



# roadmap11

schönherr







# shape

Business law is a highly complex, internationally intertwined and rapidly developing affair. Accordingly, it is essential to recognise the latest changes in the legal environment in a timely manner, establish appropriate strategic plans and look ahead to and position oneself for anticipated developments.

With this **roadmap 11**, we contribute to these processes from our own fields of expertise.



# Share



# Scope

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# Shape

## events

often have a tendency to sweep us along with them, to shape our lives, our work, our moods, our plans. It seems that such shaping by external events has been even more pronounced in recent times, with large-scale financial, economic and social issues dominating the headlines and threatening to overwhelm us. But the concept of “shape” has a flip side, one implying control, action and empowerment. In unpredictable times, a positive and proactive approach to shaping events towards desired outcomes is called for even more.

**Shape is the central theme** of roadmap 11, an annual Schoenherr publication which presents an overview from our lawyers of recent and upcoming legal developments in our core practice areas, as well as critical insights and analyses of those developments.

Events can be influenced, plans can be made, strategies can be developed. That is the message of the roadmap. The knowledge and expertise provided by the roadmap is intended to help readers take control of events and shape their future successfully.

The illustrations in roadmap 11 are by Matthias Hauer, an Austrian photographer and cameraman with a wealth of experience in various visual media. His images in roadmap 11 provide a poignant interpretation of its theme of shape.

BRINGS





# Corporate Finance – Need for Modernised Bondholder Laws?



Martin Ebner

The proposed future banking regulatory liquidity framework is widely regarded as favouring corporate bond issues as compared to corporate lending. The reasons for this are explained by Walter Gapp in his article in this roadmap. Provided that recent investor experience in a prominent Austrian insolvency scenario does not distract the (international) investor base from Austrian bond markets, this, along with modernised documentation and bondholder legislation (such as the German *Schuldverschreibungsgesetz*, which entered into force in 2009), could be an important driver of corporate bond financing and investment banks' origination services in Austria and other European countries.

Can a legal technique contribute to fostering corporate bond issuance activity?

Leaving aside commercial restraints (inherent in the rather granular Austrian corporate landscape) to achieving the issuance sizes and bond ratings desired to tap (international) bond markets, certain peculiarities of Austrian insolvency and corporate bond legislation, and the resulting market standard documentation, will have to be addressed at the drafting level (or, especially as concerns insolvency matters [see Wolfgang Höller's article in this roadmap], even the legislative level) in order to achieve a level playing field of issuance activity.

In light of lessons learned in times of distress of certain issuers, (potential) issuers and also investors have started exploring alternatives to the currently rather inflexible regime when it comes to bondholders rights and, even more, when it comes to readjusting the commercial terms of an issuance to changed economic circumstances.

Status quo

Market-standard Austrian bond documentation operates on the basis that each bondholder can exercise his rights (including termination rights) individually. It does not anticipate that in certain circumstances, amendments to the terms and conditions of an issuance may be beneficial to both issuer and investor (eg, recalibration of covenant levels following a corporate reorganisation or temporary waivers to overcome short term financial distress).

In contrast to a loan instrument, where a borrower can turn to a specific lender or group of lenders, amendments to bond documentation can usually be achieved only with the consent of all parties (which, for all practical purposes, is not an option in case of a publicly offered and/or listed instrument) or by involving a bondholder trustee (*Kurator*) on the basis of a statute as old as 1874<sup>1</sup>. This creates a level of inflexibility that is not desirable. Whereas few issuers have launched exchange offers,

<sup>1</sup> Act on Trustees (*KuratorenG*) (Official Law Gazette RGBI 1874/49 as amended by BGBl 1991/10).

others have been left with no option but to open insolvency proceedings and have the court appoint a bondholder trustee.

### Changes to documentation

One way to address the above dilemma is to use bond documentation that (not dissimilar to the Anglo-Saxon market standard) provides for bondholder decisions to be taken by majority vote, with (of course) required majorities differing depending on the subject of the vote. Stipulations to this effect would in practice be supplemented by provisions on the appointment of a *Kurator* under the documentation governing the issuance.

Legal writing supports such structuring options also under Austrian law as it currently stands, provided that a level of bondholder protection equivalent to the statutory regime of the *KuratorenG* is achieved<sup>2</sup>. However, some uncertainty remains. For retail issuances, this uncertainty is mainly caused by the increasingly restrictive case law of the Austrian Supreme Court of Justice (*Oberster Ge-*

*richtshof*; OGH), testing terms and conditions of Austrian law governed bond issues against consumer protection legislation. In addition, two 1937 decisions of the OGH<sup>3</sup> will have to be taken into account, which held that the competent court may appoint a *Kurator* notwithstanding the fact that a bondholder trustee had been appointed in the terms and conditions of issuance.

### Need for legislative action?

To date, the Austrian legislator has not moved to modernise bondholder legislation. However, we believe that not only arranging investment banks and their (legal) advisors would welcome certain changes to this effect. Also corporate issuers aiming at tapping the (international) bond markets would certainly appreciate a more up-to-date and flexible legal regime. Ideally, the legislative process should be completed a bit swifter than in Germany, where the *Schuldverschreibungsgesetz* took some 15 years to finally be enacted – against the backdrop of the financial crisis, to enhance flexibility in restructuring situations.

 In order to support the expected increase of buy-side demand for corporate bond issuance which is expected to be largely driven by banking regulation, certain contract law mechanisms would seem to be helpful in order to preserve issuer flexibility.

<sup>2</sup> *Kalss, Anlegerinteressen*, p. 440 with further references.

<sup>3</sup> OGH 31.3.1937, 1 Ob 325/37 and 1 Ob 113/57

# Corporate Finance – From Lending to Bond Financing Implications of the Basel III Liquidity Framework<sup>1</sup>



Walter Gapp

The situation of short term liquidity and mid/long term structural liquidity were major factors contributing to the first stage of the financial market crisis affecting the world in 2008/2009. Liquidity was key to surviving at a time when Lehman Brothers collapsed and governments and central banks were busy developing rescue strategies. Although liquidity was not unregulated before the crisis, it was widely left to banks themselves to determine the precise impact of liquidity risk on their balance sheet. New regulatory measures<sup>2</sup> aim at setting precise liquidity standards, which are intended to have a significant influence on the composition of banks' balance sheets on both the asset and the refinancing side. Risk-based considerations and maturities are at the root of newly defined categories of assets and refinancing instruments (and the way they are interrelated).

Whereas the overall focus of a bank's future investment side may be expected to be on government bonds (as opposed to bank bonds), the proposed liquidity framework is widely regarded as favouring corporate bond issues as compared to corporate lending.

## Short term liquidity – Liquidity coverage ratio (LCR)

This short term liquidity ratio is intended to harmonise and flesh out the composition of highly liquid assets available to a bank under an acute stress scenario, taking into account an assumed 30 days survival period. Whereas, according to the proposed Basel III framework, bonds issued by banks (other than covered bonds)

would not qualify under any of the privileged categories of highly liquid assets, corporate bonds rated at least AA or A- will be eligible, subject to certain haircuts.

Moreover, according to the broad agreement of the Group of Governors and Heads of Supervision of 26 July 2010, a Level 2 bucket of liquid assets is proposed to be introduced. Such Level 2 assets may be eligible up to a cap of 40% of the required liquid stock. High-quality non-financial corporate bonds (and covered bonds) at a proposed rate of AA- and above are said to be included, subject to a haircut of 15%.

These measures may be expected to increase the demand for corporate bonds and cause banks to re-

<sup>1</sup> BCBS, International Framework for Liquidity Risk Measurement, Standards and Monitoring, 17 December 2009; broad agreement of the Group of Governors and Heads of Supervision of 26 July 2010.

<sup>2</sup> The Basel III liquidity framework, as proposed on 17 December 2009 and as revised by the Group of Governors and Heads of Supervision on 26 July 2010, is still subject to further review and calibration by the BCBS. In particular, the definition and the calibration of the Liquidity Coverage Ratio and the Net Stable Funding Ratio, as mentioned in this article, are subject to further change.

structure their asset portfolio in a way that, while giving priority to government bonds<sup>3</sup>, results in a greater volume of corporate bonds and covered bonds (the latter being the privilege of certain bank issuers only) and a smaller portion of bank bonds.

For the purpose of the Basel III liquidity framework, corporate bonds are said to include plain vanilla instruments only and are meant to exclude instruments issued by banks, insurance undertakings or investment firms.

#### Long term/structural liquidity – Net stable funding ratio (NSFR)

Under this long term and structural liquidity ratio, bank assets and activities (in liquidity terms: the required amount of stable funding) – based on a time horizon of one year – must be fully covered by available stable funding. The various categories of required stable funding (RSF) and available stable funding (ASF) are subject to specified factors expressed as percentages, thereby influencing on the composition of banks' balance sheets (in terms of instruments, counterparties and maturities). Whereas liquid unencumbered corporate bonds (or covered bonds, the latter being limited to bank issuers) rated at least AA and having a maturity of one year or over are currently proposed to attract a 20% RSF factor, corporate loans of a residual maturity of less than one year are proposed to attract a 50% RSF factor, and corporate loans of longer maturities are expected to be attributed a 100% RSF factor.

Having regard to this pattern, balance sheet managers may, while giving priority to government bonds, be expected to favour liquid and highly rated corporate bonds over (mid- and long-term) corporate loans and over classic bank bond instruments (where the circumstances allow).

#### Quantitative impact of higher liquidity requirements

On the refinancing side (which is not specifically considered under this article), banks are expected to lengthen the maturity of their wholesale funding (in particular, by continuously reducing wholesale debt of less than one year), thereby suffering increased funding costs. In addition, on the investment side, the shift towards higher yielding, better rated assets is assumed to considerably reduce the return on interest-earning assets. It is generally expected that banks will pass on the subsequent loss in profitability to their lending activities, resulting in increased lending spreads. To some extent, the effect may be mitigated by favourable effects on RWA charges, which are expected to be created by the rebalancing of assets towards less risky items .

As a corollary, the corporate origination business of banks offering those services will be favoured at the expense of classic lending. By thus "Americanising" corporate financing activity and instruments, the Basel III liquidity framework may further contribute to the increase of corporate bond issuance in Europe.

 The Basel III liquidity framework is expected to make highly rated corporate bonds a more attractive investment for banks both at the expense of bank bonds and corporate lending. Banks' balance sheet requirements will therefore likely be a driver for increased corporate bond issuance activity. Modernised bondholder laws (see the article by Martin Ebner in this roadmap) might help to address certain practical aspects of issuing bonds to a wider and sometimes inhomogenous investor base.

<sup>3</sup> In the consultation process, participants pointed out that this development would create concentration risk in respect of sovereign debt (eg BMF/OeNB/FMA, Answers to the Questions Contained in the Basel Committee on Banking Supervision's Consultative Documents, 14).

## F/X Hedging: Dealing with Foreign Exchange Risk in Serbia



Nataša Lalatović / Matija Vojnović

Financial instruments for reducing foreign exchange risk are available but have rarely been used... until recently. The National Bank of Serbia has taken a series of actions to promote the use of financial derivatives, and for the first time is loosening up its typically restrictive, formal approach.

### Foreign exchange risk

As many other countries in transition, in an effort to keep stable, low inflation, Serbia has a floating exchange rate. For Serbian companies involved in international trade, this means even higher foreign exchange risk. Doing business on the international market involves use of different currencies and a time gap between conclusion of a transaction and fulfilment of its obligations. Companies are facing uncertainty as to the final result of their transactions. They are unsure how to price their products to cover exposure to the foreign exchange risk. As a consequence, creating a stable, realistic business plan becomes very difficult.

### Instruments for reducing risk

The floating exchange rate will not be eliminated any time soon, and a natural hedge is not an option for most of the Serbian international trade companies. However, foreign exchange risks can be mitigated with the use of financial derivatives.

In Serbia, the legal framework allowing the use of financial derivatives was established in 2006, by the Foreign Exchange Act<sup>1</sup> (the F/X Act) and the Law on Securities' Market and Other Financial Instruments<sup>2</sup>. The necessary

by-laws were adopted in the middle of 2007. However, the actual practice started only in 2009 – 2010. Even then, they were used very rarely, and users were mainly large multinationals companies who were already familiar with these instruments. Small and medium size companies were either not interested or unfamiliar with currency hedging. Most of their scepticism stems from a lack of knowledge.

### Latest developments

In order to improve the current situation, the National Bank of Serbia (NBS) started a major campaign promoting hedging instruments, educating about their characteristics, appropriate use and benefits. In July 2010, the NBS started organising conferences and lectures and has created a special internet service. At the same time, more banks started including financial derivatives in portfolios of services they offer. Currently 17 out of 33 banks in Serbia are offering various FX hedging instruments. They started raising awareness about the options local companies have when trading on international market from their side as well.

Main financial derivatives currently available on the Serbian market are: (i) forwards, (ii) swaps and (iii) options.

<sup>1</sup> Official Gazette of the Republic of Serbia no. 62/06

<sup>2</sup> Official Gazette of the Republic of Serbia no. 47/06

The pricing of forwards or swaps is based on the current exchange rate of the currency being bought/sold and the difference in the interest rates of the two currencies involved.

The NBS also adopted additional bylaws in 2010 in order to loosen the requirements for documentation proving the obligation to pay in foreign currency, and regulated the spot sale/purchase of foreign currency between banks and the NBS. It also proposed amendments to the F/X Act which would provide for a more precise and wider definition of financial derivatives, and which would enable free and easy performance of transactions involving hedging instruments, with very limited and exceptional interference from the central bank. The legal procedure of amending the F/X Act is currently on the way, but information as to the final version of the text and the time estimate when it will be adopted is still not available.

## Conclusion

It is interesting to note that NBS is regarded as extremely cautious and conservative regulator. Generally, its regulators still base their work on the principle that everything that is not explicitly allowed in the laws or by-laws and regulated in detail is deemed prohibited. However, when it comes to derivatives, its approach is surprisingly liberal.

The effects of the latest action taken by the NBS are yet to be seen in the months to come. There is a lot of space for improving the level of sophistication of the current regulations and it is expected that higher demand will result in banks offering even better conditions for hedging instruments. However, it will ultimately be up to the companies to decide how to conduct their business and their readiness to rely on financial derivatives when trading internationally.

 **Small and medium size companies were either not interested or unfamiliar with currency hedging. Most of their scepticism stems from a lack of knowledge.**

## Ukraine Lifts Limitations Introduced during Crisis



Denys Sytnyk

On 24 November 2009, the Ukrainian government introduced a number of limitations to minimise the consequences of the global financial crisis. The lifting of these limitations should signal to potential investors that Ukraine feels confident about the future of its economic and financial system.

In May 2010, the Ukrainian government lifted the following:

- The ban on early repayment of loans by resident borrowers to non-resident lenders. The pre-term fulfillment of obligations of resident borrowers *vis-à-vis* non-resident lenders under cross-border financings is no longer prohibited.
- The ban on amendments to loans whereby repayment terms were shortened. In particular, it is no longer prohibited to introduce amendments whereby the terms of performance of obligations of resident borrowers *vis-à-vis* non-resident lenders were shortened, or an early repayment is agreed upon. It is no longer prohibited for the National Bank of Ukraine to register amendments of such nature to the already existing loans.
- The ban on foreign investments in currencies other than Ukrainian national currency (UAH). Foreign investments in monetary form could only be made in the national currency of Ukraine via investment accounts opened by foreign investors with Ukrainian banks and under a procedure set by the National Bank of Ukraine.
- The ban on settlements between non-resident investors (eg regarding shares in Ukrainian companies) in currencies other than the national currency of Ukraine. Such settlements do not have to be made in UAH.

Previously the government was concerned about Ukrainian individuals taking currency exchange risks. Starting on 1 January 2011, financial institutions will not be

prohibited from granting loans in foreign currencies to Ukrainian individuals.

In order to exercise greater control over lending, the government restricted loans granted in cash. Starting on 1 January 2011, the granting of loans in foreign currency and the repayment of loans (as well as the payment of interest) do not have to be made by wire transfers, ie such loans may now be granted and repaid in cash.

### Reintroduction of maximum interest rates

In order to attract long-term foreign capital regardless of price, the National Bank of Ukraine on 25 September 2008 lifted a limitation on interest rates on loans granted for over one year. However, starting from 15 October 2009, the limitation of interest rates under cross-border loans is again in force, as follows:

- for loans under one year, not to exceed 9.8% p.a.;
- for loans of one to three years, not to exceed 10% p.a.;
- for loans of over three years, not to exceed 11% p.a.

Floating interest rate may not exceed the LIBOR for three months deposits in USD plus 750 basis points.

The reimposition of maximum interest rates shows that the National Bank of Ukraine is no longer concerned about just attracting foreign loans at any cost, but is also conscious of the interest rates for such loans.

## Currency loosened

Certain currency control restrictions have also been loosened providing more freedom in export and import transactions. Starting with 23 June 2009:

- currency proceeds from the export of goods and services had to be credited to the exporter's account within 90 days of customs clearance for export or confirmation on service delivery; and
- importers could agree on a prepayment for goods and services up to 90 days prior to the customs clear-

ance for import of such goods and services or confirmation on service delivery.

These terms were extended to 180 days starting with 11 February 2010. The 180-day term may be exceeded if a positive conclusion from the Ministry of Economy and Industrial Policy of Ukraine is obtained for each transaction.

The above changes, reflecting Ukraine's confidence about its economy and financial system, were recently supported by the international credit rating agencies, who all upgraded Ukraine's short- and long-term outlooks to stable.

 Previously the government was concerned about Ukrainian individuals taking currency exchange risks. Starting on 1 January 2011, financial institutions will not be prohibited from granting loans in foreign currencies to Ukrainian individuals.

# Czech Republic: Intra-group Guarantees Evaluated by Experts – Court Decisions and Practice



Veronika Odrobinová / Miroslav Gejdoš

One of the most frequently negotiated and discussed topics for Czech joint-stock and limited liability companies in financing transactions is intra-group guarantees and security and their assessment by experts. Czech obligors often end up having longer accession periods and spend additional money to obtain the expert opinions and valuations. Is this really necessary?

The concerns are unfortunately well founded. The offender is Section 196a of the Czech Commercial Code (CC) and its unclear wording and interpretation.

## Loans and security

Paragraphs 1 and 2 of Sec. 196a of the CC deal with certain transactions (eg loans, securing debts, etc.) between a company and its statutory body, member of supervisory board, procurist, persons entitled to conclude such agreements on behalf of the company or their close persons (*osoba blízká*), as well as between companies on behalf of which the same persons can act.

Prior to entering into these transactions, the company (i) needs to obtain the prior consent of its general meeting; and (ii) the transaction must be under the conditions customary in commercial dealings (*podmínky obvyklé v obchodním styku*).

If these conditions are not complied with, the transaction is null and void unless a statutory exception applies.

## Transfers of assets

Paragraph 3 of Sec. 196a of the CC deals with the sale or purchase of assets between, in particular, companies creating concern or a company and its founders, share-

holders or persons acting with them in agreement or persons specified in paragraphs 1 and 2 of Sec. 196a of the CC.

Provided that the consideration for the sold/purchased asset is equal to or greater than 1/10 of the company's registered capital, the transaction requires (i) evaluation of the purchased or sold asset by a court-appointed independent expert, (ii) that it be under the conditions customary in commercial dealings and (iii) general meeting consent (even if subsequent), if the sale/purchase occurs within three years from the company's incorporation. The purchase price of the assets must match the award of the expert. Transactions falling within the usual course of business (*běžný obchodní styk*) (and some others) are explicitly exempted from this rule.

If any of these conditions are not complied with, the transaction is null and void unless a statutory exception applies.

The difference between these regulations is obvious. Unfortunately, both provisions get mixed together when it comes to the guarantee.

## The guarantee

Sec. 196a para 5 of the CC stipulates that paragraphs 1–3 shall also apply as appropriate to the guarantee. As

there is a risk of the guarantee being invalid, Czech lawyers have developed a very thorough practice: to obtain both the prior consent of the general meeting and an evaluation of the guarantee by a court-appointed independent expert, and require some kind of confirmation that the guarantee is provided under the conditions customary in commercial dealings.

Even at first sight the “evaluation” of the guarantee seems unclear. What will be valued and how? The Czech Supreme Court reached the same conclusion in various cases (eg 29 Cdo 3276/2008, 29 Odo 996/2004). According to these judgments, an expert evaluation of the guarantee by a court-appointed expert is not required at all; only the other two requirements apply. This is, however, contrary to the current wording of the CC. Consequently, a part of the legal community (in particular banks’ legal counsels) has not accepted this position and continues to require the expert valuation.

The practice has not been unified yet and Czech courts sometimes refuse to appoint the expert for the evaluation of guarantee, referring to the Supreme Court. Therefore, it has become practice that, if the application for the

appointment of the expert is refused, the expert is then determined by the company (subject to consent of the other party).

### Conditions customary in commercial dealings

Additionally, banks’ legal counsels also require confirmation by an expert that the guarantee and security (if the same persons are entitled to act on behalf of both contracting parties) are provided under the conditions customary in commercial dealings. This addresses, in particular, whether or not some consideration need be paid for the provision of the guarantee and security.

Such an expert opinion does not have any legal basis but, rather, has become a market practice in financing transactions with intra-groups guarantees and security. The companies then must comply with the findings of the expert (in particular pay the correct fee amount) before the guarantee or security is granted. The consequence is a situation where the market standard lies far from the legal regulations and their interpretation by the Supreme Court.

 As there is a risk of the guarantee being invalid, Czech lawyers have developed a very thorough practice: to obtain both the prior consent of the general meeting and an evaluation of the guarantee by a court-appointed independent expert, and require some kind of confirmation that the guarantee is provided under the conditions customary in commercial dealings.

# Bulgaria: The Special Pledge and its Undermined Effectiveness in Insolvency Proceedings



Anton Andreev

The special pledge is a flexible and cheap security instrument which creates a fixed and floating charge on existing and future assets. It is widely used in Bulgaria to secure the interests of creditors. However, some unsettled issues regarding enforcement of pledges in the event of debtor insolvency may undermine the effectiveness of this type of security in certain cases.

This article briefly reviews the scope and nature of the special pledge, focusing on certain controversial issues of enforcement in insolvency proceedings.

## Security instruments

Under Bulgarian law, security interests over assets can be created by way of a pledge of chattels and receivables or a mortgage over real property.

A pledge over movable assets requires, in principle, that the pledgor surrender possession of the assets. A pledge over receivables has to be notified to the debtor to take effect towards third persons. Because of this handing over condition, possessory pledges are rarely used in commercial transactions.

Registration of a mortgage agreement with the Real Estate Registrar (*Имотен регистър*) is a requirement for the validity of this type of security.

Apart from other taxes, the registration triggers a filing tax of 0.1% of the secured amount. There is no fixed limit to the amount of this tax. Therefore, the mortgage may turn out to be an unreasonably expensive security instrument where – as is usually part of a security package – a mortgage on real estate in Bulgaria is envisaged to secure all repayment obligations arising from a large financing.

## Special pledge – Scope and nature

In 1997, the Bulgarian Special Pledges Act (*Закон за особените залози*; SPA) introduced a special non-possessory pledge (*особен залог*). A pledge under the SPA may create (i) a floating charge on a pool of ownership rights and factual relationships (including inter alia present and future machinery, goods, raw material receivables and real estate as a part of a business enterprise) and (ii) a fixed charge on certain assets that must be explicitly specified for that purpose. The material terms of the pledge agreement, including a list of assets subject to fixed charge, must be registered with and made public at the Bulgarian Central Registry for Special Pledges (*Централен регистър на особените залози*).

In the event of a pledge of an entire business as an enterprise which, among other assets, includes real property, the security rights on such property may be opposed to any third person only after the additional registration of the pledge at the Real Estate Registrar. In such a case the filing fee is insignificant compared to the case of a mortgage as it is calculated on the basis of the number of the pages of the application. Therefore, a special pledge on the debtor's enterprise is often the preferred type of security since with a single agreement it may cheaply create security rights over all the real estate and other types of assets of the pledgor.

The pledgor remains in possession of and may continue to use the collateral. All assets except the assets subject to the fixed charge may be freely disposed of in the usual course of business until the debtor is served with a notification for commencement of enforcement. The pledgor may alienate any fixed charge asset only with the prior consent of the pledgee. If consent has not been given, the pledgee may enforce the pledge against any third person that has acquired pledged assets.

### Enforcement

In the event of default by the debtor the pledgee is entitled to take possession of and sell the pledged assets at its sole discretion. The pledgee does not need to obtain any court judgment, arbitral award, writ of execution or any other court ruling affirming its right to foreclose on the collateral. Once notification for commencement of enforcement is filed with the public register the floating charge on the pool of assets converts into a fixed charge on each specific asset within the pool and the pledgor is obliged to hand over the collateral to the secured creditor. The handing over of the collateral may be enforced with the support of an execution officer, if necessary. In any case the creditor is entitled to sell the pledged assets at its own discretion.

### Insolvency

The SPA was meant to ensure a more efficient type of security for creditors. It contains a clear provision stipula-

ting that the commencement of insolvency proceedings does not affect the already commenced enforcement of a special pledge over the assets of the insolvent debtor. Moreover, the SPA requires the administrator in insolvency proceedings to hand over the pledged assets of insolvent debtor to the creditors having priority rights under a special pledge created in their favour.

However, due to the controversial case law, at present this rule may not be fully relied upon. Some courts maintain the point of view that the court does not have the power to stay special pledge execution proceedings since no public officer is involved and these proceedings involve an out-of-court sale of assets – a matter that is the sole discretion of private persons.

Other courts acknowledge only that the commencement of insolvency proceedings does not automatically stay the ongoing enforcement of a special pledge. However, they argue that it is in the courts' discretion to issue an order staying enforcement, in particular when it would prejudice the interests of other creditors or the implementation of a reorganisation plan for an insolvent debtor.

Thus, though the SPA initially created a very strong and efficient tool for creditors to secure their claims, unsettled court practice is creating confusion. Under the applicable procedural rules, at present recourse to the Supreme Court, which unifies court practice on controversial matters, is not available. Therefore, legislative measures would have to be taken to eliminate the uncertainty.

 A special pledge on the debtor's enterprise is often the preferred type of security since with a single agreement it may cheaply create security rights over all the real estate and other types of assets of the pledgor.

# Poland: Outsourcing of Banking Activities – Current Controversies and Proposed Amendments



Magdalena Nilsson

According to estimates by the Polish Bank Association, 75.9% of banks in Poland use outsourcing and a further 13.8% plan to commission certain activities to external entities. Current legal conditions in Poland make it difficult for banks to use outsourcing. From this year on, the possibility of using such services became even more complicated.

## Current problems

Bank outsourcing is an instrument by which the bank (outsourcer) commissions banking activities to be performed by “external” entities not belonging to the bank’s organisational structure (insourcers). It facilitates the activities of financial institutions, making processes easier and reducing costs. By outsourcing some of its own activities, the bank can focus more on its core business from the point of view of strategy, specialisation and experience, or influence on financial results. The experience of cooperation among banks and entrepreneurs based on the currently applicable provisions of the Banking Law points to the need to change the current regulations.

Entrepreneurs commissioned by the bank to perform certain activities often find it necessary to use the services of other entrepreneurs. But the current provisions do not include the concept of sub-outsourcing. Furthermore, in an event of *force majeure*, an entrepreneur, as a party to the agreement concluded with a bank, cannot commission a single activity to another entrepreneur.

Further complications arise in practice due to the separate regulation of so-called foreign outsourcing. If a bank wants to conclude an outsourcing agreement with a foreign entrepreneur not based in an EU member state or an agreement on performance of certain activities perma-

nently or temporarily abroad, it requires a permit from the Financial Supervision Authority. The argument in favour of changing the above regulation is the need to remove doubtful interpretations arising out of the current wording, suggesting that a permit from the Financial Supervision Authority is required in order to conclude an agreement under which the activities to be outsourced may be performed abroad in a member state of the EU. The current interpretation is contrary to Arts. 43 and 49 of the European Union Treaty, which establish the principle of freedom to conduct business and perform services.

Banks are also obliged to provide information to the Financial Supervision Authority. This obligation is extremely restrictive because banks are always obliged to notify the Financial Supervision Authority of their intention to conclude an outsourcing agreement at least 14 days in advance. Under the currently applicable provisions of the Banking Law, the obligations to report the conclusion of an outsourcing agreement are too broad, in particular reporting obligations which de facto create an additional and unnecessary administrative requirement for entities involved in outsourcing activities.

## Proposed amendments

Because of the above, an amendment to the Banking Laws proposed by the Polish government is very wel-

come. On 19 April 2010, the Ministry of Finance adopted a bill to amend the Banking Law in terms of regulations of bank outsourcing. The proposed amendments include inter alia an extension of the statutory catalogue of activities which may be entrusted to an entrepreneur or foreign entrepreneur without a permit from the Financial Supervision Authority. The bill also introduces sub-outsourcing, which will enable entrepreneurs or foreign entrepreneurs who are party to an agreement with a bank to commission certain activities to another entrepreneur or foreign entrepreneur after meeting additional requirements.

Two cases of sub-outsourcing are currently planned. The first would be to commission activities aimed at achieving the main purpose of the agreement. The second would

be to commission the activity on a temporary and one-off basis when the insourcer cannot perform the activity itself due to force majeure. Another proposed amendment would exclude from so-called foreign outsourcing agreements ensuring that entrusted activities are performed abroad in the territory of an EU member state.

The abovementioned proposed amendments result from the intention to adjust outsourcing adequately to the needs of the trade. However, there is no need to adjust local regulations to the community regulations. Bank outsourcing has not yet been regulated by binding acts of community law. Member states will remain responsible for regulating bank outsourcing, the scope of this regulation and specific solutions.

 **Bank outsourcing is an instrument by which the bank (outsourcer) commissions banking activities to be performed by external entities not belonging to the bank's organisational structure (insourcers). It facilitates the activities of financial institutions, making processes easier and reducing costs.**

## Security Pooling Solutions under Hungarian Law



Gábor Spitz

In the aftermath of the financial crisis, multijurisdictional group-level (re)financing transactions have gained significant importance in the Hungarian market. With Hungarian civil law somewhat lagging behind continental and Anglo Saxon developments, syndicated leveraged structures require creative and flexible thinking from local counsel on both the lender and borrower side. Implementing security pooling/security trust structures can be particularly challenging, as the concept of trust is not recognised under Hungarian law.

