Germany

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1. ASSET VERSUS SHARE PURCHASE

1.1 The major advantage for a buyer in choosing an asset acquisition rather than an acquisition of shares is the tax advantage deriving from the possibility of stepping up the tax basis of current and fixed assets for the purposes of German income taxes. Another major consideration in choosing an asset acquisition is the possible reduction of environmental exposure and other past liabilities (see Subsections 1.3 and 5.1).

Due to the principle of specification applying to asset acquisitions, such transactions are considered more complex and time consuming than share acquisitions (see Section 2).

The distinction between asset and share acquisitions is currently not as significant in the case of takeovers, as Germany has at the moment soley a nonmandatory Takeover Code (Übernahmekodex), which has to be acknowledged in order to be applicable. Because the Takeover Code applies solely to share acquisitions, a prospective buyer who had already accepted the Takeover Code could choose an asset acquisition as a way of avoiding application of the Code.

Upon the entering into force of the new, mandatory German Public Acquisition and Takeover Act (Wertpapiererwerbs—und Übernahmegesetz, WÜG), which is expected for January 2002, this issue may gain relevance. The prospective buyer may then choose an asset acquisition as a way of avoiding application of the Takeover Act. According to the current Ministerial draft, the Act[1] will apply not only to takeovers but also to all public acquisition offers, i.e., offers that are not aimed at acquiring control. It shall regulate the acquisitions of shares and securities of stock corporations (Aktiengesellschaften—AG) and commercial partnerships limited by shares (Kommanditgesellschaften auf Aktien—KGaA) that are domiciled in Germany and whose shares are listed on an organized market within the European Economic Area.

- The German Public Acquisition and Takeover Act will apply solely to share acquisitions and not asset deals. According to the draft of the Act, a mandatory offer is to be made to all shareholders of a company when a buyer has obtained control of a company (i.e., upon reaching at least thirty percent of the voting rights in the target company).

1. The current draft is subject to considerable change. No information from the draft can be considered certain prior to adoption of the Act.

- The distinction between share and asset acquisitions is important before the launching of an offer for the shares in the target company. According to the draft of the Act, a bidder launching a takeover offer can pay for the shares in the target company in either cash or shares. If the bidder has acquired at least five percent of the shares or voting rights in the target company during the three months preceding the announcement of the offer to the public, or if the bidder has acquired any shares parallel to the offer, and if the bidder has in both cases paid cash for these shares, then the bidder must also offer cash as one type of consideration. Acquiring assets in the three months before or parallel to the offer would not lead to the obligation to offer cash as one type of consideration.

Asset deals are also currently used in Germany as a way of excluding minority shareholders from the company.

- The German Stock Corporation Act (Aktiengesetz—AktG) provides that a company holding ninety-five percent of the shares in another company may integrate this company by granting the minority shareholders a consideration in shares in the integrating company. If the integrating company is a controlled company, the consideration must be in cash or in shares at the minority shareholder's discretion. This provision does not have the same effect as a squeeze-out, as the minority shareholders are not excluded from the company. (A real squeeze-out regulation, which presently does not exist in Germany, would allow the majority shareholder who reaches a certain threshold to exclude minority shareholders by paying them a consideration in cash.)
- The asset deal may therefore be chosen to exclude minority shareholders. This happens by selling the company's assets to another company controlled by the same shareholders. The transferring company may afterwards be liquidated.
- Together with the coming into force of the German Public Acquisition and Takeover Act, squeeze-out provisions will also be introduced in the Stock Corporations Act (Aktlingesetz—AktG). Accordingly, the exclusion of minority shareholders (squeeze out) in stock corporations and commercial partnership limited by shares will become admissible above a threshold of ninty-five percent. Regarding the consideration paid to minority shareholders in the case of an asset transfer followed by the liquidation of the company, a German court recently stated that such consideration is challengeable in court (Spruchverfahren).

1.2 Asset acquisitions offer many tax advantages for the buyer, although they may be disadvantageous to the seller. The seller's capital gain from the sale of the entire business is subject to both trade tax (at effective rates of approximately thirteen percent to twenty percent) and corporate income tax at a rate of twenty-five percent for both retained and distributed income, plus a solidarity surcharge of 5.5 percent on the tax—equaling 26.375 percent in total. By comparison, in a share acquisition, the seller, if an individual, normally would pay personal income tax at a maximum of 48.5 percent, plus a solidarity surcharge, but no trade tax unless the shares were held as an asset of a commercial business (Betriebsvermögen), or no tax at all, if such person has not held ten percent or more of the shares of the target company at any time during the five years immediately preceding the sale (and if certain other conditions apply). As of 2002, such capital gains will be subject to tax if the shareholder has held as little as one percent or more of the shares of the target company at any time during the five years immediately preceding the sale. Only half of the capital gains will be taxed, however. The tax rate will be the applicable ordinary rate, with the maximum rate being further decreased to forty-seven percent for 2003 and 2004, and to forty-two percent after 2004.

Another disadvantage of an asset acquisition is that when a corporate entity that sells its assets has a net operating loss in excess of the capital gain, the shareholders may not be able to convert the loss into depreciation potential for tax purposes. Also, the tax basis for purposes of the real property transfer tax may be greater in an asset acquisition than in a share acquisition, depending upon the method of evaluation applied in the share acquisition.

See Subsection 1.1 and Section 5 for discussion of the distinction between share and asset deals in connection with takeovers and successor liability, respectively.

1.3 The answer under Subsection 1.2 would be different regarding tax considerations if only part of the assets were to be acquired. If a buyer purchases assets that would not constitute an entire business or a separately organized business unit, there may be a value added tax (VAT) issue involving real property. This applies when the seller, upon originally buying the property or upon erecting a building, had used an input VAT credit (i.e., claimed a tax credit for VAT paid on the purchased real property or on goods and services received in connection with the construction of the building). If the real property is sold within ten years after its acquisition or construction, the seller must either repay a part of the input VAT credit received or sell the real property subject to VAT, which would start another ten-year correction period for the buyer. If a buyer purchases the real property as part of an entire business or a separately organized business unit, the ten-year correction period commenced by the seller would continue for the buyer.

Also, in general, risks of successor liability (see Section 5) are reduced if only part of the assets is acquired.

2. FORM OF DOCUMENTS

2.1 Generally, an asset acquisition does not require notarization. However, when shares (as assets of the entity) in a limited liability company (Gesellschaft mit beschränkter Haftung—GmbH) or real property are transferred, notarization is necessary. The invalidity of an acquisition agreement because of a lack of notarization can be cured by a later, valid notarization of the deed of transfer/conveyance.

The principle of specification should be observed in asset acquisitions. Under this principle, each asset (as well as liability) or group of assets must be clearly defined so that any third party can easily determine which assets have been sold or transferred, solely by reviewing the acquisition agreement (including its annexes, and without the help of any additional documents or information). This is because the asset acquisition is considered a case of singular successions, which means that a separate sale and transfer of each individual asset (as well as liability) is required by law. Nevertheless, the acquisition agreement is valid even if the principle of specification has not been observed. In such a case, however, specification must be achieved through the transaction in rem (conveyance) for effectiveness vis-à-vis third parties. If the assets have not been sufficiently specified, but only vaguely described as the entire business of the company or a certain percentage thereof, the acquisition agreement (i.e., a contractual obligation as opposed to a transaction in rem/conveyance) would be valid only if notarized in compliance with German law.

2.2 It is possible for a company to transfer all assets by way of one document, although it may be advisable to have separate conveyancing documents to reduce costs due to the requirement to notarize only certain conveyancing documents. Whether to notarize part of the transaction or the entire transaction is an issue that must be resolved in each individual transaction.

A special form is not required for the transfer of intellectual property rights. Nevertheless, registration of the transfer of such rights with the Patent Office is advisable. In general, a declaration of acceptance signed by the buyer, and the seller's certified authorization to register the transfer, must be submitted to the Patent Office when filing an application for registration.

For the transfer of contracts, the approval of the other party to the transferred contract is necessary (see Section 9).

