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RESOLVE INFORMER SERIES

Corporate Simplification: Removing dormant entities from your group

A guide to legal and practical issues for FDs, CFOs and Tax Professionals

CONTENTS

INTRODUCTION

As part of the ReSolve Informer series, welcome to LCN Legal and ReSolve's guide to removing dormant entities. It is for you if you are a group FD, CFO, Company Secretary or In-house Tax Professional, and you need to remove a number of dormant entities from your group.

The aim of this guide is very simple – it is to answer the most common questions that our clients ask when they are starting out on this kind of project.

We hope that this will help you get your project off on the right foot, and completed on time and on budget.

OUR EXPERIENCE OF REMOVING ENTITIES FOR LARGE CORPORATES

Our teams have advised a number of FTSE entities and other large corporates on dormant entity removal projects involving the removal of hundreds of entities. We have also helped SMEs and owner-managed businesses to achieve the same result.

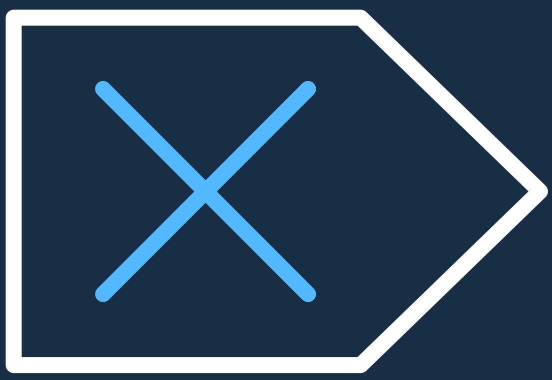
Some of these projects have simply involved the removal of dormant entities by strike-off, following an abbreviated due diligence process. Other projects involved formal liquidation processes, reductions of capital, transfers of trade and cross-border mergers under the relevant European Directive.

BENEFIT FROM THE EXPERIENCE OF YOUR PEERS

By acting on the information in this guide, you can benefit from the experience of your peers and avoid the pitfalls. You will find out:

- the typical reasons why other groups decide to implement dormant entity removal projects
- how to organise the due diligence process so that you avoid getting bogged down in inappropriate, unfocussed questions
- how to decide whether the relevant entities need to be put into liquidation, or whether they can be simply struck off
- the simple legal steps (which are often overlooked) that you must make sure every company does before it is dissolved or wound up (see Section 6)

SECTION 1
WHY DO OTHER GROUPS REMOVE DORMANT ENTITIES?



Corporate groups tend to accumulate additional entities over time. This often happens because:

- they acquire other groups, which already have a number of subsidiaries;
- subsidiaries or SPVs are set up for specific joint ventures/ projects, or to hold particular assets. Those ventures or projects may each come to the end of their life cycle, and the relevant assets may be disposed of; or
- entities have been created as part of tax planning structures, which later may have become ineffective or may be regarded as inappropriate.

The decision to remove unnecessary entities is often made for a number of reasons. Here are some of the most common ones.

- **Reducing ongoing costs** – including costs such as audit fees, tax compliance and company secretarial compliance. For more information on this, see Section 2: "What cost savings will we actually produce?".
- **Reducing compliance burdens** – this is closely linked to reducing ongoing costs. The overall compliance burden can include the management time spent in reviewing and approving regulatory filings and reports for different entities.
- **Reducing transactional costs** – the more legal entities a group has, the more complicated the arrangements are likely to be when the group refinances or undergoes some other corporate change. This takes up management time as well as increasing professional costs.
- **Improving governance** – making the group structure easier to understand and reducing the number of entities makes it easier for directors to show that they are complying with their legal obligations as directors. Conversely, if directors are not aware of which entities they are directors of, and what those entities actually do, it is very hard for them to defend themselves from personal attack if something goes wrong.
- **Avoiding criticism for lack of transparency** – having a complicated group structure can support an impression that the group wants to make it more difficult for outsiders to understand its activities. This may be completely misguided, but nevertheless the impression may remain.
- **Removing dividend blocks** – removing unnecessary intermediate entities often allows funds to move more easily through the group, by addressing entities or activities which have negative reserves or which are subject to volatile profit levels.

For many groups, all these reasons translate into an ongoing programme to remove unnecessary entities on an annual and ongoing basis. Other groups may prefer to deal with things on an ad-hoc basis, perhaps triggered by some external event such as a proposed refinancing, a recent acquisition, or a managed exit from a business line.

Sometimes, the trigger is even more basic - simply a missed filing deadline, leading to a reminder or other official communication being sent to directors personally, which highlights the embarrassment factor of why the group structure has been allowed to remain as it is.

SECTION 2

WHAT COST SAVINGS WILL WE ACTUALLY PRODUCE?

The desire to reduce cost is often one of the initial drivers for a corporate simplification project.

In theory, the savings can be expressed as an annual, ongoing amount. On paper, this may comfortably justify the up-front costs of planning and implementing a dormant entity removal project.