### General collateral principles

The most commonly used forms of collateral are accessory and perfected with registration in public registers (eg Land Registry, Register of Pledges). Incorporating the collateral agreements into a Hungarian notarial deed will offer the possibility of direct enforcement (ie there is no need to obtain a court judgement before enforcement), but this requires specifying the secured liabilities in detail.

A security trusteeship is not recognised; consequently, only the direct claims of the registered beneficiary(ies) may be secured. Multiple beneficiaries can only be registered either as joint and several beneficiaries of the same rank (where any of the beneficiaries can enforce the security) or of subsequent ranks.

### Issues

The above principles result in a relatively rigid form of security, which cannot fully accommodate key features of syndicated structures. Frequent changes in the amount of the secured liabilities or the beneficiaries of the security would require an amendment to the security documentation and re-registration, potentially resulting in insolvency-related suspect/hardening periods being restarted.

Registering all syndicate members as security holders would increase transaction costs and complicate the enforcement of the security, and having all syndicate members as joint and several beneficiaries rarely reflects the enforcement mechanics of the underlying loan documentation.

If the designated security trustee were registered as the sole holder of the security, only the independent direct claim of the security trustee could be secured, which in itself would not provide sufficient cover for the whole facility. The widely used parallel debt structure may address this specific issue, but we have experienced some extent of reluctance from Hungarian notaries to accept the abstract parallel debt as a valid claim.

Defining the secured liabilities in detail sufficient to achieve direct enforceability would usually require incorporating extensive language from the loan documentation into the Hungarian security agreements, but certain concepts would likely be invalid and not enforceable under Hungarian law.

### Potential solutions

In order to circumvent the above issues, local counsels frequently use the independent mortgage (*önálló zálogjo-*

*gjog*), an instrument originally devised to enhance the mortgage-backed retail financing of housing. Being non-accessory in nature, the independent mortgage allows for the security to be separated from the underlying claim. Theoretically, the independent mortgage can be terminated at any time, and the beneficiary can enforce up to an amount specified in the agreement.

In such structures, the designated security trustee is generally registered as the holder of the independent mortgage. The Hungarian security documentation is usually kept short and simple. The link between the security and secured obligation is established by a separate side agreement (preferably governed by the law of the loan documentation) setting out the detailed rules of the enforcement, default events, etc, that would otherwise be provided in the mortgage agreement itself.

As a further alternative, the security provider/debtor may instruct the security trustee to issue a bank guarantee to the other syndicate members, with the collateral securing the guarantee facility (and not the loans/loan facility provided by the lending syndicate). In case of default, the syndicate members can satisfy their claims by drawing the bank guarantee, while the security trustee can enforce the security up to the amount drawn under the bank guarantee.

However, neither of these solutions is perfect. Syndicate members still do not hold *in rem* security; they only have

contractual rights against the security trustee. Furthermore, in a simple (non-syndicated, local) financing arrangement, normally all or most material provisions of the security package would be covered in a single document. Having a fragmented security framework, with potential collision of different laws governing different elements of the security package may also cause problems in case of eventual disputes.

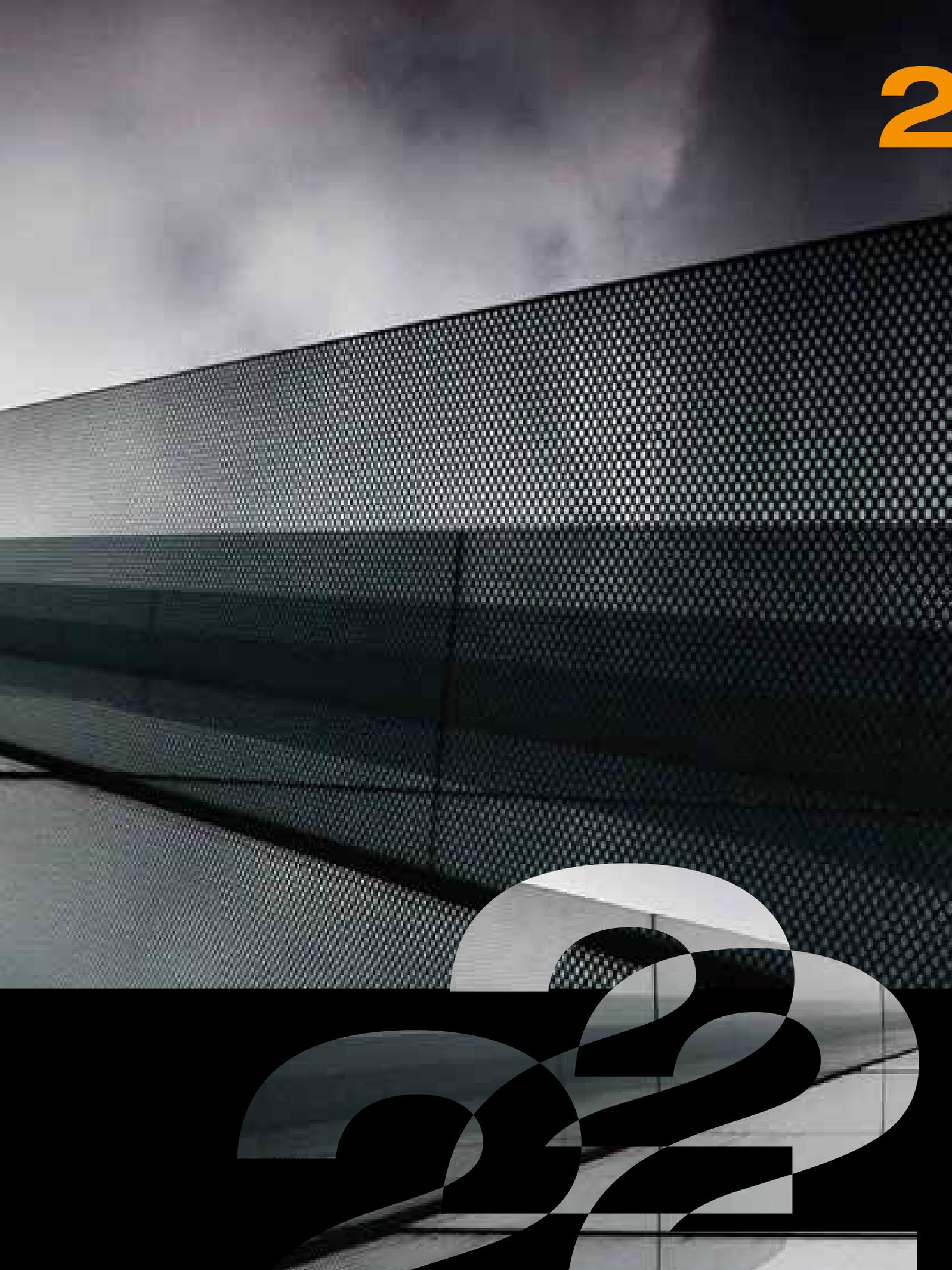
In case of an independent mortgage, the security provider may feel particularly uncomfortable with the enforcement restrictions and events of default not being governed by local, registered collateral documentation. The validity of an independent mortgage that is in fact strongly “connected” to an underlying claim may also be questionable, although most practitioners seem to take a relatively relaxed approach to this risk.

#### Future developments

Complete re-codification of Hungarian civil law has been a recurring issue for the better part of the last decade. The latest comprehensive draft of the new Civil Code aims to introduce the concept of trust, but the legislation procedure has been delayed due to the recent political changes, with drafting committees having been replaced and drafts rewritten a number of times over the past two years. With the current government facing more pressing issues at the moment, the introduction of modernised legislation may be further delayed.

 The general collateral principles result in a relatively rigid form of security, which cannot fully accommodate key features of syndicated structures. Frequent changes in the amount of the secured liabilities or the beneficiaries of the security would require an amendment to the security documentation and re-registration, potentially resulting in insolvency-related suspect/hardening periods being restarted.





## Criminal Compliance Programmes: Good for your Company



Heidemarie Paulitsch / Luka Fabiani / Pavel Grushko

Under Austrian and Slovenian law, and Ukrainian law beginning January 2011, a company can be liable for the actions of its employees if it can be shown that the company had insufficient measures in place to prevent criminal offences such as bribery. It need not be proven that the company had actual knowledge of the actions of the employees; the emphasis is upon whether the company had adequate measures in place.

### Corporate criminal liability in Austria

The Austrian Code on Corporate Criminal Liability (*Verbandsverantwortlichkeitsgesetz*; the Austrian Code) establishes liability of entities (companies) for criminal offences committed by their employees or decision-makers. If the perpetrator is a “decision-maker”, the entity is liable for an offence if it is committed in the interest of the entity or occurred due to negligence. The commission of an offence by an employee of the entity also leads to corporate criminal liability if a decision-maker breached its duty to supervise or control as required by law.

The only defence to this strict liability offence is for the company to demonstrate that it had adequate procedures in place to prevent such conduct. The Austrian Code is, however, geared strongly towards preventative measures by companies. A compliance programme, if implemented properly, can help stop criminal acts from being committed in the first place. Additionally, it can bring relief from corporate criminal liability.

### Corporate criminal liability in Slovenia

In Slovenia, criminal liability of entities is established by the Liability of Legal Persons for Criminal Offences Act (*ZOPOKD*; the Slovenian Code). The Slovenian Entities

Penal Code follows the basic rule of ancillary liability of companies in addition to the perpetrator. However, the company may only be liable for explicitly listed offences, primarily regulated in the Slovenian Entities Penal Code. Among others, the Slovenian Entities Penal Code covers all bribery and corruption-related offences, including bribery of foreign public officials. Prevention mechanisms such as compliance programmes are therefore strongly recommended. Also, early detection mechanisms should be established within the entity so as to limit the negative impacts of criminal offences.

### Corporate criminal liability in Ukraine

As regards Ukraine, a new act on liability of legal entities for corruption offences (the Ukrainian Act) was adopted on 11 June 2009 and will be effective on 1 January 2011. It imposes liability upon a commercial entity whose manager, participant, founder or other authorised person committed a criminal offence when acting on behalf and for the benefit of such entity.

A guilty court verdict against a manager, participant (ie shareholder), founder or other authorised person of the company serves as the formal basis for criminal liability on the part of the company, although such liability is not expressly referred as “criminal” in the Ukrainian Act. Any

penalty against the company may only result from a court award against the natural person.

The legal basis for this kind of case is the Ukrainian Act, not the Ukrainian Penal Code. It involves representatives of the company on one side and the state prosecutor on the other. Corporate criminal liability may entail forceful liquidation, a fine (up to UAH 255,000; EUR 23,400), the confiscation of property and/or a prohibition to conduct certain activities.

#### Getting your compliance programme right

The Austrian Code and Slovenian Entities Penal Code provide a defence for companies that can prove they

had procedures in place to prevent criminal actions. The Ukrainian Code can be similarly interpreted.

Companies operating in these countries therefore need to ensure they prevent criminal offences being carried out on the companies' behalf by implementing the required procedures. To avoid liability the company must show it has adequate procedures in place to prevent the person from engaging in bribery, for instance. A reverse burden of proof applies whereby, once an offence is found to have taken place, the onus is on the organisation to show that it occurred in spite of the company's preventative measures. The key issue, therefore, is the level and adequacy of procedures required for each organisation.

 The commission of an offence by an employee of the entity also leads to corporate criminal liability if a decision-maker breached its duty to supervise or control as required by law.

## An About Face in Austria: The Outlook for the Leniency Regime in Criminal Proceedings in 2011



Heidemarie Paulitsch / Christoph Haid

The success of a new leniency regime, as provided for in the Austrian Criminal Code as of 1 January 2011, will depend on whether it gives the whistleblower sufficient incentives to present themselves to the public prosecutor, and whether the regulation offers a high level of predictability for those involved in the case. A number of objections have been raised against the draft version.

Whether it is a spillover from the global economic crisis that the judiciary has to deal with increasingly complex white collar cases, or that the criminal landscape has recently changed, is ultimately irrelevant. The fact is, the legislature wishes to prepare itself to deal with white collar cases and increase efficiency.

By means of the proposed leniency regime from January 2011, the legislature is pursuing the goal of exposing complex corruption and white collar crimes.

### Cooperating with criminals

Opponents of the leniency regime argue that it would be contrary to the rule of law and, above all, to the common sense of justice if the state were to make a pact with criminals, thereby sparing them their deserved penalty as a reward for their turning leniency. Reaching an agreement with lawbreakers aimed at exempting them from punishment if they assist in solving crimes is deemed questionable as regards the rule of law.

However, the risk that those who turn leniency will not testify truthfully, or that the legal institution of the leniency regime could be abused, is limited. This is because whistleblowers would completely forfeit their immunity and, in the event of giving false evidence, be subject to subsequent prosecution.

### A successful investigative instrument

From experience gained in the field of antitrust law, however, the leniency regime has proven a successful investigative instrument that has led to the exposure of major cartel cases in Austria in recent years.

The anticipated leniency regime in cartel proceedings is widely welcomed by anti-trust lawyers. This is because, the leniency regime in anti-trust cases provides for leniency for undertakings only, not for implicated employees, who may face criminal sanctions for their involvement in, eg, bid-rigging (which is caught by both the cartel prohibition and the criminal code).

The practical experience made in antitrust proceedings raises hopes that the leniency regulation will also be a promising instrument in corruption offences, breaking up the interest groups of offenders and prising them open from the inside. Whistleblowers that break their silence disrupt the secrecy and mutual dependence inherent in corruption cases. Thanks to this major leniency regime, no one can be sure any more that the others involved in a corruption case will not opt for exemption from punishment by turning to the authorities. The foundation of criminal conspiracies and secret agreements would thus be significantly weakened. Companies, too, would be exposed to considerable pressure if their employees or

decision-makers were promised immunity in exchange for disclosing criminal actions to the detriment of their employer.

With respect to the efficient and successful application of this major leniency regime, the new law is linked to adequate incentives. Immunity has already proved itself an effective incentive in antitrust law, which can stave off the feared fines for the company. For the accomplice, this major leniency regulation could well be a “golden bridge” by which to leave crime behind and cooperate with investigators. The effectiveness of the regulation will depend on the predictability and safety of the proceedings when it comes to the state witness. The regulation is unlikely to gain importance in practical terms if the incentive for the whistleblower is not strong enough or if they may face personal risk.

### The leniency regime

Section 209a of the Austrian Code of Criminal Procedure in the present draft of the federal law on the “criminal competence package” contains proposals regarding the introduction of a leniency regime. The proposed section should come into effect on 1 January 2011 and would be limited to six years.

The leniency regime will apply to all serious offences resulting in a sentence of more than five years in prison. It also applies to assisting in the investigation of persons who hold a leading position in a criminal association or a criminal terrorist organisation.

This ambitious proposal is, however, undermined by the present arrangement of the act. Contrary to all expectations, the whistleblower does not go unpunished, but can expect to pay a fine. It is still unclear how much this may be in individual cases. The public prosecutor must proceed as follows: the whistleblower is offered a fine and a provisional suspension of the criminal proceedings is declared. The proceedings are then dropped if the whistleblower pays the fine.

### Objections

A number of objections have been raised in respect of the draft. One is the lack of a legal right to invoke application of the leniency regulation. Furthermore, it carries a risk of the proceedings being taken up again after their suspension. A whistleblower might be “digging his own grave”, impeding a willingness to cooperate. The whistleblower’s defence counsel might therefore be reluctant to recommend exposure to the leniency regime.

Currently, there are considerable uncertainties hindering potential state witnesses from testifying before the public prosecutor. The inevitable consequence would be that the employees of potential state witness companies would refuse to cooperate with the Austrian Federal Competition Authority. This would also impair the efficiency of the anti-trust law leniency regime. If the leniency regime is to achieve the desired success, the legislature will have no other option but to remove the described obstacles and clarify the material and procedural questions raised.

 This ambitious proposal is, however, undermined by the present arrangement of the act. Contrary to all expectations, the whistleblower does not go unpunished, but can expect to pay a fine.





# Austria: Takeover Commission Rulings on Acting in Concert and Change of Control in Shareholder Syndicates



Christian Herbst

Recent rulings by the Austrian Takeover Commission (TC) reflect a case by case approach to acting in concert situations and changes in shareholder arrangements. The TC will review and decide cases based on a substantive analysis rather than by form or strict letter law, guided by what is in the best interest of the free-float shareholders. This has allowed core shareholders and their advisors to argue the specific facts of a case, often resulting in the avoidance of a mandatory offer.

## Acting in concert

The Austrian Takeover Act (TA) defines acting in concert as an agreement based on collaboration with a bidder to achieve or exercise control over a listed target, in particular by coordinating the voting rights<sup>1</sup>. The legal consequences include: shareholdings of persons acting in concert will be added up; the obligation to launch a mandatory offer will be extended to all parties acting in concert; and/or prior and parallel acquisition of shares will affect the determination of the minimum price applicable to a mandatory offer.

The TA provides for a rebuttable presumption of acting in concert when parties agree or act together in voting to elect members of the supervisory board of the target. To avoid the usually undesired legal consequences of acting in concert, parties will have to argue that coordination of voting in a particular resolution (eg, as to a capital increase or in the appointment of supervisory board members) was a one-time event and will not lead to a permanent

influence on or control of the management or supervisory board decision making.

In *Binder & Co*<sup>2</sup>, the TC held that coordinated stake-building and identical board compositions in the boards of two different core-shareholders were relevant when considering whether those shareholders were acting in concert. In a different case, the TC held that coordinated voting in a shareholder aided debt restructuring of the target in distress did not constitute acting in concert<sup>3</sup>. The debt restructuring involved coordinated shareholder action at the target level to allow one of the core-shareholders of the target to take over a major participation of the target against assumption of debt. The corporate reorganisation allowed the restructuring of the balance sheet of the target in distress.

In *Erste Group Bank/Criteria Caixa Corp*, the TC had to decide a more complex case<sup>4</sup>. Spanish Criteria Caixa Corp (Criteria) had increased its stake in Erste Group Bank and also entered into various cooperation arrange-

<sup>1</sup> sec 1/6 TA

<sup>2</sup> Übk 27.03.2009, GZ 2009/1/1-36

<sup>3</sup> Übk 25.06.2009, GZ 2009/2/3-17

<sup>4</sup> Übk 20.05.2009, GZ 2009/1/3/30

ments under the heading of a so-called Preferred Partnership Agreement with Erste Private Foundation, Erste Group Bank's 31.12% core-shareholder.

The terms of the the Preferred Partnership Agreement included that: (i) Criteria could not influence the business of Erste Group Bank or act jointly with Erste Private Foundation concerning voting; (ii) Criteria could not transfer its shareholding to a party considered hostile by Erste Private Foundation or participate in a hostile offer on Erste Group Bank (it would, however, be allowed to tender into such offer); and (iii) Criteria's supervisory board members would remain in the minority and Erste Private Foundation kept control of the supervisory board. The TC held that the parties had sufficiently demonstrated that they were not acting in concert. Given this analysis, both these arrangements and the acquisition by Criteria Caixa of 2% or more in the shareholding of the target during 12 month intervals (otherwise "creeping") did not trigger a mandatory offer.

The TC applies special scrutiny to option arrangements, where the it attributes shares to the option beneficiary even before the beneficiary has influence on voting rights if such shares are held for the account of the beneficiary of the option<sup>5</sup>.

### Changes in shareholder syndicates

Under the TA, the formation, dissolution and changes in the composition of a group of shareholders acting in concert will trigger a mandatory offer<sup>6</sup>. The TC has developed substantial case law when a change in a shareholder syndicate will constitute a material change which triggers a mandatory offer.

In the course of a restructuring of the core-shareholder base implemented by a capital increase in listed construction company Porr<sup>7</sup>, core-shareholders in a so-called unanimity-syndicate rearranged the syndicate composition. The TC qualified the rearrangement as an exit of one syndicate member from a syndicate with an

ad personam structure, where each shareholder in the syndicate irrespective of its shareholding percentage had one-vote in the syndicate (a so-called "personalistic unanimity syndicate").

Under the TC's standard practice such exit, bringing substantial change in the composition of the the membership in the shareholder syndicate triggered a mandatory offer<sup>8</sup>. However, in the Porr-case, the TC applied special scrutiny and held that the change in the composition of the syndicate was in fact a substantial change of the shareholder syndicate<sup>9</sup>. Rather than concluding that such substantial change triggered a mandatory offer, the TC reviewed whether it in fact endangered the interests of others, in particular of the free float shareholders. The analysis focused on the shareholder structure of the target, on the voting power of non-syndicated minority core-shareholders and free float versus syndicated shareholders. In rearranging the terms of the syndicate agreement, the syndicated shareholders agreed to limit the exercise of the aggregate voting power of the syndicate to 50% plus two votes. Moreover, the syndicate gave up control of the supervisory board by increasing the number of and admitting independent supervisory board members. This allowed the TC to conclude that no obligation to launch a mandatory offer was triggered since free float shareholder interests appeared to be sufficiently protected despite the material change in the syndicate of the controlling shareholders.

In re STRABAG<sup>10</sup>, the TC held, against the backdrop of the credit crunch, that no change of control was involved and a mandatory offer was not triggered if one of the partners in the three party co-controlling syndicate at STRABAG temporarily reduced its 25% plus 1 vote shareholding and participation in the syndicate to one registered share with the co-shareholders taking over the former participation for a period of up to 1.5 years. In non-crisis times, the asymmetry of equity participation and contractual voting right in a shareholder syndicate would likely have been deemed to constitute a control change triggering a mandatory offer.

<sup>5</sup> ÜbK 23.10.2009, GZ 2009/1/4-103; ÜbK 31.01.2008, GZ 2007/3/3-157

<sup>6</sup> sec 22a TA

<sup>7</sup> ÜbK 5.05.2010, GZ 2010/1/2-30

<sup>8</sup> sec 22a/3 TA

<sup>9</sup> sec 22a/3 TA

<sup>10</sup> ÜbK 27.04.2009, GZ 2009/3-2-42

In a recent follow up ruling<sup>11</sup>, the TC allowed that the option exercise, and thus reacquisition of the shareholding by the co-controlling minority shareholder, related to a 17% shareholding rather than to the full 25% with a further extension of the option as to the remaining 8% stake until 2014. The TC held that no mandatory offer was triggered despite “restructuring” of the 2009 option arrangements of the co-controlling shareholders since the reacquisition of the 17% stake

corrected the earlier asymmetry of equity participation and core-shareholder co-control under the syndicate arrangements.

This ruling reaffirmed the casuistic approach of the TC, who is prepared to be flexible in applying the takeover rules where the financial interests of the free float shareholders would have been negatively affected had the rules been applied narrowly.

 The TC will review and decide cases involving acting in concert based on a substantive analysis rather than by mere form or strict letter law, guided by what is in the best interest of the free-float shareholders.

<sup>11</sup> ÜbK 19.10.2010, GZ 2010/3/2-31

## Austria: The Duties of a Supervisory Board Member towards his Former Company



Stephan Frotz / Clemens Spitznagel

Is a supervisory board member justified in taking a decision which helps his current company at the expense of his former company?

### Background

In spring 2010 a considerable former Austrian politician stepped down from his supervisory board seat at a big Austrian stock company (A-AG). A few days later, it became known that he had been elected chairman of the supervisory board of another Austrian stock company (B-AG). Due to the fact that both companies were strong competitors this “change over” caused harsh reactions from A-AG.

The main apprehension was the potential disclosure of confidential information he, as a former supervisory board member, had collected through his activities on the supervisory board. This led to lively public discussions about under which circumstances the acceptance of a supervisory board mandate might be inappropriate or even illegal.

### No explicit conflict of interest rules

Despite the fact that such situations might occur more often than publicly known, the Austrian Stock Corporation Act does not provide any explicit rules governing such conflicts. Neither does the Austrian Corporate Governance Codex, although it does contain several conflict of interest rules. For example, according to rule 44 Austrian Corporate Governance Codex, supervisory board members may not pursue their own interests or those of associated companies or persons being in conflict with the interest of the company they are responsible for. If a conflict arises, the supervisory board member must

immediately disclose the conflict of interest to the chairman of the supervisory board. Case law and doctrine outlined several instruments to overcome such conflicts of interest, including:

- voting bans
- information restrictions
- shifting to committees
- dismissal of the supervisory board member (in case of a structural or permanent conflict of interest)

However, it is questionable whether these considerations can be transferred equally to the subject at issue. The intention of Rule 44 is to protect the company for which the supervisory board member is presently active. In the case described above, not B-AG but A-AG was worried about a potential conflict of interest; B-AG could only benefit from their new supervisory board member's knowledge.

### The duty to observe secrecy

In general, supervisory board members shall be guided by the interest of the company and the enterprise connected therewith. They must apply the standard of care of a diligent manager. The duty not to disclose confidential information (or trade secrets) is one of the key obligations a supervisory board member is bound to. The task of the supervisory board is to advise regularly and supervise the management board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise. Therefore,

good corporate governance requires an open discussion between the management and supervisory boards, as well as among the members within the supervisory board. The comprehensive observance of confidentiality is of utmost importance for this.

This obligation outlasts membership in the supervisory board. Applied to the case described above, this means at first and as a matter of principle that the observance of an adequate cooling off period of six to twelve months is indicated. However a rigid fixed period of time cannot guarantee that any potential conflict will be eliminated in future. Therefore, the supervisory board member would still be bound to strictly observe the following:

- to not make use of any information obtained during his supervisory activities for A-AG to the detriment of A-AG;
- in case of a conflict, to report the conflict to the chairman or vice chairman of the supervisory board. Depending in the specific facts of the case, the member might be prevented from taking part in the respective meeting and from exercising its voting rights;
- rescission of the mandate (or refusal to accept in the first place), but only as a last resort and under the precondition that the strict observance of the confidentiality would harm B-AG.

## Conclusion

Supervisory board members must comply with the rules of proper corporate management. If they violate the duty of due care and diligence of a prudent and conscientious supervisory board member, they are personally liable to the company for damages. It should be noted that any company having suffered a loss through the misconduct of the supervisory board member may be entitled to claim damages!

Apart from this, several other consequences are conceivable, such as:

- a recall of the member;
- resolutions passed with the conflicted member's involvement might be void and subject to actions for declaration of nullity.

A supervisory board member should therefore check, prior to accepting a mandate, whether a conflict of interest with any prior supervisory board memberships is likely. If so, the potential member has to decide whether the conflict affects only single issues or the function as a whole. In the latter case, the mandate should not be accepted. If conflicts arise only sporadically, appropriate steps will have to be assessed on a case-by-case basis.

 Good corporate governance requires an open discussion between the management and supervisory boards, as well as among the members within the supervisory board. The comprehensive observance of confidentiality is of utmost importance for this.

## Privatisation in Slovakia – *Quo vadis?*



Gudrun Stangl Lutz / Stanislav Kovár

Over the past 20 years Slovakia has gained extensive experience in privatisation as part of the process of transferring state property into private hands. Slovakia's privatisation backlog started shortly after the fall of the Iron Curtain, continues to the present day and, apparently, will have to be dealt with for some time to come.

Over those years, Slovakia saw a number of privatisations and experienced a range of privatisation policies: from the conviction that the state is a good owner to the exact opposite; from preferring voucher privatisation in favour of “all citizens” to preferable privatisation to selected “domestic capitalists”.

### The golden age of privatisation

The golden era of privatisation was during the two terms of Prime Minister Dzurinda, between 1998 and 2006, when for the sake of tackling the country's economic lag, a liberal attitude prevailed that led to the extensive privatisation of substantial parts of the economy. Due to this, reputable international players managed to acquire principal local enterprises in the energy, telecommunication and banking sectors, as well as other industries, such as the Enel acquisition of 66% in Slovenské Elektrárne, the E.ON Ruhrgas and GDF Suez acquisition of 49% (in aggregate) in SPP (the main Slovak gas company) and the Deutsche Telekom acquisition of 51% in Slovak Telecom.

### A return to the view of the state as a good owner

After Prime Minister Fico came to power in 2006, the runaway privatisation train was suddenly derailed. This related in particular to Rail Cargo and Bratislava Airport, where the privatisation processes were abandoned almost at the last minute. Once again, the theory of the state as a good owner prevailed.

Naturally, the idea of the state as a good owner cannot be labelled as being without merit. After all, some of the foreign investors that acquired majority holdings in Slovak enterprises in privatisation proceedings are partly state-owned themselves. Unfortunately, a number of scandals at Slovak state-owned enterprises have been revealed, indicating that this might not be the right way for Slovakia.

### A limited about-face

Prime Minister Radicova has now turned back towards privatisation, although not without limitations. The Government's Programme Declaration proclaims entry of a strategic business partner into Rail Cargo or Bratislava Airport, as well as the denationalisation of six state-run heating utilities and the remaining shares in bus transport companies. Discussions are still underway about the sale structure, the amount of equity the government is considering retaining and the overall timeline.

On the other hand, state-owned shareholdings in partially privatised monopolies remain taboo, and the same holds true for other attractive Slovak family silver assets, such as Tipos (the betting company) or Transpetrol (oil transporter).

Consequently, even though the current government demonstrates the clear political will to privatise, the question remains of whether the proposed extent of privatisation can significantly help the financially strained state budget.

Regrettably, the current financial condition of the privatisation candidates contrasts negatively to 2006. The results of the economic crisis, the decline in the number of passengers and some recent dubious trades (eg the unprofitable exchange of the airport's real estate and the lease of the airport's car park spaces) have raised concern that Bratislava Airport will not be an overtly attractive target.

Moreover, the decline in the amount of transported freight, repeated occurrence of losses and loan debts towards the Slovak state all indicate that the current condition of Rail Cargo is also not too promising.

Evidently, the biggest temptation will be the state-run heat utilities in Kosice, Bratislava, Zilina, Trnava, Zvolen and Martin that might attract attention due to their relatively good financial status as well as investments made to increase the quality and environmental friendliness of their heat production facilities.

Market observers estimate that foreign investors' interest in the six state-run heating utilities could potentially mirror the 2005–2006 scenario. In particular, the adjoining Austrian and Czech regional utility companies may express a renewed interest. Whether Rail Cargo Austria or Deutsche Bahn will be sufficiently motivated to again take part in the race for Rail Cargo Slovakia remains to be seen.

