SZECSKAY
ÜGYVÉDI IRODA - ATTORNEYS AT LAW

H-1055 BUDAPEST, KOSSUTH TÉR 16-17
(MAIL: H-1245 BUDAPEST PF/POB 1228)
HUNGARY

TEL: +36 (1) 472 3000 • FAX +36 (1) 472 3001 • INFO@SZECSKAY.COM • WWW.SZECSKAY.COM

CROSS-BORDER MERGERS FROM THE PERSPECTIVE OF HUNGARIAN LAW

PUBLISHED BY:

CENTER OF INTERNATIONAL LEGAL STUDIES AND KLUWER LAW INTERNATIONAL

IN

COMPARATIVE LAW YEARBOOK OF INTERNATIONAL BUSINESS ON

ISSUES IN CROSSBORDER MERGERS AND ACQUISITIONS

1 INTRODUCTION

Due to the close and continuous interaction between the economies and markets of different EU member states, there is a growing pressure on companies to adapt to the changes of the economic climate as freely as possible, and without administrative burden. In the face of such a vivid economic environment, companies that want to survive must be able to keep up with the fast flow of changes.

This now makes the proper harmonization of corporate law vital in order to facilitate the operation of the internal market, by allowing companies to either relocate their seats from one member state to another or carry out cross-border mergers.

1.1 Cross-Border Merger Regulations in Hungary, Applicable Rules

Member States were required to transpose the Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (hereinafter the "**Directive**") into their national laws by 15 December 2007. Hungary achieved this by adopting the Act CXL of 2007 on the Cross-Border Mergers of Limited Liability Companies (hereinafter the "**Merger Act**"), which entered into force on 15 December 2007.

While Hungary has fulfilled its harmonization obligation, the Merger Act only contains special rules governing cross-border mergers, including rather technical rules governing, for example, the contents of a draft merger agreement, the reporting obligations of the merging companies' executives, or the participation of employees in the decision-making.

As for the general rules of mergers, it is the Act IV of 2006 on Business Associations (hereinafter the "**Business Associations Act**") that regulates the process and necessary steps of mergers, whereas the Act V of 2006 on Company Information, Company Registration and Winding-Up Proceedings (hereinafter the "**Company Registration Act**") applies to procedural issues.

Based on the Merger Act, limited liability companies, public limited liability companies, European public limited liability companies, cooperative and European cooperatives qualify as a limited liability company.

Pursuant to Section 1 (2) b) of the Merger Act, the merger of limited liability companies as per the Business Associations Act qualifies as a cross-border merger if each of the companies involved in the merger was established under the laws of any EU member state and each of the companies' seat, central place of management or business headquarters is located in any EU member state, provided that at least one of the companies concerned is governed by the laws of another member state.

1.2 Importance of Cross-Border Mergers

Under the current state of the harmonization, if a company established under the laws of a member state wishes to relocate its seat to another member state, it must re-establish of that company in the member state the company wishes to relocate to. In case of an operating company, this relocation is impractical because continuity of the operation of the company cannot be adequately ensured.

One of the fundamental reasons why the existence of cross-border mergers is so meaningful is because such mergers can be used as a method of corporate restructuring and seat relocation within the European Union. In case of legal succession through mergers, the continuity of operation can be assured. In addition, under the principles of general legal succession, various problems can be prevented which may have otherwise arisen when terminating a company in a member state, when founding a new company in another member state, and when transferring assets and contracts to the new company can be prevented.

Since companies are established under national laws, relocating their seat from one member state to another is generally not possible according to the opinion of the Court of Justice of the European Union (previously, European Court of Justice), as indicated in the Daily-Mail casein reference to community law.

