Triangle Mergers
A Distinctive Norwegian Type of Transactions

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1 Introduction

A merger according to the third EEC Company Law Directive is carried out through a transfer of the entire assets and liabilities of a transferor company to a transferee company. The consideration is rendered from the transferee company to the shareholders of the transferor company. The consideration normally consists of shares in the transferee company, or possibly shares with an additional sum of cash. As a consequence of this transaction, the transferor company ceases to exist. This is also the main system in an ordinary merger according to Norwegian company law.

In 1985 Norwegian legislators gave way to an alternative way of merger in certain group affiliations, by allowing the consideration to consist of shares in the transferee company's parent company. In that way at least three companies are involved. These are the transferor company, the transferee company and the parent company, which renders the consideration, a "triangle merger". The main features are retained in the Norwegian company law acts, the Limited Liability Companies Act (Aksjeloven – ASL) and the Public Limited Liability Companies Act (Allmennaksjeloven – ASAL) of 1997 Section 13-2.

The wording of ASL/ASAL section 13-2, subsection 2 is as follows:

> If the transferee company belongs to a group, and if one or more of the group companies holds a total of more than 90 per cent of both the shares and the votes at the General Meeting of the transferee company, the consideration in shares may instead consist of shares in the parent company or shares in another subsidiary in which the parent company alone or through a subsidiary holds more than 90 per cent of both the shares and the votes at the General Meeting. The increase in capital in the parent company or the subsidiary may be implemented by using as a share capital contribution a claim issued by the transferee company and which is equivalent to the equity injected into the transferee company in connection with the merger. The claim shall have priority after the other creditors of the transferee company.

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The provision was given the present wording after an amendment of the Limited Liability and the Public Limited Liability Company Acts in 1998. (The official text of these acts is in Norwegian only. This translation is from a publication published by The Norwegian Institute of Public Accountants, ISBN 82-7082-144-6).

For another company than the transferee company to be allowed to render the consideration two cumulative conditions must, according to this provision, be fulfilled. First: The transferee company must belong to a "group". Second, "one or more of the group companies holds a total of more than 90 per cent of both the shares and the votes at the General Meeting of the transferee company". If these conditions are fulfilled, the consideration can be rendered by the parent company of the transferee company, or another subsidiary in which the parent company alone or through a subsidiary holds more than 90 per cent of the capital and voting power as mentioned.

In the Norwegian company acts there are not many rules designed especially for triangle mergers. The general rules on mergers must be complied with, to the extent possible. As a result of Norway's commitments to the EEA-agreement, most of these rules are based on the Merger Directive (the third EEC Company Law Directive, 78/855/EEC). This directive has no rules concerning triangle mergers, nor are such rules to be found in the other Nordic countries' company acts. Even if these triangle arrangements fall outside the EEC Company Law directives, it may be a violation of Norway's commitments to the EEA-agreement if the interests of shareholders and creditors as laid down in the directives, do not apply in a triangle merger.

2 When may a Triangle Merger be Suitable?

A triangle merger can be a solution in at least three types of situations. First: When merging into a group where the parent company is a holding company, which owns subsidiaries where the operations are carried out. The transferor company can be merged into the subsidiary if the operations carried out there make this sensible. The shareholders in the transferor company may prefer to gain a part of the value in the group as a whole, and not just become shareholders in the subsidiary. This may be fulfilled by receiving shares in the parent company.

Secondly: A triangle merger can be appropriate where the transferor company is considerably larger than the transferee company. An ordinary merger with consideration consisting of shares from the subsidiary might break the group affiliation, because the parent company could get in minority. If the parent company does not want this, a triangle merger is a possibility.

Thirdly: A triangle merger presents a solution if there are legal barriers for an amalgamation of the companies. The Norwegian bank legislation is an example. The Ministry of Finance would likely not permit a merger between a bank and an insurance company. If a bank is to be merged into another finance group, a triangle merger might be necessary, due to the fact that the banking

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operations and other operations (e.g. insurance) is to be carried out by different subsidiaries.

