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PROCEDURE AND EFFECTS OF DIVISION BY SEPARATION

1. Definition and types of division of companies

The division of companies is an operation enabling the restructuring of a company whereby all the assets and liabilities of one company shall be divided and then all parts, or at least one part of the assets and liabilities, shall be transferred to acquiring or new companies in exchange for the allocation to the shareholders of the company being divided of shares in the recipient companies (1 p. 23). The division of companies is regulated in the European law by the Sixth Council Directive 82/891/EEC of 17 December 1982 (1 p. 4 - 11) concerning the division of public limited liability companies (joint stock companies). The Directive was implemented into the Polish Commercial Companies Code of 15 September 2000 (Journal of Laws 2000.94.1037, as amended, hereinafter abbreviated as CCC) which came into force on 1 January 2001 in the provisions of art. 528 – 550 CCC. Under Polish law, it is allowed to divide only companies, private limited companies and public limited companies, but not partnerships. Moreover, division shall be prohibited for companies in liquidation which began to distribute their assets and for companies in bankruptcy.

The types of division operations are regulated in art. 529 § 1 CCC. From the perspective of the divided company, the division procedure provides for two main types of operations. The first one consists in the transfer of all the assets and liabilities to other companies (two or more) and the divided company being wound up without going into liquidation (art. 529 § 1 p. 1 – 3 CCC). The second operation involves transfer of only part of the assets and liabilities to one or more companies while the divided company continues its activities after the division (art. 529 § 1 p. 4 CCC). From the perspective of the recipient company, it is possible to transfer the assets and liabilities to a formerly existing (acquiring) company or a newly-formed company, moreover, division by acquisition may be combined with division by formation of a new company.

Division by acquisition (art. 529 §1 p. 1 CCC) shall mean the operation whereby, after being wound up without going into liquidation, a company transfers to more than one company all its assets and liabilities in exchange for the allocation to the shareholders of the company being divided of shares in the companies receiving contributions as a result of the division. Division by formation of new companies (art. 529 § 1 p. 2 CCC) means the operation whereby, after being wound up without going into liquidation, a company transfers all its assets and liabilities to more than one newly-formed company in exchange for the allocation to the shareholders of the company being divided of shares in the recipient companies. In addition, it is also possible to carry out operations whereby division by acquisition is combined with division by formation of one or more new companies (art. 529 § 1 p. 3 CCC). Lastly, pursuant to art. 529 § 1 p. 4 CCC, division by separation is an operation whereby only part of the assets and liabilities shall be transferred to an acquiring or new company (one or more) without the company being divided ceasing to exist.

Apart from the aforementioned types of division operations, pursuant to art. 23 of the Directive 82/891/EEC of 17 December 1982, Member States may also introduce division operations which shall be subject to the supervision of a judicial authority, but the Polish legislator did not decide to introduce this type of division. Nevertheless, all the operations are to a certain extent subject to the judicial authority as the final step in the division procedure involves registration of the division by the Register Court.

The division operation in all its types involves allocation of shares of the acquiring or a newly formed company to the shareholders of the divided company, even in cases of division without the company being divided ceasing to exist. Thus, the holding structure shall not be formed during such operations (2 p. 1310 - 1311). However, it is also possible to implement such operations into national law, e.g. according to the German transformation act (*Umwandlugsgesetz* of 28 October 1994, BGBl I 1994, p. 3210) it is possible to create holding structures (3 p. 19 - 27) when the shares are allocated to the company being divided which does not cease to exist (the so-called *Ausgliederung*).

2. Procedure of division by separation

Pursuant to art. 529 § 2 CCC, division by separation shall be governed by the division of companies concerning the recipient company or the new company, as applicable. Taking into account the procedure, the differences in the division operation whereby a company being divided does not cease to exist and the division with the liquidation of the company being divided are not too large, however, some of the provisions require modifications. The procedure is divided into three stages (4 p. 856). The first one is the so-called "managerial stage" where management bodies prepare all the documents prescribed by the provisions of the Commercial Companies Code. The second stage - "the owners stage" - consists in the general meeting of the company making a decision on the division. The last stage is "the authorization by the court" where the division operation is legitimated by the Register Court.