Cartesio case

The Court's decision the Cartesio-case contributed significantly to the above interpretation of the role of national corporate laws in the EU. A company called Cartesio, with a Hungarian registered seat, wanted to relocate this seat to Italy and requested the Court of Registration to register the change. The Court of Registration ruled that the simultaneous relocation of the registered seat to another member state while keeping the national law of the company is not possible. In order to perform such a change, the company would first have to be terminated in Hungary and then re-established in Italy. Cartesio has appealed against the decision at the Court of Appeal of Szeged, arguing that if Hungarian law differentiates between business associations on the basis of the location of their registered seat, it may violate Articles 43 EC and 48 EC. The Court of Appeal of Szeged has contacted the European Court in order to request its preliminary decision. On 16 December 2008, the Court ruled that

"*as Community law now stands, Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.*"

(Articles 43 and 48 of the Treaty on the establishment of the European Community correspond to Articles 49 and 54 of the Treaty on the Functioning of the European Union.)

The Court has clearly stated that a company shall only exist in the legal framework of a member state and cannot simply up sticks and move its registered seat on the basis of Articles 43 and 48.

Although there is a growing demand for simple seat relocation for companies established under national laws, this question remains open.

Companies that are established under EU law however have no such problems relocating their company seat. Section 13 of Act XLV of 2004 on the European Public Limited Liability Company contains the rules applicable in case of seat relocation, whereas additional "technical" rules are contained in the Company Registration Act (see *e.g.* Section 28 (4) and (5) and Section 54 (4) and (5) *etc.*). Similar rules can be found in laws applicable to European Economic Interest Groupings and European Cooperatives.

It may become even more difficult for cross-border seat relocation of companies established under national laws due to certain tax considerations on top of the above-mentioned legal difficulties.

As already touched on above, if a company established under the laws of a member state wishes to relocate its seat to another member state, this can only be done by re-establishing the company in the new member state. Unfortunately, this is totally impractical for an operating company, since operations would have to be stopped once the company terminated in the original country. Fortunately, in case of legal succession through mergers, the continuity of operation can be easily ensured based on the principle of general legal succession, and various problems can be prevented that arise through termination of a company in one member state and founding a new company in another and transferring assets and contracts to the new company.

Cross-border mergers clearly play a vital role in EU corporate law, since they can be used as a method of corporate restructuring and seat relocation within the European Union instead of a seat relocation procedure which is rendered almost impossible by the national laws.

In our article we also reflect in detail on the role of a European Public Company (hereinafter the "**SE**"), an alternative form option to the corporate form currently primarily chosen by companies. An SE operates in the territory of at least two member states, and a dominant part of their operation is located in the Member States of the European Union.

An SE can function as a corporate form that promotes the mobility of the companies in the EU member states. If the operation of the SE proved to be more effective in another EU Member State due to business considerations or a change in the legislative climate, the company's registered seat can be relocated quickly and inexpensively without having to terminate the company.

We further address the issue of the legal succession of employers during cross-border transactions, because these schemes also materially affect the relationship with the employees of the entities involved in the cross-border transaction. Harmonization in this are was and still is a particular challenge, as legal regulations were very much diversified even within the European Community. As the safe operation of the internal market requires harmonized rules in various fields of law, including employment-related regulations, the harmonization of laws with respect to the protection of employee rights in the case of transfer of undertakings, business or parts of undertaking or business was an important step in the development of Community law. In our article we attempt elaborate on these issues in detail.

As is clear from this introduction alone, there are still a number of open issues in terms of harmonization in both corporate law and cross-border mergers. It would be a significant step for EU legislation if companies other than limited liability companies were also allowed to participate in cross-border mergers, if cross-border demergers were also made available to companies, or if EU laws provided detailed provisions on the cross-border legal succession on the employer's side, as this is another field of law that can raise concerns when managing cross-border mergers or other cross-border transactions.

2 APPLICABLE RULES ON THE PROCESS OF CROSS-BORDER MERGERS IN HUNGARY

The process of a cross-border merger does not substantially deviate from a national merger because the same basic steps apply in both circumstances, as pursuant to the applicable provisions of the Business Associations Act. Yet, in case of cross-border mergers, certain additional requirements must also be met. Experience shows that the preparation of company restructurings, especially with cross-border mergers starts well before the first formal steps commence. This is because the preparation of documents necessary for restructurings and the preparation undertaken by the respective companies for the restructuring may take considerable amounts of time.