### The Privatisation Act of 1991 and the National Property Fund

The procedural framework of privatisation will continue to be shaped by the "grey-haired" Privatisation Act of 1991, along with the National Property Fund – both successful survivors of all Slovakia's democratic regimes. The Act vests responsibility for drafting a particular privatisation project with the founder, which is usually the ministry that governs the state enterprise at stake. The decision on privatisation is subsequently taken by the Ministry of Economy, except for decisions on privatisation by direct sale, which are within the competence of the government. The government may reserve the right to also decide in other cases. Consequently, the enterprise to be privatised shall be transferred to the National Property Fund that carries out the privatisation, in the way as approved in the decision on privatisation.

Having learned the lessons of the past, Slovakia is being asked to demonstrate stable political conditions and the government's ability to transpose the Government's Programme Declaration into reality. Moreover, the ultimate success of the upcoming privatisation efforts will largely depend on two factors: (i) the attractiveness of the privatisation package put up for sale and (ii) the transparent procedures applied by the authorities with the aim of enhancing competition among bidders while minimising the risk of bribery and nepotism.

 Good corporate governance requires an open discussion between the management and supervisory boards, as well as among the members within the supervisory board. The comprehensive observance of confidentiality is of utmost importance for this.

## Contingent Equity Facilities – A Good Alternative when Commercial Banks are Reluctant to Finance



Florian Cvak

In continental Europe businesses are still highly dependent on commercial lending. While some of them have tapped the debt and equity capital markets, the reluctance of commercial banks to finance CAPEX or R&D absent a very strong balance sheet has left a vacuum. But the financing needs may not justify a public rights offering. In such cases, a contingent equity facility may be the answer.

### What is a contingent equity facility?

In last year's roadmap I wrote about private investments in public entities (PIPE). A PIPE is a private transaction between a single or a limited number of investors and the target company, which is listed on a stock exchange. This feature distinguishes the transaction from a public rights offering. The investor(s) and the target company enter into a negotiated agreement setting forth the investment terms. The contingent equity facility (also called equity line) is a variation of a PIPE, the main difference being that the company, at its discretion, can issue shares over an agreed time frame with a pricing formula based on the future share price and trading volume to the investor.

The company pays a capital commitment fee to the investor, who undertakes (in advance) to purchase the shares issued up to a certain threshold (typically below the notification requirement, in most jurisdictions, 5%) in case the company so requires. The investor can usually choose to hold on to the shares or sell them on. The investor, however, would typically commit not to hold on to shares exceeding the threshold. The commitment to subscribe is a very firm commitment (and this is fundamentally different from lines of credit) subject to very limited conditions such as only shares trading, no change in business (but nothing related to financial standing of

the target company), etc. Therefore the conditional equity facility could also be drawn if the target company is in financial difficulty (eg to avoid breach of gearing covenants). The contingent equity facility allows equity to be raised at relatively low cost (no bank underwriting cost, no prospectus requirement, no "road shows") in an opportunistic way (without subscription period and without taking the risk of market volatility), tailor made (in small tranches, for which an underwriting would be too expensive) and without placement risk.

### Main legal implications

There are two decisive elements. First, the management of the target company needs to determine if entering into the conditional equity facility is in the best interest of the target company and compliant with applicable law. Whereas management's determination in relation to the former is more to protect itself from liability, an adverse determination would not affect the validity of the investment agreement in most jurisdictions.

That is different, however, in relation to compliance. In most jurisdictions financial assistance rules prohibit a stock company from financing (directly or indirectly) the acquisition of its own shares or from paying consideration for a third party committing to acquire its shares. Capital maintenance rules typically provide that transactions bet-

ween a share-holder (and in most jurisdictions a prospective shareholder) are entered into on arms' length terms.

Now, at the time of entering into the investment agreement, the target company only agrees to pay to the investor a standby fee (typically in the range of 1–2% of the facility amount). If the target company does not draw under the facility, the only expense to the standby company is the standby fee. As such, in most jurisdictions, payment of the standby fee would not be considered a financing of the acquisition of the target company's shares or consideration for a commitment to subscribe for shares, but rather consideration to the investor for keeping funds available to honour draw down requests similar to standby fees paid to banks under credit facilities. The standby fee must be arms' length (which is the same as for fees paid to a shareholder-bank). To be on the safe side, the fee should not be substantially higher than for credit facilities of similar amount.

The second decisive element comes into play when the target company draws under the facility. As outlined above, one of the main advantages of the conditional equity facility is that the target company can draw small tranches which it could likely not efficiently place in a public rights offering at very short notice (typically subscription is within 10 to 15 days upon drawing). A prerequisite for that is that the target company has in place (or can put into place) authorised capital and the terms contemplated by the investment agreement are within the authority granted to the management board (eg authority to exclude subscription rights, to issue agreed type of shares, minimum issue price and restrictions as to purpose of issuance, etc).

Typical issues relate to the possibility to exclude statutory subscription rights (which in most jurisdictions is only possible if justified and is particularly difficult if the investor only offers cash).

### Issue price

A related topic is the issue price. The investor would typically agree to subscribe at a discount over (typically weighted average) share price in the range of 5%. In most jurisdictions, management is not free in its determination of the issue price when exercising the authorised capital but must avoid dilution of existing shareholders and consider the financing needs of the company (which under normal circumstances means, management needs to obtain the best price available). The conditional equity facility therefore should only be used where management can argue that the (discounted) price is the best price in the given circumstances (eg because shares could not efficiently be placed in those tranches, the target company needs equity which could not be obtained in a public rights offering at short notice, etc.).

Affected shareholders typically have a right to challenge the management's decision to exclude their subscription right and its determination of the issue price within a certain period and to also seek compensation for damages. The company may also seek compensation for damages from management and/or the board of directors for failure to consider its financing needs. The investor, on the other hand, is usually only exposed in certain limited circumstances (eg intentional infliction of damages).

### Notification requirements

In most European jurisdictions a target company would be obligated to announce any event that could have a material effect on its share price. It is widely accepted that capital measures qualify for such notification requirements. What is not so clear is the timeline (ie, from the management's decision to exercise authorised capital or only upon approval by the board of directors) and the required detail of the announcement. Practice substantially differs by jurisdiction.

 The management of the target company needs to determine if entering into the conditional equity facility is in the best interest of the target company and compliant with applicable law. Whereas management's determination in relation to the former is more to protect itself from liability, an adverse determination would not affect the validity of the investment agreement in most jurisdictions.

# Uncapped Penalty Clauses in Commercial Contracts – Upheld by the Bulgarian Supreme Court



Ilko Stoyanov / Tsvetan Krumov

Penalties for a breach of contract that accrue without an amount or time limit are not void. However penalties that are not genuinely intended to serve as a security, compensation or sanction may be void as incompatible with good faith.

## Introduction

Penalties are liquidated damages clauses whereby the parties agree in advance on compensation due for breach of contract without the need to prove actual damages. Under Bulgarian civil law, penalties might be reduced by the court if they are excessive compared to actual damages. However this power of the court does not apply to commercial contracts (eg contracts to which at least one party is a company). What the court can do is void such penalties in their entirety if they are incompatible with good faith.

In the last years there has been a myriad of conflicting case law in Bulgaria on when penalties in commercial contracts are incompatible with good faith. Thus, with respect to penalties that accrue for each day of delay, it was held in a number of cases that the lack of restriction on the period for which penalties would accrue, or on the maximum amount they may reach, makes them per se incompatible with good faith. In other judgments, however, uncapped penalty clauses were upheld.

On 15 June 2010, following this conflicting approach of the courts, the Bulgarian Supreme Court of Cassation (the Court) adopted Interpretative Judgment No1/2010 (the Judgement) to resolve in a uniform manner what

aspects of penalties in commercial contracts would make them incompatible with good faith.

## Key points of the Judgement

At the outset the Court held that compatibility with good faith is to be assessed at the time when the contract was entered into.

What is essential for the assessment is to consider, firstly, the characteristic functions of penalties and, secondly, the principle of justice<sup>1</sup>. A penalty would be invalid according to the Court if it violates the three characteristic functions of penalties: compensation, security and sanction. This seems to mean that if the financial terms agreed in a penalty clause do not represent a reasonable estimation of the monetary value that might be apportioned to each of these three characteristic functions, it may be construed as seeking to protect interests that are not legally recognised and is thus invalid, being in conflict with the principle of justice.

The Court listed by way of example four criteria that may be used to determine whether penalties are valid:

- whether the obligation secured by penalties is to pay money (eg to provide a service) and the monetary value

<sup>1</sup> The Court held that the statutory term "good faith" embraces unwritten moral rules that exist only as general principles and that such a principle, in particular, is the principle of justice.

- of the obligation secured by penalties;
- whether the obligation is secured by other legal methods, eg guarantee, pledge, or mortgage;
- the type of penalty, eg for full compensation or only for delayed performance, and the type of non-performance, eg for a substantial or for a small part of the obligation<sup>2</sup>; and
- the ratio between the amount of the penalty and the expected damages from non-performance.

The Court emphasised that in determining the validity of particular contractual penalties, other criteria may be taken into account in light of all the circumstances of the particular case.

The large amount of the penalty (if it is agreed as a lump sum) or the fact that it may accrue without any limit as to amount or time does not render it invalid per se. The Court's argument here is that an assessment of whether a penalty is excessive, and thus contrary to good faith, is

possible only at the stage of non-performance when the amount of penalties and the actual damages may be compared. It is not possible to do so at the time of entry into contract, which is the relevant time for assessing whether penalties are valid.

### Conclusion

The Court thus rejected the simplified approach advocated in some previous case law that looked only into whether penalties might accrue without any limit as to amount or time. A more complex approach is needed because, in order to take proper account of all criteria suggested by the Court, it may be important to consider individually all possible breaches of each contractual obligation.

In light of the Court's decision, drafting a penalty clause in a commercial contract may turn out to be a rather time consuming exercise requiring expert advice, but this is the price parties must pay to ensure its enforceability.

 The Court's argument here is that an assessment of whether a penalty is excessive, and thus contrary to good faith, is possible only at the stage of non-performance when the amount of penalties and the actual damages may be compared. It is not possible to do so at the time of entry into the contract, which is the relevant time for assessing whether penalties are valid. Drafting a penalty clause in a commercial contract may turn to be a rather time consuming exercise requiring expert advice but this is the price that parties must pay to ensure its enforceability.

<sup>2</sup> Criticism against this criterion has been levelled in a dissenting opinion of the Supreme Court Justice Ms Tatyana Varbanova, where she argues that the type of non-performance may be taken into account only if and when there is actual non-performance. Therefore, it is impossible to take into account the type of non-performance at the time of entry into contract which is, in turn, the relevant point in time to consider whether a penalty is valid. We are of the opinion that what might be most relevant is whether the penalty seeks to compensate an essential or non-essential breach of contract. Thus, a large penalty for non-essential breach of contract may be operative in a finding that a penalty is contrary to good faith.

# What a Foreigner should know before becoming a Member of a Supervisory Board in a Moldovan Joint-stock Company



Vladimir Iurkovski

The rise in foreign investment in Moldova and joint projects with local investors means that supervisory boards must often be instituted in Moldovan joint-stock companies (JSC). This leads to effective and operative control over the company's management. This article deals with the questions of whether foreign citizens may be appointed as members of supervisory boards and whether there are any impediments to ensuring compliance with Moldovan legislation.

## Introduction

Under the Moldovan Joint-Stock Companies Act No. 1134/1997 (Act No. 1134), the decision to institute and appoint a supervisory board<sup>1</sup> in a JSC rests exclusively with the general shareholders' meeting. Having a supervisory board in a JSC is optional.

Moldovan legislation does not prohibit foreign citizens from exercising the mandate of a supervisory board member, including that of chairman. There is no norm prohibiting non-Moldovan speakers from exercising the mandate of supervisory board member.

Nevertheless, the general rules of law regarding impediments/restrictions are relevant. For instance, pursuant to Art. 66(5) of Act No. 1134, the JSC's employees<sup>2</sup> can be elected as supervisory board members, but cannot constitute more than half of the members, except when the employees are also the JSC's shareholders. A repre-

sentative of the Moldovan state cannot be appointed to more than one supervisory board.

The following people cannot be elected supervisory board members: (i) those lacking full legal capacity; (ii) those having outstanding convictions for fraud, theft, false testimony, bribery, other economic criminal acts; (iii) members of five supervisory boards of other JSC registered in Moldova<sup>3</sup>; (iv) members of a JSC's executive board or a representative of a company administering the JSC (*organizatia gestionara a societatii*); (v) the internal auditor of a JSC; (vi) other situations as provided in the JSC's articles of association (eg to possess a particular background, language skills, etc.).

## Becoming a supervisory board member

The members of a JSC's supervisory board are elected by the cumulative vote of the general shareholders' meeting for a period that cannot exceed four years

<sup>1</sup> Moldova applies the one-tier system of corporate governance. Accordingly in Moldova the legal notion of "council" (*consiliul*), as used by the local legislator, is the closest legal meaning to the notion of "supervisory board" as used in countries that apply the two-tier system of corporate governance.

<sup>2</sup> Members of the JSC's executive board are also its employees. Note that a member of the executive board cannot be a member of its supervisory board at the same time.

<sup>3</sup> The sixth appointment cannot be exercised, whereas the person has to return the amounts received while exercising the mandate to the respective JSC. Claims against such members can be raised by any shareholder and the competent Moldovan authorities.

(Art. 66 of Act No. 1134). A single member can be re-elected to the same supervisory board an unlimited number of times. Should the shareholders so require, for opposability purposes the names of supervisory board members can be included into the State Register of Companies (*Registrul de Stat al persoanelor juridice*) – ie, the trade register. While offering the position of a supervisory board member, the JSC may request that the candidate present a written declaration by which he: (i) presents his consent to the appointment; (ii) declares that there are no impediments to exercising the mandate; and (iii) discloses sufficient information to track possible conflict of interest situations in advance.

Unless the JSC's statute provides otherwise, rules of mandate must apply in the legal relationship between the JSC and the members (Art. 66(14) Act No. 1134). Accordingly, a member can be revoked at any time with or without reason by the general shareholders' meeting. In practice, the JSC executes either a mandate or management agreement with its supervisory board member (a labour agreement is also possible).

### Termination

According to Art. 66(12) of Act No. 1134, the supervisory board's powers are considered terminated as of the day of: (i) announcement of the decision of the general shareholders' meeting on approval of a new list of supervisory board members; (ii) announcement of the decision of the general shareholders' meeting on revocation of the supervisory board members before expiry of their mandate without appointing new members; (iii) expiry of the mandate; or (iv) decrease in the number of supervisory board members by more than half.

Pursuant to Art. 50(3) of Act No. 1134, the general shareholders' meeting sets the amount (if any) of retributions,

remunerations and compensations payable by the JSC to its supervisory board members. Payment of retribution is not compulsory (except when a labour agreement is in place).

Under Moldovan Act No. 199/1998, supervisory board members are considered insiders. In this respect, supervisory board members are obliged to duly disclose complete information to the JSC (as many times as necessary, but at least once per year) that would enable the JSC to pinpoint potential conflicts of interest in advance (Art. 85(3) Act No. 1134).

For situations in which foreign supervisory board members intend to reside in Moldova while exercising their offices (eg for EU citizens, for periods exceeding 90 days in a six-month period), they will need to obtain a temporary residence permit that will enable a longer stay. Due to the specifics of Moldovan legislation, labour/immigration/resident permits are issued only to foreigners exercising labour activities in Moldova. A labour agreement would therefore need to be executed between the supervisory board member and the JSC.

### Liability of supervisory board members

Pursuant to Art. 74(2) of Act No. 1134, supervisory board members are liable, including materially, if they intentionally lead the JSC to bankruptcy, spread unreliable or misleading information, use other methods in order to change the price of securities prejudicing the JSC, or fail to disburse dividends or other mandatory payments.

The supervisory board members are jointly and severally liable for any decision that they took causing a prejudice to the members before the JSC. Supervisory board members may be assisted by advisors (eg, lawyers) while exercising their mandate.

 Supervisory board members are liable, including materially, if they intentionally lead the JSC to bankruptcy, spread unreliable or misleading information, use other methods in order to change the price of securities prejudicing the JSC, or fail to disburse dividends or other mandatory payments.

# Turkey's Electricity Market – Developments, Opportunities, Prospects



Kazım Yılmaz / Levent Çelepçi / Burcu Özdamar

Turkey's electricity energy market, which accounts for about 2.5% of the Turkish economy, has been in a state of constant change in recent years. Turkey's electricity sector is attractive to many investors and shows enormous potential, triggered by the economic and population growth of the country. This recent development has been rapidly changing the rules of the game, pushing the electricity sector towards liberalisation and market actors towards fast adaptation to changing provisions.

With a constantly developing legal infrastructure, the recent liberalisation and the establishment of an autonomous regulatory authority, the Energy Market Regulatory Authority (EMRA), Turkey's electricity market has changed significantly.

## Investment needed

The impact of the global crisis on Turkish electricity demand was particularly strong in 2009. However, since the first quarter of 2010 a rapid recovery has occurred in Turkey's electricity demand. With the positive effects of this recovery, the instalment of an additional capacity of about 24,000 MW is deemed to be necessary within the next eight years.

The electricity demand in Turkey, which had a compounded annual growth rate of ca 4.7% between 2005 and 2009, is expected to increase by 6.4% to 7% between 2009 and 2018. In order to meet this increasing demand there will be a significant need for additional investment<sup>1</sup>.

## Privatisation of the electricity generation and distribution segments

The ongoing privatisation of the electricity power plants of the state-owned electricity generation company (Elektrik Üretim A.Ş., EÜAŞ) will change Turkey's electricity energy market by decreasing the state share in this segment. This in turn will lead to an increase of competition, with higher commercial availability and more efficiency of privatised power plants. Privatisation of the generation business started in 2008. In 2009, privatisation continued with the tender of 52 hydro power plants. Another 45 power plants will be privatised in the near future. The privatisation of the electricity generation segment provides substantial opportunities for local investors who want to diversify their generation portfolio and for international investors who want to enter Turkey's fast growing electricity market.

The privatisation of the electricity distribution companies of the state-owned electricity distribution company (Türkiye Elektrik Dağıtım A.Ş., TEDAŞ) will develop and

<sup>1</sup> Investments from the private sector reached USD 3 bln in 2009 and were expected to reach USD 4 bln in 2010.

expand electricity grids, advance service and technical quality, guarantee supply sustainability, improve operational efficiency and decrease larceny and loss. The privatisation of 11 distribution companies, whose tenders are already completed, account for a total value of ca USD 5 bln. The share of the private sector in the distribution segment will be about 46% after the completion of the privatisation of the four distribution companies in the regions of Uludağ, Camlıbel, Firat and Vangölü, whose tenders were realised in February 2010.

Furthermore, the tender procedures of the distribution companies in Boğazici, Dicle, Gediz and Trakya have already been completed in 2010, while the completion of the privatisation of these regions is expected in the near term. The tender procedures for the Toroslar, Istanbul Anadolu and Akdeniz regions started in August 2010. Privatisation of the whole distribution segment is expected to be completed by the end of 2011.

### Recent legal developments

An effective legislative structure is an important requirement for a well-organised, reliable and efficient electricity market. Thus, with the Electricity Market Law (*Elektrik Piyasası Kanunu*, EPK) no. 4628, which came into force on 3 March 2001 and has been amended several times, an important step in creating a reliable energy market and conforming to the EU *acquis communautaire* has been taken.

One of the most recent laws concerning the Turkish electricity market is the regulation regarding licence applications with respect to the establishment of a generation facility based on wind park energy (*Rüzgâr Enerjisine Dayalı Üretim Tesisi Kurmak Üzere Yapılan Lisans Başvurularına İlişkin Yarışma Yönetmeliği*), enacted in September 2010. Wind licences have been in limbo in Turkey since November 2007, causing huge frustration

and delaying investments. EMRA's decision to restart wind energy project licensing will kick off a first wave of licensing in the next months, which may represent up to USD 1.77 bln. However, the regulatory environment must be changed to attract more potential investors. For example, legislation to fix a viable feed-in tariff for wind is needed.

With the amendment of the EPK by the amendment act no. 5784 (Amendment Act 5784), enacted on 26 July 2008, the transition period regarding vesting contracts has been extended to 31 December 2012. During the transition period, distribution companies that have obtained a retail sales licence have the exclusive right to sell electricity and/or capacity to non-eligible customers in their regions. After the transition period, private retail sales companies will be allowed to sell energy and/or capacity to all customers across the country by determining the distribution tariffs. Furthermore, a tariff equalisation system to transfer revenue across the regions is being applied by EMRA, and a fully cost-based tariff structure is in the works. Thus, a smooth transition from monopoly to a competitive market is expected.

In order to avoid the licence trading, the Amendment Act 5784 sets forth that licences belonging to licensees who have not realised their generation plant investments within the term stated in the legislation will be cancelled. These licensees may not apply for further licences for three years and may not participate (directly or indirectly) in another legal entity's application.

The EPK is a milestone in the liberalisation process of the Turkish electricity market. Within a decade after its enactment, Turkey has made remarkable progress in its electricity market. Still, although significant structural and legislative developments have been achieved in the last years, a well-organised, efficient and competitive electricity energy market is a long term process.

 Since the first quarter of 2010 a rapid recovery has occurred in Turkey's electricity demand. With the positive effects of this recovery, the instalment of an additional capacity of about 24,000 MW is deemed to be necessary within the next eight years.

## Poland: Online Exercise of Shareholders' Rights in Joint Stock Companies



Dag Nilsson

Imagine sipping a refreshing drink in a lounge chair on a remote exotic island while being able to fully participate as a shareholder in the allocation of profits at the AGM of a company in which you hold shares. This is what the implementation of directive 2007/36/EC in Poland could mean for shareholders in joint stock companies.

### Making the general meeting more accessible

Instead of travelling to the shareholders' meeting or having to look for someone trustworthy to represent the interest of a shareholder at a general meeting, it is easier to get online and exercise your rights in front of a computer.

This is the idea behind the new regulations facilitating exercise of shareholders' rights in joint stock companies. Facing low shareholder participation, in particular in general meetings of publicly traded companies, work started in the European Parliament and European Council on finding the reasons of such low participation and creating instruments to counter this problem. It appeared that the main problem is the relatively high cost of participating in the general meeting, especially for shareholders residing abroad, as compared to the relatively low significance of the vote in most cases. The result of this work is directive 2007/36/EC, which was planned to create a modern legal framework rendering general meetings accessible without having to bear the costs of travelling to them.

The result of the implementation of the directive into the Polish legal system is the enacting of the Act amending the Code of Commercial Companies and the Act on Trading in Financial Instruments (Amending Act), which entered into force on 3 August 2009.

### Compulsory and optional regulations

The Amending Act introduces a number of provisions which render exercising rights in joint stock companies possible through electronic means of communication. Part of the changes concern all joint stock companies, while part of them relate only to publicly traded joint stock companies. However, most of the new regulations are not compulsory: whether they apply to a given company depends on the wording of its bylaws which, in turn, depends on the shareholders.

Among the compulsory regulations, it is now possible in every joint stock company for shareholders representing at least 5% of the share capital to ask for a general meeting to be convened or having specific issues inserted on its agenda simply by sending, eg, an email to the company's management board.

As far as the participation in the general meeting is concerned, if the bylaws of a joint stock company so provide, it is possible to attend its general meeting electronically. In particular, this can take place by real-time transmission of the general meeting, real-time two-way communication enabling shareholders to address the general meeting from a remote location or a mechanism for casting votes, whether before or during the general meeting, without the need to appoint a proxy holder who

is physically present at the meeting. This does not mean, however, that the general meeting can be held exclusively virtually. Electronic participation by part of the shareholders in the general meeting is meant to complement a real meeting, not replace it.

The Amending Act introduced also additional information duties and other facilitations with regard to exercising voting rights. For example, the announcement about the general meeting of a publicly traded company must contain precise information about, among others, the possibility of participating electronically as well as directions as to how statements can be made and voting rights exercised also electronically.

## Conclusion

Although the compulsory provisions of the Amending Act have been rapidly implemented in the corporate governance of joint stock companies, the more far-reaching provisions regarding participation in the general meeting from a remote location are still not widely used. For publicly traded companies, it is believed that this is due to the technical challenges associated with the organisation of general meetings with thousands of virtual participants<sup>1</sup>. Nevertheless, given that the law is now in place, it is hoped that with time remote participation in general meetings can be as widespread as possible – including participation from a lounge chair.

 Instead of travelling to the shareholders' meeting or having to look for someone trustworthy to represent the interest of a shareholder at a general meeting, it is easier to get online and exercise your rights in front of a computer.

<sup>2</sup> See eg Joanna Krukowska-Korombel *Prawa akcjonariuszy wykonywane za pośrednictwem środków elektronicznych w świetle przepisów kodeksu spółek handlowych*, published in: *Przegląd Prawa Handlowego*, 09/2010.

# Austria: Financial Remedies for Breaches of Representations & Warranties in Share Purchase Agreements – An M&A Classic



Thomas Kulnigg

It often appears that, when negotiating share purchase agreements (SPA), clients are most attracted by the catalogue of representations & warranties (RW). However, the most comprehensive catalogue does not serve its purpose<sup>1</sup> if losses resulting from breaches of RW are not subject to proper financial compensation. This article is a friendly reminder of a classic but often less regarded topic in Austrian law governed M&A transactions: financial remedies for breaches of RW.

When referring to “representations & warranties” in Austrian law governed M&A transactions, the appropriate (Austrian) equivalent of these Anglo-American *termini technici* is the Austrian legal concept of “Gewährleistung”. Under such concept, the primary remedy for breaches of a RW is restitution in kind by reparation or replacement (*Verbesserung/Austausch*). Very briefly, only if restitution in kind is not feasible or acceptable to the buyer, the buyer can (i) claim financial compensation by purchase price reduction (*Preisminderung*) or, provided that the defect is not marginal, (ii) rescind the agreement (*Wandlung*)<sup>2</sup>.

## Purchase price reduction

Focusing on the financial remedy (purchase price reduction), the question is how the reduction-amount should be calculated. If the SPA does not set out a specific procedure, statutory law applies, and this is where the trouble starts.

According to legal literature and case law, the applicable method for calculating claims for a purchase price reduc-

tion is the so called “relative calculation method” (*relative Berechnungsmethode*), which means that the value of the asset without defect (V) is compared to the reduced value of the asset with the defect (v). The purchase price originally paid (P) shall then be reduced in the same ratio as “V” compares to “v”. The resulting difference between “P” and the reduced purchase price (p) is the reduction-amount to be claimed. In figures:

$$V \div v = P \div p \rightarrow p = (P \times v) \div V$$

As “simple” as this formula reads, the obvious next (and decisive) question is: how are these values (“V” and “v”) determined? Pursuant to the prevailing opinion and case law, the “objective value” (*objektiver Wert*) at signing of the relevant agreement (eg, the SPA) shall be relevant for such calculation. But what is the “objective value” of a share (or other equity instrument acquired) in the target company? Skipping the discussion on the various calculation methods and the various opinions on which method shall be applied, the quick answer is: Unless the shares in the target company are publicly traded, it is not clear!

<sup>1</sup> For the buyer, the protection of its investment, and for the seller (if there are RW on the buyer), the protection of the release of its rights to the assets sold.

<sup>2</sup> NB: The right to rescind an SPA is usually excluded to the extent admissible as it is usually the least attractive remedy in case of a breach of a RW.

Obviously, if acting for a seller, one wants to leave as much room for discussions as possible in order to make claims for breaches of RW as unattractive as possible. But the seller also wants to avoid surprises (which can go both ways), as Austrian rules for civil procedures grant the judge the right to reasonably determine a reduction-amount if the RW has been breached but it cannot be established what the “V” and/or “v” described above are (cp. Art. 273 of the Austrian Act on Civil Proceedings).

#### Setting out the calculation method in the SPA

Thus, in order to reduce uncertainties, the SPA should set out the procedure for compensation of losses from a breach of a RW. There are countless ways to structure such compensation, and this article is not intended to provide boiler plate language. However, there are certain items which should at least be discussed with the client, including:

(i) **When is a party entitled to claim compensation?**

As outlined above, purchase price reduction is only a secondary remedy. Thus, if a party wants to have a choice what remedies apply in case of a breach of a RW, the SPA should provide for such right to choose.

(ii) **What is the “loss”?**

Does the loss include costs incurred for remediation? Does it include consequential (indirect) damages, such as an increase of an insurance premium, and/or loss of profit or bargain?

(iii) **Whose “loss” shall be compensated?**

Obviously, “losses” incurred by a party to the SPA are covered. However, a loss at the level of the target company does not necessarily have a negative impact on the value of the shares/equity instruments of the target company. Thus, it should be clarified whether any losses at the level of the target company are also subject to compensation.

(iv) **Who is entitled to directly claim compensation?**

Usually, only parties to the SPA can claim compensation. However, sometimes it makes sense that, eg, the target company shall also be able to directly claim, if the buyer so elects.

In addition, one may want to clarify what limitations apply to such compensation claims.

Again, there are some classic items to be considered, including limitations: in amount (hurdle/basket/cap), in time, for certain benefits (tax benefits as a consequence of reduced income, payments by insurance companies), and for provisions or accruals made for certain losses and payments by third parties.

Summing up, one should not rely on statutory law when it comes to the question of financial compensation of losses resulting from breaches of RW. Rather, it is advisable to try to clarify the relevant rights and obligations in the course of the SPA negotiations in order to avoid lengthy and costly discussions down the line.

 Obviously, if acting for a seller, one wants to leave as much room for discussions as possible in order to make claims for breaches of RW as unattractive as possible. But the seller also wants to avoid surprises (which can go both ways), as Austrian rules for civil procedures grant the judge the right to reasonably determine a reduction-amount if the RW has been breached but it cannot be established what the “V” and/or “v” described are.

## Ukraine: Application of the Joint-stock Companies Act – New Challenges



Artem Sokurov / Iana Kuzmina

Although the Act on Joint-stock Companies contains more transparent rules and more certainty for investors, its implementation is fraught with difficulties and requires further legislative amendment.

### Introduction

In April 2009, the Ukrainian Joint-stock Companies Act (the Act) came into force. Pursuant to the Act, all joint-stock companies (JSC) may be either private or public, and existing open and closed JSC must change their names accordingly. The deadline to bring the companies' charters and internal regulations into compliance with the Act is April 2011. The deadline for all JSC to change their form of issuing shares from documentary to electronic is the end of October 2010.