Various generic estimates can be found for the ongoing cost of maintaining dormant entities. The amounts can range from £5,000 or £10,000 to even £20,000 and £25,000 per company per year.

Often these numbers are quoted by consultants or advisers who want to sell you their services. That does not mean that they are not valid, but clearly you need to form an assessment based on your own particular circumstances. Your assessment will be an important part of the communications with people whose help you will need to progress the project, whether you need them to champion the project or merely respond to information requests.

Here is one way to look at things.

EXTERNAL COSTS

Some savings are direct, external costs of the business. These may include:

- Audit fees
- Company secretarial fees
- Filing fees
- Regulatory filing fees
- Licence fees (as applicable per entity)

There may be others, depending on what the group does and how it is owned and regulated.

INTERNAL COSTS

Another way to look at the issue is to consider what tasks need to be completed for any given company every year, who needs to carry out those tasks and how long it will take. And then attribute a notional daily or hourly cost to that process.

Those tasks may include:

- Preparing, approving and filing statutory accounts
- Preparing, approving and filing annual returns
- Preparing, approving and filing tax returns
- Preparing regulatory disclosures
- Carrying out internal audits

Even with a modest hourly rate and a conservative estimate of the time required for each task, it is easy for the total costs to be in the thousands of the relevant currency.

Of course, this kind of calculation does not automatically produce an actual cash saving if a given number of entities is removed. A cash saving would only be realised if the people who were spending time on these things can do other tasks which are equally valuable instead – or if redundancies are made (which is not usually the aim of this kind of project).

OTHER INTERNAL COSTS

Some costs are less tangible, but no less real. We've all been in the situation of starting off a corporate finance or group reorganisation project, and spending the morning with the group structure charts – working out which group entities will be affected, how they relate to each other, and what that means for the project.

Other internal costs may include:

- Needing to brief each new joiner to the tax or finance team as to why the group structure looks like it does, and where the sensitivities are
- The incremental time cost of advisers getting to grips with the structure, whenever anything happens
- The additional minutes, resolutions and documents required every time a particular company needs to participate in group arrangements, such as banking and transfer pricing
- Answering questions from directors as to why a particular company exists and what it does (and if they are not asking those questions, that in itself is cause for concern)

All these costs are almost impossible to quantify on a per-entity basis, let alone on a group basis.

In our experience, cost savings are rarely the driving motivator to kick off a dormant entity removal project at any particular point in time. However, as mentioned above, having a reasonable, conservative estimate of the likely savings is an important tool in communicating the importance of the project internally.

SECTION 3

WHAT POTENTIAL PROBLEMS SHOULD WE BE AWARE OF?

As with any project, problems and blockages can arise. It is not unusual for dormant entity removal projects to be delayed or even to be abandoned because of unexpected issues.

It is helpful to be aware of the typical causes of problems, so that they can be anticipated and addressed in advance. Here are some of the more common ones which other large corporates have encountered.

1. **Lack of accountable project resource** – the time and focus which is required for this kind of project is often under-estimated. Without dedicated resource, it can be difficult to make consistent progress.

2. **Respondents are too busy** – before any given entities are removed, information requests are usually sent out to various people internally and externally, as part of the due diligence process. This places demands on respondents' time, in addition to their 'day job', and it is easy for the project to be delayed if responses are not produced promptly.

3. **Staff attachment to sub-brands / product brands** – in some larger organisations, particular brands used within the group can have a strong emotional attachment for some members of staff. There can be a resistance to removing legal entities which are associated with a particular brand, even if there are no plans to discontinue the use of that brand.

4. **Staff who knew about the relevant entities have left** – this is a key component of the 'corporate memory' issue which can make it more difficult to gather information about the status of particular legal entities which are to be removed. Section 4 contains a fuller discussion of this issue.

5. **Confidential projects** – at times entities which are within the scope of a dormant entity removal project are also the subject of other, confidential, projects within the organisation. The project team may not be aware of that other project. This can result in time being wasted on due diligence, planning and even implementation work, only for the company to be taken out of scope at a late stage.

6. **Lack of high level support** – corporate simplification projects can sometimes be regarded as purely administrative tasks which do not warrant senior, director-level involvement. This is a mistake, because high level support is critical in order to be able to escalate issues and deal with blockages as they arise.