2.1 Preparation of Merger, Joint Draft Merger Agreement

The process officially starts with the proposal of the executive officers. If there is a supervisory board at the company, the proposal of the executive officers must be opined by the supervisory board. This is when the quotaholders' meeting and shareholders' meeting first decide on a merger by determining the end date of the draft balance sheets. At the same time, the quotaholders/shareholders also authorize the executive officers of the company to prepare the draft balance sheets and the supporting draft asset inventories along with any other documents necessary for the passing of the final merger decision as required by law or required by the quotaholders' meeting/shareholders' meeting. In the case of cross-border mergers, the most important of the "other necessary documents" is the joint draft merger agreement, which is prepared by the executive officers of the companies concerned with the merger. Content-wise, this corresponds to a national merger agreement, however, the Merger Act also requires some extra elements to be contained in the merger agreement, beyond those laid down in the Business Associations Act.

2.2 Merger Report of the Executive Officers and the Auditor

Pursuant to Section 4 of the Merger Act, the executive officers of the limited liability companies taking part in the merger are required to prepare a written report and a joint draft merger agreement for the quotaholders (shareholders), in which they detail the reasons for the merger, including the legal and economic factors. The report also explains the impact of the merger upon the quotaholders (shareholders), creditors, and employees (the "Report"). The executive officers of the companies involved in the merger have unlimited liability and are jointly and severally liable under Section 26 (2) of the Business Associations Act for the damages caused during the preparation and execution of the cross-border merger in a manner attributable to them.

The auditor examining the draft balance sheets is required to make a report at least 30 days prior to the date when the quotaholders' meeting/shareholders' meeting will decide on the approval of the draft merger agreement. In the report the auditor must describe the methods which the limited liability companies involved in the merger have chosen to determine their stakes in the new company. The auditor's report must also describe the results derived from such methods and whether the auditor believed the stakes reached through such methods were adequate or not. If the assessment by the auditor is extremely difficult, such difficulties must also be described in the report.

However, Section 4 (5) of the Merger Act provides that upon unanimous agreement by all the owners of each limited liability company involved in the merger, no such auditor's report is necessary. Due to the requirement concerning unanimity, this exemption may be hard to apply in practice, especially if the companies involved in the merger have several owners.
In connection with the auditing obligation, it is worth emphasizing that not all member states are familiar with the obligation set forth in the Business Associations Act, under which the draft balance sheets must be examined by an independent auditor. For example, the Austrian and the Polish legal system are silent on such an obligation. In this respect, this means that Hungarian law prescribes an additional obligation, which must be taken into account when determining the time frame for the merger process.

2.3 Information, Consultation, Legal Succession on the Employer's Side

The Merger Act provides for some extra requirements concerning the disclosure of information, in addition to those laid down in the Business Associations Act. The purpose of these extra requirements is to furnish creditors with information before the approval of the joint draft merger agreement. The joint draft merger agreement and notice to the creditors must be published in the Companies Gazette at least 30 days prior to the date when the draft merger agreement is approved by the quotaholders / shareholders. The report of the executive officers and the auditor's report on the new stakes (if such report has been prepared) must be submitted to the court of registration, contemporaneously with the date of publication.

Under the current regulations, in case of cross-border mergers the informing the employees and involving the employees in decision-making process are of utmost importance. The Merger Act itself does not provide for the involvement of employees in the decision-making process in detail; instead those rules are set forth in the Business Associations Act and the Act on European Public Limited Liability Company.

2.4 Decision on Merger, Last Phase of Merger Process

The decision on cross-border mergers has to be made in accordance with the deadlines laid down in the Business Associations Act. In case of cross-border mergers, it is possible for the owners of the respective Hungarian company to decide on the merger in one step instead of two, so long as the articles of association of the company provide for this in accordance with Section 71 (1) of the Business Associations Act. In this case, the decision shall be made on the basis of the documents and reports prepared by the management prior to the date of the owners' meeting.

Within eight days following the date of the decision on a merger, measures must be taken to have the decision published in the Companies Gazette on two separate occasions. Following publication, the court of registration may be requested to issue a certificate proving that the company has fulfilled the applicable merger rules.