### Pros and cons

Although the Act envisions bright prospects for Ukrainian corporate governance, only corporate and court practice will show how the positive novelties of the Act will be applied, since existing practice is insufficient and has only exposed the weaknesses of the Act. There are a number of gaps and uncertainties in the text of the Act. Not all bylaws are amended to comply with the Act. The State Securities and Stock Market Commission (the SSSMC) chose the path of least resistance to deal with legislative gaps by issuing separate clarifications on application of the Act. Although from a legal perspective these clarifications are insufficient, the market accepted the recommendations and clarifications based on "political expediency"; otherwise it would have been unclear how JSC were to operate in Ukraine. The SSSMC clarified that (i) the Act applies only to those JSC that brought

their documents in line with the Act; (ii) JSC that did not bring their documents in line with the Act are subject to the existing legislation on business associations.

### What the Act does not mention

The procedure of changing the names of JSC and corporate documents triggered the necessity of updating corporate stamps, agreements, bank accounts, licences, real estate documents and so on. One of the most problematic matters was changing bank accounts. Before the spring of 2010, all JSC which changed their name were required by the Act to first close their accounts and then open new ones, which technically meant that account numbers were changed. This was a serious business issue for companies with a large number of clients and potentially triggered the loss of money receipts. In the spring of 2010, the National Bank amended its regulations to clarify that bank account numbers in such cases remain the same.

### Listing

The Act stipulates that public JSC must be listed in at least one Ukrainian stock exchange. In September 2009, however, the regulations of the SSSMC were amended to allow more public JSC to be listed. Before this, the regulations provided for thresholds and requirements which for some JSC were either difficult or impossible to meet, such as an absence of losses or turnover thresholds.

The issue is still to be resolved since some thresholds for listing are unjustifiably high, which means that not all public JSC may get listed.

#### The dematerialisation process

Pursuant to the Act, all shares of private and public JSC should be in electronic form only. This requirement is subject to the burdensome procedure of dematerialisation, which takes approximately three months. The main difficulties of dematerialisation include strict requirements by the SCSSM regarding the form and content of the documents to be submitted and the insufficient level of cooperation between securities registrars, custodians and depositaries, as well as difficulties due to insufficient and inconsistent bylaws.

#### Obligatory payment of dividends

In 2010, temporary amendments regarding the obligatory payment of dividends resulting from the adoption of the

state budget were introduced into the Act. JSC are now obliged to make the dividends payment from net profit and/or undistributed profit based on the results of the fiscal year of not less than 30%. Dividends payments in this sum must be made within six months from the end of the fiscal year. This unclear provision was introduced with a purely fiscal goal. At the moment of writing, it is unclear whether such amendments will be reflected in the Act in 2011.

#### Conclusion

A significant number of novelties in the Act have increased the costs for JSC and shareholders to comply with it. Moreover, some JSC are still waiting for the legislative deadline for compliance to be extended. Other JSC considering such compliance disadvantageous are in the process of reorganising into limited liability companies. Still, it is the author's belief that despite the disadvantages, the Act will bring more transparency and certainty to the market, as well as a completely new culture of corporate governance.

 Although the Act envisions bright prospects for Ukrainian corporate governance, only corporate and court practice will show how the positive novelties of the Act will be applied, since existing practice is insufficient and has only exposed the weaknesses of the Act.

## Czech Republic: A Surprising Decision to Prohibit Profit Distribution based on Audited Financial Statements older than Six Months



Veronika Odrobinová

An apparently straightforward situation has ended in a conclusion that has disturbed the Czech legal practice. By extensive interpretation, the Czech Supreme Court has broadened the requirements applicable for the distribution of profit. What was once a common practice has now become a serious liability for the statutory bodies of Czech limited liability companies required to audit their financial statements, as well as for joint-stock companies.

### Background of the case

It was a clear case. After the company received an application for bankruptcy filed by a creditor, its general meeting decided to distribute a significant amount of profit.

One month after this decision, the court declared bankruptcy over the company's assets. The bankruptcy trustee rejected the shareholders' receivables for the payment of the participation in profit.

At first glance, and even for persons without any legal education, the shareholders' receivables seem illegitimate. It is therefore no wonder that the Supreme Court confirmed the bankruptcy trustee's approach. Nevertheless, the Supreme Court's reasoning has straddled the border of insolvency law.

The Czech Commercial Code (CC) sets several tests which must be complied with so that general meetings can decide on profit distribution. In a completely different context, it also stipulates that a company's annual general meeting must be held at the latest within six months from the last day of the accounting period.

### Reasoning of the Supreme Court

According to the Supreme Court, the law implies that the audited financial statement of the company (if required) as of the last day of the accounting period must be available at the annual general meeting. The Supreme Court concluded on this basis that the six-month period is also the period during which the audited financial statements can be used as a basis for the distribution of profit. The decision related to joint-stock companies, but the same conclusions would likely apply to limited liability companies required to audit their financial statements.

As a result, companies can decide on the distribution of profit only within six months from the date as of which their audited financial statements were issued. Otherwise, they will have to arrange for new audited financial statements. However, the Act on Accounting explicitly states the situations for which audited financial statements must be prepared, and none of them relates to the decision of the shareholders or company to distribute profit. Therefore, it is questionable whether the company/shareholders have at all an option to decide on the distribution of profit later than in the above period.

### Liability of statutory bodies

A serious threat in this respect is the liability of statutory bodies. Statutory bodies who paid out the dividend approved by the general meeting without complying with the statutory requirements (now including the six-month period) are jointly and severally liable for repayment of the distributed profit participation by the relevant shareholder. This liability is objective without any liberation options.

### Conclusion

It seems that the Supreme Court's interpretation is too broad as it creates additional obligations not grounded in

written law. Furthermore, this is the first decision of the Supreme Court in this respect, which can be further reviewed and amended. Nevertheless, legal and business professionals will have to take the decision into account for the future.

Regardless of whether or not the judgement is generally accepted, companies must comply with the new rule.

Not only this rule should be complied with this year but, at their next annual general meeting companies should also take the opportunity to approve the profit distribution which was paid in the past in breach of this "newly discovered" rule.

 The Czech Commercial Code sets several tests which must be complied with so that general meetings can decide on profit distribution. In a completely different context, it also stipulates that a company's annual general meeting must be held at the latest within six months from the last day of the accounting period.

## Restructuring Group Companies



Alina Niculciu

In recession periods, many companies face the necessity of restructuring their business in order to reduce costs and identify auxiliary activities to the main scope of business that offer possibilities to redirect their investments. The profits and losses of the group companies may be significantly affected by the way the functions, risks, assets and group financing are structured within the group. The key aspects guiding companies when taking restructuring measures are benefits from fiscal opportunities and a decrease of total costs at the group level.

### Restructuring measures undertaken by the group companies

The restructuring usually concerns the business but it may involve reorganisation measures at the level of the group companies. Therefore, the group may choose to restructure its activity by reconsolidation of its lines of business. Or it may prefer to take further steps like merging, demerging, spinning-off of group companies or transferring a business from one company to another within the group.

### Restructuring the business on international and local levels

There are certain advantages of cost optimisation when restructuring the business by reconsolidation of activities, ie when certain activities are concentrated in dedicated companies within the group. In case of international restructuring, it is important to make an optimal selection of the jurisdiction where such dedicated companies will operate, taking into account the taxation risks.

For instance, at the international level, the restructuring may involve establishing a holding company. In this re-

spect, the current Romanian legislation does not encourage the establishing of holding companies in Romania.

Another possible measure would be the restructuring of the production, distribution and services chain in order to carry out activities in favourable jurisdictions. Other group companies choose to establish a company which exercises and centralises an activity for the entire group. For instance, they establish a financing company at the group level by taking into account, inter alia, a favourable jurisdiction for taxation of the interest income and allowing the deduction of the interest at the level of the borrowers' group entities. This is done by using the cash pooling system at the group level. Under Romanian law, the cash pooling system is not yet clearly regulated.

### Advantages

There are cases when group companies decide to take significant decisions to create cost efficiency. They then use the merger, demerger and spin off of business depending on their particular situation.

The advantages of such reorganisational measures are mostly economic and tax related. Their implementation

would grant the companies a better use of the resources at the group level and operational advantages. In addition, reorganisation may provide an exit for companies from activities no longer profitable, such as in case of a spin off. Also, it is a better choice in case the group no longer prefers to use the transfer pricing rules when making transactions between the group companies.

Additionally, there will be tax advantages from consolidation of tax results. For example, under Romanian law, the operations of merger, demerger and spin off are generally considered tax neutral and do not fall under the scope of VAT. Conversely, the transfer of assets from one company to another within the group generally gives rise to VAT liability, except when the transfer qualifies as a transfer of a business. It should be noted that transactions between group companies must be arm's length under Romanian tax provisions.

Another advantage specific to cross border mergers relates to regulatory obligations and costs. Sometimes reorganisation reduces the specific obligations imposed by the regulators, as well as costs, if the operations are transferred to a jurisdiction more tax attractive.

### Disadvantages

Reorganisation can also give rise to certain disadvantages, some relating to tax implications. For example, in the case of a merger, the loss of the absorbed company is no longer reported. Moreover, there is a potential risk in carrying over the historical tax liabilities of companies

subject to merger/demerger. Also, additional expenses may arise in connection with the immovable assets transferred via merger, demerger or spin off operations, such as notary fees in Romania, which may amount to 1% of the value of the transferred immovable property. However, in the case of cross border mergers, there are still unclear aspects on how immovable assets belonging to the Romanian absorbed company would be transferred to an absorbing company resident in another EU member state.

There are also other aspects to be observed in case of reorganisation of the group companies. The labour agreements of the absorbed or spun off company are automatically transferred to the new or absorbing company. In Romania, the employees' rights under the collective labour agreements with the absorbed or spun off company shall be preserved in accordance with the Law 67/2006, which transposes the Directive 2003/23 on the approximation of the laws of the member states relating to the safeguarding of employees' rights in the event of transfer of undertakings, businesses or parts of undertakings or businesses.

### Conclusion

The decision to implement restructuring measures for a group of companies depends on a careful balancing of all of the potential advantages and disadvantages, taking into account the specific economic, tax and legal aspects of the jurisdictions of the companies within the group.

 The transfer of assets from one company to another within the group generally gives rise to VAT liability, except when the transfer qualifies as a transfer of a business.

## Albania's new Step in Support of Foreign Direct Investments: Special Protection of Foreign Investors Involved in Dispute Resolutions



Endrit Mema

Albania's attraction of foreign direct investment (FDI) has been, and remains, a major factor in its recent strong economic growth. In September 2010 the Albanian Parliament approved amendments<sup>1</sup> to law no. 7764 dated 2 November 1993 "On Foreign Investments" (Foreign Investments Law). The amendments caused a heated public and political debate, not only because they were the first in 17 years but because they introduced a significant change to the foreign investment framework in Albania.

Unfortunately, one of the main obstacles to FDI in Albania remains disputes on real property ownership related to the restitution and compensation process of the ex-nationalized lands. The new amendments to the law aim to provide the foreign investors with a special protection to prevail such difficulties in case of disputes resolution with private parties.

### Legal status of foreign investors

According to Albanian law, "foreign investor" means a (i) citizen of a foreign country, (ii) Albanian citizen who resides outside the country, (iii) legal person established under the laws of a foreign country or (iv) a "community company" or "establishment"<sup>2</sup> that directly or indirectly seeks to or carries out an investment in Albania.

Foreign investments in Albania are granted treatment not less favourable than domestic investments and generally

accepted norms of international law. Additionally, the law forbid expropriation, nationalisation or any similar measure towards foreign investments, except in special cases. Moreover, foreign investors have the right to repatriate all funds and contributions in kind related to the investment, including revenues.

### Special protection to overcome difficulties

Pursuant to the Foreign Investment Law, disputes between a foreign investor and a private party can be settled either according to previously agreed modalities or through the competent court or arbitrator in Albania. The same principle is applicable in relation to disputes between a foreign investor and the Albanian state.

According to the new amendments, the Council of Ministers may grant through an ex-post decision "special state protection" to foreign investments, when a judiciary

<sup>1</sup> Law no. 10 316, dated 16.09.2010.

<sup>2</sup> These categories are described by article 49 of law no. 9590, dated 27.07.2006, "On Ratification of the Stabilization and Association Agreement between Albania and the member states of the European Communities".

dispute raised with third private parties impedes the execution or exercise of the economic activity deriving from or otherwise related to the foreign investment. This special state protection contains the following provisions:

- Replacement in full rights of the foreign investor by the Albanian state in a civil dispute with private third parties in accordance with article 184 of law no. 8116 dated 29.03.1996 “The Albanian Civil Procedures Code” (ACPC) as amended. This measure, however, gives rise to some uncertainties since, under article 184, in order to proceed with the replacement in a dispute resolution procedure, the court must obtain the approval of all the involved parties.
- The protection may also include the state’s commitment to take over the obligations of the foreign investor sentenced by the court in favour of private third parties.

Additionally, after the foreign investor is granted the protection:

- The court cannot rule on the confiscation or suspension of the activities on the related goods (assets) of the foreign investment. If the court has already adopted these measures, it is obliged to follow the request of the State Attorney to replace them with other measures.
- If the court transfers the foreign investor’s rights over the real property in favour of third private parties, the Council of Ministers may decide, for the public interest, to expropriate the third parties and transfer the real property to the foreign investor<sup>3</sup>.

### Procedure to obtain special protection

Special state protection is not a legal right of the foreign investors; the decision to grant or refuse it is at the discretion of the Council of Ministers.

The foreign investor can submit a written motivated request and supporting documents to the ministry that covers the field related to the investment. Within 30 days from receipt, the ministry will evaluate and present the proposal for approval to the Council of Ministers.

The request for special state protection should be considered refused if the approval is not made public within 45 days. There is no obligation to explain the refusal.

### Entitled investments

The Council of Ministers may grant special state protection to investments performed in the following fields:

- public or touristic infrastructures, energy or agriculture;
- concession agreements pursuant to law no. 9663 dated 18.12.2006 “On Concessions” as amended;
- on real property provided to the foreign investor by the Albanian state;
- on real property obtained by the foreign investor through regular public documents or valid acts provided by government competent bodies or public entities;
- when an investment of not less than EUR 10 mil is foreseen.

 According to the new amendments, the Council of Ministers may grant through an *ex-post* decision “special state protection” to foreign investments, when a judiciary dispute raised with third private parties impedes the execution or exercise of the economic activity deriving from or otherwise related to the foreign investment.

<sup>3</sup> The expropriation procedures are provided by law no. 8561 dated 22.12.1999 “On the expropriation and taking under temporary possession of private properties for the public interest”.

## New Serbian Insolvency Act: More Protection for Creditors



Aleksandar Jokić / Olga Šipka

Designed to promote efficacy and improve creditors' position in insolvency proceedings, the new Insolvency Act (Official Gazette of Republic of Serbia, no. 104/2009; Insolvency Act) may significantly impact the Serbian business environment through: (i) detailed regulation of the procedure for selling the insolvency debtor as a legal entity; (ii) automatic insolvency (AI); and (iii) new provisions on voluntary reorganisation.

### Selling the debtor as a legal entity: New protection for secured creditors

Thus far, the insolvency practice in Serbia has shown that the rights of secured creditors can be compromised in cases where a debtor's business as a whole is sold (as a legal entity). In such cases, secured creditors are entitled to receive priority in the distribution of proceeds from the sale. However, since the transaction is carried out as a share instead of an asset deal, secured creditors are often not guaranteed full recovery of the value of their collateral. Consequently, a share deal can result in a built-in haircut for the secured creditors, depending on the result of the ultimate valuation of the overall business. In such cases, secured creditors are entitled only to a share of the entire proceeds corresponding to the value of their collateral in the aggregate value of the debtor on a pro rata basis.

The Insolvency Act and the new Ordinance on National Standards for the Management of Bankrupt's Estates (Official Gazette of the Republic of Serbia, no 13/2010; National Standards) have introduced new measures whose purpose is to protect secured creditors. The National Standards provide that in cases where a debtor is sold as a legal entity the appraisal must show that the estimated value of a debtor is higher than the total appraised sum of its individual assets. If a debtor's assets are

encumbered by a security interest, an independent expert must perform a valuation of the debtor as a legal entity, as well as of the debtor's collateral. The Insolvency Act provides that the insolvency judge must examine, in particular, whether the valuation of a debtor as a legal entity or its collateral was done in accordance with National Standards, and whether a sale of a debtor as a legal entity would result in less favourable recovery for secured creditors. Furthermore, the insolvency judge can order (i) a reassessment of the debtor as a legal entity or of the debtor's collateral, or (ii) exclusion of collateral from the estate sold as a legal entity, and order their separate sale.

### New provisions on voluntary reorganisation

The Insolvency Act has introduced more detailed rules on reorganisation according to the pre-packaged plan, aimed to encourage voluntary reorganisation and decrease the number of slow, inefficient and costly insolvencies. The new provisions on voluntary reorganisation should facilitate the adoption of the pre-packaged plan within 60 days of filing. Also, the Insolvency Act provides that the pre-packaged plan must include (i) a certified statement of consent by majority creditors of each class (including secured creditors) and (ii) a statement signed by an auditor or a receiver confirming the feasibility of the pre-packaged plan. This provision will arguably provide

more control and protection to secured creditors, which are normally not regarded as insolvency creditors in regular insolvency proceedings.

#### Automatic insolvency – How does it work?

The AI rules were designed to eliminate companies which have suspended all their payments over an extended period of time. In 2010, AI is triggered for every company which has suspended its payments for over three years, in 2011 this period is set at two years and, finally, from 2012 AI will apply to all suspensions longer than a year. To identify the companies which have suspended their payments, the National Bank of Serbia (NBS) is required to publish a list of companies which meet the aforementioned requirements at the end of each month. Once the NBS list has been received by the Commercial Court, the competent insolvency judge is obligated to commence insolvency proceedings over the listed companies. Creditors and debtor are given 60 days to pay the advance for starting regular insolvency proceedings. If no advance is paid within the given timeline, the insolvency judge can open and immediately close the insolvency proceedings. The decision on closing the proceedings is thereupon

forwarded to the Agency for Commercial Registers (ACR), which can delete the company from the companies' register. Any remaining assets of the deleted company are automatically transferred to the Republic of Serbia.

Prior to AI, most of the companies whose business accounts were blocked for a long period of time conducted their business through affiliates and by cash payments. In these circumstances, payments were made only to preferred creditors with no incentive to settle the accumulated debts. The AI procedure is designed to stop this practice. At the outset, AI enables interested creditors to open a regular insolvency proceeding in which the equality of creditors is secured by the law. However, if a regular insolvency proceeding is not initiated, AI eliminates all inactive entities, bringing an end to the described dishonest activities.

As of now over 11,000 companies are in the process of being deleted from the ACR register. Only about 140 entities listed by the NBS did not undergo the AI process and have either opened their accounts for business or are currently going through the standard insolvency procedure.<sup>1</sup>

 A share deal can result in a built-in haircut for the secured creditors, depending on the result of the ultimate valuation of the overall business. In such cases, secured creditors are entitled only to a share of the entire proceeds corresponding to the value of their collateral in the aggregate value of the debtor on a pro rata basis.

<sup>1</sup> Primena odredbi o automatskom sečaju, Ministry for Economy and Regional Development, available at [www.merr.gov.rs/sr/c/vesti/primena-automatskog-stecaja/147](http://www.merr.gov.rs/sr/c/vesti/primena-automatskog-stecaja/147)







# Slovenia: Bills of Exchange in Enforcement Proceedings



Ana Filipov / Franc Crmok

Recent amendments to the Enforcement Procedure and the Interim Protection Act facilitate repayment in enforcement proceedings.

## Introduction

Bills of exchange are mostly regulated by the sector specific act of 1946 (based on provisions of three 1930's Geneva conventions). Provisions of other acts (eg, Obligation Code; *Obligacijski zakonik*) are used secondarily if the Bill of Exchange Act (*Zakon o menici*) does not contain applicable provisions.

In practice, besides as a credit or payment instrument, the bill of exchange is mainly used as a security instrument. Most likely it will take on an even larger role in commercial practice due to the latest amendments of the Enforcement Procedure and Interim Protection Act (*Zakon o spremembah in dopolnitvah Zakona o izvršbi in zavarovanju*, Official Gazette no. 51/2010; the ZIZ-H), which entered into force on 15 July 2010.

## Two types of enforcement proceedings

Until the abovementioned amendments, a bill of exchange was – like invoices, excerpts from business records, calculations of interest, checks, etc. – listed as an “authentic document” on a basis of which enforcement proceeding could commence. The main characteristic of such proceeding, where a proposal can still be filed either electronically or in hard copy, is that the debtor is given time for voluntary repayment and the creditor cannot be repaid before the writ of execution becomes final.

In addition, the ZIZ-H provides an exception relating to the bill of exchange whereby in commercial disputes a creditor is entitled to repayment before the writ of execu-

tion becomes final. The act defines specifics relating to the proposal: a creditor has to file a proposal with the district court where the debtor has its registered seat, in hard copy, accompanied by the original bill of exchange. If the proposal is filed by the attorney-in-fact, it is sufficient to state that the power of attorney was given and its scope. The proposal must include information about:

- the creditor and debtor;
- the bill of exchange;
- the debtor's obligation;
- the means of execution (whereby the court has to acquire information on eg the debtor's bank and bank account number or other information on the debtor's securities *ex officio*); and
- all data necessary for the enforcement to be performed.

In addition, in its proposal the creditor must request the court to ask the debtor to pay the claim (principal, interest and costs) within three days after receipt of the writ of execution.

## Fast track proceeding – better for creditors than debtors

The new option clearly brings advantages for creditors. The court, obliged to issue the writ of execution within five days from the day it received the proposal, sends the writ by registered mail to the parties of the proceedings and the debtor's bank(s). After receipt, the bank must immediately seize the assets in the debtor's account(s). If the debtor does not voluntarily pay the creditor within three days, the bank transfers the seized amount to the

creditor even if the debtor objects to the writ of execution. However, payments from other means of execution are performed after the writ of execution becomes final.

The fact that the debtor's objection does not affect the repayment from its bank account(s) may have severe effects on the debtor. If the creditor's claim is later found to be unjustified, it then becomes the debtor's job to get the funds back from the creditor.

According to publicly available information, one Slovenian company is dealing with this problem right now. Based on information from its website, in May 1991 the debtor, as a guarantor, issued a bill of exchange to secure repayment of a loan for USD 6 mln, which three of its subsidiaries had taken at the New York branch of a Yugoslav

bank. Although the debtor claims that the claim is disputed and litigation pending, at the end of September 2010 the competent court issued a writ of execution relating to this surety, now based on a proposal of a Lichtenstein company for a principal of almost USD 9.8 mln. This example shows how the change of legislation can have a severe impact not only on future issuers of bills of exchange but also those who acted as guarantors expecting that their objections would prevent wrongful claims being repaid.

### Conclusion

It is expected that the expedited enforceability of the bill of exchange provided by ZIZ-H will increase the use of bills of exchange despite the risks mentioned above.

**“ In practice, besides as a credit or payment instrument, the bill of exchange is mainly used as a security instrument. Most likely it will take on an even larger role in commercial practice due to the latest amendments to the Enforcement Procedure and Interim Protection Act.**

## Lifting the Veil of the New Romanian Arbitration Rules



Anna Cuşnir

On the 25 March 2010, the new arbitration rules of the Court of International Commercial Arbitration of the Romanian Chamber of Commerce and Industry (the Court) entered into force. The document brought about a series of substantial changes to the previous set of rules. Certain eye-catching features of the new edition are discussed below.

### Constitution of the arbitral tribunal

Parties' wide discretion in choosing who will decide their fate is one of the appealing aspects of arbitration. Choosing the right arbitrators is a key factor in effective proceedings and a reliable outcome, and who knows better than the parties themselves who is trustworthy and competent to rule on their case?

The new institutional arbitration rules incorporate a somewhat exotic arbitrator selection procedure, which tends to neutralise this attractive trait of arbitration.

First, arbitrators can be selected only from the Court's list. In case of a single arbitrator tribunal, the parties may simply agree on one listed arbitrator. If the tribunal shall consist of three arbitrators, the claimant and respondent each have the right to nominate an arbitrator out of the pool of listed arbitrators. The list consists of 89 Romanian and 37 foreign arbitrators, including a number of prominent names in the field. There are no formal restrictions in appointing foreign arbitrators to hear a domestic Romanian case. However, considering the fixed duration of the arbitral proceedings, particularly short in domestic cases (see below), appointing arbitrators with overbooked schedules to resolve complex disputes can cause practical difficulties in meeting the deadline.

Second, in a three-arbitrator format the chairperson is always appointed by the appointing authority, ie the

President of the Romanian Chamber of Commerce and Industry. He also serves as the appointing authority when the parties fail to nominate arbitrators. The pool of potential chairpersons is included in a list, which is for internal use and not published. The new rules, hence, deviate from the classical arbitrator selection model whereby each claimant and respondent selects an arbitrator, and the selected arbitrators appoint a chair of the tribunal.

Save for the above modifications, the rules have not been changed with regard to the constitution of the arbitral tribunal in multi-party disputes. Pursuant to the rules, in case of several claimants or respondents, parties with common interests shall appoint one arbitrator.

The concept of "common interest" is not defined. The Courts' practice has been to interpret this concept to mean the common procedural interest of co-claimants to sue or of co-respondents not to be sued. In lack of a definition of "common interest" the Court will probably use the same interpretation in the future. Such interpretation, however, does not appear to be in line with the fundamental principle of equal treatment of the parties (established by both the rules themselves and the Romanian arbitration laws) who, being in the same procedural position, may still have divergent substantive interests. And such discrepancy of interests may prevent them from appointing a common arbitrator, thus putting them in a disadvantageous position relative to the other party(ies). The party who generally benefits from such inter-

pretation is the claimant, as it is the one who determines the composition of the parties. It can sue more than one respondent – including by bringing frivolous claims – to reduce the potential of co-respondents to jointly nominate an arbitrator.

### *Ad-hoc* arbitration

The new rules have certain modified provisions on *ad-hoc* arbitration, some of which are available only in the Romanian language. Their interpretation suggests that the *ad-hoc* format can be used inclusively when the parties derogate from the mandatory rules of institutional arbitration.

The rules, though, seem not to favour this type of proceedings. First, the administration fee in *ad-hoc* cases is 1.5 times higher than in institutional arbitration. Second, the Court provides assistance in organising *ad-hoc* arbitration only based on a request accepted by all parties involved. It is of course difficult to reach such unanimity in disputes between parties with strongly adversarial positions.

### Other features

There are other particularities of the current version of the rules.

- Terms of reference, a distinguishing feature of the ICC arbitration, also adopted by the previous version of the Romanian rules, is not found in the new rules.

- The duration of domestic arbitration has been extended from five to six months. In international arbitration, the 12-month term of the proceedings has been preserved. The relevant term starts to run from the time of constitution of the tribunal and can be amended by the parties. It can also be extended by the tribunal for up to two months. The rules, as before, provide that prior to the first hearing the interested party may invoke nullity of the proceedings should the tribunal subsequently fail to render an award within the established term.
- The arbitral tribunal, *ex officio* or upon a party's request, may reduce reimbursable attorney, expert and interpreter fees if it finds that such fees are excessive compared to the dispute value or to the services rendered.
- The list of grounds for setting aside an arbitral award has been shortened. In particular, failure to constitute the arbitral tribunal in conformity with the arbitration agreement has been excluded from the list of the grounds for setting aside. However, despite this exclusion, the parties may still challenge the award based on this ground if it is provided in the applicable (eg, Romanian) arbitration law.

### Conclusion

Some features of the new Romanian arbitration rules reinforce the perhaps trivial-sounding, but often neglected, importance of a careful choice of the rules of the arbitration game.

 **There are no formal restrictions in appointing foreign arbitrators to hear a domestic Romanian case.**

# Austria: Interim Measures to Ensure the Enforceability of Foreign Arbitral Awards



Alfred Siwy / Lisa Beisteiner

Frequently, a claimant may be well advised to ensure the eventual enforceability of an award he hopes will be rendered in his favour already in the course of, or even before, initiating arbitral proceedings.

For this purpose, a claimant will primarily consider obtaining an interim measure freezing the respondent's assets. Especially when raising claims against multinational corporations the claimant will detect such assets in various jurisdictions – some apparently more attractive in this respect than others.

Under Austrian law, a claimant in a pending or upcoming arbitration can request interim measures from state courts or, alternatively, from the arbitral tribunal.<sup>1</sup>

Whenever Austrian state courts are called upon to grant interim measures to secure the enforceability of an upcoming arbitral award, their jurisdiction will be based on section 387(2) Austrian Enforcement Act (EA). Accordingly, the court in whose jurisdictions the respondent is domiciled or has its seat will have jurisdiction to issue interim measures. If the respondent happens to be neither seated nor domiciled in Austria, in particular the location of the asset to be frozen will be determinative.

## Two possibilities

The EA provides for the issue of preliminary measures to secure the enforceability of monetary claims in two

cases, presupposing either a subjective or an objective threat to the prospective enforcement.

First, interim measures may be granted if it is probable that without the requested measure respondent would impede or considerably exacerbate the enforcement of a monetary claim<sup>2</sup>, eg by damaging, destroying or relocating assets etc. In practice, establishing that the respondent is likely to take specific acts to impede the enforcement of the award is difficult.

Consequently, applicants will likely base their application (also) on section 379(2)(2), according to which preliminary measures may be granted if a judgment would have to be enforced in a state in which Regulation 44/2001<sup>3</sup> does not apply or which is not a party to the Lugano Convention of 1988, if it were not for the interim measure which would ensure the enforceability against assets located in Austria.

Here, the applicant must only make a credible case that the respondent will have no assets on Austrian territory by the time the award can be enforced, not that the respondent will take actions by which assets will be removed from Austrian territory.

<sup>1</sup> Sections 585 and 593 of the Austrian Act on Civil Procedure.

<sup>2</sup> Section 379(2)(1) EA.

<sup>3</sup> EC-Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters.

The rationale of this provision is to protect applicant from having to enforce a judgment outside Austria which the Austrian legislator considers more burdensome than enforcement in Austria.