2.3 The form of the document makes no difference in the tax effects of the transfer, but the notary deed concerning the purchase of real property must be filed with the tax authorities.

2.4 Registration in a public register (Land Register) is necessary for the transfer of immovable property and related rights.

For intellectual property rights, reregistration in the name of the new owner is advisable (see Subsection 2.2).

3. PRELIMINARY LEGAL REQUIREMENTS

3.1 No governmental approval is required regarding foreign investments, but, in general, cross-border capital investments must be reported if they exceed DEM 1 million. The same applies to cross-border payments if they exceed € 12,500. Furthermore, investments of more than twenty percent of the value of a foreign company with total assets exceeding DEM 1 million must be reported annually. All reports must be filed with the German Federal Bank or the applicable state bank.

The board of directors, the supervisory board, the entire shareholders meeting and all, or a specific number, of the shareholders may have to provide prior consent or subsequent approval of a sale under the articles of association or the bylaws. The consent of the shareholders meeting may be a condition for the validity of an agreement (i.e., a contractual obligation as opposed to a transaction in rem/conveyance) by which a stock corporation transfers its assets. According to the current German Stock Corporation Act (Aktiengesetz—AktG) and the current case law, a distinction is made between agreements by which all or essential assets of a company are sold and agreements by which only a nonessential part of the assets of the company is sold:

- According to the German Stock Corporation Act, an agreement by which all assets of a stock corporation are transferred to another person or entity (by way of singular succession) is subject to the consent of the shareholders meeting. According to German case law, this rule applies not only when all assets are transferred but also when the object of activity cannot be carried on with the remaining assets. The shareholders' resolution approving the agreement is a condition for the agreement's effectiveness.
- German case law also provides that the consent of the shareholders' meeting may be equally required if substantial (but not all) assets of the company are sold. For advising counsel, this presents a difficult question, as neither courts nor scholars have established a standard concerning what is considered "substantial." Currently, the threshold is considered to be twenty-five percent of all the assets. Agreements by which substantial (but not all) assets are sold which are entered without consent of the shareholders' meeting are not considered ineffective, as management has authority to represent the company vis-à-vis third parties. Nevertheless, shareholders may hold management liable for entering such agreements without their consent.
- Although certain businesses require a license (e.g., banking, insurance, newspapers, shipping, communications, air traffic and real estate) and therefore are subject to regulatory approval, the acquisition of an interest in a business entity as part of the assets requires no regulatory approval, except for compliance with merger control. Certain exceptions apply to banking, financial institutions and insurance companies.

3.2 There are no special registration requirements that would prevent a foreigner from engaging in such activities. For certain areas of business—such as banking and insurance—permits are linked to the legal representatives of the company, who may be required to provide proof of knowledge of the German language. Also, for certain activities—such as construction, financial institutions and utility and pharmaceutical companies—at least one manager must have special professional qualifications.

4. UNFAIR COMPETITION

4.1 Under German competition law, notification of the transaction to the Federal Cartel Office (FCO) (Bundeskartellamt) is necessary if, in the fiscal year preceding the merger, the merging parties (including all affiliate companies) achieved a combined worldwide consolidated turnover of more than DEM 1 billion, and at least one of the merging parties (including all affiliate companies) achieved a turnover of more than DEM 50 million in Germany.

This does not apply when a company that is not controlled by another and that had a worldwide turnover of less than DEM 20 million in the last fiscal year merges with another company, or where a market is concerned in which goods or commercial services have been offered for at least five years and which had a sales volume amount of less than DEM 30 million in the last calendar year.

The merger control notification, when mandatory, is to be made before consummation of the merger project. The consummation of the merger project may then take place only after the FCO either (a) has granted express clearance of the merger or (b) has not indicated within one month of receipt of a complete notification that it will conduct an extensive investigation. If the FCO chooses to conduct an extensive investigation, the merger may be consummated if the FCO has not forbidden the merger project within four months of receipt of the complete notification. Consummation of a merger project in violation of this rule may result in severe fines.

5. SUCCESSOR LIABILITY

In a share acquisition, all the liabilities incurred before the acquisition remain with the acquired company, whereas in an asset acquisition, the buyer is generally not responsible for liabilities incurred by the seller before the acquisition. There are a few exceptions to this general rule, however.

Before January 1, 1999, in cases where all or substantially all assets of a company were acquired, creditors of the target company were protected by an automatic and mandatory assumption of liability by the buyer, without prejudice to the continuance of the liability of the original debtor. The liability of the buyer was limited to the total value of the assets transferred. Although this provision was abolished on January 1, 1999, it still applies to asset deals entered into before January 1, 1999. Asset deals entered into after this date are governed by the above-mentioned general rule (i.e., the buyer is not responsible for liabilities incurred by the seller before the acquisition), unless the deal falls under the provisions of the German Commercial Code.

The German Commercial Code provides that, in the case of an inter vivos acquisition where a buyer continues to use the previous company name, the buyer assumes joint liability for all obligations of the seller arising out of the conduct of the business. Any agreement to the contrary is effective against third parties only if such agreement is registered in the Commercial Register and published, or if the third party has been informed thereof by either the buyer or seller.

5.1 For asset deals entered into before January 1, 1999, the assumption of liability mentioned above applied to all categories of predecessor obligations and, therefore, also to civil claims for environmental damages. It did not matter that the local authorities had not yet held the seller liable at the time of the acquisition, even though, according to German law, the obligation usually does not exist until the administrative authorities have cited it by an act of administration. This assumption no longer applies to asset deals. The assumption of liability persists, however, for the situation regulated by the Commercial Code as discussed above.

If the purchased asset is a commercial operation (e.g., a manufacturing facility), the purchaser normally becomes the operator of the facility. As such, it is responsible for compliance with all applicable environmental laws, rules and orders. If noncompliance issues exist, the buyer becomes responsible for the environmental liabilities attached as of the date of the purchase.

Another major area of potential liability for a buyer of assets is liability for contamination of land and water resulting from industrial production. According to German environmental and administrative law, the owner of contaminated real property may be held liable by the authorities in addition to the environmental disturber of the real property where the contamination damage now exists.

The competent environmental agency has discretion to decide which party (property owner or disturber-by-conduct) will be held liable for cleaning up a contaminated site. Some rule that, all other circumstances being equal, the disturber-by-conduct is primarily liable. If this party cannot be found, however, or is not financially capable of paying for the resulting damage, then the seller/buyer may be held liable as the present owner of the site. Furthermore, if allocating responsibility among several environmental disturbers is impossible or difficult to prove, the agency may well revert to holding the owner liable.

A cleanup liability is strict (i.e., irrespective of the environmental violations on the past or present owner's fault). Under German soil contamination law, a past owner of real property sold after March 1, 1999, remains in principle liable for remediation measures, even if it has sold the property in the meantime.

5.2 There is no special provision under the German Product Liability Act that provides for the assumption of liability for defective products that were produced by the seller and subsequently sold to customers by the buyer. However, warranty claims for defective products or poor services can be transferred by operation of the provisions of the German Commercial Code, which is described in the general statements at the beginning of Section 5.

5.3 Predecessor obligations for fulfilling outstanding orders are transferred only by operation of the provisions of the German Commercial Code or by contract between seller and buyer, which requires approval of the creditor of the obligation to be transferred (see Section 9).

5.4 See Section 9 and the general statements at the beginning of Section 5.

5.5 See Section 9, Subsection 5.1 and the general statements at the beginning of Section 5.

5.6 Under German tax rules, if a buyer acquires an entire business or a separately organized business unit in an asset acquisition, the buyer becomes liable for certain taxes of such business or business unit (e.g., trade tax and VAT, but not corporate income tax) as well as any taxes that should have been withheld and remitted. This applies to taxes that originated in the most recent calendar year before the acquisition through the date of consummation of the acquisition. The liability to pay such taxes is restricted to the value of the assets acquired.

