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MEMORANDUM

From: Alexandros Economou LLC

Date: 20 July 2016

Subject: **Arrangements and Reconstructions under Sections 198 – 200 of the Cyprus Companies Law**

1. Arrangements and Reconstructions under Sections 198 - 200

- 1.1 An arrangement or a compromise under Sections 198 - 200 (**‘Section 198’**) of the Cyprus Companies Law, Cap. 113 (**‘Law’**), can be proposed between a company and its creditors or any class of them or between the company and its members or any class of them, for the purpose of, or, in connection with a scheme for the reconstruction of any company or the amalgamation of any two or more companies.
- 1.2 Section 198 is titled **‘Arrangements and Reconstructions’**. These terms are of the widest character, ranging from simple composition to an amalgamation of two or more companies, with a complete reorganisation of their share and loan capital. In relation to share capital reorganisation, the term **‘arrangement’** expressly includes the consolidation of shares of different classes, the subdivision of shares into shares of different classes or a combination of the two. The only limitations are that the scheme of arrangement or compromise cannot authorise something contrary to the general law, and that if capital is to be reduced the specific formalities of the Law must also be complied with.

2. Practical Application of Section 198

2.1 In order for the scheme of arrangement (**‘Scheme’**) or the compromise (**‘Compromise’**) to become effective the following steps are required under the Law:

- (a) an application by the company, a shareholder, a creditor or the liquidator (if the company is under liquidation) to the District Court to approve the holding of (separate) meetings of the shareholders or any class of them or the creditors or any class of them (as the case may be) of the company or the companies (in case of amalgamation of two or more companies) in respect of which the Scheme or Compromise is to apply (**‘First Representation’**);
- (b) the approval of the Scheme or Compromise is effected by resolutions passed by a majority (i) in number of votes of all shareholders; and (ii) in value of all creditors, of the company or the companies (in case of amalgamation of two or more companies) (**‘Participants’**) present and voting, either in person or by proxy, at the meetings of the Participants convened by order of the Court as per (a) above (**‘Meetings’**) at which all Participants may attend and vote;
- (c) a second application to the Court that the Scheme or Compromise has been validly approved by the Participants and requesting the sanction of the Scheme or Compromise by the Court (**‘Court Hearing’**); and
- (d) the submission with the Cyprus Registrar of Companies (**‘Registrar’**) of a copy of the order of the Court sanctioning the Scheme or Compromise.

2.2 In connection with the approval of the Scheme or Compromise at the Meetings and the Court Hearing, the company or the companies (in case of amalgamation of two or more companies) are required to send to all Participants, together with the notice convening the Meetings, the Scheme or Compromise in a composite

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printed document ('**Document**') and an explanatory statement ('**Explanatory Statement**').¹

The Explanatory Statement must explain the effect of the Scheme or Compromise and in particular state the material interests of the directors of the companies, whether as directors or as members or as creditors of the companies or otherwise, and the effect thereon of the Scheme or Compromise, insofar as it is different from the effect on the same interests of other persons. The Explanatory Statement must further state that all the Participants will be entitled to vote (either in person or by proxy) at the Meetings.

- 2.3 A copy of the Document is exhibited to an Affidavit (sworn by a director of each company) made in support of the First Representation seeking approval of the Court in relation to the convening of the necessary Meetings.
- 2.4 Necessarily the Document must contain, amongst other information, financial and business information relating to the company or the companies (in case of amalgamation of two or more companies).
- 2.5 The First Representation, which seeks approval of the Court in relation to the convening of the necessary Meetings, will be heard by the Court. The application by way of First Representation is made *ex parte*, and the documentary evidence in support of the First Representation include the Affidavit specified in para. 2.3 above, the Document and the Explanatory Statement.
- 2.6 The Court may refuse to make an order convening the Meetings if it considers that the proposal is of such nature that it would not be approved by the Court at the Court Hearing notwithstanding that it might be approved at the Meetings.

¹ The Law does not specifically require the Company to send the Document; merely the Explanatory Statement. This seems to be an omission by the legislation (especially given that the equivalent English provision mandated it).

- 2.7 Approval given by the Participants at the Meetings convened by the Court is not final as the Scheme or Compromise will be subject to the subsequent approval of the Court.
- 2.8 There is no significant decided case law by the Cyprus courts in connection with the sanctioning of a scheme of arrangement or compromise. Section 198 is largely identical to the equivalent provisions of the UK Companies Act 1948 and therefore the Court would likely have the fullest regard to the relevant English precedents. Following the precedents of the English courts, the Court before sanctioning the Scheme or Compromise will normally need to be satisfied as to the following matters in order to approve the Scheme or Compromise:
- (a) that the provisions of the Law and the directions of the Court in relation to the Scheme or Compromise have been complied with, including that the Explanatory Statement has been issued and is correct as at the date of the Meetings, the resolutions passed at the Meetings had the statutory majority in value and number and that all necessary meetings of those affected by the Scheme or Compromise had been duly convened and held, including a determination of whether or not all the interests of those affected by the Scheme have been taken into account and if they have all assented to it;
 - (b) that the provisions of the Law and the directions of the Court in relation to the Scheme or Compromise have been complied with, including that proper notice of the Meetings has been given, that the Participants and each relevant class, were properly represented by those who attended the Meetings, including a determination that those who attended the meeting were fairly representative of the relevant class and that the statutory majority did not coerce the minority in order to promote the interests adverse to those of the class whom they purport to represent; and
 - (c) that the Scheme or Compromise is fair and reasonable.