The Merger Act requires that the court of registration, responsible for the data of the company involved in the merger, delete the company from the registry in accordance with Section 87 (1) of the Business Associations Act, following notification of the merger by the competent authority of the other member state registering the merger.

3 LEGAL SUCCESSION ON THE EMPLOYER'S SIDE

Cross-border transactions often have an impact on the structure of the involved entities, which also materially affects the relationship with the employees of the entities involved in the cross-border transaction. From the employees' perspective, it is crucial that their rights are protected in case of legal succession on the employer's side. The legal regulations in this field were originally very much diversified even within the European Community. As the proper operation of the internal market requires harmonized rules in various fields of law, including employment-related regulations, the harmonization of laws with respect to the safeguarding the employees' rights in the case of transfer of undertakings, business or parts of undertaking or business was an important step in the development of Community law. The first directive in this field was Council Directive 77/187/EEC of 14 February 1977 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of businesses. This was subsequently amended and replaced by the Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Members States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (hereinafter the "**Acquired Rights Directive**"), which contains the main rules applicable to legal succession on the employer's side that were transposed into Hungarian law back in 2003. The implemented rules apply from 1 July 2003.

3.1 The Acquired Rights Directive

Article 1 Paragraph 1 a) provides as follows:
"*This Directive shall apply to any transfer of an undertaking, business, or part of an undertaking or business to another employer as a result of a legal transfer or merger.*"

For the purposes of the Acquired Rights Directive, "*transfer*" means the transfer of an economic entity which retains its identity and "*economic entity*" means an organized grouping of resources which has the objective of pursuing an economic activity whether or not that activity is central or ancillary.

Article 1 Paragraph 2 of the Acquired Rights Directive provides as follows:
"*This Directive shall apply where and in so far as the undertaking, business or part of the undertaking or business to be transferred is situated within the territorial scope of the Treaty.*"

The wording of the cited provisions suggest that the Acquired Rights Directive applies to each transfer occurring within the EU, including cross-border transfers (*i.e.* also cross-border mergers) from one member state to another. However, the Acquired Rights Directive is silent on the issue of applicable/governing law, in that it provides no guidance as to how the relationship between the member states is governed.

The Merger Act is also silent on legal succession on the employer's side.

3.2 Transposition of the Acquired Rights Directive into Hungarian Law

3.2.1 Applicable Regulations

Pursuant to the Act XXII of 1992 (hereinafter the "**Labour Code**"), "*it shall be regarded as a legal succession in the person of the employer (referred to as "**legal succession on the employer's side**") if*

a) the legal succession takes place by virtue of legal regulation or
b) an independent unit of material and/or non-material assets of the employer (such as a strategic business unit, plant, shop, division, workplace or any part of these) are transferred based on and in accordance with an agreement to an organization/entity or person falling within the scope of the Labour Code for the purposes of further operation or the restart of operations if such transfer takes place within the framework of e.g. sale, exchange, lease, leasehold or capital contribution for a business association."

The scope of the Labour Code is worded as follows:

"*Unless otherwise prescribed by international private law, the Labour Code shall apply to all employment relationships on the basis of which work is performed in the territory of the Republic of Hungary, as well as to the work performed by an employee of a Hungarian employer abroad under temporary status.*"

Under the Labour Code, one can only talk about legal succession on the employer's side if both the legal predecessor employer (*i.e.* the transferor) and the legal successor employer (*i.e.* the transferee) fall within the scope of the Labour Code and the conditions laid down in either clause a) or clause b) above are fulfilled. For example, an Austrian company operating and having employees in Vienna does not fall within the scope of the Labour Code.

Taking the above provisions into account, one may come to the conclusion that if a Hungarian company operating and employing in Budapest transferred employees to an Austrian company operating in Vienna and the transferred employees worked in Vienna after the transfer, this would most likely not qualify as a legal succession on the employer's side for the purposes of the Labour Code. This is because the Austrian company does not fall under the scope of the Labour Code.