5.7 **(i)** After the transaction, the costs arising for environmental cleanup may exceed the purchase price. In German asset acquisitions, it is customary for the buyer to engage independent environmental experts to investigate the real property to be acquired, especially when representations, warranties and indemnities for future decontamination costs cannot be obtained from the seller.

(ii) In connection with a sale of assets, due diligence investigations of the target company—especially regarding real property, labor and pension implications—have become customary, particularly with large sellers and buyers.

6. PUBLIC RECORDS

(i) There is a public register (Land Register) that includes information regarding encumbrances on real property but not regarding liens on movable property or shares.

(ii) See Subsection 6(i).

(iii) When the seller cannot provide sufficient information, German federal law allows free access to all environmental information, which is at the disposal of public authorities in charge of environmental issues. Additionally, most German states have registers for contaminated real property, which are kept by the applicable residual pollution authority.

(iv) See Subsection 6(i).

(v) There are several registers for different intellectual property rights (trademarks, patents, etc.). All registers are kept by the German Patent Office. Information concerning some intellectual property rights can also be obtained at certain German technical universities.

(vi) There is no register for pending litigation.

(vii) There are no public records on standing, but several research companies offer EDP software services that provide information on companies. They are not completely reliable, however.

(viii) Large and medium-sized companies must file their annual audited financial statements with the Commercial Register. Small companies must file their unaudited annual balance sheets. These requirements are seldom strictly observed, however, and the Commercial Register does not control their completeness or accuracy. Financial information on publicly listed companies is also available from independent research companies.

7. LABOR MATTERS

7.1 The buyer assumes all rights and obligations of all employment contracts existing at the time of the transfer of an entire business or parts thereof. The employment relationship, as a whole, is automatically transferred from the seller to the buyer by operation of law (as implemented by the applicable European Acquired Rights Directive). The automatic transfer of an employment contract does not require the employee's consent. Each employee may, however, object to the transfer of his or her employment contract to the buyer within three weeks of obtaining knowledge of the transfer. When an employee makes such an objection, the employment relationship continues with the seller, although the seller may then terminate the employment relationship if, as a result of the transfer, the position of the employee is redundant. In contrast to a share deal, however, the buyer in an asset deal does not assume the rights and obligations deriving from contracts with registered company directors and freelancers.

7.2 The termination of the employment relationship due to the transfer of a business is void. Consequently, it is not permissible to require the seller to terminate some employee agreements as a condition of closing the transaction, although the right to terminate the employment relationship for other reasons remains unaffected (e.g., for operational reasons). The buyer and seller may agree that the seller bears the cost of terminating employment relationships.

7.3 The buyer is bound by any obligations of the seller to its employees in connection with pension plans as well as retirement, health or other benefits. In contrast to a share deal, the buyer in an asset deal does not assume any liability under such plans vis-à-vis pensioners and employees who left the company before the transfer of the assets.

7.4 The seller and buyer are jointly and severally liable for all obligations under the employment relationship, which were created before the transfer and become due within one year from the date of the transfer. The seller and buyer are not entitled contractually to modify their liability vis-à-vis the employees. However, regarding internal contributions to liability, the seller and buyer are free to negotiate the allocation of severance payment obligations and other responsibilities.

7.5 The seller and the buyer must inform their economics committees, if any, of the transfer of significant assets. Whether they must also notify their works councils (if any) is a matter of dispute. Any operational change of the business that is to take place concurrently is subject to consultation with the works council. For example, a transfer of part of a business constitutes an operational change, which requires prior consultation with the works council (see Section 8). In the case of mergers or other transformations of the company, a copy of the transformation agreement must be given to the works council at least one month before the shareholders agree on the transformation.

7.6 In general, the conditions of a collective bargaining agreement or a works agreement may not be amended to the detriment of the employees for a period of one year following the transfer. The terms and conditions of the employment agreement may not be modified without the consent of the employees.

7.7 See Subsection 7.1.

8. PLANT CLOSING LAWS

According to German labor law, an employer with more than twenty regular employees must inform the works council—in detail and in a timely manner—about operational changes (e.g., a plant closure) that may result in a significant detriment to the entire staff or large segments of it and must confer with the works council about any planned operational changes. According to case law, a mass dismissal is deemed an operational change, provided a certain number of employees is dismissed. The number depends upon the size of the company (e.g., in companies with between twenty-one and fifty-nine employees, at least six must be dismissed; in companies with more than six hundred employees, at least five percent must be dismissed). Regardless of any obligation to negotiate with the works council, the employer must timely notify the local Labor Office, in writing, about any intended mass dismissal and must include any comments of the works council.

If there is an economics committee (which is required for companies with more than one hundred full-time employees), the economics committee must also be informed about any plans that are of interest to the employees of the company.

If the employer fails to comply with the notification requirements described above, the dismissals may be invalid and/or the employer may incur a fine of up to DEM 20,000.

The works council may also apply for an injunction in order to prevent the employer from implementing the operational change.

Finally, the employer is obligated to establish a social plan to compensate employees (i.e., make severance payments) for the loss of employment or any other negative effects on the employee due to the operational change.

9. ASSIGNMENT OF CONTRACTS

A party to a contract cannot be replaced by a third party without the consent of the other party. The buyer can replace the seller in a contract only if the other party to such contract gives approval. In some cases, however, a contract between the seller and a third party is automatically by law transferred from the seller to the buyer, who then continues to have the contractual rights and responsibilities of the seller. In these cases, approval of the party of the original contract with the seller is not necessary.

The contracts transferred by operation of law in an acquisition of property are the following:

- German insurance law provides that in the case of portfolio transfers, the buyer automatically replaces the seller in the insurance contract. The validity of the portfolio transfer depends upon the approval of the supervisory authority.
- German law provides that leases, including usufructuary leases, are not terminated by the transfer of ownership of the leased real property from seller to buyer. Therefore, if

leased property is sold to a third party by the lessor, the buyer takes the place of the lessor in connection with the rights and obligations arising under the lease during the term of ownership. The seller remains liable as a guarantor for the performance of the contractual obligations by the buyer. The seller can, however, follow a notice procedure to free itself of such remaining liability.

10. NONCOMPETITION

10.1 A noncompetition clause can be enforced against the seller. The principals of the seller are not bound by a noncompetition clause unless they have approved the clause. The employees are prohibited from competing with the employer by law. A post-contractual noncompetition obligation can derive only from a contract between employer and employees.

10.2 There is extensive case law concerning the duration of noncompetition clauses. In principle, German courts have until now accepted a maximum period of five years, although a longer or shorter period may be justified by the circumstances of an individual case. On the level of the EU-cartel law, however, the European Commission recently changed its evaluation of noncompetition clauses. Due to a more restrictive approach, the Commission in merger proceedings generally only accepts noncompetition clauses up to three years when goodwill and know-how is transferred, and up to two years when only goodwill is transferred. As EU-cartel law has the priority over German national cartel law, this more restrictive approach needs to be observed. Moreover, noncompetition clauses must be limited to the geographic area in which the seller established the products or services before the transfer. Finally, the noncompetition clause must be restricted to those products or services that form the economic activity of the acquired company.

In the case of a post-contractual noncompetition obligation for an employee, however, the limitations provided in the German Commercial Code must be observed (e.g., an agreement to a lump-sum compensation to the amount of at least fifty percent of the most recent remuneration, limitation to the geographic area in which the employer established the products or services before the transfer). Any agreeement with the seller not to hire employees of the buyer is unenforceable.

11. CHOICE OF LAW, JURISDICTION AND ARBITRATION

11.1 **(i)** According to German private international law, there are no restrictions regarding the choice of law to be applicable to contracts ("proper law of the contract"). The parties can choose the law of any country, even if there are no local, economic or judicial connections to that country, unless specific exceptions apply or public policy is violated. If the case is linked to only one country, however, the mandatory statutory provisions of that country may not be contracted away by means of a choice-of-law clause. These rules apply to contracts on asset acquisitions as well as share acquisitions, but not to the acquisition itself. The parties may not choose the applicable law for (a) the transfer in rem (neither for tangible goods, nor for shares), (b) the formal requirements of a contract (the law governing the contract or the law of the country where the contract is concluded is to be applied) or (c) issues concerning the assumption of liabilities by operation of law.

