a shareholder may recourse to the court of law. This will not, however, thwart the effects of the merger, unless such a person will, at the same time, be shareholder of the company subject to the merger and will effectively challenge the resolution within the relevant time period and will indicate further premises required for the reversal of the resolution on the merger.

A specific entitlement granted to outstanding minority shareholders is the right to demand the buyout of their residual shares. The right of the minority to trigger the buyout is conferred whenever a controlling shareholder holds or acquires shares amounting to not less than 90% (in listed) or 95% (in non-listed) of the total shares in the company.

In this context it is worth mentioning a new stream in Polish case law, namely the acknowledgement of the duty of loyalty on the part of minority shareholders. In 2009 the Supreme Court for the first time made an express reference to the obligation of the loyal execution of corporate rights by the minority shareholders in relation to the majority shareholders. This statement was made, albeit on the basis of a case other than an M&A transaction, nevertheless it is of a general nature, it seems. Thus there are reasons to assume that the judiciary is gradually getting inclined to acknowledge the duty of loyalty as a proper benchmark applied while interpreting practical legal issues coming up in the court disputes, including conflicts arising from merger transactions. The scope of

the obligation of loyalty understood in such a way is conditioned by the evaluation of the specific circumstances, and the minority cannot abuse its rights, or try to torpedo the business decisions of the majority, insofar as this is conditioned by the real need of protecting the substantiated interests of the individual minority shareholders.

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