The Labour Code is silent on cross-border transfers/mergers and there is no underlying Hungarian judicial practice relating to cross-border transfers/mergers from the perspective of legal succession on the employer's side. Unfortunately, the Merger Act is also silent on the legal succession on the employer's side. Under the Labour Code, it is worth noting that if a Hungarian company transfers employees working in Budapest to, for example, another Hungarian company operating in Hungary, this qualifies as a legal succession on the employer's side for the purposes of the Labour Code if the requirements mentioned under clause b) above are met. However, no specific rules exist if a cross-border merger takes place.

3.2.2 General Rules Applicable to Transfers

In case of a transfer, the applicability of clause b) above shall be carefully examined. One question that arises is whether the transaction includes the transfer of an independent unit of material and/or non-material assets.

If the activity to be acquired by the transferee as a result of the transaction is an independent unit of the transferor or consists of a separable group of material and/or non-material assets, the rules of legal succession must be complied with (provided that both the transferor and the transferee fall under the scope of the Labour Code). In terms of the Acquired Rights Directive, it must be examined whether an economic entity is transferred or not.

When it comes to evaluating the situation from a labour law perspective, among other things, it must be taken into account whether (i) the acquired business unit is a complete business line or a well-separable part of the transferor's business or only a collection of agreements; (ii) only agreements are "transferred" (assigned) or also material and/or non-material assets are acquired; and (iii) the employees of the Hungarian subsidiary concerned were exclusively or mainly dedicated to works to be completed by the transferor or such work was only a partial task in the employee's job description. The issue of whether or not the business is a labour-intensive sector may also be relevant (on the basis of the practice of the European Court of Justice) since in a labour-intensive sector, the fact that assets were not transferred does not necessarily exclude the application of the rules governing legal succession on the employer's side. This means that even if only employees are transferred to the transferee, the transfer may still qualify as a legal succession on the employer's side (if the transfer occurs in a labour-intensive sector).

Pursuant to the practice of the European Court of Justice, a sector is regarded as labour-intensive if the business is essentially based on manpower and the tangible assets belonging to the business do not contribute significantly to the performance of the activity. In labour-intensive sectors, the transfer of the economic unit only takes place if the new employer pursues the activity in question and takes over a major part of the employees – in terms of their number and skills – assigned by the predecessor to that task. As concerns asset intensive-sectors, the transfer of the economic unit can only be established if the assets that are necessary to the proper functioning of the entity are transferred. However, in both sectors, other merits of the case, for example, the place of work might have substantial importance.

3.2.3 Cross-Border Mergers

When it comes to cross-border mergers, no special rules give us guidance on the issue on legal succession on the employer's side. Taking into account that there is a general legal succession that occurs upon the merger, one may conclude that the legal succession on the employer's side is covered by general legal succession. Even in this case however, the question remains: what law is applicable to such legal succession? Under the Hungarian Labour Code, there is no legal succession on the employer's side unless both the transferor and the transferee employers fall under the scope of the Labour Code and all requirements laid down in clause b) above are met. If the transferee is an Austrian company whose employees work in Vienna, no legal succession on the employer's side takes place for the purposes of the Labour Code. If the employees taken over from a Hungarian company by an Austrian company (that had employees working in Hungary before the merger) continued working in Hungary, the take-over may qualify as legal succession on the employer's side since the work would actually be carried out in Hungary.

However, if a cross-border merger takes place whereby a Hungarian company merges into an Austrian company, in most cases, no work would be carried out in Hungary. The question is what law is to be applied to ascertain whether there is a legal succession on the employer's side? If there is no legal succession on the employer's side under Hungarian law, should we also examine the provisions of the Austrian Labour Code? In our view, we should. What if there is no legal succession under the Austrian Labour Code either? Would the general legal succession give satisfactory protection to the employees taken over or the merger could be detrimental to the employees?

3.3 Main Rules of Legal Succession in Employment

If the provisions of the Labour Code concerning the legal succession apply to a transfer (or *e.g.* a cross-border merger where an Austrian company having employees in Hungary merges into a Hungarian company with employees in Hungary), the following rules must be complied with.
Under the Labour Code, the rights and obligations of the predecessor (*i.e.* the transferor) concerning employment relations existing at the time of succession are automatically transferred to the successor employer (*i.e.* the transferee) at the time of succession. This means that the employees (along with their employment agreements) are automatically taken over by the successor employer.