(ii) Within the scope of the Brussels Convention ("European Convention on Jurisdiction and Enforcement of Judicial Judgments in Civil and Commercial Matters of 27 August 1968"), there are few restrictions regarding agreements on jurisdiction. The choice-of-jurisdiction clause must be in writing and may not affect exclusive jurisdiction under that Convention. Under

German national law of civil procedure, jurisdiction clauses are restricted insofar as, if both parties reside in Germany, jurisdiction clauses may be agreed upon only by merchants within the meaning of the German Commercial Code. In international cases, there is no such restriction. If one party resides outside Germany, a jurisdiction clause is possible upon the following conditions: (a) it must be in writing, and (b) only one of the places of jurisdiction provided in the German Code of Civil Procedure for the party residing in Germany may be chosen.

11.2 Arbitration is possible. In order to be executed, a domestic arbitral award must be declared enforceable by a court (Exequatur) according to the provisions of the German Code of Civil Procedure.

The procedure for obtaining such a declaration of Exequatur has been streamlined. An application for Exequatur of a domestic award may be refused only if the conditions are met upon which it may be set aside (e.g., lack of a valid arbitration agreement, violation of the right to be heard or lack of due process). In the case of an arbital award by a non-German arbitration tribunal, the declaration of Exequatur is subject to and can thus only be refused in accordance with the provisions of the New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards of June 10, 1958. The jurisdiction for such matters has been concentrated in the Higher Regional Courts in Germany.

11.3 For confidentiality reasons, some clients prefer arbitration proceedings, even though they are generally more time consuming and more expensive than litigation in Germany. Court proceedings are comparatively cost-effective in Germany, and all costs are borne by the defeated party.

12. OTHER ISSUES

12.1 In general, costs must be borne separately by each party. Clauses providing for allocations of costs are permitted only in connection with notarization, registration or merger control costs.

12.2 [No response.]

12.3 There are considerable cultural differences that must be taken into account during negotiations. In international and cross-border transactions over the last few years, however, it has become customary to work with Anglo-American types of documents and to use the English language.

Due to the principle of specification, an asset acquisition is more time consuming and requires more preparation than a share acquisition. A buyer should also be made aware of possible risks arising from environmental issues (see Subsection 5.1). In the case of smaller-sized companies or companies active only in the national market, it may be difficult to obtain the documents needed within the set time frame.

Hong Kong

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1. ASSET VERSUS SHARE PURCHASE

The major considerations for choosing an asset acquisition rather than an acquisition of shares are as follows:

- For an asset acquisition, the buyer conducts due diligence by reviewing the title to the assets, whereas for a share acquisition, the buyer must review the entire corporate structure of the business. In a share acquisition, the buyer is usually required to assume all obligations of the business (whether disclosed or nondisclosed) and the seller is required to give broad indemnities.
- If only some of the assets of a business are being acquired, it can be much easier to structure the transaction as an asset acquisition. A buyer can choose the specific assets in which it is interested and avoid assuming unwanted and contingent liabilities.

The implications under the Stamp Duty Ordinance are often also considered when choosing between an asset or share acquisition. A stamp duty calculated at 0.225 percent of the purchase price is levied on a transfer of shares. Also, immovable property in Hong Kong is chargeable with a stamp duty based upon the market value of the immovable property at the date of the transfer. Currently, stamp duty on immovable property ranges from HK $100 to as high as 3.75 percent of the market value of the property being transferred. As a further example, stamp duty is also levied on bearer instruments issued in Hong Kong or issued by or on behalf of a Hong Kong entity, unless such instruments are issued in connection with loan capital.

Other assets such as office equipment, goodwill, stock-in-trade or inventory generally will not attract any stamp duty upon transfer.

With an asset acquisition, the day-to-day operation of the business may be interrupted and the established reputation, licenses, intellectual property rights, concessions or contracts held by the target company may not be transferred with the acquired assets. Moreover, the buyer must renegotiate supply and other contracts. Separate transfer agreements and registration may be required for certain assets, such as real estate and intellectual property. Hence, depending upon the nature of the assets acquired, an asset acquisition may be more complicated to complete than an acquisition of shares.

1.2 The distinction between the acquisition of substantially all the assets of a company and the acquisition of the shares of the company is as follows:

- From a seller's perspective, tax is generally not an issue in considering the form of a transfer (i.e., shares or assets) because no capital gains tax or goods and services tax is levied in Hong Kong. From a buyer's perspective, if a buyer acquires a business as a going concern in an asset transaction, the assets can be depreciated for tax purposes as if there had been no change of ownership. Even when a buyer chooses to acquire substantially all the assets of a company rather than shares of such company, losses of the company can be carried forward and the company's depreciation allowances remain unchanged.
- In a share acquisition, the buyer assumes the company's liabilities. Liabilities arising from an asset acquisition can be allocated on a negotiated basis.

1.3 If a buyer acquires a business as a whole, the price paid in excess of the book value of the business will generally be classified as goodwill, which is not considered a depreciable asset for tax purposes according to the Hong Kong profit tax legislation. In contrast, if only some of the assets are acquired, and such assets are used to produce taxable profits in Hong Kong, then the buyer may actually benefit from acquiring assets at prices in excess of their book value by being entitled to use the entire amount of the purchase price to calculate its depreciation allowance for the assessment of its taxable profits for the year. However, from the seller's perspective, for tax purposes, sale of assets for a price in excess of their book value may give rise to a recapture of allowances previously given.

2. FORM OF DOCUMENTS

2.1 Representations and warranties used in the United States are too far-reaching and extensive for use in Hong Kong. The Model Asset Purchase Agreement (other than those Articles pertaining to representations and warranties) could be used, however.

2.2 Often only one agreement for the sale and purchase of the assets of a company is executed; however, to effect the actual transfer of the legal title of specific assets, different documents may be required. For example, the transfer of immovable property, patents, trademarks or shares in other companies requires a separate assignment or transfer document for the buyer to be registered as the legal owner of such assets.

2.3 In general, it is substance rather than form that governs. Therefore, the form of the document should not have any significant tax impact. It is, however, important to note that certain instruments—such as agreements for the sale of real property or contract notes for the sale on purchase of shares—must be stamped to be admissible as evidence in courts in Hong Kong. Transfers of businesses must be registered with the Inland Revenue Department and published in the *Hong Kong Government Gazette* and various approved newspapers (see Section 5) to be effective against third parties. Specific types of assets (e.g., real property, automobiles and liquor licenses) must also be registered with the relevant government authorities (e.g., the Land Registry, the Transport Department and the Liquor License Board). The Business Registration Department should also be notified of the transfer.

3. PRELIMINARY LEGAL REQUIREMENTS

3.1 In general, foreign investments in Hong Kong do not require any special government approval before the investment is made. All businesses, however, must be registered with the Inland Revenue Department. There is no exchange control, and capital and profits can be freely repatriated. There is also no government restriction on the sale and acquisition of Hong Kong companies by foreign investors.

Approval by the board of directors and, in some cases, the shareholders, is often required for the acquisition or sale of all or a substantial portion of a company's assets, regardless of whether foreign investors are parties to the transaction.

3.2 There is no distinction between local and foreign ownership. All companies in Hong Kong, whether locally owned or foreign owned, must comply with the Companies Ordinance. Foreign investors are free to acquire Hong Kong companies or acquire assets from Hong Kong companies.

Businesses closed to the public and controlled by the government include the operations of the postal system, the water supply, the harbor and the airport. Also, a foreign investor is generally restricted to holding no more than ten percent of the shares of a licensed television broadcaster. Activities that must be licensed in Hong Kong include money lending, telecommunications and public utilities, and carrying on of the business of a securities dealer or an investment advisor.