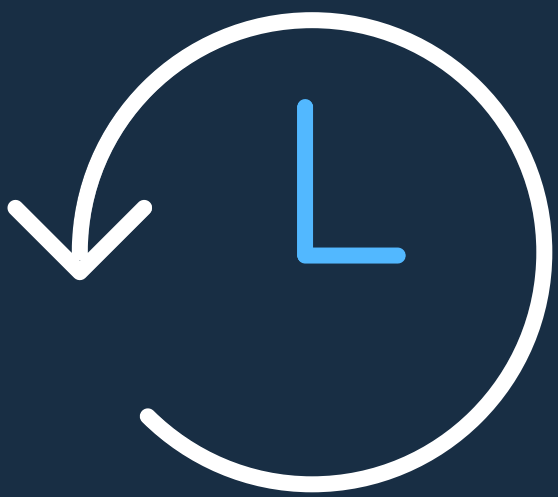
7. **Concerns about job security** – in some cases, there can be misconceptions about the purpose of the dormant entity removal project. For example, there may be a perception that the project is designed to produce cost savings through redundancies, which may not be the case. This can mean that staff members are reluctant to assist with the project. Clear communication of the reasons for and objectives of the project is important to avoid this.

8. **Well-meant but rogue 'recollections'** – this issue is very common and difficult to address. Members of the project team or respondents in the due diligence process may have a recollection or belief that a particular company is affected by a certain issue due to its historic activities. This may give rise to significant time and resource being spent on investigating that issue, with no tangible result.

9. **Unfocussed due diligence, throwing up too many unresolved questions** – if no clear materiality threshold is set for the project, it is easy for the due diligence process to get bogged down in a mass of questions and apparent issues.

10. **Project fatigue** – for more complex organisations with many legal entities, a corporate simplification project may continue for a number of months, if not years. Unless the project team is properly supported and the continuing importance of the project is communicated, the project can slowly grind to a halt.

SECTION 4
WHAT IS THE 'CORPORATE MEMORY' ISSUE, AND HOW SHOULD WE DEAL WITH IT?



The 'corporate memory' issue is often one of the most difficult hurdles to overcome when implementing a dormant entity removal project.

The problem is that a group's records of individual entities' activities and assets may be incomplete. The people with personal knowledge about those entities may have left the group. All this can make it difficult to get comfortable that removing any given company will have no negative consequences.

In some cases, concerns about this issue means that a proposed project never gets off the ground, or is shelved part-way through. But the problem does not get easier over time.

The problem can be particularly acute if the entities you want to remove have a complex history dating back decades, especially where that history includes a period of ownership by third parties.

So what approaches have other groups adopted to deal with this?

REFOCUS ON THE OBJECTIVES OF DUE DILIGENCE INVESTIGATIONS, AND ESTABLISH A CONSISTENT APPROACH

As a starting point, it is helpful to remind yourself of the objectives of due diligence in dormant entity removal projects. In general, the main objectives are to take reasonable steps to:

1. Preserve material assets; and
2. Avoid triggering liabilities.

When information is scarce, it is even more important than usual to follow a consistent methodology for due diligence. This does not have to be complicated, but by documenting and following a consistent approach, it is less likely that issues will be missed, and easier to satisfy the relevant directors and others that the necessary actions can properly be approved.

Section 7 contains more information about how to organise your due diligence.

TAKE THE LEGAL MEASURES AVAILABLE TO PRESERVE ASSETS

These measures are described in more detail in Section 6, and include the simple act of making sure a 'sweeper deed of assignment' is entered into by each company before it is dissolved.

BE PRAGMATIC

Ultimately, few things in life or business are 100% certain. Many groups take the view that assets only have a value to the group if they have been properly identified and can be managed. So if no assets have been identified after an appropriate due diligence process has been followed - including taking reasonable steps to ask any people who may have relevant knowledge – then in practice the group is unlikely to lose any real benefit by removing the entities involved.

SECTION 5
WILL WE NEED TO APPOINT LIQUIDATORS?

There are two main ways to remove a UK company: a Members' Voluntary Liquidation (MVL), or a strike off.

(Actually, there are two other options, which are creditors' voluntary liquidation (CVL) or a cross-border merger using the European Directive. A CVL would imply that there are third party creditors which will not be satisfied in full, and therefore has reputational issues for the group concerned. Cross-border mergers are possible, and are relatively expensive but are sometimes used – see Section 8 for more information.)

MVL VS STRIKE OFF: AN OVERVIEW

In short: using an MVL is generally more expensive and slower than a strike off, but gives the group (and directors in particular) the additional comfort that the liquidator will follow a statutory process of advertising creditors' claims, realising assets and making distributions to shareholders. An MVL also provides an important tool when dealing with contingent liabilities and onerous assets.

A strike off is simpler, and involves sending a form to Companies House, and notifying certain third parties.

Both these legal mechanisms represent the last phase of the process. Leading up to that, appropriate due diligence investigations would have been carried out, and any assets, liabilities or obligations would usually have been cleared out of or otherwise addressed by the company.

If you would like more detail, we have produced a guide to assist you in setting out the differences between the two processes. This can be found in the Corporate Simplification section of our website: Click here to view

DIRECTORS' PERSPECTIVE: RISK ISSUES

Striking a company off the register and using a solvent liquidation (MVL) both involve a certain amount of legal risk for the directors of the company concerned. Aside from tax considerations, the decision about which to use is usually a matter of balancing risk against cost.