### Application to awards rendered outside of Austria

The wording of section 379(2)(2) EA suggests that an applicant may apply for an interim measure to ensure the enforcement also of an arbitral award rendered outside of Austria. The Austrian Supreme Court has, however, in a consistent line of jurisprudence, held that section 379(2)(2) EA is limited to situations in which an award will be rendered in Austria.<sup>4</sup> The court has reasoned that the Austrian legislator intended to protect only applicants who would have to enforce their awards outside Austria but for the requested interim measure. Consequently, section 379(2)(2) EA was accordingly not intended to protect applicants who would have to enforce their award abroad in any event because it was rendered outside Austria.

This reasoning of the Supreme Court may be convincing in a constellation in which an award rendered abroad can be enforced in the same country in which it was rendered. This is also the only constellation which has been addressed by the Supreme Court so far. In arbitral practice, however, parties invariably will have chosen the seat of arbitration in a neutral country with which neither of the parties will have any affiliation and in which they do not have any assets against which the award could be

enforced. This constellation has not been addressed explicitly by the Supreme Court as of yet.

In this case, the applicant will have to enforce the award in a state other than the one in which it was rendered in any event. Despite the wording of the Supreme Court's jurisprudence, there is no reason why section 379(2)(2) EA should not be invoked to relieve an applicant from the burden of having to enforce an award in a country in which the enforcement procedures are far more cumbersome than in Austria. Due to broad reception of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards,<sup>5</sup> which largely levels the legal requirements for the enforcement of foreign awards in its member states, the criteria for assessing the increased burden are not legal barriers to the enforcement but practical ones. It is notorious that the enforcement of awards in many states can be factually more burdensome than in Austria. This is due, eg, to the preferential treatment of nationals against whom an award is to be enforced, the length of time and complexity of the enforcement proceedings and, more generally, the poor state of the administration of justice.

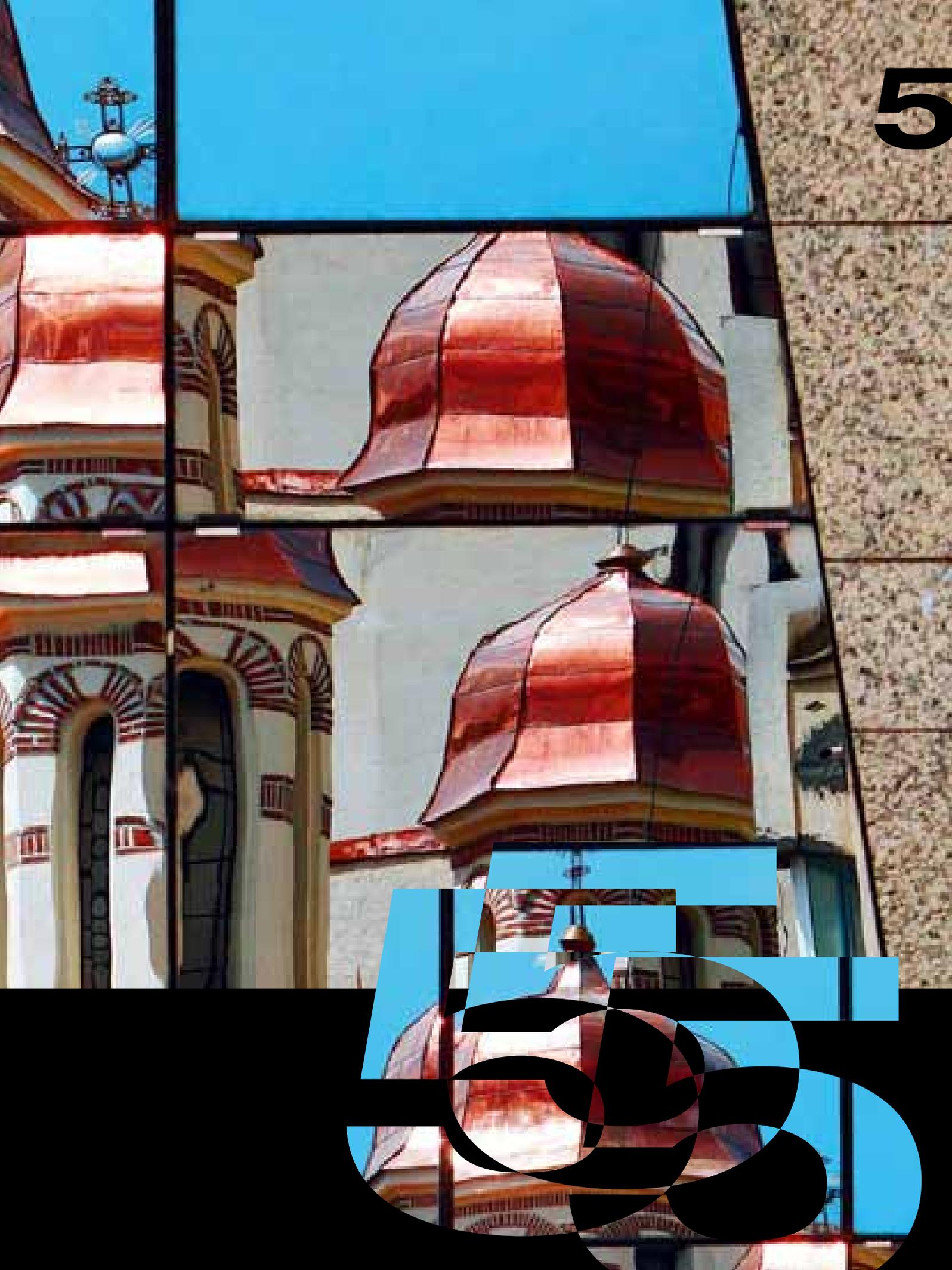
In light of such prospects, the enforcement against assets located in Austria may seem advantageous. It is therefore arguable that in cases in which the applicant can establish that he faces a more cumbersome enforcement of a foreign award in a third state than in Austria, section 379(2)(2) EA can be invoked as a basis for granting an interim measure by an Austrian court.

**Interim measures may be granted if it is probable that without the requested measure respondent would impede or considerably exacerbate the enforcement of a monetary claim eg by damaging, destroying or relocating assets. In practice, establishing that the respondent is likely to take specific acts to impede the enforcement of the award is difficult.**

<sup>4</sup> Most recently in its judgment of 27 January 2010, docket no 7 Ob 255/09i.

<sup>5</sup> The New York Convention currently has 145 state parties, [www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html).







## Austria: Bankers' Bonuses



Martin Huger / Hans Georg Laimer

In autumn 2010 the draft of the amended Austrian Banking Act (*Bankwesengesetz; BWG*) announced restrictions of the variable remuneration policy of credit institutions, irrespective of general rules of civil and employment law.

### Facts

With publication in the Official Journal of the European Union, two directives of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for resecuritisations, and the supervisory review of remuneration policies, shall enter into force.

According to the European Parliament legislative resolution of 7 July 2010 on the proposal of the mentioned directives, member states shall adopt by 1 January 2011 those laws, regulations and administrative provisions necessary to comply with the EU-Directive concerning the remuneration policies. The Austrian ministerial proposal (Ministerialentwurf-194/ME XXIV. GP) of 3 September 2010 stipulates the amendment of the BWG to implement the imminent EU-directives in Austria. The amended BWG shall be in force by 1 January 2011.

### New remuneration policies

According to the ministerial proposal, credit institutions shall stipulate and comply with remuneration policies and practices which are compatible with effective risk management, for all categories of staff whose professional activities have a material impact on the risk profile of the credit institution.

In accordance with the draft of the amended BWG in autumn 2010, the evaluation of the individual performance shall follow financial as well as non-financial criteria, eg:

- The assessment of performance should be set in a multi-year framework;
- There shall be no limitation of the credit institution's ability to strengthen its base capital;
- A guaranteed variable remuneration shall only be granted in exceptional cases.

Furthermore, credit institutions using certain government support must take into consideration, among others, also the following criteria:

- Variable remuneration may be capped at a percentage of the net profit;
- If necessary for solid risk management and long term growth, upper limits for remuneration shall be implemented;
- Senior managers will not be granted a variable remuneration in case this is not adequate.

In accordance with the ministerial proposal, the variable remuneration shall comprise different components. At least 50% of it must be granted by specifically defined shares, as set out in the BWG.

Furthermore, 40% (60% in case higher variable remuneration – not yet further defined) of the variable remuneration must be deferred for at least five years and shall be, in accordance with the remuneration policy within the credit institution, in line with the kind of business performance, its risks as well as the performance of the affected staff.

According to the draft, the entitlement for variable pay is only acquired, and the payment of the variable pay (inclu-

ding the deferred part) is only allowed when this is, in light of the financial situation of the credit institution, affordable and justified (ie, based on the performance of the affected business unit and person).

#### Who controls the remuneration policy?

Based on the ministerial proposal, the supervisory board (or other responsible supervisory body of the credit institution) is responsible for the implementation and verification of the principles of the remuneration policy. In particular cases a remuneration board (to be set up by certain credit institutions) verifies directly the application of the remuneration policy. The Financial Market Authority may impose restrictions with regard to the provisi-

ons, or even completely bar the use of certain instruments of provisions.

#### Consequences

The related legal proceedings, in particular concerning the amendment of the BWG, are currently pending and may have changed somewhat by the time of publication of this article. Both newly agreed upon variable remunerations as well as existing ones are subject to the new remuneration policies. However, payments already rendered are not affected. Credit institutions are thus well advised to monitor the introduction of the new policy and implement the principles of the final new remuneration policy in due course.

 According to the draft, the entitlement for variable pay is only acquired, and the payment of the variable pay (including the deferred part) is only allowed when this is, in light of the financial situation of the credit institution, affordable and justified.

## Poland: Additional Duties means a Right to Additional Remuneration



Barbara Jóźwik

An employer who does not have the written consent of the employee to perform additional duties without an increase in salary may be obliged by the court to pay additional remuneration.

### Facts of the case

An employee was employed as warehouseman on a full-time basis. For three years, based on a written employment agreement, the employee carried out the duties of a warehouseman and, additionally, based on the verbal instruction of the president of the management board of the company, the duties of a cleaner, which were not covered by the agreement. For the cleaning job the employee never received any remuneration despite numerous requests. After three years, the employer terminated the existing terms of employment and offered the employee a job of a cleaner. The employee did not agree, resulting in the employment agreement being terminated. Thereafter, the employee brought an action seeking additional remuneration for having fulfilled additional duties as a cleaner.

### Legal basis

Pursuant to Art. 42 § 4 of the Polish Labour Code, no notice of termination of existing work or payment conditions is required if, where justified by the needs of the employer, the employee is assigned work other than that specified in the employment agreement. This can occur for a period of up to three months in a calendar year provided that it does not result in a reduction of remuneration and corresponds to the employee's qualifications.

In the case in question, the additional cleaning duties were carried out on a regular basis; it was not a temporary work

assignment. The fact that two kinds of work (warehouseman and cleaner) were performed for the same employer in the same place and at the same time does not constitute a sufficient argument to deny the employee additional remuneration for additional cleaning work. Assigning the employee with such work meant that he was commissioned with additional duties different than those specified in his employment agreement.

Therefore, in this case, Art. 42 § 4 of the Labour Code does not apply as the employer did not entrust the employee with a different kind of work (from warehouseman) for a limited period of three months but, rather, with additional work (cleaner) for a much longer period.

### Possible legal consequences

In the opinion of the court, entrusting the employee with an additional kind of work not covered by the employment agreement required that the employer either increase the employee's remuneration corresponding to the additional duties or terminate the existing employment conditions by a changing notice. In order to assess whether a changing notice is required, the employer should compare the existing work conditions with the new conditions and, if different, whether the change is significant and beneficial to the employee. Such significant conditions include the type of work, which may be determined on a general or detailed basis. When defining the type of work on a general basis, the parties leave it to the discretion of the employer to make the employee's duties more

specific. This does not require the employee's consent. However, when the agreement defines in detail the scope of duties as part of a given kind of work, any change of such duties requires the employee's consent or termination of the agreement by a changing notice.

In the said case, the kind of work was precisely defined in the agreement between the parties. This means that any change of the kind of work required either the employee's consent (including if clearly implied) or termination of the agreement by means of a changing notice.

The Supreme Court did not accept the arguments of the employer that, by commissioning the employee with cleaning work, he intended to fill up the employee's working hours, as the duties of a warehouseman did not fill up a full working day. The court deemed that if the duties of the warehouseman could be fulfilled on a part-time basis, then the employer should have considered officially

reducing the number of working hours instead of adding duties not covered in the employment agreement.

#### Obligation to pay remuneration corresponding to the kind of work

A finding that the employee was entrusted without his consent with additional work not covered by the employment agreement leads to the conclusion that the remuneration paid to the employee in a period when he performed concurrently two kinds of work was not adequate to the amount of work performed, as the remuneration only covered warehouseman's duties, as defined in the employment agreement. The remuneration did not fulfil the criteria of fair remuneration which, according to Arts. 13 and 80 of the Polish Labour Code, is due for the work actually performed and should correspond to the kind, quality and amount of work performed by the employee.

 In the opinion of the court, entrusting the employee with an additional kind of work not covered by the employment agreement required that the employer either increase the employee's remuneration corresponding to the additional duties or terminate the existing employment conditions by a changing notice.

## Slovenia: Allowance in Lieu of Paid Annual Leave



Tomaž Petrović / Boštjan Sedmak

Slovenian labour courts have apparently changed their practice when adjudicating on the replacement of paid annual leave with allowance when the employment relationship is terminated.

The change is based upon a disputable interpretation of Directive 2003/88/EC of 4 November 2003 concerning certain aspects of the organisation of working time. It requires that employee entitlements to unused annual leave be paid out in cash when the employment agreement is terminated or ends (if concluded for a limited period of time).

For almost two decades, Slovenian courts have rigorously interpreted provisions of the Employment Relationship Act and the Basic Rights Stemming from the Employment Act to mean that employees are entitled to payment in cash only in cases where the right to use annual leave was revoked by the employer, not in cases where employees failed to exercise such right. This interpretation continued even with the adoption of a new Employment Relationship Act (ERA) in 2002. However, in 2009 a few court decisions indicated that a major change may be underway.

### A deviation

In court proceedings involving an international retailer represented by Filipov, Petrovič, Jeraj, Fabiani in cooperation with Schönherr, the court held that, according to Directive 2003/88, an employee is entitled to allowance in lieu of paid annual leave which was not taken in all cases where the employment relationship is terminated, regardless of the employer's fault.

Such a novel interpretation was based upon the reasoning of the ECJ in the case of Gerhard Schultz-Hoff v Deutsche Rentenversicherung Bund (C-350/06) and upon the Opinion of the Advocate General in the same

case. However, the court failed to recognise a key distinction which makes the ECJ case inapplicable to the Slovenian retailer case.

In C-350/06, the ECJ held that Article 7(2) of Directive 2003/88 must be interpreted as precluding legislation or practices which provide that on termination of the employment relationship no allowance in lieu of paid annual leave not taken is to be paid to a worker who has been on sick leave and thus could not exercise his right to paid annual leave. This implies that the judgment applies to cases where the employee is disabled from taking the annual leave due to reasons he could not have influenced, eg sickness, etc.

However, the Slovenian court took an excessively broad interpretation of the ECJ decision when it concluded that an employee is entitled to the allowance in lieu of paid annual leave which was not taken in all cases where the employee did not exercise his right to paid annual leave – including cases where there were no objective reasons why the employee did not take leave – and the employer was able and willing to grant the annual leave.

The Slovenian court's decision may be further challenged by analogous applications of the ERA's provisions on the employee's obligation to use the annual leave. The ERA prescribes that an employee is obligated to use at least two weeks of his annual leave by the end of the current calendar year and the remaining part by 30 June of the following year upon agreement with the employer. Should the employee fail to use the annual leave, it defaults and has no right to monetary compensation.

Bearing that in mind, the courts' decision to grant allowance in lieu of paid annual leave not taken in all cases where the employment relationship is terminated or ended (limited period) unjustly prefers employees who voluntarily failed to use their annual leave and whose employment ceased to employees whose employment continues and are not subject to the provision of Article 7(2) of Directive 2003/88.

### Impact on business

The final court's decision was promptly challenged and is currently being reviewed by the Slovenian Supreme Court. Though its decision is not expected until early next year, one may predict its impact should the Supreme Court confirm the revolutionary interpretation of the lower courts.

Slovenia is much like the rest of Europe going through unenviable economic times. More fixed term employment agreements are thus being concluded, since this allows the employer to manage labour costs more efficiently and responsively. If the final court's decision is affirmed, it would create a tacit agreement between employers and employees who opt for a cash payment for annual leave instead of actually using the leave. Once the employment is terminated, the employee could simply be employed by another employer without taking any annual leave. Another scenario can be imagined where employees are fictitiously terminated, given the allowance, and immediately re-employed by the same employer. Such arrangements would clearly violate the intention of the Directive 2000/88 and the ERA, namely to give employee actual time off in order to recuperate and offer a more productive contribution upon his return.

 For almost two decades, Slovenian courts have rigorously interpreted provisions of the Employment Relationship Act and the Basic Rights Stemming from the Employment Act to mean that employees are entitled to payment in cash only in cases where the right to use annual leave was revoked by the employer, not in cases where employees failed to exercise such right.





# Competition Law Regime closer to EU Standards

## New Regulations Governing Fining and Leniency Policy bring Serbia's



Srđana Petronijević / Danijel Stevanović

Serbia has recently taken significant steps towards modernising its competition law regime and harmonising it with EU legislation. The Serbian government adopted two regulations governing fines for competition law infringements and leniency policy, while the Commission for the Protection of Competition (the Commission) supplemented these with detailed guidelines. The introduced rules are intended to strengthen the fine-setting powers of the Commission conferred on it by the new Law on the Protection of Competition (the Competition Act), effective as of 1 November 2009.

### Introduction

On 23 July 2010, the Serbian Government adopted two regulations governing fines for competition law infringements: the Fines Regulation<sup>1</sup> and the Leniency Regulation.<sup>2</sup> Both entered into effect on 31 July 2010. The Commission issued corresponding guidelines which describe in more detail how the new rules will be implemented.<sup>3</sup>

The importance of the recently adopted regulations shall be assessed in particular in light of the developments on the market in Serbia at the end of 2009. Namely, at the end of October 2009, just before the Competition Act replaced the previous competition regime (the Competition Act, Official Gazette of the Republic of Serbia, no. 79/05; 2005 Competition Act), an avalanche of leniency applications on distribution agreements containing resale price maintenance provisions (RPM) was filed before the Commission. Numerous manufacturers, wholesalers and retailers in Serbia reported on their distributors, who in

turn reported on their own distributors, proving that RPM practice was widely spread on the Serbian market. It is believed that over 100 applications were submitted with the Commission. The applications were lodged with a sole aim of benefiting from the full immunity provided under 2005 Competition Act, regardless of whether one initiated the RPM.

As the new Competition Act was to enter into force on 1 November 2009, all leniency applications were submitted before this deadline. As of November 2010, the Commission has delivered one decision, declaring the RPM provisions in contracts between Dijamant, a producer of sunflower oil, and 23 retailers on the Serbian market null and void. The Commission delivered the decision on the basis of the 2005 Competition Act, meaning that it will initiate the fining procedure before the Magistrate. It is still uncertain how these leniency applications will be treated by the Magistrate and how the Commission will process other applications.

<sup>1</sup> Official Gazette of the RS, no. 50/2010.

<sup>2</sup> Official Gazette of the RS, no. 50/2010).

<sup>3</sup> Guideline on the implementation of the Fines Regulation of 28 July 2010 and Guidelines on the implementation of the Leniency Regulation of 30 August 2010.

Nevertheless, the new bylaws will provide certainty in the leniency and fining procedures.

### Fining policy

The Competition Act provides that the Commission may impose monetary fines on undertakings both as a fine for the infringement of competition law and as a procedural penalty. The measures are applicable in antitrust and merger control proceedings equally. Fines for infringements may reach 10% of the total annual group turnover of the undertaking concerned while procedural penalties may range from EUR 500 to EUR 5000 for each day of non-compliance with the Commission's request, but may not exceed 10% of annual turnover of the undertaking concerned.

The Commission's Guidelines on the implementation of the Fines Regulation, similarly to relevant EU rules,<sup>4</sup> provide for a two-step method when determining the amount of fines for competition law infringements.

First, the basic amount for each undertaking or association of undertakings will be calculated based upon the turnover from the sale of goods and services, directly or indirectly, related to the infringement, while taking into consideration the gravity and duration of the infringement. Certain practices – such as horizontal and vertical price-fixing agreements, horizontal market-sharing agreements, collective boycotts and bid-rigging – shall be considered as very severe restrictions of competition.

In a second step, the basic amount will be adjusted upwards or downwards based upon a number of aggravating and/or mitigating criteria, such as: the intent of the undertaking to commit an infringement of competition; the severity of the infringement, consequence and duration of the infringement; recidivism of the implicated undertaking; enticement of other undertakings to participate in competition law infringements; the time during which the acts representing an infringement were suspended; the measures undertaken to remedy the occurred consequences of the infringement; and the undertaking's level of cooperation during the proceedings to establish infringements of competition.

When determining the amount of procedural penalties, criteria such as the significance of the ordered action on the outcome of the proceedings and repeated non-compliance with orders of the Commission in the same or another proceeding shall be taken into account.

The deadline for payment of fines may not be less than three months or more than a year from the day of receipt of the decision. The deadline for payment will be determined by the Commission dependent on the financial capacity of the undertaking concerned. Exceptionally, at the undertaking's request, payment in installments may be granted. However, the undertaking has to prove the existence or the certainty of the occurrence of significant and lasting financial difficulties in its business which could, as a consequence, result in bankruptcy or a longer interruption of business.

### Leniency policy

The Competition Act provides that a party to a restrictive agreement may, under certain conditions, be exempt from fines or have its fine reduced if it submits evidence which enables the Commission to establish an infringement of competition rules. In early September 2010, the Commission issued guidelines (corresponding to EU standards) on the implementation of the Leniency Regulation and which govern in more detail the conditions under which leniency may be granted and the relevant procedure. As opposed to relevant EU rules,<sup>5</sup> immunity from and reduction of fines are available to parties to both horizontal and vertical agreements.

### Exemption from fines

An undertaking participating in a restrictive agreement shall be exempt from fines if four conditions are met:

- (i) it was the first to report the agreement (which was previously unknown to the Commission or regarding which the Commission did not have sufficient evidence to initiate proceedings);
- (ii) it submits evidence on the restrictive agreement and/or points out to the Commission the place or the person where evidence can be found;

<sup>4</sup> Guidelines on the method of setting fines imposed pursuant to Article 23(3)(a) of Regulation 1/2003 (OJ 2006 C 210).

<sup>5</sup> Commission Notice on Immunity from fines and reduction of fines in cartel cases (OJ 2006 C 298).

- (iii) it did not incite or coerce other undertakings to conclude or implement the restrictive agreement; and
- (iv) it was not the initiator or organiser of the restrictive agreement.

### Reduction of fines

A party to a restrictive agreement that does not satisfy the above exemption requirements may still have its fine reduced by 30% to 50% if it is first in order for a reduction, between 20% and 30% if it is second in order, and up to 20% if it is third or subsequent in order.

In order to be granted a fine reduction, the undertaking must:

- sign a statement undertaking to fully and continuously cooperate in good faith with the Commission until the decision on the fine becomes final and binding; submit all evidence in its possession or available to it, including documents and other evidence related to the notified agreement; and
- without delay, cease further participation in the restrictive agreement, unless approved or requested by the Commission for the purpose of conducting an investigation and collecting evidence.

By issuing a statement, the notifying party undertakes not to act in a way that might jeopardise the procedure,

and in particular not to reveal data or content from the statement and not to destroy or conceal evidence.

A leniency applicant may either notify the Commission of a restrictive agreement anonymously or make a formal request for immunity. In case of an anonymous notification, the Commission shall assess whether it has knowledge of the agreement described and/or whether it has sufficient evidence to initiate proceedings. Dependent on these circumstances, the Commission will advise the notifying party to apply for either an exemption or a reduction of fines.

If a party to a restrictive agreement does not qualify for immunity, it may apply for a reduction of fines or withdraw its request, which does not prevent the Commission from obtaining relevant evidence from said undertaking through its investigative powers.

### Remarks

Serbia has taken significant steps towards modernising its competition rules and bringing them into step with EU legislation. Nonetheless, it has opted for certain solutions which are broader than comparable EU standards. The new rules place emphasis on enforcement of competition rules and are intended to provide the Commission with significant tools to uncover and punish restrictive agreements, as well as other competition law violations.

 **The Competition Act provides that a party to a restrictive agreement may, under certain conditions, be exempt from fines or have its fine reduced if it submits evidence which enables the Commission to establish an infringement of competition rules.**

## Identifying and Mitigating Anti-corruption and Anti-trust Compliance Risks



Christoph Haid / Heidemarie Paulitsch

Multi-digit euro fines for anti-competitive behaviour and continued press coverage of bribes have moved compliance programmes ever more into the focus of attention. They shall help prevent impermissible behaviour, but how to organise a compliance programme?

There are several reasons why undertakings should invest in programmes to safeguard that their business operates in compliance with applicable rules. Beside legal obligations to this end, some consequences of illicit behaviour are too significant to be taken lightly.

These may include significant fines; forfeiture of enrichment from the illegal behaviour; administrative, civil and criminal sanctions against individuals; exclusion from public tenders; damage claims by affected customers and significant damage to reputation and share value (not to mention management time lost in dealing with investigations). In turn, effective compliance programmes may bolster credibility and even be criteria of consideration for investors.

There is no “one fits all solution”. The actual scope of a compliance programme must be assessed on a case-by-case basis. The following steps (with a particular focus on anti-corruption and anti-trust) must usually be considered.

### Step 1: Risk identification

Compliance programmes cannot exclude each and every risk associated with day-to-day-business. Their aim, rather, is to prevent systematic wrong behaviour.

Such behaviour can equally occur in procurement (risks of anti-competitive behaviour, corruptibility, defalcation),

production (environment production, work safety, etc) and sales (corruption, anti-trust, defalcation, etc).

As a first step, the risk exposure of companies in these respective areas must be assessed thoroughly.

From an anti-trust angle, one must assess whether the company faces the risk of:

- (i) the coordination with competitors of prices, production, markets or customers, which is a particular risk if:
  - customers are also competitors;
  - company representatives attend trade association meetings together with competitors;
  - staff (regularly) joins from competitors;
  - employees receive information on competitors’ future conduct; or
  - the company cooperates (extensively) with competitors.
- (ii) restrictive supply agreements, including:
  - restricting the distributor in its resale prices or the area into which or the customer to whom the distributor may sell the contract goods; or
  - agreeing on impermissible exclusivity clauses.

Should the respective company enjoy a considerable level of market power, one must also appraise whether this company is market dominant, which would entail further behavioural obligations.

From an anti-corruption angle, a company is exposed to compliance risks if:

- (i) a considerable proportion of its revenue is derived from contracts with or sales to public bodies or state-owned companies, and where the underlying negotiations are not based on transparent tender proceedings;
- (ii) agents/consultants are widely used to procure contracts, especially with the public sector, and are believed to be pivotal to being awarded new contracts, where:
  - these agents/consultants are part of or in close relationship to the public sector (public authorities) or trade unions;
  - the respective company has no real insight into the identity or reputation of the agent/consultant and the actual scope of work to be done; and
  - the agents' compensation is not transparent.and
- (iii) company funds can be misused for illicit payments that are facilitated by:
  - bank accounts that are not monitored by the company (ie such accounts are not consolidated and incoming and outgoing payments are not under the supervision of the accounting department);
  - the agent is not the holder of the bank account;
  - the company makes use of escrow accounts but there is no transparency within the company as to who has access to these accounts and what they are used for;
  - the opening of new accounts on behalf of the company is not regulated by guidelines; and
  - cash payments are not regulated by company policy guidelines or included in accounting.

#### Step 2: Risk prevention and review

Manifold means are available to mitigate the risks of illicit behaviour. They include:

- (i) compliance manuals, in which applicable rules are explained in more detail and policies to be adhered to explained in order to safeguard lawful behaviour;
- (ii) training of employees that have been identified to be at risk of wrongdoing. In order to tailor a compliance programme, one might consider carrying out a staff-based risk assessment and training employees in different levels of detail depending on their risk exposure. Such training can be performed face-to-face or online (or a combination of the two);
- (iii) testing of employees' knowledge, eg in regular interviews or through online tests, legal audits and the like; and
- (iv) sign-off procedures, eg for competitor contacts and the retaining of agents (compliance clause in contracts of employees, business partners, agents).

Once the compliance programme has been implemented, it is important to review it on an ongoing basis in order to adapt it should it turn out that risks have changed, certain measures have proven ineffective, the testing of employees has revealed that certain aspects of the compliance programme have not been understood fully or are unpractical, or that audits and interviews of that certain aspects of business need closer scrutiny.

#### Enforcing a culture of compliance

Most importantly, for the compliance programme to be more than mere lip services, it is necessary to enforce a culture of compliance from the top of the company down. This includes, first and foremost, an unreserved commitment to compliance from the board and senior management, which is continuously reinforced in the company's code of conduct and exemplified by senior management. In addition, it is advisable to make it clear that disregarding compliance rules shall be regarded as misconduct and entail disciplinary action, while continued and proven adherence to compliance rules is a requirement for bonuses and promotions.

 There is agreement that compliance programmes are a “must” for larger companies. Such programmes entail a considerable amount of personal and financial resources. Hence, one must carefully consider what the compliance risks are and who is exposed to such risks in order to tailor a programme of maximum effectiveness.

# The Hungarian Merger Control Regime: Room for Improvement



Anna Turi / Miklós Molnár

Despite the increased role of economic analysis in the merger control regime and several recent steps to modernise the merger control rules, the Hungarian merger control regime is still not client-friendly.

## First step: The 2009 changes

In 2009, the Hungarian merger control regime were amended threefold: (i) the more formalistic dominance test was replaced by the significant lessening of competition (SLC) test<sup>1</sup> (allowing the Hungarian Competition Authority [*Gazdasági Versenyhivatal*; GVH] to assess market development and behaviour of the market players on the basis of their actual economic effects), (ii) a new notice on “Differentiating between concentrations subject to authorisation in simplified or full procedure” (similar to Phase I and Phase II proceedings) was published by the authority and (iii) an amended filing form was introduced.