4. UNFAIR COMPETITION

No unfair competition or antitrust legislation exists in Hong Kong. For instance, certain utility and transportation companies currently enjoy a monopoly. There are no special restrictions on foreign investment. For an acquisition of shares in listed companies, however, the Hong Kong Code on Takeovers and Mergers (the Code) applies. For example, the Code requires any person who acquires shares that carry thirty-five percent or more of the voting rights of a company to make a general cash offer to the other shareholders of the company. Although the Code does not yet have the force of law, the Securities and Futures Commission has special power to ensure compliance by its professional members and has been planning to give the Code statutory backing.

5. SUCCESSOR LIABILITY

Section 3 of the Transfer of Businesses (Protection of Creditors) Ordinance (TOB) provides that a buyer is liable for all obligations arising out of the carrying on of the business by the seller. However, Section 4 of TOB provides that a buyer is not liable if a notice of transfer in prescribed form has been given not more than four months before the date of transfer and has become “complete.” The notice of transfer under TOB must be published in the *Hong Kong Government Gazette*, two approved Chinese-language Hong Kong newspapers and one approved English-language Hong Kong newspaper. The notice of transfer becomes complete one month after the date of the last publication (the waiting period), unless legal proceedings have been instituted against the seller or buyer before the notice of transfer is complete and the seller or buyer, as the case may be, has been served or notified of such proceedings within one month of the institution of such proceedings.

5.1 If a notice of transfer has been properly given pursuant to Section 4 of TOB, then the buyer will not be responsible for any environmental liabilities incurred or caused before the acquisition, provided the notice has become complete. Obviously, a buyer will be liable should it permit any pollution or nuisance to continue after the acquisition.

5.2 If a notice of transfer has been properly given pursuant to Section 4 of TOB, then the buyer will not be responsible for liabilities in connection with products or services sold before the acquisition, unless it has contractually assumed such liabilities. In the interest of the reputation of the acquired business, however, the buyer may decide to accept the liabilities that existed or were caused before the acquisition of the business.

5.3, 5.4 Unless a buyer has contractually agreed to fulfill the outstanding orders of the seller or to assume the liability of warranty claims that existed before the acquisition, the buyer will not be held liable if it has properly notified by publication the transfer of business under Section 4 of TOB.

5.5 A buyer of real property is liable for obligations or defaults of the previous owners in a number of circumstances.

If a covenant, whether positive or restrictive, runs with the land, it is enforceable against the buyer. Therefore, when a buyer acquires real property, it assumes the obligations and liabilities that were incurred by the previous owners and that relate to the land.

A buyer is liable for the previous owner's obligations and defaults under the deed of mutual covenant of the building, including obligations attached to the property, payment of management fees and improvement funds and compliance with building orders issued by the buildings and lands authorities.

Negative covenants (e.g., not to breach the terms and conditions in the government grant or the deed of mutual covenant) are also binding on a buyer. The acquired property is encumbered with these liabilities unless and until they have been complied with or discharged.

5.6 See Subsection 5.1 in relation to environmental liabilities and Section 7 in relation to labor matters.

5.7 **(i)** The government's environmental program in Hong Kong covers air and water pollution, noise control and waste management. Legislation is in place, but the penalties that apply to violators are often not regarded as a deterrent. Generally speaking, it is not customary for a buyer to conduct environmental audits in Hong Kong, even though this may change in the future in view of the growing environmental concern in the local community in recent years.

(ii) In general, the buyer conducts legal, regulatory and financial due diligence investigations to ensure that the seller is the true legal owner of the acquired assets and that the assets are free of any undisclosed charges, liens or encumbrances.

6. PUBLIC RECORDS

(i) All changes of legal ownership of real or immovable property must be registered at the Land Registry within one month after the date of execution of the assignment, to gain priority over other instruments from the time of their execution. An instrument that is not registered is null and void against any subsequent purchaser or mortgagee in good faith for valuable consideration who has registered its interest within one month of execution.

(ii) All encumbrances or interests against Hong Kong real property must be registered at the Land Registry within thirty days of execution, except leases at market rates for a term not exceeding three years. Encumbrances not so registered are void against any subsequent purchasers or mortgagees in good faith for valuable consideration. A computer printout of the land search record—showing transfers, charges and certain encumbrances relating to a property—can be obtained upon request at the Land Registry or through any computer terminal registered with the Land Registry by paying a nominal fee.

(iii) There are no public records that provide information about environmental issues affecting real property. A search at the Land Registry, however, may reveal any judgments against an owner of a particular property regarding contravention of environmental law if such judgments were registered against the property.

(iv) All security interests in a company's assets must be registered at the Companies Registry within five weeks after the date of creation. Otherwise, the claims are void against the liquidator and any creditor of the company.

A charge must be registered if it is (a) for the purpose of securing any issue of debentures, (b) on uncalled share capital of the company, (c) created or evidenced by an instrument that, if executed by an individual, would require registration as a bill of sale, (d) on land or any interest therein, (e) on book debts (accounts receivable) of the company, (f) a floating charge on the undertaking or property of the company, (g) on calls made, but not paid, (h) on a ship or any share in a ship, (i) on goodwill, (j) on a patent or a license under a patent, (k) on a trademark or (l) on a copyright or a license under a copyright.

It is the duty of a company to register the details of every charge created by the company with the Companies Registry. A search of such charges can be conducted at the Companies Registry for a nominal fee.

A buyer of assets may be subject to other liens or encumbrances that are not registrable (e.g., a lease of real property for a term not exceeding three years). Moreover, a buyer may also be exposed to security interests that are in the process of being filed or whose time limits for filing have not yet expired.

- **(v)** The Intellectual Property Department has records of all registered patents, trademarks and designs as well as the details of any current applications pending approval for registration in Hong Kong. Both computer and manual searches are available to the public.

In Hong Kong, copyrights are not registrable and will not be disclosed by conducting searches. Regarding well-known trademarks, unregistered owners would enjoy protection against any infringers under the common law of passing off.

- **(vi)** A writ search can be conducted at the High Court and the district courts in Hong Kong to discover whether a company is a party to any pending litigation or has been wound up by a court.
- **(vii)** A search at the Companies Registry, a writ search (as mentioned in Subsection 6(vi)) and a winding-up search at the Official Receiver's Office would only provide negative assurance regarding the standing of a company in Hong Kong. We are not aware of any public record that would certify or otherwise provide positive assurance regarding the standing of a company in Hong Kong.
- **(viii)** Only public companies are obliged to disclose and send copies of audited financial statements to shareholders. The financial statements are generally made available to the public upon request.

7. LABOR MATTERS

7.1 In an asset acquisition, employees of the seller are automatically terminated, and the buyer must reengage such employees. The Employment Ordinance provides that, if a business or undertaking is transferred, the period of employment of an employee at the time of transfer is preserved, and the buyer is liable for the benefits that have accrued during the course of the employee's employment with the seller.

7.2 A buyer may request that the seller terminate employees as a condition of closing the transaction, although the seller must make severance payments if it does so. Similarly, if the buyer decides to reduce the number of employees and terminates the employment of some of the employees after acquiring the business, the buyer must make severance payments by reason of redundancy. In contrast, if after the acquisition the buyer employs a more appropriate person to replace one of the employees who is transferred to it as a result of the acquisition, such termination may not amount to an act of redundancy. Under such circumstances, the buyer can dismiss the existing employee by serving notice or making payment in lieu of notice in accordance with the terms of the employment contract. In such a case, the buyer is not liable for severance payments (see also Subsection 7.6).

A buyer must also make long-service payments to employees whose age and years of service at the date of dismissal meet the requirements set forth in the Employment Ordinance. Generally, a long-service payment is payable to employees employed for longer than five years, although an employee who is under the age of forty-one on the date of dismissal must have had at least ten years of continuous service with the company to qualify for a long-service payment. There is no entitlement to a long-service payment when (a) the employee is summarily dismissed for misconduct, (b) the employer is required to pay the employee a severance payment or (c) the employee leaves the service of the employer before the expiration of the notice of termination given by the employer without the employer's consent or without making a payment in lieu of notice to the employer. As mentioned in Subsection 7.1, if a business is transferred, the period of employment of an employee before the transfer would be carried over regardless of the transfer.