The predecessor and the successor employer are subject to joint and several liability for liabilities incurred prior to legal succession if the claims are enforced within 1 year of the date of legal succession. This rule is in line with Article 3 (1) of the Directive, which provides as follows:

"Member States may provide that, after the date of transfer, the transferor and transferee shall be jointly and severally liable in respect of obligations which arose before the date of transfer from a contract of employment or an employment relationship existing on the date of the transfer."

The predecessor employer shall inform the successor employer of the rights and obligations arising out of the employments. Failure to supply the information shall have no effect on the application of the legal consequences arising from the succession or on the employees' rightful claims.

The period of limitation for employment-related claims is set at three years.

If an employment is terminated by the legal successor employer within one year of the date of legal succession through

a) ordinary dismissal for reasons in connection with the employer's operations or

b) the employer's immediate termination notice in case of a definite-term employment,
the legal predecessor employer shall, as a surety, be liable for the employee's emoluments due upon the termination of employment.
The surety liability applies if

a) the predecessor employer,
b) the company controlled by the predecessor employer,
c) the majority owner of the predecessor employer, or
d) the company in which the majority owner is the organization referred to in clause c)
holds more than fifty per cent of the votes in the supreme body of the successor employer.

In the case of legal succession, the predecessor and the successor employer shall, within 15 days prior to the date of succession, inform the local trade union or, if there is no trade union, the workers' council or, if there is no workers' council, the committee formed from the representatives of non-union employees concerning

a) the schedule or proposed date of legal succession,
b) the reasons for legal succession,
c) the legal, economic and social consequences affecting the employees,

and shall initiate talks aimed at reaching an agreement concerning other proposed actions that affect the employees. The talks shall cover the principles of the actions, the methods and means of avoiding detrimental consequences as well as the means for mitigating such consequences.

Where legal succession is decided by the organization or person who controls the predecessor employer, it shall have no effect on the predecessor and successor employer's obligation to provide the information and to hold talks as specified above. The predecessor and the successor employer shall not be excused regarding their failure to satisfy the obligation to provide information and hold talks on the grounds that the controlling organization or person had failed to inform them concerning its decision for succession. If an employer is dissolved without succession, the obligations prescribed in connection with the provision of information and the talks regarding legal succession shall be honoured by the liquidator or receiver. If an employer violates the rights of the workers' council or the trade union, the workers' council or the trade union affected may seek remedy in court.

3.4 Additional Considerations

On the basis of Article 4 of the Acquired Rights Directive, the transfer of an undertaking, business or part of the undertaking or business shall not in itself constitute grounds for dismissal by the transferor or the transferee. This rule is also declared in the Labour Code, which provides that the change of employer by legal succession may not in itself serve as grounds for termination by ordinary dismissal of an indefinite-term employment agreement.

On the basis of the above, the employees of the Hungarian subsidiary may not be dismissed by ordinary dismissal only because of the transaction. However, this does not necessarily mean that their employments may not be terminated by the Hungarian subsidiary on justified legal grounds in accordance with the Labour Code. The types of termination of employment agreements do not fall within the scope of this article.

It is also worth noting that the legal succession on the employer's side occurs by virtue of the Labour Code automatically if the conditions of the succession mentioned above are fulfilled. This means that the employees may not choose between the employers in their own discretion in case of legal succession and do not have a right to object to succession.

Any declaration of the employer or the employee or any agreement between them which violates the terms of the Labour Code is deemed to be void. Therefore, a written statement in which the employee declares that he/she does not wish to be employed by the transferee has no binding effect.