To initiate an MVL, a majority of the company's directors must sign a declaration to the effect that, having made a full inquiry into the company's affairs, they are satisfied that the company will be able to pay its debts in full, together with any interest, within a specified period not exceeding 12 months from the commencement of the winding up.

When striking a company off the register, no declaration of solvency is required. However, the application must be signed by a majority of directors, and the directors have a duty to notify any creditors and employees (as well as shareholders and any other directors). The directors may commit an offence if they fail to make the necessary notifications and they cannot show that they have taken all reasonable steps to comply with their situation duties. This implies a duty to take all reasonable steps to identify possible creditors, amongst others.

For both procedures, the directors will therefore want assurance that an appropriate level of due diligence has been carried out to identify material assets and liabilities. (See Section 7 for more information on this.) However, by using an MVL, directors get the added reassurance of knowing that the liquidator will follow a statutory procedure of advertising for creditors before completing the liquidation. This is often considered to be worth the extra cost involved.

LIQUIDATOR'S REQUIREMENTS

There is risk on a liquidator in taking an appointment, especially where there is a distribution of assets. If a liquidator distributes assets and a creditor claims against the company in liquidation, the liquidator may need to recall some of the distribution to settle the claim, if admitted for payment.

The way this is done is for the liquidator to be indemnified by (usually) the shareholders. The indemnity should cover the claim settlement figure and costs associated with the agreement of claim and distribution but it is often limited to the value of distributable assets.

Indemnities tend to be most common where swift distributions of assets are desired following the liquidation of a company, and before all claims are known or tax clearances provided.

LIMITATION PERIODS FOR RESTORING ENTITIES TO THE REGISTER

On occasion, a company needs to be restored to the register after it has been struck off or dissolved as the final process of a liquidation. For example, you may discover that the company holds assets which had not been identified before removal. (See Section 6 for what can be done to avoid this situation arising in the first place and Section 9 for an overview of the process for restoring UK entities to the register.) The limitation period is 6 years from the date of dissolution, whether the company was removed by strike off or by liquidation (except in the case of a personal injury claim, where there is no limitation period).

PROJECT-LEVEL CONSIDERATIONS

If your project concerns a significant number of entities, then you will probably want to develop a standardised approach. Because of the economies of scale involved, the unit cost of each MVL is likely to reduce, so that the cost benefit of strike off as opposed to MVL will also correspondingly reduce.

For this reason, large corporates sometimes make a policy decision to put all the relevant entities into liquidation – it's one less decision to be made, and the directors get the additional comfort that the liquidators will follow a statutory process to deal with potential creditors.

COMPANY-LEVEL CONSIDERATIONS

Wherever possible, assets and liabilities will usually be stripped out of each company concerned, so that it is left only with cash, intra-group debtors and intra-group creditors before the process of MVL or strike off is commenced. Sometimes that clean-up exercise will require the creation of reserves (for example, by reducing the company's capital using the solvency statement procedure), so that a distribution in cash or in kind can be made, or assets can be sold at book value rather than market value. From a director's risk perspective, the content of that solvency statement is almost identical to the declaration of solvency required for an MVL.

If the project team has not made the decision to use an MVL for all the entities within the scope of the dormant entity removal project, then often the default option is to use a strike off, since it is generally quicker and cheaper. For any given company within the scope of the project, the question is therefore whether there are special circumstances which would indicate that an MVL is more appropriate.

Those special circumstances may include:

- Material contingent liabilities – such as environmental liabilities, possible product liability claims
- Onerous assets or contracts, such as leases of real estate or equipment rental contracts. (A liquidator has the power to 'disclaim' onerous assets.)
- Uncertainty about the existence or nature of creditors
- The need to take corporate action in order to return assets to shareholders. For example, the company may have material net assets which are not matched by distributable reserves. In that case, using an MVL may be considered as an alternative to a capital reduction followed by a distribution and strike off.

SECTION 6
HOW CAN WE MAKE SURE WE DO NOT LOSE VALUABLE ASSETS?

If you are planning to remove dormant entities from your group, there can be a concern that the group might lose valuable assets in the process.

This is because when a UK company is dissolved, any assets belonging to the company at the point of dissolution will vest in the Crown as 'bona vacantia' (abandoned property).

This potential concern is common to any dormant entity removal project.

DUE DILIGENCE: THE FIRST LINE OF DEFENCE

Of course, the first line of defence is due diligence. This should include checking financial records and statutory filings, and perhaps also reviewing historic board minutes and issuing questionnaires to relevant departments and individuals within the organisation. Section 7 contains more information on how to organise this.

However, due diligence can only take you so far, and it can be impossible to prove a negative conclusively. In some cases, the people who knew about the company will have left the group, and it can be difficult to get a handle on a company's history.