## Second step: Non-binding guidelines in 2010

Next, to further harmonise Hungarian merger control rules with those of the EU, the GVH recently published guidelines on the substantive assessment of concentrations (the Guidelines). The GVH adopted guidelines on:

i) the methods of analysing concentrations, scope of the required data and requirements for such data;

- ii) the substantive assessment of concentrations (ie the application of the SLC test as opposed to the previous dominance test);
- iii) the level of detail and quality of data used by the GVH for the appraisal of concentrations;
- iv) the principles of assessing non-coordinated horizontal effects of concentrations; and
- v) the definition of the relevant markets in merger control proceedings.

The guidelines should be seen in the framework of changes to the new substantive test and of recognising the increasing significance of economic analysis in the work of the authority (the GVH has employed a chief economist since 2006). They aim to serve a similar function as do the guidelines of the European Commission<sup>2</sup> on horizontal mergers and the definition of relevant market<sup>3</sup>, to which these new Hungarian Guidelines often refer.

The actual legal status and significance of the guidelines (published only on the website of the authority) are yet to be clarified. The GVH has only stated that the guidelines do not (even) amount to a non-binding “notice” (in Hungarian, “közlemény”, such as the notice on differentiating

<sup>1</sup> The wording of the relevant provision of the Hungarian Competition Act reads that “the GVH may not prohibit the transaction if it does not lead to a substantive impediment of competition [and not the: significant impediment of effective competition – remark by the author] on the effected market, in particular as a result of the creation or strengthening of a dominant position.” This is not identical to that of the EU Merger Regulation but is reminiscent of the SLC test. The explanatory notes introducing the amendments, however, refer to both the SLC test (used in the US) and the SIEC test (used in the EU).

<sup>2</sup> European Commission’s Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03, “Horizontal Merger Guidelines”).

<sup>3</sup> Commission’s Notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03).

between simplified and full procedures) and that the GVH will continue to issue its decisions solely on the basis of the provisions of the Hungarian Competition Act. Regardless of their exact status under Hungarian law, the guidelines are expected to be referred to by the authority in future procedures, in particular in more complex (Phase II) procedures (as the guidelines elaborate on additional data beyond what is requested in the filing form, quantitative methods of analysis, and on questionnaires of the undertakings concerned, amongst others). It remains to be seen whether separate guidelines will be published on coordinated effects of mergers and to what extent the guidelines (eg definition of the relevant market) will be used in antitrust law.

### Third step: Trends in case law and a new compilation of position statements

It is still too early to judge the change of the GVH's analysis and reasoning in merger control cases, but it is noteworthy that in the last two years the authority has elaborated in its decisions on various efficiencies of a concentration, and (in the context of financial difficulties and insolvency) the failing firm defence. The case law has also provided more clarification as to whether a lease contract relating to assets or the acquisition of assets in a liquidation proceeding may constitute a concentration. This is significant as not meeting the deadline to notify the authority of a notifiable concentration (which is 30 days from the signing of an agreement, the publication of a public bid or the acquisition of control, whichever occurs first) may result in heavy daily fines.

The GVH also recently published a compilation of the Competition Council's (the authority's decision making body) merger control position statements, which reflect

the Competition Council's interpretation of the relevant provisions of the Competition Act.

### Criticism: Even unproblematic merger cases still face procedural difficulties

Despite the welcomed trends in the substantive analysis of mergers, clients still face difficulties and lengthy proceedings even in unproblematic concentrations. The 27-page filing form (with 77 questions) is not user-friendly. It does not differentiate between simple and critical concentrations; the same form (which requests more data, and several original supporting documents, than is required in most other CEE countries) must be completed in all merger cases. Moreover, additional data requests upon submission of the filing are a regular feature of proceedings in Hungary. This is particularly unfortunate as such requests, if issued within 10 working days from submitting the notification, push back the start of the waiting period in phase I and, therefore, the clearance decision<sup>4</sup>.

However, the majority of concentrations do not face serious concerns from the authority<sup>5</sup> and good (informal) cooperation with the authority may help to ease the sometimes formalistic proceedings.

### Outlook: Winds of further change?

A change in the policy of the GVH is likely to be expected as it has a new president as of November 2010, replacing the current president after 12 years in office. One may hope that the simplification of the merger control proceedings, including a more pragmatic approach to unproblematic concentrations, will be on the agenda of the GVH in the future.

 Despite the welcomed trends in the substantive analysis of mergers, clients still face difficulties and lengthy proceedings even in unproblematic concentrations. The 27-page filing form (with 77 questions) is not user-friendly.

<sup>4</sup> Although there is no explicit suspension clause in the Hungarian merger control regime and no fines for early implementation – which is often interpreted by undertakings as a green light for implementing a transaction even before clearance – there is a (limited) risk associated with closing a transaction prior to clearance, especially if clearance is not granted by the authority later on. Further legislative clarifications are needed in this regard.

<sup>5</sup> In the past year, the GVH has only prohibited one concentration. Although another application was withdrawn after it had been indicated to the parties that clearance would most likely not be granted.

## Poland: How Lenient should a Leniency Programme be? A Second Chance for Recidivists



Michał Markowicz

Although the Office for Competition and Consumer Protection (OCCP) states that there shall be no mercy for competition law offenders, recidivists will be granted immunity from a fine if they file for leniency.

### Draconian fines

At the end of last year the OCCP took an unprecedented decision about the amount of fines imposed. After years of investigation that started in 2006, the authority found seven Polish cement producers guilty of having been involved in an illegal market sharing and price fixing cartel for over 11 years. The fines imposed totalled ca EUR 100 mln; individual fines were capped at 10% of the respective undertaking's turnover. It was the highest fine ever imposed by the Polish competition watchdog. Pursuant to the leniency regulation, the authority granted full immunity from any fine to one of the seven cartel members, who had been the first to disclose its participation in the cartel. Another received a 50% reduction.

The decision in the Tikkurila case, issued in May 2010, was also remarkable. Several companies were found to have engaged in a resale price maintenance scheme regarding the prices of paints and coatings. They were fined a total of ca EUR 10 mln. Again, one of the offenders applied for leniency and received full immunity, while another implicated undertaking was granted a 50% reduction.

Not only the amount of fines imposed by the OCCP in 2010 is impressive but also the number of culprits. In the Sniezka case, the OCCP penalised Sniezka, a manufacturer of paints and varnishes, and 55 of its distributors. In the Gerda case, fines were imposed on 45 distributors and Gerda, the manufacturer.

### The leniency programme: Success or failure?

The large number of cases and significant fines have made the leniency application popular amongst entrepreneurs. Since the adoption of the first leniency law in 2004 until the end of 2009, 19 leniency applications have been lodged. After a rather slow start in 2004–2006, the number of leniency applicants reached its peak in 2007 when companies applied for leniency six times. The number of leniency applications in 2008 and 2009 slightly decreased, to five and three respectively. As of mid-October 2010 there have already been six leniency applications. However, it should be noted that these figures include leniency applications for anti-competitive agreements in both vertical and horizontal cases, as it is possible in Poland to apply for leniency for both.

Interestingly, the same company – a retailer with significant market power – applied for leniency in at least three sequential cases concerning illegal price fixing in the same market involving different suppliers. For this applicant, the leniency programme was beneficial because it received a significant fine reduction in 2006, a normal fine reduction in 2008 and full immunity in 2010. Obviously, the granting of leniency is not precluded by former cartel infringements. In the above example, the applicant received full immunity even though it was a three-time recidivist. This actually contradicts the directives of statutory law, which explicitly state that previous infringements of competition law must be taken into consideration and lead to an aggravation of the fine.

It is clear that the leniency programme has boosted the detection of cartels. But one may question whether leniency should really be available to any company irrespective of whether it has infringed competition law in the past. Public perception of this solution may not be entirely positive. One may deem it unjust that a recidivist may still apply for leniency, and it appears fairer if companies with a history of anti-competitive behaviour are not placed on an equal footing with first time offenders, especially in cases of multiple violations.

However, one must not forget that fines are only one of the negative consequences of competition law infringements. Others include significant damage to the reputation of implicated undertakings (including possible drops in share prices of listed companies), damage claims by customers and disqualification from future tenders. If the cartel activity affected other countries besides Poland,

directors of the leniency applicant may even face criminal sanctions.

### Conclusion

In the final analysis, the Polish leniency programme has proven successful in restoring effective competition in markets where competition was hampered by restrictive practices. The fact that even a repeat offender may benefit from immunity may appear unjust, but is probably necessary to achieve the overall goal of safeguarding consumer welfare by effective competition.

In order to enhance legal awareness of competition rules and foster compliance by undertakings, it is paramount that leniency applications be prosecuted swiftly and vigorously. The Polish competition authority has done this so far.

 It is clear that the leniency programme has boosted the detection of cartels. But one may question whether leniency should really be available to any company irrespective of whether it has infringed competition law in the past.







## Austria: Corporate Restructuring and Creditors' Participation



Wolfgang Höller / Barbara Steger

While in other jurisdictions creditors of an insolvent company may swap their debts into equity, creditors in Austria are still confronted with a “take it or leave it” approach as to the proposed quota payment to unsecured creditors. The recent insolvencies of large Austrian companies show the inadequacy of Austrian insolvency law in that respect.

### Financial crisis just arrives

The past year has again witnessed a spectacular surge in corporate restructuring around the world, driven by the financial crisis and the increasingly intense global competition for capital supply.

Austria is no exception. Some of the major Austrian companies are highly leveraged due to the excessive use of debt capital from the capital markets in the past. While refinancing of corporate bonds was no big issue in the pre-Lehman era, it became much more complicated for leveraged companies after the credit crunch.

With final repayment dates approaching, companies increasingly face a situation where they have fewer, or no, options for refinancing their outstanding bonds.

### Austria's best practice – resting on laurels

Recent examples show that these efforts more often fail. Bondholders do not accept exchange offers on their bonds proposed to them as a structured haircut. New bonds aimed at refinancing the old ones are not even brought on the market due to the lack of interest. And bank creditors nowadays tend to focus on their own engagement with no intention to increase their engagement by refinancing corporate bonds.

Under Austrian law the management of such overleveraged companies may file for insolvency at a very early stage. Even when the company's illiquidity is only imminent, the management may file for so called restructuring proceedings with self administration. It enables reorganisation of the debtor's business by discharging the debtor from a part of its debts (up to 70%) and enables the debtor to continue its business if the creditors accept the proposed restructuring plan (*Sanierungsplan*).

The restructuring proceeding with self administration is extremely streamlined and shall be accomplished within three months. The restructuring plan only needs a simple majority of the unsecured creditors representing more than 50% of the total claims.

While the debtor is released from its debts, unsecured creditors usually suffer a substantial loss of their investment. This often happens due to a lack of alternatives to the restructuring proposal of the company, forcing them to choose between the devil and the deep blue sea. They may either suffer a forced haircut on their claim through a restructuring plan or be confronted with the unpredictability of a liquidation of the company (if they can avoid the approval of the restructuring plan at all). Austrian law in particular does not provide for a compulsory option for unsecured creditors to transform their debt capital into equity capital.

### Practical need for a debt to equity swap

In the new insolvency law, introduced on 1 July 2010 (*Insolvenzrechtsänderungsgesetz 2010*; IRÄG), the legislator did not seriously take into account that unsecured creditors would be willing to waive their quota in exchange for participating in the corporation's future success. In its explanatory remarks to the IRÄG the Federal Ministry of Justice stated that, given the current corporate environment, there was hardly any demand from creditors for such a debt to equity swap and reserved this issue for serious consideration at a later stage.

Recent insolvency cases clearly show that the legislator was wrong. The lack of a compulsory debt to equity swap ultimately protects shareholders. While they benefit

from their company becoming substantially deleveraged, unsecured creditors still do not have any chance to get a piece of the cake. They are still confronted with an uncreative "take it or leave it" situation where they have to vote against a restructuring plan which might not be in their interest nor to the benefit of the company.

### Conclusion

To sum up, the recent reform of the insolvency proceedings has not tackled the big issue of creditors' participation in future corporate success. The legislator's opinion that there is no practical need for such instruments has been proven wrong by recent insolvency cases. The legislator should give this issue serious reconsideration, and soon.

 The lack of a compulsory debt to equity swap ultimately protects shareholders. While they benefit from their company becoming substantially deleveraged, unsecured creditors still do not have any chance to get a piece of the cake.

## Slovenia: Insolvency Legislation Faces its First Real Test



Jernej Jeraj / Matthias Wahl

The economic crisis presents a real-life test for the Slovenian insolvency legislation, unequalled in its young history. Numerous insolvency proceedings against Slovene companies have revealed several serious flaws of the Insolvency Act and forced the legislator into continuous amendments.

The global economic crisis and its local effects have put the Slovene Insolvency Act (*Zakon o finančnem poslovanju, postopkih zaradi insolventnosti in prisilnem prenehanju*, Official Gazette of Republic Slovenia no. 126/2007 et seq., ZFPPIPP) and its application in practice to a real test. Although it is a young act, which itself reformed the legal framework of insolvency in Slovenia, the legislator has been forced to amend it three times already, while the fourth amendment is currently in parliamentary.

### The recent amendment

The most recent amendment came into force on 15 July 2010 and has brought several important changes. Firstly, the position of a receiver will become professional and will impose additional mandatory qualifications and other conditions on receivers.

Until now, it was not uncommon that a receiver of a large company in a bankruptcy proceeding was a full-time primary school teacher or an engineer with limited experience or knowledge in economics and law. The obvious consequence was (is) that receivers were (are) not always up to the task of guiding a company through insolvency proceeding and protecting the best interests of the creditors of the company.

The legislator has also increased the competences of the chamber of receivers and laid down more strict and defined rules regarding the supervision of receivers' work, including fines and other disciplinary measures.

The legislator has also resolved the long pending question of whether the initiation of an insolvency proceeding affects the agreements on close-out netting; it has explicitly stated that they are not. The legislator has also put some efforts into improving the possibilities for survival of the debtor in a compulsory settlement proceeding and also into saving sound parts of the debtor in a bankruptcy proceeding over the assets of a natural person or an entrepreneur. In a compulsory settlement proceeding, the creditors may now, through the creditors' board, propose an increase in the debtor's share capital through new contributions and the issuance of new shares, which may be paid in by creditors, current shareholders and other persons – if this is foreseen in the resolution on the increase of share capital. Such decision must be adopted within four months after the initiation of the compulsory settlement procedure.

Until now, an increase of the debtor's share capital could have been proposed only by the debtor's management, provided that this measure was a part of the plan of the financial restructuring of the debtor.

Additionally, the possibility of a debt-to-equity swap via conversion of creditors' claims into debtor's shares remains a further possibility for reorganisation of the debtor. The most recent amendment has thus enabled the creditors to take over control of the debtor and ensure the continuation of its business even if this is not in the interest of the debtor's management and/or shareholders.

### Assets of a natural person or entrepreneur

With regard to bankruptcy proceedings over the assets a natural person or entrepreneur, the legislator has foreseen the possibility that the debtor after the initiation of the insolvency proceeding (again) starts conducting business as an entrepreneur or a sole proprietor, subject to prior approval of the insolvency court.

The debtor must file a motion containing the information on the planned scope of business, planned turnover and description of circumstances which make it possible for the court to assess whether there is a sufficient probability that the debtor will conduct his business at a profit. The debtor may further propose that certain assets of the debtor (with the exemption of real estate) are exempted from the bankruptcy mass, whereas he is obliged to pay an appropriate monthly remuneration for the use of these assets.

The aim of this amendment is to motivate the debtor to remain active and continue his business while improving the position of the creditors.

### Improving the payment culture

The most recent amendment to the Insolvency Act, which has not been passed yet, aims to improve the overall payment discipline and culture in Slovenia. All companies, entrepreneurs and public authorities shall become obliged to regularly report to the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES) their total sum of due and unpaid obligations, and the average term of default, towards creditors. Data about creditors and individual claims will not be disclosed. This data will be made public in order to enable businesses to check the creditworthiness of potential partner debtors. This, however, gives rise to a question that may not have been considered by the legislator. Namely, whether by making itself familiar with this data, and thus with the potential insolvency of the debtor, the potential creditor may be obliged to return payments received from the debtor as it should have suspected that the debtor was breaching the rule on equal treatment of creditors by paying it. It is thus quite possible that the planned solution will quickly turn out to be an additional problem for creditors, and the business environment generally.

**“ The position of a receiver will become professional and will impose additional mandatory qualifications and other conditions on receivers. Until now, it was not uncommon that a receiver of a large company in a bankruptcy proceeding was a full-time primary school teacher or an engineer with limited experience or knowledge in economics and law.**

## Insolvency in Bulgaria: Downsides Creditors may Encounter



Anton Andreev

The general legal framework of existing Bulgarian insolvency law covers the core features recognised by the international insolvency community and takes account of EC Regulations and Directives. On the other hand, it does not always achieve the proper balance between the need to address the debtor's financial difficulty as efficiently as possible and the interests of the creditors.

This article highlights some inefficiencies of the existing Bulgarian insolvency regime compared with international best practices.

### Scope

No collective insolvency proceedings are in place with respect to natural persons unless they are operating as sole proprietors. Individuals that do not conduct economic activities by themselves may not be discharged from their liabilities in order to have a fresh start.

### Issues related to insolvency proceedings

There are no clear rules specifying the over-indebtedness test in Bulgarian insolvency law. This creates some uncertainty for creditors who have become aware that the debtor is in financial distress but has not yet ceased paying its debts (ie, the other available test, insolvency, is not met). Such uncertainty, coupled with civil liability on the part of creditors for negligently filing an application for commencement of insolvency proceedings, may force creditors to refrain from filing. This may defer the commencement of insolvency proceedings at a time when it is possible to preserve the debtor's assets and when there are real prospects for the debtor to recover.

Once insolvency proceedings commence, secured creditors cannot enforce their security. Their priority is not affected but they are only entitled to the proceeds of the

sale of the collateral asset if and when such collateral is sold by the administrator. Thus, the general rules regarding the staying of enforcement proceedings are equally applicable to unsecured and secured creditors. Bearing in mind the usually lengthy insolvency proceedings in Bulgaria, the stay on individual enforcement of secured claims in the event of insolvency may undermine the value of security given by a debtor who becomes insolvent.

Claims that arose (ie, due, whether payable or not) before the date when the court decision for commencement of insolvency proceedings was made public but were not lodged within three months thereafter are time-barred in the insolvency proceedings. In this respect, the law does not distinguish between secured and unsecured creditors. This total bar of creditors' claims upon expiry of the statutory term is not justified and does not correspond to international best practices. The fair and equal treatment of all creditors should allow the claims of belated creditors to be accepted in insolvency proceedings where good reasons exist.

Further, neither the administrator nor the debtor is obligated to notify known creditors about the commencement of insolvency proceedings. Given the time-barring character of the statutory term for filing of creditor's claims within the insolvency proceedings, it is rather possible that (even secured) creditors learn about the insolvency only after their claims are time-barred.

### Issues related to rehabilitation proceedings

Bulgarian law does not provide for out-of-court rehabilitation procedures. The court shall decide whether the company is insolvent and/or over-indebted, announce the commencement of insolvency proceedings and ultimately approve a pre-packaged reorganisation plan. In many cases this approach can be unnecessarily burdensome, cause delay and be an obstacle to a successful reorganisation.

Two formal rehabilitation procedures are available: one for approval of a reorganisation plan and one for a composition agreement. Both require the court's approval and may be launched only after formal insolvency proceedings have been commenced. There is no legal means for the debtor to unilaterally apply for protection and obtain a moratorium when insolvency or over-indebtedness is imminent but has not yet occurred.

Although a reorganisation plan may envisage the sale of the debtor's enterprise as a going concern, there is a requirement that the proposed sale always be accompanied by a draft sale agreement signed by the prospective purchaser. Given that the statutory deadline for

submission of the reorganisation plan is only one month following the commencement of insolvency proceedings, it is not realistic to expect that a third party purchaser would be able to adequately evaluate the debtor's business and negotiate the structure and other terms of the transaction. Thus, the sale of the debtor's enterprise would be rarely carried out, although in many cases such sale may be the best option for creditors and company employees.

At no stage of the insolvency proceedings are creditors entitled to receive a full and detailed disclosure statement of the business and financial situation of the debtor. This lack of access to information renders the adoption of a plan more unlikely since creditors are not able to make an informed decision about a proposed plan. Further, they are not in a position to propose a realistic and feasible reorganisation plan themselves.

The court is not authorised to extend the abovementioned one-month limit for submission of a reorganisation plan. Little consideration seems to have been given to the need, especially in large cases, for adequate time for consultations and negotiations between creditors, which would increase the chances of the plan being approved.

 There are no clear rules specifying the over-indebtedness test in Bulgarian insolvency law. This creates some uncertainty for creditors who have become aware that the debtor is in financial distress but has not yet ceased paying its debts.

# Insolvency Set-off under the New Serbian Bankruptcy Act



Slaven Moravčević / Nikola Babić

The duration of bankruptcy proceedings and the difficulties regarding settlement of creditor claims (including derivative transactions) were key indicators that the existing Serbian bankruptcy regulation did not meet the needs of an ever-growing market or offer satisfactory solutions.

## The new Bankruptcy Act

Therefore, on 11 December 2009 the Serbian Parliament adopted the new Bankruptcy Act (*Zakon o stečaju*; Bankruptcy Act), published in the Official Gazette of RS no. 104/09. The Bankruptcy Act entered into force on 24 December 2009 and became applicable as of 23 January 2010<sup>1</sup>.

The Bankruptcy Act introduced substantive changes with regard to forced settlement, aiming thereby to, *inter alia*, improve the efficiency of bankruptcy proceeding in Serbia in: (i) the duration of bankruptcy proceedings, (ii) the degree to which creditors' claims are settled and (iii) the expense of proceedings.

One of the most significant features of the Bankruptcy Act is the introduction the possibility of set-off (netting) for the first time in the legal framework of Serbia.

## Set-off (netting)

Following modern trends in comparative legislation and aiming to provide efficient settlement of creditors claims, the Bankruptcy Act has for the first time introduced into the Serbian legislation the institute of the set-off (also known as netting), where creditor claims are off-set with bankruptcy debtor claims towards such creditor.

## General rules of set-off

As opposed to the former bankruptcy act, the Bankruptcy Act provides that a right to a set-off which was acquired prior to and following the instigation of bankruptcy proceedings remains unaffected in subsequent bankruptcy proceedings.

The only action that a creditor who is willing to off-set its claim against the bankruptcy debtor claim must take is to file its claim as well as the set-off statement with the competent commercial court. However, this must be done within the term prescribed under the Bankruptcy Act, ie not less than 30 days or more than 120 days as of the date when the request for instigation of bankruptcy proceedings was filed. Otherwise, the creditor loses its right to compensation.

## Netting

Bearing in mind the peculiarities of the financial market, and with regard to certain types of financial agreements, the new Bankruptcy Act introduces particular clauses pertaining to netting under derivative contracts such as swaps, options, futures, forwards, as well as other "unnamed" derivatives. The Bankruptcy Act allows the setting-off (netting) of creditor's claims arising out of or in connection with framework financial agreements entered

<sup>1</sup> Save for certain provisions which shall be applicable as prescribed by the Bankruptcy Act transitional provisions.

into prior to the filing of the request for instigation of bankruptcy proceedings. In addition, and on the basis of such financial agreements, creditors might be entitled to set-off (netting) even following the filing of a request for instigation of bankruptcy proceedings (but not later than the day of adoption of a decision on instigation of the respective proceedings).

Accordingly, if all legal conditions are met, the right to set-off (netting) may be exercised either automatically (introducing a major innovation in the light of the ISDA Master Agreement) or by serving the set-off declaration to the insolvency debtor within three days of the instigation of bankruptcy proceedings.

#### Prohibition of set-off

In order to avoid the use of set-off (netting) for purposes contravening the laws of Serbia or the rules of ordre public, the Bankruptcy Act explicitly enumerates the cases in which a set-off in bankruptcy proceeding is not allowed. Compensation is prohibited:

- (i) if the claim was ceded to the bankruptcy creditor within six months prior to the filling of the request for instigation of the bankruptcy proceedings, provided

- the creditor knew or ought to have known that the debtor was insolvent or over-indebted; or
- (ii) if the creditor acquired the right to set-off its claim through a voidable transaction.

#### Conclusion

It is worth mentioning, that although the concept of netting is clearly recognised by the Bankruptcy Act, the practice is yet to clarify whether the bankruptcy receiver would be able to select transactions. Namely, in certain instances, notwithstanding the bankruptcy, a bankruptcy receiver may decide to continue performance while the other transactions would remain terminated. As a consequence, the bankruptcy receiver might be able to choose certain transactions and request their full performance, rendering the netting mechanism largely inoperable. However, for transactions qualifying as “fixed contracts”, this risk is minimised.

Despite the ambiguities and uncertainties about how netting will be interpreted and applied by the insolvency judges and receivers, netting has brought about substantial changes in business transactions concerning financial derivatives, enabling the realisation of transactions which could not be realised under the former legislation.

 Following modern trends in comparative legislation and aiming to provide efficient settlement of creditors claims, the Bankruptcy Act has for the first time introduced into the Serbian legislation the institute of the set-off (also known as netting), where creditor claims are off-set with bankruptcy debtor claims towards such creditor.

## Romania: Evolution of the Insolvency Law during the Economic Downturn



Emeric Domokos-Hancu

The Romanian legal framework on insolvency procedure has been consistently improved following the enactment of Insolvency Law no. 85 (Law 85), which entered into force on 21 July 2006.

### Background

Law 85 replaced the former Bankruptcy Law no. 64/1995, establishing new mechanisms for shortening the judicial procedures in order to accelerate the reorganisation of companies undergoing financial difficulties or to put an end to their existence and preserve as many of the creditors' rights towards the bankrupt companies as possible (through the bankruptcy procedure).

The constant amendments to Law 85 have been mainly influenced by the conditions provided by the Romanian insolvency practice. Before the enactment of Law 85, approximately 71% of insolvency cases led to bankruptcy proceedings, while only a small percentage of insolvent companies managed to undergo a successful reorganisation. New mechanisms for shortening the procedures, and accelerating the reorganisation proceedings were thus necessary. Further, alignment with the European Insolvency *Acquis Communautaire* was mandatory.

During the years of economic growth of the country, Law 85 underwent only minor amendments. However, since the beginning of the economic downturn, the number of amendments has increased (once in 2009 and twice in 2010).

Because of the crisis, more companies have been facing financial difficulties. A lack of liquidities on the market has led to a significant increase in the number of debt re-

covery proceedings and insolvency cases. In practice, creditors were using insolvency proceedings as a means of debt recovery. Filing for insolvency against their debtors has mainly been done to pressure debtors to settle receivables in order to avoid entering into insolvency.

In order to stop this phenomenon and to ensure that companies facing insolvency have a fair chance to undergo a reorganisation proceeding, Law 85 has been amended. Due to such amendments insolvency has started to be perceived also as a proceeding by way of which the debtor could seek judicial protection from its creditors and companies could actually undergo a successful reorganisation. During 2010 the number of companies filing for insolvency and trying to undergo reorganisation proceedings has significantly increased. Some of the most important amendments to Law 85 are discussed below.

### Shortening the procedure and reducing the number of insolvency requests

Beginning in 2009 the concept of special insolvency departments (within county courts) has been introduced. These departments are only competent to hear insolvency proceedings under Law no. 85 and the EC Regulation on insolvency proceedings. The establishment of the insolvency departments is an ongoing process, whereas most Romanian county courts have already established such departments.

Prior to the 2009 amendments, the mandate given to statutory management bodies was only suspended following the withdrawal of the debtor's right to manage their estate. Now, however, the mandate of the statutory management is considered terminated upon withdrawal of the debtor's right to manage their estate or upon appointment of the special trustee.

The provisions regarding the appointment of a special trustee by the general assembly of the debtors' shareholders have also been amended in order to speed up the proceedings. Following such amendments, failure by the general assembly to appoint a special trustee automatically triggers the withdrawal of the debtor's right to manage its estate and management is taken over by an appointed judicial administrator. Further, in urgent cases, the judicial administrator was given the right to perform transactions without the prior approval of the creditors' meeting.

### Reorganisation before bankruptcy

In order to ensure the companies facing financial difficulties a fair chance at undergoing insolvency proceedings (and also to encourage the reorganisation of the companies and decrease the number of insolvent companies entering directly into bankruptcy), Law 85 introduced the below amendments. Article 86, introduced in 2009, provides that contracts which are ongoing at the date of opening of the proceedings shall be deemed to continue. Any contractual clauses stating that ongoing contracts are terminated due to the opening of insolvency proceedings shall be null and void. Prior to this amendment, many ongoing contracts of the debtor company were terminated solely on this ground, preventing the debtor from continuing its business and preventing any real chance of reorganisation.

Also, during the observation period, the judicial administrator now has the right to amend the clauses of facility agreements with a view to establish comparability of future performance, provided there is consent from the other

contracting parties. Former provisions establishing the obligation to subject such amendment to verification by and approval of the creditors' committee have been excluded from the wording brought by the 2009 amendments.

Further, by derogation from the provisions of the Labour Code, following the opening of insolvency proceedings, the judicial administrator/receiver (*lichidator judiciar*) has the right to terminate the individual labour agreements of the debtor's personnel without undergoing the collective dismissal procedure. The judicial administrator/receiver is nevertheless obliged to grant the dismissed person a 15 working day prior notice. Previously, the judicial administrator/receiver was only entitled to terminate individual labour agreements on the above terms if the debtor was in bankruptcy proceedings.

Finally, following the most recent amendments, the reorganisation plan may be amended at any time during the proceedings as long as the voting and confirmation procedures are observed. Previously, failure to strictly observe the voted and confirmed reorganisation plan resulted in commencement of bankruptcy proceedings.

### Unification of the case law

Law 85 also undertook some amendments in view of unifying the Romanian case law on various issues related to the insolvency proceedings. For instance, article 76 of Law 85 currently provides that failure to register a statement of claims with the file/judicial administrator within the term set by the court results in that creditor not being registered in the creditors' table and not having the right to participate in such capacity within the proceedings. Prior to the amendment the Romanian case law was not unified on this matter. The Romanian legislator has constantly tried to improve Law 85 and respond to the conditions of the Romanian market. Due to such amendments, Law 85 currently provides sufficient mechanisms enabling companies facing financial difficulties to seek protection from creditors and attempt a successful reorganisation.

