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Rescue mergers

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Introduction

Rescue mergers are vehicles which can, among other things, be relied on under the Austrian legal system for the financial restructuring of financially failing firms. They allow the financial restructuring of a failing firm through merger with another economically sound undertaking. Apart from the commercial aspects of a rescue merger, special legal constraints must also be taken into account. Although a comprehensive presentation of all the special rules regarding rescue mergers would massively exceed the scope of this update, some of the most important legal aspects of rescue mergers are discussed below.

Overview

A so-called 'rescue merger' is a special form of merger. The Austrian legal system defines 'mergers' as a transfer of two or more undertakings – excluding their liquidation – to another existing undertaking or an undertaking which is established in the course of the merger against the grant of shares in that undertaking. The assets of the transferring undertaking – as well as its liabilities – are transferred to the recipient undertaking and the 'old' undertaking(s) retain no assets. Only companies with limited liability and stock corporations can take advantage of a merger.

A rescue merger involves an undertaking in financial difficulties which is merged with a financially sound undertaking in order to improve its economic condition. A merger of valuable assets with virtually worthless assets is supposed to restructure an ailing firm and secure its survival. Depending on the objectives of the merger, the ailing firm can either survive as a recipient undertaking or be dissolved as a transferring undertaking.

Legal constraints

One initial problem is the conversion ratio at which the old shares are exchanged against new shares after the merger. Mergers will regularly dilute the shares because under Austrian merger law, all shareholders of the transferring company must also receive shares in the acquirer. The economic situation of companies involved in a rescue merger is unique, which is why the conversion ratio applied to the exchange of the failing firm's shares against new shares is a key issue. Due to the weak economic situation of the failing firm, its value may be

nearly zero. The conversion ratio of the shares reflects that value ratio and may consequently reduce the shares of the failing firm's shareholders to a miniature share. Contrary to general principles, in rescue mergers the failing firm's shareholders may not be granted any shares in the merged company and may hence be excluded.

A rescue merger may also affect the creditors of the merging companies in different ways. While the creditors of the economically sound company may face a reduction of their liability funds, the rescue merger may also result in a legal change of the claim. This may in turn have serious consequences for the enforceability of the respective claims. The creditors of the failing firm, on the other hand, will benefit from a rescue merger, since their liability funds will be increased and the default risk reduced. In order to prevent unequal treatment of creditors, Austrian corporate law grants those creditors which are negatively influenced by the rescue merger the right to demand a security for the potential reduction of their claims.

Holders of special rights may be confronted with massive changes of their legal positions in rescue mergers. A holder of special rights in stock corporations may decide whether the special rights will survive in the merged company or not apply against adequate compensation. If special rights are still issued, there is a risk that inferior special rights will be granted to the holders of special rights of the absorbed undertaking(s) in exchange for the extinguished special rights. In contrast, there is a risk that the new special rights issued to the holders of special rights of the recipient company will contain too many privileges. As a matter of principle, only equivalent, but not similar, special rights must be granted to holders of special rights.

However, in terms of antitrust law, a rescue merger is again privileged. According to European Commission guidelines,**(1)** an otherwise problematic merger is nevertheless possible if one of the merging companies is a failing firm and the same competitive structure would follow in an alternative scenario. However, Austrian case law is rigorous in its interpretation of this exemption and is of the opinion that there must no alternative buyer for the failing firm.

Comment

A rescue merger may be an effective instrument for the financial restructuring of an undertaking and for securing its survival. However, these examples show that it involves numerous legal constraints and risks which could lead to a serious encroachment on the legal positions of shareholders, creditors and holders of special rights. It is imperative to observe these constraints and risks strictly in order to avoid any risk of inequality in the treatment of the parties to a rescue merger.

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Endnotes

(1) Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 2004/31, 5 (14).

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