3 Group Connection

If a triangle merger is to be carried out, the transferee company must “belong” to a group (ASL/ASAL section 13-2, subsection 2, 1. sentence). The group concept corresponds to the general group concept in the Limited Liability and the Public Limited Liability Company Acts section 1-3. A (public) limited liability company “is a parent company if it has a controlling interest in another company as a result of an agreement or through the ownership of shares…” (ASL/ASAL section 1-3, subsection 2, 1. sentence). The legal definition of a “group” in the Norwegian company acts is harmonized with the Seventh Company Law Directive on consolidated accounts (83/349/EEC).

The group concept in these Norwegian company acts presupposes that a limited liability or public limited liability company is a parent company. If this is not the case, a triangle merger cannot go through. There might be sub-groups within a group. If an under-group falls within the scope of the Limited Liability or the Public Limited Liability Company Acts, but not the main group (for instance if the parent company in the main group is a partnership), a limited or public limited parent company in the under-group may render the consideration of shares.

The group concept presupposes that the parent company is a Norwegian limited or public limited company. Certain rules in the company acts concerning the subsidiaries also apply to subsidiaries with foreign parent companies. The merger provisions are not among these rules. If the parent company is foreign, a triangle merger is not possible.

4 “If one or more of the group companies holds a total of more than 90 per cent of both the shares and the votes” in the transferee company

Besides belonging to a group, the company acts also require that the parent company has a qualified position of both ownership and voting power. After the amendment of the law in 1985 the parent company had to own “more than nine tenths of the shares in the transferee company and [have] an equal part of the votes that [could] be given at the General Meeting”. Even though it did not follow the wording of the provision, it was agreed that the requirement for 90 per cent also could be fulfilled by shares owned by the parent company together with or via another subsidiary than the transferee company. Today, this is explicitly laid down in the 1997 acts, after which “one or more of the group companies” must hold a total of “more than” 90 per cent of both the shares and the votes at the General Meeting of the transferee company (ASL/ASAL section 13-2, subsection 2, 1. sentence). The requirement of both capital and voting power of more than 90 per cent will have independent importance if the voting

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right is not equally distributed on the shares. It is not enough to own 99 per cent of the shares if the last 1 per cent has 10 per cent or more of the votes.

Neither the statutory text nor the preparatory works clarifies the question as to what point in time the owner position and voting power must exist. The alternatives are when the boards draw up the terms of the merger (the "merger plan"), the time of the General Meetings approval, or when the merger enters into force. The boards of the participating companies must establish the consideration – amongst other things which company will render this – when working out the plan. The group must therefore be established when the boards enter into the plan, and must exist until the merger has entered into force. The same applies to the requirement of more than 90 per cent of capital and voting majority.

5 Consideration from Parent Company or Subsidiary

If the parent company has more than 90 per cent owner majority, the question arises as to which companies can render the consideration of shares. First of all, the shares may be rendered by the transferee company's parent company to the shareholders in the transferor company (ASL/ASAL section 13-2, subsection 2, 1. sentence).

Previously the shares in a triangle merger could only be rendered by the parent company. In the 1997 legislation, this is expanded to "another subsidiary". The requirement for more than 90 per cent capital and voting majority applies both in relation to the transferee subsidiary and "another subsidiary", which renders the shares. The wording "another subsidiary" does not only apply to a company which is directly owned by the transferee subsidiary's parent company. A company further down in the group chain can also render the consideration of shares. If there are many companies in a group, the freedom of choice is extensive concerning which company is to render the consideration.

6 The "Claim Model" as a Basis for Rendering Consideration of Shares

6.1 Introduction

If the "parent company" or "another subsidiary" will render the consideration there are three possibilities as to how this company shall render these shares; increase in capital by new subscriptions, increase of capital by bonus issue, or use of stock of its own shares. When the Norwegian legislature in 1985 opened up to triangle mergers, bonus issues were pointed out as a possibility. An increase in the share capital by bonus issue may take place by "a transfer from the share premium reserve to the share capital…and from distributable equity" (ASL/ASAL section 10-20, subsection 1, 1. sentence). According to the former Norwegian Companies Act of 1976 (ASL 1976), a bonus issue could also be

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covered by “amounts resulting from a revaluation of fixed assets” (ASL 1976 section 4-10, subsection 1). Revaluation of the parent company’s shares in the subsidiary was fitting. The reason for this was that the increase in assets in the transferee company due to the merger could lead to a value on these shares “considerably in excess of the figure at which it was entered on the last preceding balance sheet” of the parent company (ASL 1976 section 11-10, subsection 4). The access to revaluation came to an end with the Norwegian Accounting Act of 1998.
The acts now only mention new subscription, see ASL/ASAL section 13-2, subsection 2, 2. and 3. sentence:

> The increase of capital in the parent company or the subsidiary may be implemented by using as a share capital contribution a claim issued by the transferee company and which is equivalent to the equity injected into the transferee company in connection with the merger. The claim shall have priority after the other creditors of the transferee company.