The first stage in the division procedure is the preparation of draft terms of the division by the management board. Depending on the type of division operation, the draft terms of division by acquisition shall require a written agreement between the company being divided and the recipient company. However, in the case of division by formation of a new company it shall be drawn up in writing merely by the company being divided. Pursuant to art. 534 § 1 CCC, the draft terms of the division shall specify at least: the type, name and registered office of each of the companies involved in the division; the share exchange ratio and the amount of any additional cash payment; the terms relating to the allotment of shares in the recipient or new company; the date from which shares entitle the holders to participate in profits; the rights conferred by the recipient or new company upon the shareholders or persons having special rights; any special advantages granted to members of company bodies; the precise description and allocation of the assets and liabilities to be transferred to each of the recipient or new company, including permits, licenses or reliefs; the allocation to the shareholders of the company being divided of shares in the recipient or new company and the criterion upon which such allocation is based. The draft terms of the division must be published in the Court and Economic Journal or may be published on the website of the company instead, at least one month before the date of the general meeting which is to decide on the division.

One of the most important elements of the draft terms of division is the share exchange ratio which indicates how many shares in a recipient or new company shall be allocated to the shareholders of the company being divided. In comparison to the division whereby the company being divided goes into liquidation, in the case of division by separation the shareholders preserve their shares in the company being divided, which means that in this case it is actually not the exchange ratio but the allotment ratio (2 p. 1333). This share ratio shall be estimated on the determination of the value of the assets and liabilities of the company being divided which shall be attached to the draft terms of the division. Besides, depending on the assets of the company, division by separation may be connected with the reduction in the share capital of the company being divided, unless the separation is made from the company's own capital other than the share capital. In the case of reduction of the share capital, the draft terms of the division shall include information concerning redemption of shares or amendment of share certificates in the case of reduction by decreasing the nominal value of shares. Then, one or more experts acting on behalf of each of the companies involved in the division, appointed or approved by the Register Court, shall examine the draft terms of the division as to its correctness and reliability. As a result, the experts draw up a written report to the shareholders (art. 537 - 538 CCC). The examination of the draft terms of the division by an expert shall not be required if all the shareholders of each company participating in the division consented thereto.

The division procedure also contains provisions which guarantee the shareholders' rights to information. Pursuant to art. 536 § 1 CCC, the management body of each of the companies involved in the division shall draw up a detailed written report explaining the division and setting out the legal and economic grounds for it, in particular the share exchange ratio and the criterion determining the allocation of shares. The report shall also describe any special valuation difficulties which have arisen. Pursuant to art. 540 CCC, the shareholders of the company being divided and of the recipient company shall be entitled to inspect all the documents prepared for the division procedure, in particular the draft terms of the division, report of experts, report of the management board, financial statements and the valuation of the company being divided. Instead of making the documents available for inspection on the premises of the company's management board, the documents may be released on the website of the company.

The competence to approve the division operation rests with the shareholders. The division of a company requires a resolution of the shareholders' meeting of the company being divided and the recipient or new company to be adopted by a majority of three-fourths of votes representing at least one-half of the share capital, unless the articles of association or the statutes of the company provide for more stringent requirements. In the case of a listed company, the resolution shall be adopted by a majority of two-thirds of the votes. The resolution shall cover the consent of the recipient or new company for the draft terms of the division, consent for the amendments to the articles of association or statutes of the acquiring company, in the case of forming a new company the consent for the contents of the articles of association or statutes, and finally in the case of division by separation also the amendments of the articles of association or statutes of the company being divided (2 p. 1355; 4 p. 912). Furthermore, if the division by separation is made from the share capital, the resolution also includes the consent for reduction of the share capital of the company being divided (4 p. 757; 5 p. 352).