**“ Before the enactment of Law 85, approximately 71% of insolvency cases led to bankruptcy proceedings, while only a small percentage of insolvent companies managed to undergo a successful reorganisation. New mechanisms for shortening the procedures and accelerating the reorganisation proceedings were thus necessary.**

## Ukraine: Recent Court Practice on Insolvency Matters – Pros and Cons



Artem Sokurov

The recent clarifications of the Supreme Court of Ukraine, although intended to summarise and unify current inconsistent court practices in bankruptcy matters, actually raise new questions. Further, due to court system reforms, it is uncertain to what extent these clarifications will be followed by the lower courts.

### Background

When dealing with bankruptcy cases in Ukrainian courts, one should always consider how the existing practice of the Ukrainian law “On Restoration of Debtor Solvency or Declaring its Bankruptcy” of 14 May 1992, No. 2343 XII, as amended (the Bankruptcy Act) is practiced by different courts. Although relevant clarifications made by the High Commercial Court of Ukraine and the Supreme Court of Ukraine are not binding, they are normally followed by lower courts on a quasi-mandatory basis.

The Supreme Court recently issued clarifications regarding application of the Bankruptcy Law in its Resolution of the Plenary Assembly of the Supreme Court of Ukraine “On Court Practice in Bankruptcy Cases” dated 18 December 2009, which became publicly available only on 22 January 2010 (the Supreme Court Clarifications). Below we will focus on the most crucial clarifications which may influence existing court practice in bankruptcy cases.

### Moratorium application

In accordance with the Supreme Court Clarifications, if bankruptcy proceedings are commenced against a mortgagor, the moratorium does not prevent a mortgagee from enforcing his mortgage over the debtor’s assets. This approach is completely different from that of the High Commercial Court of Ukraine set forth in the Clarifications of the

Presidium of the High Commercial Court of Ukraine on Some Issues of Practice of Application of the Bankruptcy Act dated 4 June 2006 No. 04-5/1193, in which it was clearly stated that any enforcement against secured assets during bankruptcy proceedings contradicts the Bankruptcy Act by act of the moratorium. No sufficient court practice is available yet in order to conclude whether the lower courts would follow the approach of the Supreme Court Clarifications.

### Assignment of claims in bankruptcy proceedings

Although Ukrainian court practice is far from uniform due to the ambiguous wording of the relevant provisions of the Bankruptcy Act, the Supreme Court in its Clarifications stated that it is possible to assign claims in the course of bankruptcy proceedings.

It also stated that creditors who have obtained rights against debtors in bankruptcy proceedings should be included in the register of creditors and thereby obtain rights to vote at the creditors’ meeting.

### Three-month calculation period

Bankruptcy proceedings are opened by a Ukrainian commercial court on the basis of an application whenever the commercial court establishes that a debtor is

unable to pay its debts in due time, ie, within three months of the expiry of the initial term for the satisfaction of the claim provided the amount of the claim against the debtor is not less than 300 minimum monthly wages.

The Supreme Court stated that for the purpose of submitting a bankruptcy application, the relevant three-month period starts from the moment when the debtor's obligation to a creditor became due and payable and not from the moment when the claim became uncontested.

### Summary

Although the Supreme Court Clarifications tried to resolve certain complex issues which were construed and applied differently by the lower courts, it is still unclear how these clarifications will work in practice and be applied by the lower courts. This is especially true given the judicial reforms currently underway in Ukraine, which aim to decrease the role of the Supreme Court by reducing the grounds on which interested parties may challenge decisions of the lower courts in the Supreme Court.

 Although Ukrainian court practice is far from uniform due to the ambiguous wording of the relevant provisions of the Bankruptcy Act, the Supreme Court has stated that it is possible to assign claims in the course of bankruptcy proceedings.





## Avoiding “Genericide” of Your Trademark



Guido Kucsko

Being famous is not so bad, especially for trademarks, unless it leads to genericide.

### What is genericide?

The better known a trademark is in the market, the broader its protection. But the situation can arise where a trademark becomes so well known as a brand for a product that it becomes the generic name for all such products no matter who produced them. If a brand loses its distinctiveness and becomes a pure generic term, then it also loses trademark protection. Well known examples of this include Gervais, Escalator, Thermos, Zipper and Band-aid. This is what we call the death of a brand or “genericide”.

### Avoiding genericide

What can you do to avoid your brand becoming a generic name? Although there is no surefire rule, certain measures can definitely help.

- Do not forget to register your brand as a trademark in the respective markets in time.
- Always use a generic term for your product besides your brand.

- Monitor public, competitor and internal use and react when the brand is used as a generic name.
- Use the ®-sign to make everyone aware of the fact that this is a registered trademark.
- Never use the brand as a verb (eg “to xerox” instead of “to copy”).
- Never use the brand as a noun (“xeroxes” instead of “copies”).
- Educate the public and members of the trade, eg by publishing special advertisements informing about the trademark protection, and correct use of, the brand.
- Survey (potential) customers to find out whether your brand is still regarded as a protected trademark or whether it has become a generic name.
- Develop guidelines on how to correctly use the trademark and publish these guidelines internally and for any cooperation partner.
- Use legal remedies against misuse and generic use of your trademark.

May your brand be successful, famous and respected, but also well-protected and not generic.

 If a brand loses its distinctiveness and becomes a pure generic term, then it also loses trademark protection.

## More Flexibility for Promotional Campaigns



Christian Schumacher

In a series of recent decisions, the European Court of Justice (ECJ) held that national provisions laying down a general prohibition on sales with bonuses are precluded under the Unfair Commercial Practices Directive.<sup>1</sup> The respective Austrian provision has been found as precluded by the Directive.

### Prohibition of sales with bonuses

In the past, legislatures saw a need to prohibit sales with bonuses. The objectives were threefold:

- Protection of competitors, as weaker competitors may not be able to give the same bonuses.
- Protection of consumers, because an effective price/value comparison may be tainted.
- Protection of the fairness of competition in general, because consumers should not be attracted by bonuses but make their purchase decision according to the value or quality of the product or service.

In Austria, a very strict prohibition of sales with bonuses with only very limited exceptions is provided for under unfair competition law (Sec 9a(1)(1) Austrian Act against Unfair Competition; UWG).

In 2005, a directive concerning unfair business-to-consumer commercial practices in the internal market (the above-cited Unfair Commercial Practices Directive) was enacted. Such directive provides for a broad regulation of activities, which are dealt with by national legislations concerning unfair competition. It sets out the criteria on the basis of which unfair commercial practices are to be

prohibited. The directive further expressly provides that member states may not adopt stricter rules than those provided for in the directive, even in order to archive a higher level of consumer protection.<sup>2</sup>

### The ECJ cases

In a line of cases<sup>3</sup> the ECJ was asked by national courts for a preliminary ruling on whether the Unfair Commercial Practices Directive applies to sales with bonuses and whether general prohibitions on sales with bonuses are precluded under the directive.

The ECJ held that, indeed, sales with bonuses are regulated by the Unfair Commercial Practices Directive and that national legislation must comply with the conditions set forth in the Unfair Commercial Practices Directive<sup>4</sup>. According to the Directive, a commercial practice is unfair if it is contrary to the requirements of professional diligence and materially distorts or is likely to materially distort the economic behavior of the average consumer with regard to the product. Such practices are prohibited where, having regard to their nature and the factual context, they cause or are likely to cause the average consumer to take a transactional decision that he would not have taken otherwise.

<sup>1</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the Internal Market.

<sup>2</sup> Art 4 Unfair Commercial Practices Directive.

<sup>3</sup> ECJ 23 April 2009, C-261/07 and C-299/07 VTB-VAD NV and Galatea; ECJ, 14 January 2010, C-304/08 – *Zentrale zur Bekämpfung unlauteren Wettbewerbs eV*; ECJ, 9 November 2010, C-540/08 – *Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG*.

<sup>4</sup> ECJ VTB-VAD NV and Galatea, no 50.

Only certain specific practices, contained in an exhaustive list annexed to the directive, are regarded as unfair “in all circumstances”. Consequently, except for the annexed specific commercial practices, for a finding of a prohibition of a commercial practice as unfair a case-by-case assessment applying the criteria set forth in the directive must be made. Consequently, in the first case decided in April 2009, the ECJ held that a Belgian statute imposing a general prohibition of combined offers made by a vendor to a consumer is precluded by the directive.<sup>5</sup>

In a next step, the ECJ was asked by reference of the German Bundesgerichtshof whether a general prohibition falls within the scope of the directive even though its main purpose is the protection of competitors, not consumers. The ECJ held that as long as the protection of consumers is also intended by a statute, such falls within the scope of the directive. Therefore, the ECJ held the German general prohibition of commercial practices under which the participation of consumers in a price competition or lottery is made conditional on the purchase of goods or use of services is precluded by the directive.<sup>6</sup>

Finally, in the latest reference brought forward by the Austrian Supreme Court, the general prohibition of sales with bonuses provided by sec 9a(1)(1) UWG was at issue. The statute was also held to be precluded by the directive. The justification brought forward by the Austrian government that, in the case at issue, the Austrian statute essentially pursues the maintenance of pluralism of the press in Austria, was not accepted by the ECJ.<sup>7</sup>

## Consequences

As a consequence of the decisions of the ECJ, the Austrian general prohibition of sales with bonuses should no longer be applied by the Austrian courts. It is now the task of the Austrian legislator to amend the current provision as soon as possible so that it complies with the requirements imposed by the Unfair Commercial Practices Directive.<sup>8</sup>

This brings to an end a long-standing uncertainty for companies promoting their products or services in Austria. The general prohibition of sales with bonuses in sec 9a(1)(1) UWG theoretically outlawed most of the sales promotions common internationally. In practice, notwithstanding the legal prohibition, such promotions widely took place in Austria; the law was disregarded on a large scale. This may have also been caused by the fact that the criteria bringing a sales promotion under the general prohibition could not be understood anymore. Further, the application of the prohibition and the narrow exceptions created by the Austrian courts during the last years were often not sound. Also, in certain cases the general prohibition had already been weakened by the Austrian Supreme Court through a case-by-case creation of exceptions.

This unfavorable situation for doing business in Austria has now finally ended. In future, sales with bonuses will have to be assessed according to the general rules of unfair competition law.

 The strict Austrian prohibition of sales with bonuses (*Zugabenverbot*) was declared as precluded by the Unfair Commercial Practices Directive by the European Court of Justice.

<sup>5</sup> ECJ *VTB-VAD NV and Galatea*.

<sup>6</sup> ECJ *Zentrale zur Bekämpfung unlauteren Wettbewerbs eV*.

<sup>7</sup> ECJ *Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG*.

<sup>8</sup> At the time of writing, no proposal for amending the Austrian law has been published.

## Czech Republic: Unfair Competition and Infringements of IP Rights – Who Is Competent?



Jiří Hrádek / Tomáš Hülle

One of the most important facts to know in dispute resolution law is the local and material jurisdiction of courts with respect to the proceedings. Significant difficulties could arise if the petition is not brought before the right court, including cancellation of the judgement<sup>1</sup>. As a result, a party should be aware of procedural rules and use them to his advantage, in particular if the dispute was decided by a body not authorised to do so.

### General rules

The general procedural rules for local and material jurisdiction are contained in Act. No. 99/1963 Coll. of the Civil Procedure Code (CPC). The proceedings are held before a court which is locally and materially competent to make a decision in the matter, as determined by the facts existing at the time of commencement of the proceedings. Such facts are decisive until the end of the proceedings; nothing can change the jurisdiction during the period of the trial.

District courts are the competent courts of first instance unless otherwise indicated<sup>2</sup>. The rules for local competence stipulate that the competent court is the court where the defendant has his domicile (in the case of a natural person), place of business (a natural person doing business) or registered office (legal entity). If the foreign defendant has an enterprise or branch in the Czech Republic, local jurisdiction can be established based on the branch's location<sup>3</sup>. If more than one locally competent court exists, the claimant as the “master of proceedings” may choose in which court to file the claim.

However, it is usually more complicated to determine which court is competent for specific proceedings, such as unfair competition. Moreover, if intellectual property rights are involved in the unfair competition matter, such as trademarks or know-how, a dichotomy of the locally competent court arises.

### Unfair competition and IP-law

Protection from unfair competition is one of the proceedings to which different rules apply. Material jurisdiction is given to the regional courts, whereas determining local jurisdiction is more complicated, because the CPC recognises several procedures to determine the competent court. The locally competent court can be a general court, the court in the jurisdiction where the defendant has his permanent place of work, the court in the jurisdiction where the fact establishing a right to damages occurred or the court where the defendant's branch is located.

Act No. 221/2006 Coll., on the enforcement of intellectual property rights (Enforcement Act), established in

<sup>1</sup> Sec. 219a Para. 1 Lit. a) CPC.

<sup>2</sup> There are many exceptions enumerated in Sec. 9 Paras. 2, 3, 4 and others CPC.

<sup>3</sup> Sec. 86 Para. 3 CPC.

2006 specific rules for the determination of a court's jurisdiction for IP proceedings. Material jurisdiction is given to the regional court in cases involving unfair competition. The regulation of local competence is given exclusively to the municipal court in Prague. The main reason for this is the fact that the Czech Industrial Property Office is located in Prague.

However, the crucial issue is not that specific jurisdiction is established for IP disputes but that the legislator has not comprehensively defined IP rights.

Meanwhile, IP rights specifically stipulated in special laws (patents, trademarks or designs) are explicitly determined to be the subject of protection under the Enforcement Act, but know-how or some other cases of IP-related rights are not determined as being subjects of the specific provision on jurisdiction.

#### Where is the locally competent court?

Since problems caused by the unclear regulation of court jurisdiction in cases of unfair competition and IP-rights disputes were quite frequent, the representatives of the high courts in Prague and Olomouc (there are only two courts in the Czech Republic) adopted a joint statement on the jurisdiction issue in early 2010.

Consequently, in cases involving the argumentation of IP rights in civil or commercial law disputes regarding unfair

competition, the only materially and locally competent court shall be the municipal court in Prague. Should such a claim be brought before another regional court, such court shall not be competent and shall refer the claim.

This solution is not only reasonable from the point of view of legal certainty but also in regards to consistent legislation.

#### Conclusion

In unfair competition cases based on the IP rights of the claimant filed with a different regional court than the municipal court in Prague, the regional court in question must declare its lack of competence to decide on the dispute and refer the claim to the municipal court in Prague.

However, since the joint statement of the high courts is not well known, the problem of acceptance of a claim by an incompetent court is common. Many legal practitioners are not aware of all the regulations for the establishment of the competent court and submit petitions to the wrong court.

It may happen that no harm will come to the client from the delegation of the claim by the incompetent court because the commencement of the proceedings remains preserved. However, such error could cost the claimant a year or more of anxiety and legal uncertainty.

 If intellectual property rights are involved in the unfair competition matter, such as trademarks or know-how, a dichotomy of the locally competent court arises.

## Romania: New Remedy in Trademark Law



Eduard Sorin Pavel

### Are the opposition proceedings provided by the new Romanian Trademark Law the latest trademark prosecution remedy against a conflict with prior rights?

The former Romanian Trademark Law (Law 84/1998 on trademarks and geographical indications) did not provide for any remedy to contest a pending trademark application within the prosecution proceedings once the opposition deadline expired. The only procedural remedy in such case was a cancellation action with the court after registration of the mark. Since recently, interested third parties seem to have access to an additional remedy.

In June 2010 the Romanian Trademark Law has been amended. According to these most recent amendments, the Romanian State Office for Inventions and Trademarks (OSIM) no longer examines *ex-officio* conflicts with prior rights (“relative grounds of refusal”) which only constitute the basis for opposition proceedings initiated by third parties against the published trademark application.

#### Right of third party appeals

If OSIM does not find any absolute grounds to refuse a trademark application (eg lack of distinctiveness, descriptiveness of a sign, etc) and if no opposition is filed, the trademark is registered and published. Different from the old law, according to the new provisions any decision of OSIM regarding a trademark application can be appealed by any concerned person within 30 days from

the communication of such decision or, as appropriate, from the publication of the trademark registration. In this respect, filing an appeal against a trademark application by the holder of a prior right who missed the opposition deadline appears to be admissible since no restrictions are expressly provided. We consider that the basis of the appeal could be both relative and absolute grounds since the law provides no specific requirements. The sole condition for raising an appeal is that the appellant be a concerned person, meaning he must prove a legitimate interest in filing the appeal. In comparison to a trademark cancellation action, such an opposition and (if the case) appeal initiated against a trademark application are short-term proceedings and much cheaper. However, since the annulment of a registered trademark resulting from a cancellation action has effect *ex tunc*, the rejection of a trademark application by a successful opposition has only effect *ex nunc*.

#### Clarification expected

So far, neither OSIM nor the Bucharest Court has issued an official interpretation on the admissibility of such remedy in trademark prosecution proceedings. However, a clarification of this issue is expected in the near future since several such cases are pending before OSIM.

“ The Romanian State Office for Inventions and Trademarks (OSIM) no longer examines *ex-officio* conflicts with prior rights (“relative grounds of refusal”) which only constitute the basis for opposition proceedings initiated by third parties against the published trademark application.

# Keyword Advertising in Austria – Answers and Questions



Adolf Zemann

Recent decisions of the European Court of Justice (ECJ)<sup>1</sup> and the Austrian Supreme Court<sup>2</sup> have answered open questions in regard to keyword advertising. However, other issues still need clarification by the courts of the member states.

## Introduction

Keyword advertising refers to an advertising method making use of internet search engines (eg Google) by linking selected search terms with advertisement links. The search engine provider profits from the fee the advertiser has to pay for such service. The advertiser profits since he can direct his advertisements to certain target groups efficiently.

From an intellectual property point of view, this form of advertising became interesting when ingenious entrepreneurs decided to use trademarks as keywords. The ECJ and the Austrian Supreme Court recently had to decide upon one of the open issues, namely whether and under which conditions the use of the trademark as a keyword is a violation of the trademark owner's rights.<sup>3</sup>

## State of the law

The ECJ decision resolved some issues which had been discussed and disputed in the last years. It held that the advertiser's use of a trademark as a keyword can be prohibited by the trademark owner according to trademark law if such use leads to a likelihood of confusion, even if

the sign selected as the keyword does not appear in the advertisement itself.

The court further specified that keyword advertising may negatively affect the trademark's function of indicating origin if (i) the third party's ad suggests that there is an economic link between the third party and the owner of the trademark or (ii) it is not clear from the advertisement who the actual advertiser is.

As a result, the court held that the owner of a trademark is entitled to prohibit an advertiser from advertising using his trademark as a keyword if such advertising does not enable an average internet user (or enables that user only with difficulty) to ascertain whether the goods or services referred to in the ad originate from the trademark owner (or an economically connected undertaking) or from a third party.

The Austrian Supreme Court went into more detail and stated that to decide whether a likelihood of confusion exists, the concrete content and the makeup of the advertisement must be taken into account. It took a stricter approach and decided that the use of a trademark as a keyword does not infringe trademark rights only if the

<sup>1</sup> ECJ, 23 March 2010, Google France/Louis Vuitton and others, C-236/08 - C-238/08; ECJ, 25 March 2010, BergSpechte/Guni, C-278/08; ECJ, 26 March 2010, Eis.de, C-91/09.

<sup>2</sup> OGH, 21 June 2010, 17 Ob 3/10f.

<sup>3</sup> The ECJ also had to decide on the liability of the search engine provider: Such is limited to situations where a search engine provider (i) plays an active role in choosing and designing the advertisements or (ii) does not act expeditiously after having obtained knowledge of an infringement.

average internet user can easily detect that the goods or services advertised neither originate from the trademark owner nor from an economically connected undertaking.

### Open issues

Having clarified some of the fundamental open issues, further issues await clarification:

- Under which conditions does the use of a famous trademark as keyword infringe the trademark owner's rights? Famous trademarks enjoy protection against unfair exploitation, which may well be the case when a famous trademark is used as a keyword by a competitor or for counterfeit goods.
- Unfair competition: Is advertising by using the trademark of a competitor as a keyword similar to the situation where one intercepts a competitor's customers, when they are about to enter the competitor's shop (eg in the parking lot<sup>4</sup>)?

### Conclusion

All in all, the recent decisions strengthen the position of trademark owners in cases where their trademarks are used as keywords in internet search engines. Even if an advertiser using another's trademark as a keyword is able to clear the hurdle set up by the courts in these recent decisions, trademark owners may still successfully employ other open legal avenues.

 The advertiser's use of a trademark as a keyword can be prohibited by the trademark owner according to trademark law if such use leads to a likelihood of confusion, even if the sign selected as the keyword does not appear in the advertisement itself.

<sup>4</sup> OGH 15 October 1996, 4 Ob 2244/96w.



# 999



## Czech Republic: Typical Legal Issues Encountered in Real Estate Due Diligence



Martin Kubánek / Pavla Šlapáková

In almost every due diligence involving real estate in the Czech Republic, several legal issues emerge which are crucial for the existence (or non-existence) of ownership or other rights regarding real estate established in favour of certain subjects. The following legal issues are typically encountered in due diligence projects. It is important to understand and assess these issues correctly.

The real owner of the real estate and the owner registered in the Land Register

The restricted principle of material publicity applies under Czech law. According to Sec. 11 of the act on entries of ownership and other substantive rights relating to real estate, any person who relies on information in the Land Register registered after 1 January 1993 is (only) in good faith that the entry in the Land Register corresponds to the real state of affairs, unless the person knew that the records are not in accordance with reality. This means that if there is a discrepancy between the entry in the Land Register and reality, reality shall prevail.

In accordance with the general legal principle that nobody can transfer more rights than he possesses, a person acquiring real property who is acting in good faith on the entry in the Land Register cannot acquire the real property from the non-owner. The acquiring person can only become the holder of the real property in good faith and can acquire the ownership of the real property by usucaption (provided that the other legal conditions for usucaption are fulfilled).

According to Sec. 134 of the Czech Civil Code (CC), which regulates usucaption, the holder of the real property, taking into account all circumstances, shall become the owner of the thing in good faith if he keeps

the thing in his possession for an uninterrupted period of 10 years.

A structure is not part of a plot

According to Sec. 120 of the CC, a structure does not form part of a plot. Therefore, the owner of a plot and the owner of a structure placed on/under the plot may differ. Under these circumstances, the owner of the structure (building, fence, wires, pipelines, etc.) requires a legal title in the form of an easement or lease for placing the structure on/under the plot owned by a third person.

The best way to secure the right to place a structure on/under a plot owned by a third person is to establish an easement as a right *in rem*, which is appurtenant to the plot owned by the third person regardless of the eventual future ownership change (serving real estate).

Easements are limited rights of use granted in favour of another person's real property, in our case a structure (easements *in rem*), or in favour of a particular person (easements *in personam*) granting their beneficiaries the right of use over the serving real estate in a certain manner (in our case, the right to place a structure or the right to pass through a plot or to take water from a plot and other rights).

Easements *in rem* are appurtenant to the structure (eg, a building or other real estate) – dominant real estate, granting its owner the right to place a structure on the plot owned by a third person. Easements *in rem*, unlike easements *in personam*, are transferred with the ownership of the structure to the new owner of the structure.

Easements *in personam* grant the entitled person or corporation the right to use other real estate in a certain manner, in our case the right to place a structure. Easements *in personam* are connected only to a certain person or a certain corporation and end at the latest with the death of the person or the dissolution of the corporation. If the ownership of the structure is transferred to another person as an asset deal, the new owner of the structure must obtain a new legal title for placing its structure on a plot owned by a third person.

#### Agreements on future contract – Specification of time period

According to Sec. 50a of the CC or Sec. 289 of the Czech Commercial Code, if entrepreneurs want to enter

into a contract, one of the prerequisites of agreements on future contract is proper specification of the time period within which the contract is to be closed.

We regularly come across agreements on future contracts in which the time period for conclusion of the contract is specified something like, “within 90 days after the release of the occupancy permit or within 30 days after payment of...”. However, pursuant to decisions of the Czech Supreme Court and the Constitutional Court, such uncertain specification of the time period may cause the invalidity of the agreement on future contract because the time period is set depending upon a future event, and it is not known when this future event will occur, and if ever.

To make the time period certain, the latest possible day for conclusion of the contract must be determined, for example, as follows: “within 90 days after the release of the occupancy permit, at the latest by 31 December 2011.” This kind of provision in an agreement on future contract does not raise doubts about its certainty and, therefore, its validity.

 The best way to secure the right to place a structure on/under a plot owned by a third person is to establish an easement as a right *in rem*, which is appurtenant to the plot owned by the third person regardless of the eventual future ownership change (serving real estate).

## Restitution of Property to non-Croatian Citizens – Possible at Last?



Jana Cvim Adamčić

After 14 years from the adoption of the Croatian Restitution Act, restitution to non-Croatian citizens of their nationalised property has become possible after the issuance of a Croatian Supreme Court ruling. Will the remaining restitution proceedings be finalised at last?

### Restitution of nationalised property regardless of citizenship or exceptions

Initially, the Croatian Restitution Act (CRA) enabled restitution of property nationalised during the former Yugoslav regime only to Croatian citizens. In 1999, three years after the passage of the CRA, the Croatian Constitutional Court abolished this restriction as being discriminatory and unjust and mandated the Croatian parliament to amend the CRA to permit restitution regardless of citizenship. In 2002, the CRA was amended accordingly, but with certain exceptions.

According to the amended CRA (CRA 2002), no restitution for nationalised property could be granted to a non-Croatian citizen if the restitution was regulated by a bilateral treaty between Croatia and that person's state. The same provision left open the possibility that restitution may be possible if so determined under (another) bilateral treaty between Croatia and such state.

### No coherency in proceedings on restitution to non-Croatian citizens

The provisions of CRA 2002 raised substantial doubts and questions when it came to their interpretation and enforcement in administrative proceedings initiated by non-Croatian citizens seeking restitution. Due to a lack of a uniform, authoritative interpretation of CRA 2002,

the decisions of administrative authorities varied widely – from accepting the claim to rejecting all such claims to preliminary suspension of all such proceedings. Decision granting or rejecting restitution were regularly appealed, either by the Croatian state (represented by the Croatian Attorney General's Office) or by the claimant. The appeal proceedings usually ended before the Croatian Administrative Court, who in 2008 took a stand in favour of non-Croatian claimants.

However, the Attorney General's Office always appealed against such decisions, thus pushing the matter before the Croatian Supreme Court.

### The Croatian Supreme Court ruling

The Ruling of the Croatian Supreme Court of 26 May 2010 (the Ruling), publicly announced in September 2010, provided the long-expected clear, uniform and authoritative interpretation of the CRA 2002. It stated that a non-Croatian citizen is entitled to restitution provided no bilateral treaty on the matter has been concluded between Croatia and the respective state.

### Finalisation of ongoing restitution proceedings?

According to some estimates, there are currently more than 4,000 proceedings in which non-Croatian clai-

licants are seeking restitution of nationalised property. Although each claim must be verified and decided upon individually, the Ruling should move “dormant” proceedings forward and speed up those based on the until recently unclear question of the claimant’s citizenship.

One of the expected effects of the Ruling may also be a significant decrease of future appeals by the Croatian

Attorney General’s Office based (solely) on the claimant’s non-Croatian citizenship, thus enabling a faster resolution of restitution proceedings.

Experts expect that further governmental decisions and instructions on the handling of ongoing proceedings (restitution in kind, monetary compensation, etc) will now be passed.

**“ Although the Ruling does not necessarily ensure a finalisation of restitution proceedings, it is a significant milestone. Finalising this restitution issue is certainly a high priority for Croatia’s admission to the EU. For the real estate market, clear ownership over such former nationalised property means safer, and thus more, property transactions.**

## Serbia: Incentive Schemes for Developers



Slaven Moravčević / Ivan Pantović

In order to stimulate growth in the Serbian construction industry and promote foreign investment, the Government of Serbia adopted the Decree on the Disposal of Construction Land below Market Value (the Decree). It entered into force on 20 March 2010.

### The Planning and Construction Act

The new Planning and Construction Act, which entered into force on 11 September 2009 (the Act), introduces the possibility of acquiring the right of ownership over publicly-owned construction land.

According to the Act, publicly-owned construction land may be disposed of or leased out (i) in consideration for its market value, for construction purposes in a tender procedure or (ii) by local self-governments, below its market value or without consideration, through a tender procedure or even by means of a direct bargain, provided that the government consents to such disposal.

### The Decree

Under the conditions stipulated by the Decree, local self-governments may dispose of or lease out publicly-owned construction land below market value, or even without consideration.

This may be conducted provided that such construction land is designated for the construction of:

- buildings to be used in the implementation of economic development projects. Economic development projects in this case are defined as projects of particular significance for the economic development of the Republic of Serbia and local economic development, provided that they increase the employment

rate in the concerned municipality by at least 1% and increase public revenues *pro rata*;

- buildings intended for social housing or buildings intended for use by state, regional or local authorities where the investor is the Republic of Serbia, an autonomous province or local self-government;
- apartments in accordance with the Decree on Support Measures for the Construction Industry through Subsidising Loan Interest Rates for Financing the Construction of Residential Buildings, provided that the investor is the Republic of Serbia; and
- buildings to be used for communal services.

According to the Decree, there are two possible ways of disposing of or leasing publicly-owned construction land below its market value or without consideration.

Publicly-owned construction land may be disposed of or leased through a public announcement procedure, or by means of a direct bargain, provided that the local assembly adopts a feasibility study pertaining to the contemplated disposal/lease.

In addition, the government must give its prior consent to the respective disposal/lease.

### Conclusion

Through the adoption of these changes, Serbia expects to boost the development of projects of public interest by cutting investment costs associated with such pro-

jects. And local self-governments have been handed an important role. By availing themselves of this incentive instrument, they can significantly influence the implementation of their development policies.

 Under the conditions stipulated by the Decree, local self-governments may dispose of or lease out publicly-owned construction land below market value, or even without consideration.

# Slovenia: Parties in a Proceeding to acquire a Building Permit



Ana Filipov / Iztok Zupančič

Legislation adopted with the intent to shorten the time needed to acquire a building permit is still under the review of the Constitutional Court.

## Introduction

The Slovenian legislator has tried to shorten the proceeding to acquire a building permit by changing the Slovenian Building Act (*Zakon o graditvi objektov*; ZGO-1) with regard to the type of administrative proceeding and legal means.

Changes to the ZGO-1 also limit the involvement of parties in the proceeding. Namely, pursuant to paragraph one of Article 62 ZGO-1, only the investor is a party to the building permit proceeding for a building within an area regulated by a state spatial plan or municipal detailed spatial plan. The legislator deemed that the process of adoption of such specific spatial plans provides sufficient legal protection of other interested persons.