7.3 Upon a transfer of a business, a buyer is not normally required to continue any pension, retirement, health or other benefits unless the buyer has contractually assumed such obligations. If, however, an employee has a contractual right to amounts contributed to a pension scheme, an occupational retirement scheme, etc., the buyer may be bound by such obligations. With the introduction of the mandatory provident fund scheme in December 1, 2000, every buyer of a business should give careful consideration to this issue.

7.4 A seller and buyer may allocate responsibility between themselves for severance payment obligations.

7.5 In Hong Kong, sellers are free to sell their assets to anyone. Asset sales are not subject to any consultation with, or authorization from, any works council, union or other similar body. Trade unions in Hong Kong have the legal status of corporate bodies through a system of registration by the Registrar of Trade Unions under the Trade Unions Ordinance. If the effect of the sale of a business is perceived to be against the interest of the employees or the public, such bodies may organize strikes or demonstrations to attempt to put political pressure on the government to intervene. Nevertheless, at present, there is no strong trade union movement in Hong Kong. Unions that have been established in Hong Kong are more like "self-help" or lobby groups and are not militant—at least when compared with their counterparts in other developed jurisdictions.

7.6 A buyer may change the terms of employment of employees if there is mutual agreement between the buyer and the employees. The new terms of employment, however, must not be less favorable or constitute an offer of unsuitable employment to the employees.

In this regard, the Employment Ordinance provides that an employee may be entitled to a severance payment by reason of dismissal when the employee leaves the service of the buyer because the capacity and place in which the employee will be employed, and other terms and conditions of the renewed employment contract offered by the buyer, differ (wholly or in part) from the corresponding provisions of the contract in force immediately before the acquisition date. If the offer constitutes (a) an offer of suitable employment in relation to the employee and (b) an offer of employment no less favorable to the employee than before, and the employee unreasonably refuses that offer, then the employee is not entitled to a severance payment by reason of dismissal.

7.7 A buyer assumes all accrued liabilities in connection with the employees reengaged by the buyer. This includes contractual and statutory liabilities.

8. PLANT CLOSING LAWS

There is no legislation in Hong Kong that restricts large companies from plant closings or mass layoffs, nor is there any requirement for a company to consult with any government authorities or unions in connection with such actions.

The procedures for mass layoffs are basically the same as those for individual dismissals. The company must give notice or payment in lieu of notice to the employees, in accordance with the terms of the employment contracts, and must make any required severance payments or long-service payments.

9. ASSIGNMENT OF CONTRACTS

Generally, in the absence of express provisions to the contrary, contracts are not automatically transferred by the seller to the buyer.

10. NONCOMPETITION

10.1 All clauses in restraint of trade against a seller, its principals or employees of a company are, on their face, deemed unenforceable; they may be enforced only if it is shown that they are reasonable as between the parties and the covenantor and are in the interest of the public.

10.2 To be valid, such clauses must be reasonable in terms of time and geographic area, the extent of the restraint imposed and the kind of work on which the restraint applies. All factual circumstances must be considered carefully. There is no registration possible nor is there any statutory limitation.

11. CHOICE OF LAW, JURISDICTION AND ARBITRATION

11.1 Parties to an agreement may agree to the choice of any applicable law, venue and jurisdiction. In particular, there is no restriction on asset acquisitions by foreign parties regarding the choice of applicable law, venue or jurisdiction.

11.2 Arbitration is possible and an award is considered final and enforceable in Hong Kong. It is unlikely that a judicial body would reexamine an award.

11.3 The parties may prefer arbitration to litigation because litigation in Hong Kong is very costly and time consuming.

12. OTHER ISSUES

12.1 It is typical to provide in an agreement that the parties will bear their own solicitor's fees in connection with the negotiation and drafting of the agreement.

12.2 Under the laws of Hong Kong, a buyer in a bulk sales transaction usually requires notice of such transaction to be published to alert the seller's creditors under TOB and thereby limit the buyer's exposure (see Section 5). When possession of the assets would not be delivered immediately upon acquisition, it may be necessary to consider the application of the Bills of Sale Ordinance. Also, under the Sale of Goods Ordinance (SOGO), buyers of goods (defined in SOGO to include all chattels personal other than things in action and money) are to some extent protected. According to SOGO, there is an implied condition in a contract of sale that the seller has a right to sell the goods. In addition, the seller is deemed to have given implied warranties that (a) the goods are free—and will remain so until the time the property is to pass—from any charge or encumbrance not disclosed or known to the buyer before the contract is made and (b) the buyer will enjoy quiet possession of the goods against any such undisclosed or unknown charge or encumbrance.

12.3 In Hong Kong, no significant statutory provision governs the position of the respective parties in an asset acquisition transaction. The parties are free to negotiate the contracts and their obligations arise from such contracts.

Hungary

Contributed by Robert Hayhurst, Hayhurst Berlad Robinson

On many issues, Hungarian law may be less settled than the laws of other jurisdictions due partly to the fact that much of the current legislation has been enacted in the postcommunist era and, in many cases, has not been subject to judicial interpretation. Hungarian law is currently undergoing further revision because of the need to harmonize Hungarian law with that of the European Union (EU) before Hungary's anticipated accession to the EU. Many areas of the law will likely be modified in the next few years.

1. ASSET VERSUS SHARE PURCHASE

1.1 The considerations that would lead a buyer to choose an acquisition of assets rather than shares in a Hungarian company are similar to those in many U.S. jurisdictions. The primary concern of the buyer who chooses to proceed by way of an asset purchase is to prevent the acquisition of undisclosed or unwanted liabilities and obligations that could occur through a share acquisition.

Hungary does not have a capital gains tax. When a natural person sells shares, that person must pay income tax, at his or her applicable personal income tax rate, on any profits made from the sale. When a company sells shares or assets, the revenue from the sale is included in the gross annual revenue of the company, and the company must pay corporate taxes on its aggregate annual profit. In 2001, the tax rate was eighteen percent of the positive tax base.

1.2 The choice of the form of the transaction as an asset or share purchase principally affects (a) the liabilities that may flow to the buyer of the assets, (b) the liability of the parties for taxes and (c) the responsibility of the buyer for environmental risks.

The transfer by sale or lease of all or substantially all the assets of a company or a business unit of a company as a going concern carries with it successor liability in connection with employee matters. The extent of this liability is described in Section 7. To the extent that only part of the assets of a company are purchased or leased other than as a going concern, it is unlikely that the buyer will incur liability of the seller's employees.

No value added tax (VAT), transfer duty, stamp tax or other similar tax is payable in Hungary on the transfer of shares or a "quota" (essentially, an undivided business interest) of a Hungarian company. VAT (currently twenty-five percent of the value of the assets transferred) is, however, payable on sales and transfers of assets, including when assets are transferred as a contribution-in-kind to the registered capital of a Hungarian company. Furthermore, certain categories of assets carry a transfer duty or tax. The transfer of real estate, for example, attracts a duty of ten percent of the market value of the real estate sold, and vehicle transfers attract a duty based upon the size of the vehicle's engine. Movable assets acquired at public auction bear a transfer duty of ten percent of the value of the assets sold.

If the property purchased is contaminated, a buyer of assets may be required to take steps to remedy the contamination. The buyer's liability is discussed in Section 5.

1.3 The response in Subsection 1.2 would be no different if only part of the assets were acquired as a going concern.

2. FORM OF DOCUMENTS

The transfer of certain assets must be done according to specific rules. When registration is required, it is necessary to record the transfer in various documents that must be filed to effect registration.

2.1 The form of asset purchase agreement found in the United States and Canada is a relatively new concept in Hungary. During the years of the communist regime, contractual documentation tended to be very cursory because transactions in a nonmarket economy are not really commercial in nature. In addition, Hungary is a civil law jurisdiction and, as such, typically requires much less detailed documentation for share or asset acquisitions than do common law jurisdictions. This fact is due in large part to the Hungarian Civil Code, which contains many provisions that supplement any agreement and which will be read into the sale and transfer documentation, unless the parties deal otherwise with the issues. In recent years, perhaps due to the strong influence of American and other "Western" trained lawyers, asset transfer agreements and legal documentation in general have tended to develop more along the lines of the typical Western-style documentation. In the view of many Hungarian lawyers, however, the standard clauses of such agreements, including many representations and warranties, are unnecessary under Hungarian law because they are already provided for in the Civil Code.