Pursuant to art. 530 § 2 CCC, division by separation shall be effective on the separation date. In the case of division by acquisition, the separation shall take effect on the day when the increase in the share capital of the recipient company is registered. The separation of a new company shall take effect on the date of its registration. If the division by separation is connected with the reduction of the share capital, the separation shall be registered immediately after registration of the reduction of the share capital of the company being divided (4 p. 716 – 718).

3. Effects of the division operation

As stated above, in comparison to the other types of division, the company being divided does not cease to exist after the division but continues its business activity. Division by separation produces the following effects on the separation date: partial general succession, acquiring by the shareholders of the company being divided shares in the recipient or new company, and - depending on the financial grounds, if necessary - reduction of the share capital of the company being divided.

First, pursuant to art. 531 § 1 CCC, as of the separation date, the recipient company or new company shall assume all the rights and obligations of the company being divided, as set forth in the draft terms of the division. During the division operation, the possibility of transferring the assets and liabilities stems from the general succession, which is in this case called partial general succession since the assets and liabilities specified in the draft terms of the division and allotted to a specific acquiring or new company constitute only part of all the assets and liabilities of the company being divided. Thus, from the perspective of the company being divided, succession is partial. However, from the perspective of the recipient company, under the law (2 p. 1315) it is the general succession which enables the acquisition of the assets and liabilities as a whole. The general succession involves civil rights and obligations as well as administrative ones, since pursuant to art. 531 § 2 CCC, the recipient or new company shall take over, in particular, permits, licenses and reliefs which relate to the transferred assets and liabilities, unless the law or the decision on granting them provides otherwise. In the case of a division of a financial institution the Supervisory Authority may also lodge an objection to the transfer of licenses or permits (art 531 § 6 CCC).

Secondly, pursuant to art. 531 § 5 CCC, as of the separation date, the shareholders of the company being divided shall become shareholders of the formerly existing or new company indicated in the draft terms of the division. The shareholders obtain the shares due to the allotment ratio. In fact, it is connected either with increasing the share capital of the acquiring company or with the registration of a new company. Clearly, they also remain the shareholders of the company being divided.

Depending on the financial situation of the company being divided, division by separation may also be connected with the reduction of the share capital in the company being divided where the separation is made from the share capital. In such cases, either a number of shares of each shareholder shall be reduced (redemption of shares), or the nominal value of shares shall be decreased. If the separation is made from the company's own capital other than the share capital, the position of the shareholders of the company being divided remains unchanged, though the real value of shares shall be decreased due to the transfer of part of the assets to another company.

The provisions concerning the division operation also involve a protection system for the creditors of the company. The creditors of the company being divided and of the recipient company who submitted their claims to the company before the publication of the draft terms of the division and made it credible that the satisfaction of their claims was jeopardized by the division shall be entitled to obtain adequate safeguards. Moreover, pursuant to art. 546 § 1 CCC, the companies to which the assets and liabilities of the company being divided were transferred shall be jointly and severally liable for the obligation assigned in the draft terms of the division to the recipient or new company for three years following the announcement of the division. The inclusion of this provision into the division by separation is viewed as controversial in the literature on the subject and in the jurisdiction. For instance, the Supreme Court in the judgment of 21 April 2010 (V CSK 318/09) stated that the interest of the creditors requires protection during the division by separation and adopting the art. 546 § 1 CCC as applicable, the several and joint liability in the case of division by separation refers to the company being divided and the recipient company. This opinion is also represented in the literature (2 p. 1369; 4 p. 978 – 979; 6 p. 1349). On the other hand, the Supreme Court in the judgment of 28 April 2016 (V CSK 524/15) stated that this provision does not refer to division by separation.

Taking into consideration the protection of the interests of creditors, there should be no doubts as to the inclusion of the provision of art. 546 § 1 CCC into division by separation. If the company being divided is allowed to transfer its liabilities to another company without any limits and without the consent of the creditors, such a company should also be jointly and severally liable for such obligations. This interpretation is also a consequence of adopting the provision of art. 529 § 2 CCC according to which, division by separation shall be governed by the division of companies concerning the recipient company or the new company, as applicable. However, given the different interpretation manner it is recommended that the liability of the company being divided in the division by separation be expressed literally.