USING 'SWEEPER' DEEDS OF ASSIGNMENT

A basic but effective legal step which can be taken is to ensure that each company executes a 'sweeper' deed of assignment before it is dissolved. This transfers whatever assets the company has to another, retained, company in the group.

The assignment can contain a 'further assurance' clause saying that the transferring company must execute whatever other deeds and documents may be required to complete the transfer. This can be backed up by a power of attorney granted by the transferring company in favour of the transferee. If this power of attorney is expressed to be irrevocable and given by way of security for the performance of the transferring company's obligations, then it can survive the dissolution or winding up of the transferor.

This means that if assets are discovered after the company is removed and dissolved, a further deed of assignment dealing with those assets can be signed.

This approach is not bullet-proof, because some types of assets, such as contractual rights, may terminate automatically when a company is dissolved. However it does provide important protection, and it can often give the additional comfort required to go ahead with a dormant entity removal project, and achieve ongoing cost and governance benefits.

USING CROSS-BORDER MERGERS

For the sake of completeness, it is worth mentioning the option of using a cross-border merger under the European Directive. This gives effect to a 'true merger', whereby the assets of the transferring entities transfer by operation of law into a retained transferee company, and the transferring entities cease to exist without liquidation. There must be a cross-border element, so at least one of the participating entities must have their seat in another country in the EU. See Section 8 for more information.

SECTION 7
HOW SHOULD WE ORGANISE THE DUE DILIGENCE PROCESS?

Due diligence investigations form part of the wider processes which are undertaken to decide whether to go ahead with a particular set of steps, and to identify what actions are needed to implement them.

As already mentioned, the objective of the due diligence process is usually to take reasonable steps to preserve material assets and to avoid triggering material liabilities.

HIDDEN ASSETS AND HIDDEN LIABILITIES

One of the challenges of due diligence is that some assets and liabilities may not appear on any given company's balance sheet, and may also not appear on any public register. Such assets may include:

- Assets held on trust or as nominee (for example, shares held in other group entities)
- Contractual rights
- Unregistered land
- Unregistered intellectual property
- The benefit of restrictive covenants

Similarly, hidden liabilities may include:

- Contractual obligations
- Contingent liabilities such as guarantees
- The burden of restrictive covenants
- Environmental liabilities relating to historic assets or activities
- Employee personal injury claims, such as hearing loss

Where there is considered to be material risk that hidden assets or liabilities may be present, then additional investigations should be considered as part of the detailed due diligence process – see further details below.

A WORD ON CONTINGENT LIABILITIES

Liquidators have a duty to expedite the return of assets to the shareholders that appointed them. This expeditious duty provides liquidators with an ability to force creditors with contingent claims to crystallise their claim and submit it to the liquidator.

Contingent claims cannot be easily ascertained and therefore whilst claims are made, they are often rejected. There is recourse for a creditor to apply to court in such cases although current case law favours a liquidator.

A contingent claim case study can be found in the Corporate Simplification section of our website:
Click here to view

Directors, when making the declaration of solvency, may find it difficult to value contingent claims as there may be risk that the claim could exceed the value of the company's assets. Accordingly, a director might seek an indemnity from a parent or group undertaking to cover the possible exposure before making the declaration so as to avoid an insolvent liquidation.

A TYPICAL DUE DILIGENCE APPROACH

The approach taken will need to be appropriate in the context of the project and the group concerned. Typically it may involve:

1. Setting a materiality threshold for due diligence issues
2. Preliminary 'desktop' research on the entities involved
3. Issuing information requests
4. Where appropriate, undertaking additional investigations

These are considered in turn below.

MATERIALITY THRESHOLD

In many cases, this will be implicit rather than explicit. However, for larger projects, it can be very useful to make sure that the team has a clear understanding of what amounts are likely to be regarded as material.

It can be impossible to 'prove a negative', and significant amounts of time and cost can be wasted in attempting to chase down every possible issue. Being clear about what is material in the context of the project is one way to make sure that investigations remain focused and productive.

DESKTOP RESEARCH

In a larger project, this research may be organised by the core project team in order to categorise the relevant entities and plan more detailed work.

The desktop research may include information sources such as:

- Companies House or the relevant company registers
- Internal company secretarial records
- Annual accounts
- Internal accounting records
- Internal treasury records (such as whether the relevant entities have bank accounts)
- The Register of Data Controllers
- HM Land Registry
- Trademark Register, Patent Register etc.
- Registers of domain names
- Pensions Regulator
- Other regulators (such as the UK Financial Conduct Authority)

When searches of public registers are carried out, it is important to search using former company names, rather than merely the current name.

Thought should also be given to possible typographical errors which may have occurred at the time of the original registration, and carrying out searches using those variants of the company name involved. This may be particularly relevant if the company name includes digits which may have been transposed on the original registration.

ISSUING INFORMATION REQUESTS

In most cases, it will be advisable to create information requests (due diligence questionnaires) and issue them to the relevant functional heads. Clearly, this will need to be adapted to suit the particular circumstances of the group or entities involved.