Parties to a contract may depart from the provisions of the Civil Code, except when the Civil Code expressly prohibits such departure.

In Hungary, the concept of "public order" appears in the International Private Law Act (Act XIII of 1979). When one party to a civil law, family law or labor law action is a Hungarian resident and the other party is a non-Hungarian resident, the act determines which country's laws apply. When application of foreign law would conflict with Hungarian public order, Hungarian law will be applied.

2.2 The transfer of assets does not require any specific form of documentation. It is, however, customary to prepare specific conveyancing documentation for certain types of assets to facilitate the registration procedure. When documentation evidencing a transfer of title must be registered (e.g., a transfer of real estate), a specific conveyancing document can be more easily filed with—and processed by—the relevant registry than a full asset purchase agreement.

2.3 The form of the document does not affect the tax consequences of the transfer.

2.4 Transfers of title to real estate must be registered. An application to register such transfers must be made within thirty days after the execution of the agreement purporting to transfer title to real estate. Registration has a constitutive or enabling effect and is necessary for the enforcement of rights against third parties. Trademarks and transfers of trademarks must be registered, and such registration is necessary to assert rights against third parties. Transfers of vehicles must also be reported to the police, and a separate registry for vessels exists.

3. PRELIMINARY LEGAL REQUIREMENTS

3.1 In general, government or other approvals are not required for foreign investments in Hungary, including investments by way of asset acquisitions. The Hungarian Foreign

Investment Act (Act XXIV of 1988 on the Investments of Foreigners in Hungary) provides that foreigners may invest in Hungary on the same terms and conditions as Hungarian nationals and residents and contains various other guarantees concerning protection of foreign investors' rights, including guarantees against expropriation or nationalization without compensation. Government or other regulatory approvals are required for acquisitions of companies or assets in certain regulated industries. As a general matter, however, there is no distinction made between foreign buyers and Hungarian nationals regarding such approvals.

An exception to the general rule is that foreign natural or legal persons may not acquire agricultural land, directly or indirectly. In the absence of special permission, foreign natural or legal persons may acquire ownership and other rights pertaining to real property (except agricultural land) only through a Hungarian company. Hungarian companies that are partly or entirely foreign owned may acquire all ownership and other rights pertaining to real property (other than agricultural land) necessary for the performance of their business activities as defined in the deed of foundation and articles of association of the company.

Administrative filings may be required for companies operating within regulated fields of activity, such as the banking, securities and financial services industries, and may also be required under competition legislation. These issues are discussed in greater detail in Section 4.

The deed of foundation and articles of association of the seller determine whether the approval of a general meeting of the shareholders of the company, the board of directors or some other authority within the company is required for the sale of assets.

Hungarian law does not regulate bulk sales or the "sale of an enterprise."

4. UNFAIR COMPETITION

Hungary has recently adopted new competition legislation that is intended in part to harmonize this field of law with similar legislation in countries of the (EU) in preparation for Hungary's anticipated accession to the EU.

The Hungarian Competition Act (Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices), which came into force in January 1997, regulates certain mergers, joint ventures and consolidations that lead to a "concentration" of "undertakings." Concentration of undertakings includes, inter alia, the acquisition of the whole or part of the assets of an enterprise provided that the assets so acquired (independently or together with the assets of the acquiring party) are sufficient to carry out business activity in the market. A concentration of undertakings comes about, inter alia, if a sole undertaking or more than one undertaking jointly acquires control of the whole or parts of one, or more than one, other undertaking.

The approval of the Office of Economic Competition (OEC) is required before the creation of a concentration if (a) the aggregate net turnover of the undertakings involved in the concentration exceeded FT 10 billion in the previous business year and (b) the net turnover of the undertaking over which control is being acquired, or which is being merged with another undertaking, or the net turnover of at least two of the undertakings taking part in the concentration, exceeded FT 500 million each.

Even when the net turnover of an undertaking over which control is acquired, or which is being merged with another undertaking or otherwise taking part in the concentration, does not exceed FT 500 hundred million, the authorization of OEC is still required when, taking this turnover into account, the concentrations implemented by the undertaking acquiring control during the last two years preceding the concentration concerned exceeded FT 500 hundred million in aggregate.

For the purposes of such calculations, the net turnover of an undertaking includes that of any entity controlling, controlled by, or under common control with the parties directly participating in the concentration. In the case of non-Hungarian entities, however, only net turnover in Hungary is taken into account.

When the approval thresholds are met or exceeded, the entity acquiring control of another must apply to OEC for approval within eight days from the conclusion of the purchase and sale contract, or the acquisition of a right of control. OEC may not refuse approval if the combination does not create or strengthen a dominant position, which prevents the development, maintenance or expansion of efficient competition in the market concerned or a material part thereof.

5. SUCCESSOR LIABILITY

5.1 Under the Hungarian Environmental Act (Act LIII of 1995 on the General Rules of Environmental Protection), the owner of real property has joint and several liability with the user of the property for all damage caused to third parties, unless the owner is able to establish the responsibility of the user or another third party. The owner of real property may also be subject to a cleanup order and fines issued by the relevant regional environmental inspectorate, which could apply to preexisting environmental damage. If, however, the owner of the real property is able to prove "beyond any doubt whatsoever" that it was not responsible for the environmental damage, the owner may avoid liability.

5.2 A buyer generally is not liable for products or services sold before the asset acquisition unless the agreement provides otherwise.

5.3 A buyer generally is not liable to fulfill outstanding orders entered before the asset acquisition unless the agreement provides otherwise.

5.4 A buyer generally is not liable for warranty claims predating the asset acquisition unless the agreement provides otherwise.

5.5 A buyer generally is not liable for obligations of the previous owner or lessee, except in connection with environmental liability. If the fact, extent and nature of permanent environmental damage, established by a final decision of the relevant environmental authority or a court ruling, is registered on title in the appropriate land registry office, the buyer's liability for such permanent environmental damage may not be excluded under the asset purchase agreement, except when the buyer can prove "beyond any doubt whatsoever" that the responsibility for the environmental damage does not lie with it.

5.6 No liabilities would automatically transfer, except those under employee successor liability, as discussed in Section 7.

5.7 Environmental audits are becoming increasingly common in Hungary in the context of both share and asset acquisitions. Legal due diligence investigations are increasingly conducted in the context of acquisitions of assets or companies of significant value.

6. PUBLIC RECORDS

(i) The Land Registry provides conclusive evidence about the existence of mortgages and those liens and encumbrances against real property that are subject to registration. At the request of the plaintiff, litigation involving real property will also be registered against the property in the Land Registry.

(ii) See Subsection 6(i).

(iii) See Subsection 5.5.

(iv) Recent amendments to the Hungarian Civil Code have created a register for security over movable (personal) property maintained by the Hungarian National Chamber of Notaries Public. A valid security interest can be created in movable property without dispossession of the pledgor upon conclusion of a pledge agreement certified by a notary public and registration of the pledge in the register.

(v) Hungary has a trademarks registry and a patent registry, which maintain public records of the ownership of intellectual property.

(vi) In Hungary, there is no statutory right to obtain—or judicial practice allowing the obtaining of—information regarding litigation against particular natural or legal persons, nor does a registry or central record of litigation exist. According to regulations made by the Minister of Justice and applied to the courts, the chairman of court may permit a person with sufficient legal interest to inspect court records to determine whether a particular person is the object of litigation. There have been cases where, to our knowledge, courts have refused to grant access to court records when the access was requested as part of a legal due diligence investigation of a target company.

(vii) It is possible to verify at the Court of Registry the due existence of a company, as well as certain other information regarding registered capital, the identity of members of the board of directors and supervisory board (where such exist), the address of the registered head office and certain other matters.