4. Adoption of the division operations

The division operation may be carried out by different means. In general, the division of a company is a form of its restructuring aiming at proper management of a company in cases of excessively complex structures of the enterprise. It allows for a more efficient use of the company's assets by creating new companies or by strengthening existing companies with prospects of greater profitability. Undoubtedly, the market position of the divided company may be used by the newly formed or by the acquiring company to generate more profits, but on the other hand, less profitable or riskier activities of a company may be transferred to a newly formed company so as to prevent a decline in profits. It is thus possible to react flexibly to rapid changes in the market by creating companies in line with the current market needs. As a rule, the division is an operation conducted to introduce reforms in the management of the enterprise. It is also worth mentioning that in the case of division by acquisition, the divided company and the acquiring company often belong to the same investor, so from the economic point of view the transfer of assets does not produce changes for the investor, even though from the legal point of view, the assets change ownership.

Moreover, under Polish law, the division operation is an instrument which may be used by the President of the Office of Competition and Consumer Protection. Pursuant to art. 99 of the Act of 16 February 2007 on Competition and Consumer Protection (Journal of Laws 2015.184), the President of the Office may decide on the division of an enterprise which does not execute the President's decisions concerning market concentration, in particular if the enterprise does not fulfill the obligation to provide information concerning the intention of concentration, provides false information or does not implement the President's decisions under the required conditions. In such cases, the

President of the Office shall use the provisions on the division of companies and exercise the competences of the company's bodies (4, p. 677 – 679).

Division may also be an alternative for the acquisition. In the case of a merger, all assets and liabilities of one company shall be transferred to the acquiring company, whereas during a division only part of the assets and liabilities of the divided company shall be transferred to the acquiring company (the other part is transferred to another company or remains in the divided company). Taking into account the position of the acquiring company, it is more or less the same in a merger operation as in a division operation. A merger operation not only leads to strengthening the position of the acquiring or new company but above all it gives the synergy effect (less cost and more profits), therefore if the merger of the company is not allowed, an investor may decide to divide a company and transfer only part of its assets to another company.

The question why an investor makes a decision to divide a company instead of conducting a merger operation concerns the regulation of the protection of competition. In general, the consent of the President of the Office of Competition and Consumer Protection, and sometimes additionally the consent of supervisory institutions such as the Polish Financial Supervision Authority in the case of financial institutions, is required for market concentration (M&A Transaction). In such cases, it must be determined whether the dominant position in the market due to an M&A Transaction shall be achieved, or if the competition on the market shall be narrowed. In 2007, one of the banks with its registered office in Poland, BPH S.A., was divided and part of its assets and liabilities were transferred to another bank, Pekao S.A. In both banks there was the same dominant shareholder UniCredit Group (*UniCredito Italiano SpA*) who wanted to merge both banks but the consent for the merger was not obtained due to gaining the dominant position. The investor decided to divide BHP S.A., whereby 280 branches from total 480 branches of the BPH bank were transferred to Pekao S.A. The investor was also obliged to sell its shares in BPH S.A. after the division.

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Pinior P. Procedure and effects of division by separation

The division of companies is an operation enabling the restructuring of a company whereby all the assets and liabilities of one company shall be divided and then all parts or at least one part of the assets and liabilities shall be transferred to acquiring or new companies in exchange for the allocation to the shareholders of the company being divided of shares in the recipient companies. From the perspective of the divided company, the division procedure provides for two main types of operations. The first one in which the divided company is wound up without going into liquidation (art. 529 § 1 p. 1 – 3 CCC), and the second one in which the divided company continues its activities after the division (art. 529 § 1 p. 4 CCC). The second type which is called division by separation requires the adoption of the provisions of the division operation as applicable. This type of division allows for a more efficient use of the company's assets by creating new companies or by strengthening existing companies with prospects of greater profitability. It may also be an alternative to the merger by acquisition.

Keywords: division, acquisition, company, shareholder, partial general succession