For example, it will need to be adapted to take into account:

- The functions within the relevant organisation
- The group's processes for corporate approvals
- The business units involved
- Typical assets and liabilities
- The geographical scope of operations, and requirements of local law
- Third parties, such as external advisers or agents, who may need to be consulted as part of the process

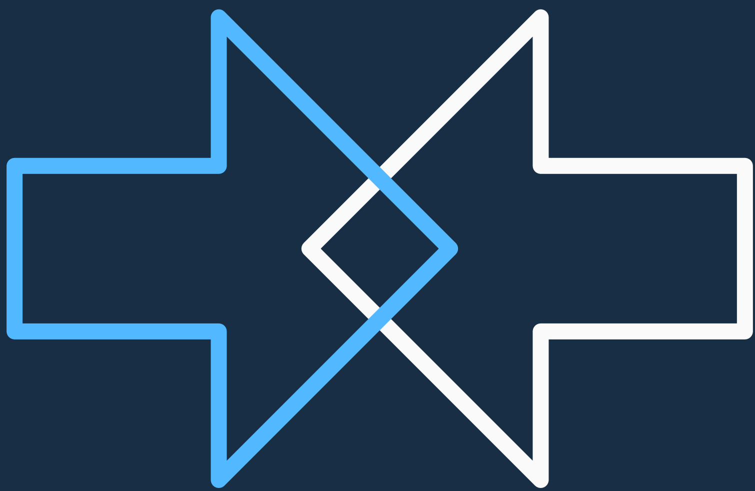
ADDITIONAL INVESTIGATIONS

Depending on the circumstances, additional due diligence measures may be justified to address a perceived higher risk of hidden assets or hidden liabilities. These may include:

- Reviewing historic financial records e.g. for rents received and paid
- Reviewing historic board minutes and corporate approval documents
- Reviewing internal announcements
- Reviewing registers of sealings (if applicable)
- Reviewing deeds packets

SECTION 8

HOW CAN A CROSS-BORDER MERGER BE USED TO REMOVE ENTITIES?



The European Directive 2005/56/EC on cross-border mergers provides a way to achieve a 'true' merger of legal entities.

It can be used as a way to remove unwanted entities from a group without having to put those entities into liquidation, transfer assets by contract or make distributions.

The procedure can deal with a number of entities at the same time. Under those arrangements, the assets and obligations of the entities to be removed will automatically transfer to the transferee company. This has an important benefit of reducing the risk of losing assets unintentionally – see Section 6 for more information on this.

WHEN IS A CROSS-BORDER MERGER AVAILABLE?

This mechanism is available for entities which have their statutory seat, central administration or principal place of business within the EEA. There must be a cross-border element, so at least two of the entities involved must be governed by the laws of different member states.

It is possible to use the Directive to achieve a domestic merger between two or more UK entities, by making sure that a non-UK company also participates in the merger. So, for example, UK entities UK1, UK2 and UK3, together with Luxembourg company Lux1, could all merge into UK company UK4. The assets and obligations of UK1, UK2, UK3 and Lux1 would all transfer automatically to UK4. As part of the procedure, UK1, UK2, UK3 and Lux1 would then cease to exist.

The Directive can be used for:

- Upwards mergers – where one or more subsidiaries cease to exist and merge into the holding company
- Downwards mergers – where a holding company ceases to exist and merges into its subsidiary
- Sideways mergers – where one or more 'sister' entities merge into another sister company
- Merger by creation of a new holding company – where one or more existing entities cease to exist, and merge into a new holding company.

In the context of dormant entity removal projects, an upwards merger is most commonly used. If necessary, the shares in the relevant entities to be removed can be transferred as a preliminary step, so that the entities are direct subsidiaries of the same transferee company.

OVERVIEW OF THE PROCESS

This is how it works:

- The main legal document is called the 'Draft Terms of Merger', which sets out the key terms of the merger, including the effective date of the merger for accounting purposes.
- The merger must be approved by the shareholders of the relevant entities. Usually this is not an issue for group reorganisations, although in some cases minority shareholdings may need to be considered.
- In some cases, the approval of creditors is also required (see the 'key issues' on the next page).
- A "pre-merger certificate" must be issued by the 'competent authority' in each jurisdiction. This certificate confirms that the requirements of the Directive and local implementing law have been satisfied. The competent authority for England & Wales is the High Court, and various procedural applications must be made. For other jurisdictions, the "competent authority" may be a notary or a court.
- Once a pre-merger certificate has been issued by each of the competent authorities, an application is made to the competent authority in the jurisdiction of the transferee entity (i.e. the surviving entity) to sanction the merger.
- The merger then takes place on the date specified by the sanctioning authority. This has the effect that the assets and obligations of the transferring entities are transferred by operation of law to the surviving entity.
- The transferring entities cease to exist, and the relevant national authorities (e.g. Companies House in the UK) are notified of the dissolution.
- Because of the court applications required, the minimum time frame to complete a cross-border merger involving a UK company is usually around 4-5 months.

