Downstream mergers under Polish company law

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Introduction

The Code of Commercial Companies allows for mergers of both independent companies and related entities. Transactions which involve the transfer of all of a company's assets (ie, the company being acquired) to another company (ie, the acquiring company) for shares which the acquiring company issues to the acquired company's shareholders are referred to as 'mergers by acquisition'. Dominant companies acquiring subsidiaries (so-called 'upstream' mergers) are common and uncontroversial. However, concerns arise in the opposite situation when subsidiaries take over dominant companies (so-called 'reverse' or 'downstream' mergers) and the domination results in a subsidiary having a controlling shareholding package. Downstream mergers are conducted for various reasons, including:

- tax optimisation;
- synergistic effect;
- capital group restructuring;
- operational considerations (eg, concessions);
- to bind the subsidiary company with change of control clauses; or
- to transfer the dominant company's headquarters abroad through a cross-border merger with its subsidiary.

The admissibility of such a combination does not raise any concern in many EU countries.

Acquisition of dominant companies

Downstream mergers involve the transfer of a dominant company's assets, which consist mainly or exclusively of shares of its subsidiary. As a result of the merger, the dominant company's shares are acquired by the subsidiary by way of universal (general) succession. Under company law, the acquisition of own shares by capital companies is generally prohibited, with the exception of cases envisaged by the law.

Therefore, an acquisition by a subsidiary joint stock company is regarded as fully admissible and lawful pursuant to Article 362(1)(3) of the Code of Commercial Companies, which allows for the acquisition of a company's own shares by way of universal succession (the company cannot exercise only voting rights from these shares). However, there are several concerns regarding the admissibility of an acquisition by a subsidiary limited liability company, due to a lack of appropriate provisions in Article 200 of the Code of Commercial Companies enabling limited liability companies to acquire their own shares by way of universal succession.

Controversy

In these ambiguous and problematic circumstances, parties try to find arguments weighted in favour of the acceptability of an acquisition by a subsidiary limited liability company, as well as possible alternative solutions leading to the same result.

The simplest solution is using an analogy to Article 362(1)(3) of the Code of Commercial Companies and applying it *per analogiam* to the acquisition of own shares by a limited liability company by way of general succession. Both joint stock and limited liability companies are capital companies and their nature is similar. However, Article 362(1)(3) of the Code of Commercial Companies is an exception to the ban on acquiring own shares and exceptions should not be interpreted broadly. Thus, this solution is not safe enough to be recommended.

Second, Article 200(1) of the Code of Commercial Companies enables the acquisition of own shares for the purpose of redemption. Therefore, it is advisable to introduce a resolution into the draft terms of the merger that an increase of the share capital of the acquiring company will be simultaneous with its reduction and redemption of all own shares, which were acquired as a result of merger. In that case, it can be argued that own shares were acquired for the purpose of redemption, which is admissible.

Apart from the aforementioned arguments, Article 200(1) *in fine* of the Code of Commercial Companies allows own shares to be acquired in cases envisaged by the law. Such a case may use Article 494(1) of the Code of Commercial Companies to establish mergers by acquisition. Additional justification is due to the fact that Article 494(1) may be treated as *lex specialis* towards Article 200(1) and the acquisition should prevail over the prohibition of acquiring own shares. Purposeful considerations also support this interpretation.

Comment

Despite the existing concerns and legal problems, a subsidiary limited liability company acquiring a dominant company is admissible under Polish company law. Nevertheless, a high level of uncertainty remains as to whether the above solutions this will be accepted by a particular registry court. In addition, the Supreme Court has not ruled on this issue, providing no clarity or guidance. Parties should consider conducting a more time-consuming but certain pre-merger procedure by transforming the subsidiary limited liability company into a joint stock company and then finalising the acquisition.

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