4 MIGRATION OF COMPANIES (TRANSFER OF REGISTERED OFFICE)

Council Regulation No. 2157/2001 on the Statute for a European Company (hereinafter the "**Regulation**") and the Act XLV of 2004 on the European Public Limited Liability Company (hereinafter the "**European Company Act**") entered into force on October 8, 2004. The purpose of the Regulation is to enhance the internal market of the European Union through the establishment of a new company form whose operations and activities are not limited to only one Member State. The possibility of transferring the registered office of the SE (the "SE") from one Member State to another was created within the framework of the new legislation.

Instead of the current corporate forms, the form of the SE may be chosen primarily by the large or mid-sized companies, operating within the territory of at least two Member States, and who have a dominant part of their operation located in the Member States of the European Union.

The new corporate form of the SE is a result of a nearly 30-year long legislative work. During the nineteen-seventies, numerous member states strongly objected to, or wished to limit the introduction of this corporate form. Although the draft of the law underwent several modifications in the European Union, Regulation on the SE was finally passed, together with the directive on the participation of employees. These two laws, together with the respective national laws, such as Hungary's European Company Act, entered into effect simultaneously in all EU Member States. By way of a rather complex system of legal provisions, on both the EU and the national level, they provide companies the opportunity to decide whether they wish to pursue their operation in a corporate form accessible within the legal framework of the member states, or under the new provisions on the SE.

The SE corporate form enables greater mobility for companies in the Member States of the European Union. If the operation of the SE may be more effective in another EU Member State due to certain business considerations or changes in the legislative climate, the registered seat of the company may be relocated quickly and inexpensively without having to terminate the company.

The provisions concerning the transfer of the registered office have particular significance in European company law because prior to their enactment there were no general rules in this specific area of the law. The transfer of the registered office between Member States produces several questions from the point of view of the investors, the creditors, the employees, and the authorities (especially the tax authorities), since the migration of companies may involve serious risk factors.

4.1 The Concept of Registered Office

Pursuant to Section 7 of the Regulation, the registered office of the SE must be located in the same Member State as its head office. The Member States may impose additional obligations on the European Companies within their territory by requiring that the registered office and the head office be located in the same place. The Hungarian regulation allows for this additional obligation by providing that the registered office of the SE must be the place of its head office. The concept of a registered office has not yet been defined or perhaps requires further clarification by the courts. In European practice, the registered office can be the business office of the management or the company's primary place of business.

4.2 The Possibility of Transferring the Registered Office between Member States

The former Hungarian regulation did not deal with the question of transferring the registered office between different states. If a Hungarian company wanted to migrate, it could be achieved only through indirect means. One of the ways in which to achieve this was to establish a foreign subsidiary in combination with the liquidation of the parent company. It is in this way that a new company could be established. The other possibility is that of a cross-border merger as described above.

On the basis of the Regulation, the European Company Act expressly declares that the registered office of an SE may be transferred from one Member State to another without the winding up of the SE or the creation of a new legal entity; in effect the company can preserve its former legal status following the transfer. This is one of the most important changes made by the Regulation because prior to this change, the transfer of registered offices was out of the question due to the discrepancies in the company and company registration laws of the different states. In the case of migration, the legal entity established by the law of one Member State would have moved into the jurisdiction of another state without the termination of its former legal status. Companies are the creatures of the national laws, and their creation, registration and operation are governed by the provisions of their national law. At the same time, it must be emphasized that among the Member States of the EU, cross-border mergers were not without precedent based on the harmonization of company laws. There are uniform provisions governing the creation and the legal status of SEs so that the different legal systems of the Member States cannot hinder the effective and less expensive transfer of registered offices.

4.3 The Protection of Investors and Creditors

On the basis of the Regulation, the European Company Act declares that the shareholders and the creditors of a company shall be entitled to examine the transfer proposal and the report on the legal and economic aspects of the transfer at least one month prior to the quotaholders/shareholders meeting to decide on the transfer. The Act emphasizes the protection of the minority shareholders who opposed the transfer (hereinafter the "**minority shareholders**") and the creditors.