The transferee subsidiary issues a claim with itself as the debtor and its parent company as the creditor. The foundation for the claim is neither dealt with in the company acts nor in the preparatory works of these acts, but there must be an agreement between the parent company and its subsidiary. Likewise the consideration issuing parent company must enter into an agreement with the transferor company, and assume a duty to render the consideration to the latter company’s shareholders.

The claim is a share capital contribution in the parent company, hence the term “the claim model”. The legislature has considered this to be the most correct description of the economic reality in a triangle merger. The claim shall be equivalent to the equity obtained by the transferee company. The merger will therefore in principle not change the value of this company. An amount equivalent to the transferor company’s equity is injected into the parent company through the claim. This influx of capital lays the foundation for the issuing of shares.

6.2 The Claim as Share Capital Contribution

The claim is a contribution in non-cash to the parent company. It follows from this that the rules ensuring that contributions in non-cash must give full cover for the increase in share capital, will apply. These rules are in Norway harmonized with the Second Company Law Directive, 77/91/EEC (especially ASL/ASAL section 2-6 and section 10-2). An accountant has to confirm that the contribution in non-cash has “a value which is, as a minimum, equal to the consideration agreed”, see ASL/ASAL section 2-6, subsection 1, no. 4. In a triangle merger, an accountant must confirm that the value of the claim at least corresponds to the face value of the consideration of new shares.

An accountant must give “information on the principles which have been used for the valuation of the assets [the claim] which the company is to take over”, ASL/ASAL section 2-6, subsection 1, no. 2. In a triangle merger the

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parties in the claim are closely related, a parent company and its subsidiary. The requirement set out in the preparatory works of the Accounting Act for a "thorough" assessment when the parties are closely related, can have the effect that the accountant must disclose information on the elements that have been emphasized in the valuation, and how these elements have been weighed. Such elements are the financial position and future prospects of the subsidiary, postponed debts and any possible exemption from interest. The face value of the claim shall be equivalent to "the equity injected into the transferee company in connection with the merger" (ASL/ASAL section 13-2, subsection 2, 2. sentence). If the actual value due to postponed debts, exemptions from interest and/or other negatives in the value is lower than face value, there is a risk that the parent company will not be seen as having obtained a value which gives grounds for rendering the necessary consideration of shares.

6.3 The Connection Between the Claim Model" and other Company Law Rules

It is set out in ASL/ASAL section 3-4 that a (public) limited liability company "must .. have an equity, which is sound, based on the risk and the extent of the activities of the company's activities". According to the preparatory works, the term "equity" refers to actual, not booked, capital. A possible problem related to triangle mergers may arise because the claim model entails that the net assets of the transferee subsidiary will not increase, but the total capital and operations increase.

According to ASL/ASAL section 8-10 a (public) limited liability company can not "grant a loan .. in connection with the acquisition of shares in the company or units in another company in the same group". One of the consequences of the "claim model" is that the parent company, which renders the shares, becomes creditor with a subsidiary as debtor. This is a "loan" according to this provision. The debt is contracted "in connection with the acquisition of shares" in the parent company. The claim model therefore constitutes an exception to this prohibition. This prohibition to grant certain loans has its background in the EEC Second Company Law Directive art. 23. According to this provision, "a company may not .. make loans .. with a view to the acquisition of its shares by a third party". The Norwegian ASL/ASAL section 8-10 prohibits loans "in connection with the acquisition of shares in the company or units in another company in the same group". In a triangle merger, the loan from the subsidiary finances the acquisition of shares in the parent company, which is "another company in the same group". On the other hand, the Second Company Law Directive art. 23 does not prohibit loans financing the acquisition of shares in another company in the same group. Therefore, the Norwegian system of triangle mergers does not violate the Directive, by permitting loans from the subsidiary to finance the acquisition of shares in the parent company.