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- 2.9 The Scheme or Compromise will involve two Court hearings: the first on the First Representation to convene the Meetings, and the second for the Court Hearing, pursuant to which the approval of the Court is sought in relation to the Scheme or Compromise.
- 2.10 In respect of advertising, the Court may order that the notice convening the Meetings be published in newspapers in Cyprus and in other jurisdictions where there are material numbers of shareholders registered or creditors.
- 2.11 When a scheme or compromise envisages the reorganisation of a company or companies or the amalgamation of two or more companies, and that the whole or any part of the undertaking or the property of any company concerned in the scheme (**‘Transferor Company’**), is to be transferred to another company (**‘Transferee Company’**), the Court in exercising its power of discretion may, under Section 200(1) of the Law, make provision for all or any of the following matters:
- (a) the transfer to the Transferee Company of the whole or any part of the undertaking and of the property or liabilities of any Transferor Company;
 - (b) the allotting or appropriation by the Transferee Company of any shares, debentures, policies or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;
 - (c) the continuation by or against the Transferee Company of any legal proceedings pending by or against any Transferor Company;
 - (d) the dissolution without winding up, of any Transferor Company;
 - (e) the provision to be made for any persons, who within such time and in such manner as the Court directs, dissent from the compromise or arrangement;

A§E

- (f) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

Section 200(2) of the Law further states that where an order provides for the transfer of property or liabilities, that property shall be transferred and those liabilities shall be transferred and become the liabilities of the Transferee Company; in the case of property, the Court may direct that the Transferee Company be transferred the property free from any charge which ceased to have effect because of the compromise or arrangement.

- 2.12 The Court order approving the Scheme or Compromise takes effect only when a copy of the order is delivered to the Registrar for registration (which order is attached to the memorandum of the Companies).
- 2.13 Enclosed as **Annex 'A'** is a draft timetable setting out the minimum timescales achievable under Sections 198 in order to effect the Scheme or Compromise. This timetable will vary in light of commercial and judicial timetabling issues and restrictions.

3. Universal Succession

- 3.1 The principle of universal succession, largely a civil law concept, is not recognised as such by common law jurisdictions. A reminder that when Cyprus gained its independence in 1960, it adopted the English legal system to a great extent.
- 3.2 Nevertheless, it is clear that the powers of the Court referred to in para. 2.16 above, and in particular paras. 2.16 (a), (c) and (d), achieve a result similar to that of universal succession.
- 3.3 It has to be noted that the universality principle is not laid as such by EU Law either. Nevertheless, it seems consistent with the model implicitly followed by the Cross Border Merger Directive 2005/56/EC which establishes the principle that a merger entails a transfer of all assets and liabilities of the merging company; other EU

instruments, e.g. the Societas Europaeae Regulation 2157/2001, follow the same approach.

- 3.4 Though the term is not specifically mentioned in the aforesaid EU legislation, common law countries like England and Cyprus now refer to the concept of universal succession through these EU instruments, i.e. the coming together of two or more entities to form a single entity with the assets and liabilities of each absorbed entity transferred to the surviving entity by operation of law.
- 3.5 On the basis of the above, whilst the principle of universal succession does not exist under Cyprus law, the concept is clearly embodied and incorporated by operation of law (see in particular para. 2.16 above). Any suggestion to the contrary would make the amalgamation of businesses following acquisition inefficient; thus ‘universal succession’ is achieved between the transferee company and the transferor companies under Section 198.

4. Relevant Tax Considerations

- 4.1 The Cyprus Income Tax Law, Law 118(I)/2002 (as amended) makes provision for the recognition of certain types of reorganisations (based on the EU Merger Directive) and affords certain favourable tax treatment of the consequences of the company reorganisation. It may, therefore, be possible to do a local or cross border merger without triggering any adverse tax implications in Cyprus.
- 4.2 The term ‘reorganisation’ is defined in the Cyprus Income Tax Law as a merger, division, partial division, transfer of assets, exchange of shares and transfer of registered office involving companies resident in Cyprus (or companies which are not resident in Cyprus).
- 4.3 Pursuant to current tax practice, an application can be made to the Cyprus tax authorities to request the examination of the proposed company reorganisation in order to confirm that this has been made in accordance with the Cyprus Income Tax

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Law and that the relevant tax exemptions are available. In such case, the Cyprus Tax Department would examine the ‘open’ tax years of all the companies involved in the company reorganisation.

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ANNEX 'A'

TIMETABLE FOR SCHEME/COMPROMISE UNDER SECTION 198

DAY	STEP
Day 1	Sign and file affidavit in support of application exhibiting Scheme or Compromise.
Day 15	Hearing of application before Court and submission of draft order, notice of, and proxies for, court-ordered meetings. Court approves Scheme or Compromise with or without modification and makes order to convene meetings, send out notices, appoint chairman of meeting and if necessary advertise notice of meetings in newspapers.
Day 16	Preparation of adverts (if required), notices and proxies.
Day 17	Post Scheme or Compromise document with notice of the meeting to shareholders and advertise notice of Court appearance in newspapers, if directed by Court.
Day 38	EGM and creditors' meetings held. Note: 21 days should be the minimum notice period for EGM's under the Articles of each Company.
Day 43	(a) Chairman signs affidavit in support of application exhibiting chairman's reports on the meetings. (b) Present affidavit to Court. (c) File at Court chairman's affidavit and affidavits of service of notice convening the meetings.
Day 60	Hearing before Court. Order confirming Scheme or Compromise sealed by Court.
Day 65	File order of court at Companies Registry