KEY ISSUES

- **Pre-steps** – if the participating entities are not already in a direct parent company / subsidiary relationship, or immediate subsidiaries of the same holding company, then it is often better to carry out share transfers prior to the cross-border merger to achieve this. This simplifies the operation of the cross-border merger itself.
- **Employees** – where the participating entities have employees, it is usually necessary to set up a 'Special Negotiating Body' in order to fulfil certain consultation requirements. This adds to the timeframe and cost of the merger.
- **Liabilities** – the competent authority for any participating entity may order a meeting of creditors to approve the merger. In that case, the merger would require consent by majority in number, representing 75% in value, of creditors present and voting. In practice, any actual or contingent liabilities should be considered in advance, so that appropriate arrangements can be put in place to demonstrate that creditors are protected.
- **Contracts and licences** – although rights transfer by operation of law, due diligence is still required in relation to any ongoing contracts and licences to ascertain whether change of control or event of default-type provisions apply.

ALTERNATIVE OPTIONS

The main alternative option would be to transfer the relevant trade and assets at an appropriate price. The price would usually be left unpaid as an intercompany receivable. A solvent liquidation or a reduction of capital may be needed in order to transfer the debt receivable up to the immediate parent company(ies).

PROS AND CONS

Here are some of the pros and cons of a cross-border merger from a legal perspective, as compared to a transfer of trade and assets.

Advantages

- Assets and liabilities transfer by operation of law. This usually avoids the need for novation of contracts or other actions to perfect the transfer of individual assets.
- A merger under the European Directive avoids the problem of assets being trapped in a transferring entity after a transfer of trade or assets.

Disadvantages

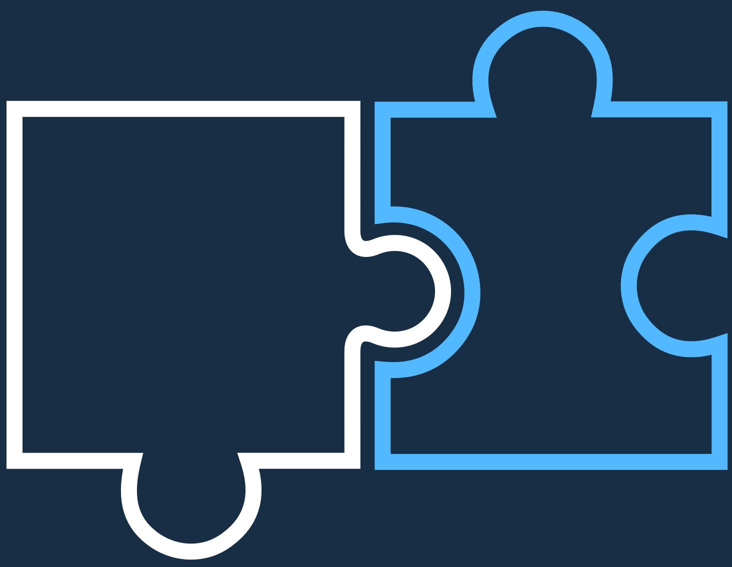
- Because of the court applications required from a UK perspective, a cross-border merger is often significantly more expensive than a simple transfer of trade and assets.
- For the same reasons, it usually takes longer.
- As mentioned in 'key issues' above, legal due diligence is still required to assess the feasibility of merger.
- Due to the employee consultation requirements, it is usually more efficient for any employees to be transferred out prior to a merger.

PRACTICALITIES

In practice, cross-border mergers are more often considered than actually implemented. This is partly because of the costs involved – the UK end of the procedure involves court applications. However, if your group has a number of UK entities which can be dealt with at the same time, then the unit cost should reduce considerably.

SECTION 9

WHAT IF WE NEED TO RESTORE A COMPANY TO THE REGISTER AFTER IT HAS BEEN DISSOLVED?



Sometimes, after a group company has been removed (whether by liquidation or strike off), it is necessary to restore it to the register.

This may be because there is some kind of windfall profit, for example a contingent claim has crystallised. Or it may simply be because a pre-existing asset has been overlooked.

The likelihood of this situation arising should be small, because firstly if an appropriate due diligence process is followed as described in Section 7, the risk of overlooking assets should be low. And secondly, if a 'sweeper' assignment is put in place as described in Section 6, it is often possible to extract the relevant asset without having to restore the company.

Nevertheless, the good news is that the procedure to restore a company to the register is straightforward. Here is a summary of how it works for entities incorporated in England and Wales.

TIME LIMITS

The time limit for applications to restore a company is 6 years from the date of the dissolution. (No time limit applies where the application is for the purpose of bringing a personal injury claim against the company, but that is not the kind of scenario we are talking about here.)