(viii) Hungarian companies must file copies of their annual financial reports, consisting of their balance sheets and statements of income and loss, with the Court of Registry.

7. LABOR MATTERS

7.1 When a person acquires by purchase or lease as a going concern all or substantially all the assets of a company or of a business unit of a company, the doctrine of general succession of labor rights applies. In such circumstances, the buyer of assets becomes the legal successor as employer of the employees related to those assets. Under this doctrine, employees are deemed to have been employed by the person acquiring the assets for the entire duration of the period for which such persons were employed by the seller of the assets.

7.2 It is possible to stipulate contractually that the seller will terminate employees as a condition of closing. The matter of who will be liable for severance pay and other severance liabilities should also be stipulated contractually. In the absence of such a stipulation, the buyer of the assets may be liable under the doctrine of general succession of labor rights because, under Hungarian law, the seller and buyer are jointly and severally liable—for a period of one year following the closing—for claims resulting from termination of employees before closing or any other employee claims arising out of events occurring before closing.

7.3 The buyer assumes all the obligations of the seller in connection with employee matters, including collective bargaining agreements, retirement and other benefits, as stated above. For a period of one year following the transfer, the new employer cannot terminate or modify the existing collective bargaining agreement, except in connection with working hours. If, however, the employees are acquired by a company that, from the perspective of the employees, already has in place a more favorable collective bargaining agreement, then the terms of that agreement will apply to the new employees.

7.4 A contractual stipulation in an asset purchase agreement to the effect that the buyer will not be responsible for severance and similar liabilities is not enforceable against employees who were terminated at or before closing. It is fairly common practice, however, for the asset purchase agreement to stipulate that the seller is liable for such payments and will indemnify the buyer to the extent that a terminated employee takes action against the buyer for such liabilities. The buyer's recourse in the event of a claim by a terminated employee is to enforce the seller's indemnity.

7.5 A seller must notify and seek the opinion of the employees' workshop council before making a decision concerning the sale of all or substantially all the assets. The workshop council must respond to the seller within fifteen days of such notification; otherwise, the consent of the workshop council is presumed. If the employer fails to comply with this requirement, the sale of the assets is null and void if the workshop council applies to the court to establish such nullity.

7.6 If a collective bargaining agreement is transferred with the employees, then for a period of one year following the acquisition, the collective bargaining agreement cannot be modified (except in connection with working hours) absent the consent of the employees. (See Subsection 7.3.) If there is no collective bargaining agreement, the normal provisions of the Labor Code apply regarding termination, taking into account the accrued benefits of the employee according to the doctrine of general labor succession as described above.

7.7 The buyer assumes all accrued liabilities in connection with employees transferred to it as a result of the acquisition (e.g., occupational injury and long-term disability payments, bonus payments for long-term employees, subsidized holiday payments, annual bonuses, subsidized meals and low-interest housing loans).

8. PLANT CLOSING LAWS

The ordinary provisions on termination of employment are set forth in the Hungarian Labor Code, which describes the procedures to be followed by an employer in case of a "staff reduction" (i.e., the mass layoff of employees), as well as the rights of so-called interest representation organizations of the employees in this situation. The powers to enforce the relevant provisions of the Labor Code are vested in the local (county) labor centers under the direction of the National Labor Center, which is in turn under the supervision of the Ministry of Labor. Each local labor center has jurisdiction over employers having their registered head office or place of business in that county.

Staff reduction is defined more specifically as a reduction that occurs in connection with an employer's operation when the relevant numbers of employees affected are the following:

- an employer that employs between twenty and 100 employees decides to reduce the number of its employees by at least ten, or
- an employer that employs between 100 and 300 employees decides to reduce the number of its employees by at least ten percent or
- an employer that employs at least 300 employees decides to reduce the number of its employees by at least thirty.

In these cases, the employer must inform (a) the competent labor center and (b) the workshop council of the employer (or in the absence thereof, the employees' interest representation organization at such employer) of its decision. Before making its decision on staff reduction, the employer must initiate a consultation with a committee formed by the representatives of the employees' interest representation organization. Seven days before such consultation, the employer must provide written notice to the representatives on the following:

- the reason for the planned staff reduction,
- the number of employees affected and their occupations,
- the total number of employees employed before the decision on staff reduction and
- the time of implementation of the planned reduction.

The consultation must begin at least fifteen days before making the decision on staff reduction.

The employer must advise the affected employees and the local (county) labor center of its decision regarding staff reduction at least thirty days before delivery of the notice of ordinary termination. This provision also applies in the event of liquidation or final accounting (winding up) of a company. The delivery of any notice of ordinary termination of employment by the employer, in breach of any of the provisions outlined above, is null (i.e., ineffective). To make a determination of such nullity, the workshop council, the trade union or the affected employees may have recourse to the relevant labor court.

Under the Labor Code, the employees of a single employer elect a workshop council from among themselves to manifest their participation vis-à-vis the operation of their employer. In Hungary, trade unions are usually organized on an industrywide basis and, quite often, more than one trade union is active in one company. Trade unions and workshop councils are distinct entities with different rights and obligations under the Labor Code.

9. ASSIGNMENT OF CONTRACTS

As a general rule and apart from contracts of employment, there is no provision in Hungarian law under which contracts are automatically assigned to the buyer upon an acquisition of assets.

10. NONCOMPETITION

10.1 The Hungarian Competition Act prohibits agreements (a) that are aimed at the prevention, restriction or distortion of economic competition or (b) that have or may have such an effect, except when such agreements are of minor importance or when they are concluded between related undertakings. An agreement is deemed to be of minor importance when the total market share of the entities concerned does not exceed ten percent of the total market. Noncompetition clauses in the context of asset sales are generally understood to fall within the scope of such prohibition, although the Competition Act was enacted very recently and there are only a few decided cases under the new legislation.

10.2 Noncompetition clauses between employer and employees, outside the context of an asset sale, have been held valid under the Labor Code for a maximum of three years, provided the employee receives a separate consideration for agreeing to the restriction on employment. It is unclear whether the new employer (i.e., the buyer of the assets) could enforce such a clause against the employee. Many lawyers believe that the new employer could do so on the ground that the central principle of general labor succession means that the employer has not changed when a buyer acquires all or substantially all the assets of a company or a business unit of a company.

11. CHOICE OF LAW, JURISDICTION AND ARBITRATION

11.1 Generally speaking, Hungary allows freedom of choice in determining applicable law in asset purchases and other types of acquisitions when at least one of the parties is not Hungarian. In disputes regarding real estate and intellectual property rights, however, Hungarian law must be applied.

When the parties to an asset purchase agreement include at least one non-Hungarian person, the parties may, as a general rule, freely stipulate the jurisdiction to which they will submit themselves, whether before a court of law or to arbitration. Restrictions apply when such a choice of law or jurisdiction is contrary to principles of Hungarian public order or is designed to avoid the application of mandatory provisions of Hungarian law.

Two Hungarian companies may not validly stipulate for the application of non-Hungarian law.

11.2 Binding arbitration is possible in Hungary pursuant to Act LXXI of 1994 on Arbitration. The Hungarian Chamber of Industry and Trade has established a court of arbitration, which has its own rules of procedure. Arbitration awards are enforceable in local courts, subject to certain limited rights of appeal and review.

The New York Convention of 1958 has been ratified in Hungary and foreign arbitration awards are generally enforceable in Hungary, subject to limited rights of appeal and review.

11.3 Foreign investors in Hungary are in many cases wary of submitting themselves to the jurisdiction of Hungarian courts and, to a lesser degree, to the jurisdiction of Hungarian arbitration. Arbitration before the Court of Arbitration attached to the Hungarian Chamber of Industry and Trade is, however, increasingly viewed as an acceptable alternative to international arbitration by many investors.

12. OTHER ISSUES

12.1 We are not aware of any such clauses being included in asset acquisition agreements in Hungary.

12.2 [No response.]

12.3 We are not aware of any other significant issues related to asset acquisition transactions in Hungary that should be raised.