The claim model can lead to a withdrawal of capital from the transferee company that is not compatible with the rest of the rules on merging. The reason for this is that because the claim must be equivalent to "the equity injected into

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the transferee” subsidiary, the merger can have the same economic effect for this company as a purchase of the transferor company. The subsidiary obtains e.g. the transferor company’s net assets of 1 million Norwegian Kroner, the parent company renders a consideration of shares of this amount, and the parent company obtains a claim on the subsidiary for the same amount. As to the economic effects of the merger for the transferee subsidiary, there is a great difference between triangle mergers and ordinary mergers. In a triangle merger, the transferee subsidiary obtains an amount equal to the equity of the transferor company. At the same time the claim is contracted. Consequently, the subsidiary does not receive a net injection of capital. If the merger is carried out according to the standard procedure – the transferee company renders the consideration in shares – the Norwegian limit at 20 per cent cash consideration in mergers will stop the merger from in reality constituting a purchase, because the transferee company will receive a net amount of capital. Obtaining that kind of net asset in a merger, has in Norwegian law traditionally been seen as corresponding to the fact that creditors of the transferor company cannot plead the general rules that apply to change of party in debtor positions. In a triangle merger it is the parent company which obtains these net assets (the claim that corresponds to the net value of the transferor company). The creditors in the transferor company can however not stick to the parent company. Whether this will lead to more objections from creditors in triangle mergers, e.g. that a creditor demands a guaranty from the parent company to accept the merger, remains to be seen when these rules have been practiced for a longer time.

One of the consequences of the “claim model”, is that a triangle merger for the transferee company in reality is a purchase which leads to a considerably larger cash withdrawal from this company than would have happened if the company itself had rendered the merger consideration (where the 20 per cent limit for the additional consideration applies). This risk should have been considered compensated by special rules. Such a rule could be that payment of the claim only can be done after notification of the creditors.

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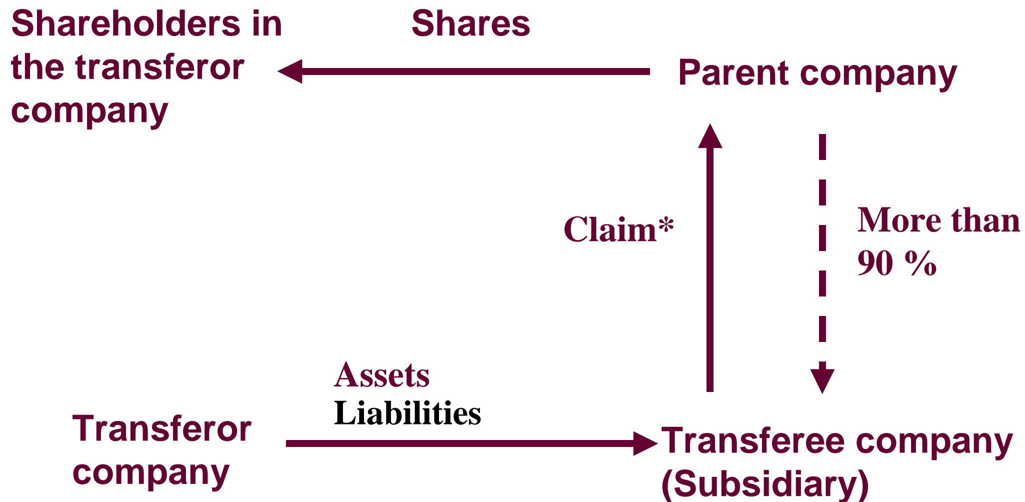
TRIANGLE MERGERS NORWAY

Act No. 44 1997 relating to Limited Liability Companies (asl) § 13-2, section 2
Act No. 45 1997 relating to Public Limited Liability Companies (asal) § 13-2, section 2



Companies Act § 13-2, section 2, 2 sentence: “The increase of capital in the parent company .. may be implemented by using as a share contribution a *claim* which is issued by the transferee company and which is equivalent to the equity injected into the transferee company in connection with the merger.”

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