ADMINISTRATIVE PROCEDURE AND COURT PROCEDURE

There are two types of procedure to restore an English company to the register: the administrative procedure and the court procedure.

The administrative procedure is simpler and cheaper, but is only available where:

- the company has been struck off the register under sections 1000 or 1001 of the Companies Act 2006 – this is effectively where Companies House struck off the company because the returns have not been filed; and
- the company was "carrying on business or in operation" at the time of striking off.

This means that the administrative procedure is not available if the company was struck off following an application by its own directors, or where it was dissolved following the completion of a liquidation process.
In those situations, an application to court will be needed in order to restore the company.

THE COURT PROCEDURE – WHAT'S INVOLVED

In order to restore a company to the register using the court procedure, the following steps are required:

1. **Preparation of documents** – the main documents consist of a claim form for filing at court, supported by a witness statement. The witness statement is often made by a director of the parent company and includes an explanation of why the company was struck off the register, and why an application is being made to restore it.
2. **Application** – the claim form and supporting documents are filed at Court (together with the relevant fee), and copies are served on Companies House and the Treasury Solicitor. If the company's registered office is in Cornwall or Lancashire, Merseyside or parts of Greater Manchester, Cheshire and Cumbria, another copy of the claim form and supporting documents must be served on the solicitors to the Duchy of Lancaster or the Duke of Cornwall.
3. **Consent** – the Treasury Solicitor (or the solicitor for the Duchy of Lancaster/Duke of Cornwall if applicable) will write to confirm whether any objection will be raised to the restoration of the company – usually, there is none. When received, the relevant letter must be filed at court together with a witness statement of service.
4. **Court order** – in most cases, the court can deal with the application without a formal hearing. Once the order is made, an office copy of the order must be delivered to Companies House. The company is regarded as being restored when the order is delivered, and the company is then regarded as having continued in existence as if it had not been struck off and dissolved.
5. **Recovery of assets from the Crown** – if the company held any funds or assets on dissolution, then they will belong to the Crown as 'bona vacantia' (abandoned property). In that case, an application will need to be made to the Bona Vacantia Division (BVD) of the Treasury Solicitor's Department. The BVD will pay to the restored company:
    - all cash which belonged to the dissolved company which BVD collected, and
    - the net proceeds of sale of any other property and rights which belonged to the dissolved company and which BVD sold

    For this, application must be made to the BVD, including a copy of the court order. In some cases, proof of identity may be required (e.g. if the amount to be repaid is more than £10,000).

SECTION 10

WHAT IS THE BEST WAY TO GET STARTED?

In general, the best way to begin a project to remove dormant entities (or to resume a project which has stalled) is to start with a small batch of, say, 5 entities.

Ideally, these entities would be "easy" ones with no ongoing operations and for which you are reasonably confident of their corporate history.

This enables you to demonstrate progress, without getting bogged down in complicated project plans and without having to set aside a significant budget.

If the number of unnecessary legal entities in your group is small, this may be as far as you need to go for now.

If you have a large number of entities to remove, this 'pilot' batch will help you to start to create processes and templates which work for your working group. Based on your experiences, you can start to create an ongoing approach.

This may involve:

- Establishing a more formal project team and allocating responsibilities
- Dividing the relevant entities into batches, and setting deadlines for achieving specified milestones in relation to each batch
- Establishing standard procedures for due diligence and sign-off
- Creating standard templates to implement the corporate actions needed to clear out assets and liabilities before a company is removed
- Streamlining the decision-making process, such as making a decision that all UK entities should be placed into members' voluntary liquidation
- Establishing a system for reviewing progress and escalating issues and blockages
- Establishing controls to manage the ongoing creation of new entities

WHO WE ARE

LCN Legal is an English law firm which is authorised by the Solicitors Regulation Authority. We are independent and don't advise on tax. We are specialists in the legal implementation of group structures, and this includes 'corporate simplification' and 'legal entity reduction' projects.

We contribute to the LexisNexis online resources on transfer pricing, as well as various other publications such as Financial Director Magazine, Practical Law Magazine, Practical European Tax Strategies, International Accountant, Tax Journal, Estates Review, Butterworths Journal of International Banking & Financial Law. We regularly present training sessions to major accounting firms, large corporates and banks on a range of corporate law issues.

ReSolve is a corporate advisory firm authorised in the UK by the Institute of Chartered Accountants in England and Wales. We are a boutique practice with four licensed insolvency practitioners and a wealth of experience working with groups of entities. We can assist with determining the best corporate removal strategy and are experienced in offering a personable service to all relevant stakeholders.

Our unrivalled services have won us a number of national awards in recent years, most notably Turnaround Firm of the Year in 2016 and Corporate Recovery Firm of the Year in 2013. If you have any questions regarding this guide, or if you would like help getting started please do not hesitate to contact us:

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To learn more about how corporate simplification can help you, please get in touch.

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