The settlement of demands with the minority shareholders can be an important means to exit from the company for those stakeholders who do not want to take part in the migration. The proposal for the method of the settlement of demands must be prepared based on the application of funds statement and draft inventory of assets made according to Act C of 2000 on Accounting (hereinafter the "**Accounting Act**"). The settlement of demands with minority shareholders must be arranged in the same way as in the case of transformation of companies with respect to the proportion of equity to subscribed capital and the proportion of equity to the balance sheet grand total, as indicated in the application of funds statement. The general meeting will decide on the share of assets or on the method of payment to the minority shareholders. The share of assets must be paid to the minority shareholders within 30 days after the registration of the transfer, except if the parties agree otherwise.

When transferring the registered office from Hungary to another Member State in the EU, the obligations specified by the Accounting Act, such as preparing a report, preparing an audit, and publishing data, must be completed within 150 days after the registration of the newly registered office.

The Regulation protects the interests of the creditors and the stakeholders with a provision that excludes the transfer of the registered office if proceedings for winding up, liquidation, insolvency, or other similar proceedings have been brought against the company.

4.4 Issues Concerning Taxation

Act LXXXI of 1996 on corporate and dividend tax (hereinafter the "**Corporate Tax Act**") concerns SEs, which are registered in Hungary. The tax liability is all-inclusive in respect to these companies; meaning that the tax liability includes all income derived either from abroad or from within Hungary.

The Corporate Tax Act defines certain provisions concerning those SEs that transfer their registered seat from Hungary to another Member State. Pursuant to Section 16(7) of the Corporate Tax Act, the transfer is equivalent to termination without legal succession, except when the SE continues its activities in Hungary as a foreign company. After the transfer, the tax liability of the SE is limited to income derived from the activities conducted in Hungary.

One of the primary questions with respect to the taxation aspects of the transfer is that the tax authority is able to hinder the transfer if the conditions of termination without legal succession are not fulfilled. This is particularly true when concerning the above mentioned provisions of the Regulation, which exclude the transfer of the registered office in the case of commencement of winding up, liquidation, insolvency, or other proceedings.

4.5 The Effects of the Possible Establishment of SEs

The Regulation and the provisions of the Member States concerning SEs create a new company form that can be established according to the same rules throughout the European Union. If the economic interest of the shareholders with the controlling majority interest dictates, the registered office of an SE can be transferred among the Member States.

It still remains a question whether or not those engaging in business will use this opportunity. The minimum amount of the subscribed capital, EUR 120,000, and the relative high costs of the registration process can make the expansion only possible for large or medium sized Hungarian companies that wish to expand in the European Union. In practice, the variable taxation environment on the Hungarian and on the European level may hinder the spread of European Companies. Additionally, with large companies, the transfer can result in social upheaval as well, which regulation attempts to govern. With the transfer of branch offices, important factories, parts of factories, transfers of production, the reduction or cessation of activities or for measures concerning collective redundancy, the Board of Directors is obligated to inform the representative body of the employees before the acceptance of any such decision. If the Board of Directors accepts a decision which is not in compliance with the opinion set forth by the representative body of employees, the representative body may initiate negotiations to try to reach an agreement. Until the conclusion of any such negotiations, the decision cannot be executed.

Furthermore, the complex legal background of the SE and the changes initiated among the laws of the member states may provide the opportunity for different schemes involving taxation, since it is not likely that new significant tax provisions would be passed on a community level regarding the SE because of the danger of violating different provisions of EU law.

In summation, on the basis of the possible advantages and disadvantages, migration of the traditionally large Hungarian companies, en masse, is not a real possibility. A noteworthy example from Hungary involves the success story of the engineering firm Graphisoft, which after its continuous growth in 2006, demerged its real estate division from the software division to create Graphisoft Park SE; a public European corporation listed on the Budapest Stock Exchange. Another prominent example involved Fotex Group, the extraordinary General Assembly of which decided on the transformation of the company into a European Corporation in 2008. The transformation into an EU company provides the opportunity for changing the company's registered place of business within the European Union. Besides having other advantages, this provides the company with the opportunity to carry out the expansion of the companies business activities on an International level.

The contents of this article are intended to provide only a general overview of the subject matter. Specialist advice should be sought for specific matters. Queries relating to this article should be addressed to the authors at:

INFO@SZECSKAY.COM