## Legitimacy of Article 62 ZGO-1

In practice, despite its clear language excluding all persons other than the investor, Article 62 of ZGO-1 has not been applied uniformly. Some administrative units still incline to allow subjects who claim that they have a legal interest (eg neighbours, beneficiaries of easement, holders of building rights, etc) to participate in the proceeding.

The legal commentary has also questioned the constitutionality of the provision. The principal question is whether merely having the possibility to submit comments in the proceeding to adopt a spatial plan is sufficient to ensure adequate protection of other interested parties. State and municipalities must consider them but are not obliged to accept them.

## Decision U-I-165/09-8 of the Slovenian Constitutional Court

While dealing with a petition to initiate proceedings to assess the constitutionality and legality of the ordinance on municipal detailed spatial plan (*Apartmajsko naselje Ankaran hrib*) the Slovenian Constitutional Court *ex officio* decided to commence a proceeding to assess the constitutionality of the first and second paragraph of Article 62 ZGO-1. In its decision no. U-I-165/09-8 of 9 July 2009 (published in the Official Gazette of the Republic of Slovenia no. 57/2009), the court stated it is necessary to review whether these provisions are in compliance with the Constitution, in particular relating to its Articles 22 and 23 – equal protection of rights and the right to judicial protection.

A final decision has not been issued but the court has declared it to be a matter of absolute priority.

 The principal question is whether merely having the possibility to submit comments in the proceeding to adopt a spatial plan is sufficient to ensure adequate protection of other interested parties.

## Bulgaria: No Time Limits to Challenge Detailed Zoning Plans in Court



Mariya Mihaleva / Dimitar Vlaevsky

Void administrative acts might jeopardise the operation, and even existence, of completed projects in Bulgaria.

The detailed zoning plan (DZP) is one of the key steps in every real estate development project in Bulgaria. It sets the parameters of the future construction, such as maximum built-up area, height and location.

Moreover, it is the basis for the issuance of the construction permit and the operation permit. Thus, it is very important that once approved, the DZP remain stable and resistant to claims that might jeopardise subsequent permits or the existence and operation of the completed construction.

The Bulgarian zoning law envisages several measures intended to ensure that the zoning procedure will be expedient and the approved DZP stable. Two of the most important provisions in that regard relate to the right to appeal the order for approval of the DZP.

First, only a limited scope of interested parties is entitled to appeal the order. In general, these are the neighbours or owners of other real estate nearby that might be affected by the intended plan. Second, the term for appeal is limited and relatively short – 14 days as of the announcement of the approval of the DZP either (i) by publication in the State Gazette or (ii) by notice to the interested parties (in case of zoning of small areas)<sup>1</sup>.

### Administrative act

However, the order of the respective mayor for the approval of the DZP is, by definition, an administrative act, meaning it also is subject to the general rules for issuance and appeal of the administrative law.

One of the key principles in the Bulgarian administrative law is that void administrative acts can be challenged by everyone who has an interest (which might include parties beyond the scope mentioned in the paragraph above) without time limits for filing of such claim. The justification for this is that the imperative public interest requires such void acts to be revoked.

Therefore, if there are serious flaws in the procedure for issuance of the order for approval of a DZP or in its content, any interested person is entitled to file a claim and ask the court to declare the order (eg, the DZP) void. Moreover, there is no time limit to exercise such right, regardless of the mentioned 14-day period.

### Investor unease

Even though only very serious flaws can justify a decision of the court to declare the order void, the very possibility

<sup>1</sup> The proper notification of all interested parties is also a very important step of the procedure for approval of the DZP, which is usually not done in accordance with the law, as from the date of the notification the 14-day term for appeal starts running. That is because the Municipality, which is in charge of the procedure for approval of the DZP and the notifications, does not have an up to date list of all interested parties or is not aware who is an "interested party" within the meaning of the law. However, this is changing with the implementation of the cadastre map, which is currently going on for most parts of Bulgaria.

that such a lawsuit can be initiated at any time creates significant uncertainty.

Investors feel uneasy knowing that a key stage of their investment project can be the target of a (justified or unjustified) challenge. Considering the time and expenses that a court proceeding usually requires, such risk is not to be underestimated.

On the other hand, if the order is appealed within the “regular” procedure of the 14-day period, the court is required by law to review all potential grounds for voidance of the order. If it holds that the order is valid and enforceable, no further challenges can be allowed.

The problem occurs when the court rules that the order is void after the construction approved with the revoked DZP has already been started or, even worse, is completed. According to the law, all subsequent acts in the development process are based on the approved zoning. If the latter is revoked, the main question is how this will affect the construction permit.

#### Case-by-case basis

Since the issue is not explicitly regulated in the legislation, only the case law of the Bulgarian Supreme Administrative Court can provide some guidance. According to it, the effect of a void DZP on the construction permit and the permits thereof is to be decided on a case-by-case basis.

If the court, upon its own discretion, decides that the construction also is in major violation of the material legal requirements, it can be declared unlawful and ordered demolished. Conversely, if the court decides that the construction complies to a sufficient extent with the law, it might rule that despite the void zoning, the construction is lawful and can be used as intended.

The trick is that decisions are taken, as mentioned, on a case-by-case basis and the chances to predict the ruling in the particular case are slim. Further, according to the Spatial Development Act, the appeal of an order for approval of DZP is reviewed at one instance only – the decision of the regional administrative court is final and binding and cannot be appealed.

#### Expected amendment of the Spatial Development Act

The problem might be solved with the expected amendment of the Spatial Development Act. One of the changes is to make the judicial review of the orders for approval of the DZP a two-instance procedure. This is generally deemed to improve the quality of the control even though it will inevitably lead to longer periods for completion of the trials.

In the meantime, investors are advised to carefully observe the procedure for approval of DZP and be in constant touch with the Municipality to ensure that there will be no grounds to void the issued order.

 Investors feel uneasy knowing that a key stage of their investment project can be the target of a (justified or unjustified) challenge. Considering the time and expenses that a court proceeding usually requires, such risk is not to be underestimated.

## Ukraine: Construction Law Reform



Denys Sytnyk

The construction law reform initiated by the new Ukrainian government is expected to boost the investment attractiveness of the Ukrainian real estate development market and move Ukraine up in the ease of doing business ratings.

### Complete abrogation of the existing legislation

Two different scenarios for construction law reform were considered: (i) improving the existing laws and regulations, or (ii) abrogating the entire current construction legislation and adopting completely new legislative acts. The governmental working group decided on the latter option.

A new, clearer structure of construction legislation should reduce ambiguities and create a clear hierarchy and ease of interpretation of legal norms. At the top level, legal norms setting out the basic principles and general norms regulating construction relations will be incorporated into a single law on construction (construction code). This will be derived from several current laws, such as the Laws of Ukraine on Bases of City Construction, on Architectural Activity, on Territory Planning and Construction, on Investment Activity, on Local Governance in Ukraine, the Land Code of Ukraine, etc.

At the middle level various legal procedures for approving construction projects, expertise of the most important projects, supervision of construction activity, commissioning of new structures, etc. should be incorporated in resolutions of the Cabinet of Ministers of Ukraine and the Ministry for Construction and Housing Policy. The bottom level shall consist of construction standards mainly of a technical nature. It is being discussed whether construction standards of other more developed jurisdictions (eg European or US) may also be applied in Ukraine.

### New zoning policy

Currently, most cities and towns in Ukraine do not have an approved zoning plan. A new zoning policy will oblige all local authorities to adopt a zoning plan. Local authorities will be allowed to accept voluntary donations from real estate investors and developers to assist in the elaboration of detailed local zoning plans. Local authorities will not be allowed to approve construction projects until detailed zoning plans are in place.

The terms for granting land plots for construction will be substantially liberalised and simplified. Currently, (i) it takes at least 270 days and (ii) there are 50 procedures to follow and comply with (including obtaining two decisions from the local council and approval of two deputies' committees) in order to obtain a land plot for construction.

The reform aims at setting (i) a maximum term for granting a land plot for construction at 60 days and (ii) six procedures to follow and comply with (including eliminating decisions of local councils and of deputies' committees).

### Simplified construction permits

The procedure for issuing construction permits will be simplified. Currently, (i) it takes at least 175 days and (ii) there are 31 procedures to follow and comply with. It is envisaged to set (i) a maximum term for issuance of construction permit at 50 days and (ii) two stages involving

just two official bodies. Construction permits will be issued for construction projects (not for the developers of such projects, as is the case now), thus enabling free transfers between developers together with construction permits. No construction permit will be necessary for simple structures (individual housing, cottages, retail centres, etc).

The single-window principle will be implemented to the extent possible. As many procedures as possible will be transformed into a single filing to a single official body for obtaining a land plot for construction and approval of the construction project. The application of this principle should limit contacts between developers and officials, thus simplifying construction procedures and reducing corruption.

The silent consent principle will be applied to reduce the risks of authorities' inactions and corruption.

Thus, should the authorities fail to issue a certain approval or a reasonable refusal within a set term, such approval shall be deemed as granted. Also, the scope of individual administrative responsibility of officials for breaches of construction legislation will be increased.

The state will be deprived of its monopoly to conduct an expert review of construction projects; such review will be delegated to certified professionals. A compulsory expert review of construction projects will be limited to complicated structures which require a construction permit. Experts and project developers will be equally responsible for construction projects.

The reform should further promote the principle of inseparability of land and structures thereupon. The sale of land for construction at public auctions shall enjoy priority over land leases.

A maximum term of 10 days shall be set for commissioning new structures. It is being discussed whether the developer's liability for the quality of construction should be insured.

The reform envisages speeding up the formation and launch of the single State Register of Titles to Real Estate, which should replace several currently existing registers.

Schoenherr appreciates the possibility to directly influence the Ukrainian construction reform through its participation in the governmental working group.

 **A new, clearer structure of construction legislation should reduce ambiguities and create a clear hierarchy and ease of interpretation of legal norms.**

## Hungary: Finance Lease of Real Properties – A Good Alternative



Sándor Habóczy / Tamás Balogh

The benefits of finance lease, the traditional alternative to mortgage backed loans, have decreased with the entering into force of the Hungarian government's decree on the mandatory rules of prudent lending practices, introducing restrictions on financing granted to private individuals. But finance lease can still be a favourable option, especially for companies, considering the lower initial direct financing costs and the tax benefits.

### Finance lease benefits in general

Finance lease, as a flexible method to raise funds for the acquisition of real properties, has been a favourable alternative to mortgage backed loans also for private individuals lacking the equity required for traditional loan financing structures. Before the restrictive rules on lending practices entered into force, the main up-front benefit of the finance lease was that, subject to certain conditions, no financial contribution from the lessee was required at all. The additional costs occurring at the financing entities were also lower than in the case of mortgage backed loans, considering the lower business risks of the financing entity, remaining as the actual owner of the leased property through the term of the lease. Therefore, finance lease construction resulted in lower interest surcharges and required only moderate collateral to secure the payment obligations of the lessee under the lease agreement, altogether resulting in lower additional costs.

### Both restricted and supported by legislative changes

In January 2010, the Hungarian government introduced restrictions on both foreign exchange based mortgage loans and finance lease arrangements. It did this by way of the government decree referred to above, whereby only a maximum of 80% of the market value of a real property – to be acquired by the private entity at the end

of the financial lease term – can be covered from financing sources (ie own equity of at least 20% is required).

In August 2010, to address the long-lasting crisis of the Hungarian Forint (HUF), especially its depreciation against the Swiss Franc, as well as the extreme foreign currency loan exposure of the population and of the national economy, the Hungarian Parliament decided to prohibit any further granting of foreign exchange based mortgage loans for individuals by altering the relevant provisions of the Hungarian Civil Code. Exempt from this prohibition – in the absence of a mortgage or other significant collateral needs – foreign exchange based financial lease arrangements may gain in popularity again.

### Benefits for corporate entities and business associations

Taking into consideration the substantial tax and accounting benefits, mainly Hungarian corporate entities are expected to remain beneficiaries of finance lease. In addition to lower administrative costs, the depreciation of the real property, as well as interest and additional costs connected to finance lease constructions, can also be deducted from the corporate tax base of a lessee company. Furthermore, corporate tax payers qualifying by law as small- and medium-sized enterprises are eligible for a corporate tax allowance of up to 40% of the

interest paid upon the finance lease in a given tax year. However, the amount of the corporate tax allowance may not exceed HUF 6 mln per tax year.

### Care required

When contracting, it is essential for both individuals and companies to identify all hazards and eventualities in the finance lease agreements and to understand all details of the arrangement, with special regard to the rules on ultimate financial settlement. For example, if the financial entity acquires ownership of a property for the purpose of granting a finance lease, the acquisition is subject to a stamp duty payment, settled by the financing entity at the time of the acquisition. The stamp duty is typically charged to the lessee. The lessee is obliged to pay the stamp duty again when acquiring actual ownership title over the property, which, depending on the finance lease construction, usually occurs at the end of the lease term.

Before entering a finance lease arrangement, it should be thoroughly clarified with the financing entity what additional costs may arise on the lessee's account at different stages of the lease term. One of the most important

issues to be clarified is the method of the financial settlement between the parties in case the lessee cannot fulfil its payment obligations and a termination event occurs. Particularly, the agreement should regulate the process of an eventual forced sale of the real property (ie, in case the financing entity terminates the finance lease agreement because of the payment default or the insolvency of the lessee) in an acceptable way for the lessee, including the method of sale of the leased property at a reasonable market price and a fair settlement in respect of the purchase price received. This is because, for obvious reasons, financing entities are interested in a rapid sale of the real property even at depressed price, in order to obtain the principal outstanding under the lease agreement as soon as possible.

As a result of the termination of the lease agreement, the lessee might also face additional charges, contractual penalties and other expenses, which might entirely eliminate the lessee's settlement portion from the real property's purchase price. Given the current economic conditions, particular attention should be devoted to these provisions as the sale of real properties might be problematic and time consuming in a stagnant Hungarian real property market.

 **When contracting, it is essential for both individuals and companies to identify all hazards and eventualities in the finance lease agreements and to understand all details of the arrangement, with special regard to the rules on ultimate financial settlement.**

## Romania: Bringing Land to Book



Eva Hegedüs-Brown

In last year's roadmap we reported on those changes to the new Romanian Civil Code that will impact on ownership and other rights in real estate. As reported then, one of the most important achievements of the new Code will be the new rule that transferring rights in property will depend on the fact of Land Book registration (the constitutive character of registrations). Currently ownership rights in real estate are transferred by notarised agreement and excerpts from the Land Book are for information only. Land Book entries may not be relied on by a purchaser as a guarantee of the measurements or other details it contains. Unfortunately, the new Civil Code has been delayed and still requires a number of conditions to be fulfilled before it can enter into force.

### Unregistered land

The first precondition for deriving and proving property rights based on Land Book registration is the existence of the Land Books in the first place. The reliability and coverage of such registers has long been a cause for concern. However, Government Ordinance No. 64/2010 has now laid an important milestone in speeding up the creation of a comprehensive Land Book system and brought further flexibility in how rights can be evidenced and safeguarded.

Having had different real estate systems in different regions of the country, Romania started to build a unified Land Book system back in 1996 (with Law No. 7/1996 on cadastre and real estate publicity). This piece of legislation imposed the Land Book system on the whole country. Since the information in Land Books is based on cadastral measurements and drawings, only those plots that had been surveyed and mapped could be included. Consequently, given that so much property had never been surveyed, considerable areas remained unregistered. This made it impossible for such property to

be bought, sold, developed or mortgaged until the owner had gone to the not inconsiderable cost of having the land surveyed, mapped and registered in the local Land Book.

It is not unusual for vast areas of land (often owned by farmers) to comprise a multitude of small plots where the cost of such mapping and registration is prohibitively expensive. Such plots are usually registered only when they have been earmarked for a large real estate project and the investor-developer is willing to advance sufficient funds to cover the necessary expenses. The lack of registration can be an impediment to the development of an area or even a whole region. Since liens on real estate are among the most preferred securities for bank loans, the lack of registration also precludes access to a considerable asset and source for finance that could otherwise be channelled into small and medium sized enterprises (particularly in the current financial climate where collateral is required for even the most modest of loans). The negative impact on the economy of an incomplete and inconsistent real estate registration system is self evident.

### Multi-annual Registration Plan

Government Ordinance No. 64/2010 introduces the idea of a Multi-annual Registration Plan as the basis for funding the mapping of unregistered property. The principle behind this new piece of legislation is that all land should be registered in Land Books *ex officio* financed out of the central budget of the Ministry for Public Administration and Home Affairs. At the same time the law allows for town councils as well as individuals and private legal entities to finance cadastral drawings and the creation of Land Books for themselves. This is intended to allow local communities to develop at their own pace according to their financial capacity and to allow individual projects to be developed. This last point has proven a welcome and vital provision given that, for the moment and under prevailing economic restrictions, the Multi-annual Registration Plan is without funds.

So, given the lack of public finance and the financial crisis facing private individuals, when could the rules on constitutive Land Book registration come into force? Ordinance 64/2010 suggests perhaps a surprisingly optimistic time-

frame: Article I Point 38 states that any charges registered only in the old real estate evidence systems shall lose their opposability towards third parties if not registered in the Land Books by 31 December 2014.

The Ordinance also states that all property titles derived from the restitution of real estate expropriated by the communist regime shall be registered with Land Books *ex officio*.

The Ordinance has proposed a series of amendments that take immediate effect, such as the simplified procedure for the rectification of certain registration errors in the Land Books, the possibility to register structures at different stages of their construction, the possibility to register letting agreements regardless of their duration and the simplification of the partition of plots charged with liens.

Unfortunately, the present lack of funding for the central government to take the necessary remedial action means that the promise of Ordinance 64/2010 is likely to take a long time to be realised.

 The principle behind this new piece of legislation is that all land should be registered in Land Books *ex officio* financed out of the central budget of the Ministry for Public Administration and Home Affairs.

## Austria: Is an Established Model for Real Estate Transactions Now Malpractice?



Ayla Ilicali / Nicole Waldhauser

In a recent decision<sup>1</sup>, the Independent Finance Board Innsbruck (*Unabhängiger Finanzsenat*) questions a well-established practice for reducing taxes related to real estate transactions. Until the Highest Administrative Court (*Verwaltungsgerichtshof*) issues a final decision (not expected for at least two years), parties to real estate transactions will not have legal certainty and will need to act with caution when drafting agreements.

The transfer of land in Austria entails a land transfer tax (*Grunderwerbsteuer*) of 3.5%<sup>2</sup> and a registration fee (*Eintragungsgebühr*) payable to the competent District Court of 1%. The basis for calculation is the purchase price including any other benefits, such as an assumption of debts. If the transfer is free, the calculation basis is the assessed tax value (*Einheitswert*).

### The established model

Up to now, it was common practice to avoid land transfer taxes and registration fees by transferring the shares in a company holding the real estate. For this purpose, as a first step, a limited liability company is set up and the respective land contributed to the company. Such a contribution also gives rise to land transfer taxes and registration fees; the calculation, however, is based on the triple assessed tax value, which is usually far below the market value.

The acquisition of shares in a company holding real estate is tax free unless 100% of shares are being transferred and held by only one legal entity. Therefore, as a

standard model, the shareholding was split and a “mini-share” of 1% or less was held in trust by an attorney or an affiliated company. No registration fee is due as the legal entity holding the real estate remains the same and no registration with the land register is required. The legality of such practice has been consistently upheld by the courts.

### The Independent Finance Board ruling

Lately, however, the Independent Finance Board has ruled differently. In the present case, a father sold 99% of his shares in a company holding real estate to his son and retained 1%. In an escrow agreement the father agreed to hold the “mini-share” in trust for the son.

The Independent Finance Board argued that such structuring is illegal because it seems, in light of the intended economic goal, unusual and merely chosen for tax evasion reasons. All non-tax-related economic grounds for the chosen model have been deemed insufficient by the authority and the contracting parties have incurred land transfer taxes.

<sup>1</sup> RV/0226-I/09 (25.6.2010)

<sup>2</sup> Between family members the rate is reduced to 2%.

### Ongoing uncertainty

A final decision is currently pending before the Highest Administrative Court and is not expected for at least two years. Therefore, for the time being, share deals should

not be structured with a trustee, as no legal certainty can be guaranteed. If shares of a real estate company are split and transferred, the economic reasons behind such structure should be thoroughly documented so as to avoid suspicions of tax-evasion.

**“ If shares of a real estate company are split and transferred, the economic reasons behind such structure should be thoroughly documented so as to avoid suspicions of tax-evasion. Therefore, upcoming share deals should not be structured with a trustee as no legal certainty can be guaranteed at the moment.**

# Austria: Real Estate Acquisitions and Liability for the Transfer of Business



Stephan Eberhardt

While the seller of real estate often tries to shift risks to the purchaser, the latter is interested in minimising exposure. Thus, handling the legal liability framework is critical in sale and purchase contract negotiations. Hence, the question arises if and to what extent provisions regarding the transfer of a business may also apply to real estate transactions; that is, whether real estate, especially if sold with inventory, shall be regarded as a business.

## Introduction

Apart from mandatory provisions for taking over a business by means of an asset deal<sup>1</sup>, § 38 Commercial Code (*Unternehmensgesetzbuch*; UGB) and § 1409 General Civil Code (*Allgemeines Bürgerliches Gesetzbuch*; ABGB) deal with the basic idea that the purchaser of the business is liable for the business as a liability fund<sup>2</sup>.

Whereas § 1409 ABGB focuses on the purchaser's continued liability either for the assumed assets or business, pursuant to § 38 UGB (also dealing with legal succession by transfer of an enterprise [*Unternehmensübergang*]), existing non-personal legal relationships of an enterprise pass over to its purchaser. Real estate transactions usually deal with the sale and purchase of leased real property (housing, office building, restaurant, hotel, etc). Provided that the transfer of the property and the simultaneous assumption of the respective lease agreement are considered a transfer of an enterprise, the legal liability regime will apply.

## Transfer of business v transfer of assets

§ 38 UGB and § 1409 ABGB in principle require the transfer of a total enterprise. The transfer of an enterprise means that a permanently established entrepreneurial organisational structure<sup>3</sup> or earning opportunity is transferred to the legal successor. The former § 25 HGB (preceding § 38 UGB) ruled that the transfer of the core of an enterprise is sufficient for business continuance and consequent purchaser's liability.

Taking this as a basis under § 38 UGB, all essential parts of the enterprise must be transferred while against that transfer of the main asset(s) (eg the transfer of the real property nearly representing the seller's single fund(s))<sup>4</sup> shall suffice for § 1409 ABGB, which applies also to the transfer of only private assets or shares. Without a doubt both provisions shall apply to asset deals.

In 3 Ob 290/01w the OGH<sup>5</sup> did not rule whether the sale of a tavern including inventory qualified as a sale of in-

<sup>1</sup> See eg § 6 Employment Contract Adjustment Act (*Arbeitsvertrags-Anpassungsgesetz*), § 67 General Social Insurance Act (*Allgemeines Sozialversicherungsgesetz*) and § 14 Federal Fiscal Code (*Bundesabgabenordnung*).

<sup>2</sup> OGH 27.2.1992, 6 Ob 2/92.

<sup>3</sup> See § 1 para. 2 UGB.

<sup>4</sup> OGH SZ 22/255=JBI 1955, 250 and OGH SZ 74/106. Case law is not consistent: approximate value of 90% of total assets (see Andreas Aigner, *ecolex* 2007, 16 for share deals).

<sup>5</sup> 20 March 2002.

ventory, single goods and business assets on the one hand, or enterprise by means of an asset deal on the other. Furthermore, if in addition a lease contract (eg between the seller of the property including inventory as lessor and the hotel operator as lessee) is assumed by the purchaser becoming the new lessor, there might be good arguments that the transfer of real estate including inventory and appurtenant business accessories<sup>6</sup> constitutes the transfer of an enterprise.

Even if we do not share this view, diligent contract drafting requires an indemnification clause such as suggested below (see Contract drafting, below) at least in favour of the purchaser. As a quantum of solace, § 38 UGB is dispositive within its model for the transfer of existing non-personal legal relationships (as long as no special provisions apply pursuant to § 38 para. 6 UGB, such as for lease agreements<sup>7</sup>) and § 38 para. 5a UGB explicitly excludes the lease of an enterprise (*Unternehmenspacht*)<sup>8</sup>.

#### The concept of “contract takeover by law”

As per § 38 para. 1 UGB, existing non-personal legal relationships *in personam* shall be assumed by the purchaser *ex tunc* – and upon dispositive liability exclusion for old liabilities *ex nunc* – by means of “contract takeover by law” (*gesetzliche Vertragsübernahme*).

However, contracting parties can deviate from this model; pursuant to § 38 para. 4 UGB, the purchaser’s liability can be excluded under certain requirements (eg by means of an entry into the Austrian Companies Register). Nonetheless, such an exclusion does not apply to § 1409 ABGB, whereupon the purchaser’s liability shall only be limited to

the liabilities appertaining to the transferred enterprise or assets to a maximum amount of the transferred value (*cum viribus*).

Further, whereas the seller’s continued liability pursuant to § 1409 ABGB is unlimited in time, § 39 UGB establishes a time-limited liability of the seller.

#### Third party objection right

The concept of “contract takeover by law” goes along with the third party’s objection right to the transfer of a contract it is a party to. Consequently, as a result of the third party’s objection upon notification of the transfer of the enterprise, the seller remains liable for the transferred contract.

#### Contract drafting

To structure their real estate transaction in a responsible way, the contracting parties should look into § 38 UGB to determine if the transaction might qualify as the transfer of an enterprise by means of an asset deal. They should also look into § 1409 ABGB in the event of an asset deal or a share deal nearly representing the seller’s single fund(s). In addition to common warranties, the purchaser should be interested that the seller shall hold the purchaser indemnified and harmless from any claims of third parties arising out of any liability under § 1409 ABGB and § 38 UGB, provided that these provisions apply. In accordance with § 38 para. 4 UGB, the contracting parties may expressly agree that the liability of the purchaser for the liabilities relating to the seller’s property-related business shall be excluded.

 To structure their real estate transaction in a responsible way, the contracting parties should look into § 38 UGB to determine if the transaction might qualify as the transfer of an enterprise by means of an asset deal.

<sup>6</sup> See OGH 27.11.1991, 3 Ob 105/91.

<sup>7</sup> See § 1120 ABGB and § 12a Austrian Tenant Law Act (*Mietrechtsgesetz – MRG*).

<sup>8</sup> The same is true for the sale of an enterprise by means of a compulsory auction or insolvency proceeding.







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## Award Procedures in the Field of Emergency Services



Philipp J. Marboe / Raimund Schüller

According to the European Court of Justice (ECJ), emergency and rescue transport services are not connected with the exercise of official authority and therefore not exempt from applicability of the Public Procurement Directive (2004/18/EC).

These exemptions must be interpreted so that their scope is limited to what is strictly necessary in order to safeguard the interests which they allow member states to protect. The fact that such services contribute to the protection of public health is not sufficient for there to be a connection with the exercise of official authority.

Through its decision, the ECJ brought to a halt the practice followed by local and regional authorities in Germany of awarding contracts for rescue transport services without applying transparent contract award procedures.

### Background

Through its decision of 29 April 2010 (C-160/08; the ECJ Judgment) the ECJ introduced more competition in the German and European ambulance market. This came after the Commission had received a number of complaints about awards for public ambulance services and qualified patient transport services.

The complainants stated that the public procurement rules had been breached by failing to publish contract notices at the EU level and that the contracts had not been awarded in a transparent way.

The conflict has been simmering since 2006 when emergency medical service providers from outside Germany (including from Austria) complained about non-transparent award procedures.

The question of whether ambulance services are to be awarded by means of a formal public procurement procedure has kept the courts busy over the last years. The courts ruled both on concessions and the tender model for the supply of public emergency ambulance and qualified patient transport services.

In this respect, the ECJ pronounced in the ECJ Judgment the obligation to award tender contracts for the supply of public emergency ambulance by means of a procurement procedure. However, a decision of the ECJ with regard to concessions is still pending.

### Concession model and tender model

Tenders concerning public emergency services usually cover emergency ambulance and qualified patient transport services. In the field of public emergency services, the local authorities, in their capacity as the authorities responsible for organising those services, conclude contracts with providers of such services to the entire population of the area within their remit.

Payment for the services in question is made either directly to the tenderer in accordance with the tender model (the only one to which the aforementioned ruling relates) or in the form of charges levied directly by the contractor on patients or sickness funds, in accordance with the concession model. Most public authorities (mainly local) have opted for the concession model.

### Public procurement procedures for the tender model

Until 2008, pursuant to the German case law, there was no obligation to observe public procurement procedures. A decision of the German Federal Court of Justice (BGH) dated 1 December 2008 revived the case law ruling that ambulance services must be awarded by means of public procurement procedures. Otherwise, according to the BGH, German competition law had to stipulate explicitly that ambulance services are exempt from the public procurement law.

This decision was approved by the ECJ Judgment and deviated from the opinion that ambulance services are rendered in the exercise of official authority. Pursuant to the ECJ Judgment, no connection can be seen between the exercise of official authority and the emergency vehicle drivers' right of way or the use of flashing blue lights and sirens, which is within the competence of the police and judicial authorities. It follows from this, the court con-

cluded, that Articles 51 and 62 TFEU were not applicable to the activities at issue in the case.

### Public procurement procedures for the concession model

So far the application of the public procurement procedures for the concession model for ambulance services has not been determined. Advocate General Mazák stated on 9 September 2010 in the case C-274/09 that the lack of direct compensation by the public authority which awarded the respective service can be seen as an adequate criteria for the qualification as a service concession within the meaning of the Directive 2004/18/EC; thus, this Directive does not apply to service concessions as defined. The decision of the ECJ in that case is pending. If the ECJ recognises the existence of a service concession, the public authorities will in future be able to choose between public procurement procedures or not when tendering ambulance services. That this will ensure transparency and competition is to be doubted.

 Through its decision, the ECJ brought to a halt the practice followed by local and regional authorities in Germany of awarding contracts for rescue transport services without applying transparent contract award procedures.

## The Recent National Action Plans for Renewable Energy for Austria, Bulgaria and Romania: Everything in Order?



Andreas Orator / Bernd Rajal  
Mariya Mihaleva / Anca Velicu

Under the Renewable Energy Sources Directive 2009/28/EC (RES Directive), member states have to report on how they intend to meet the renewable energy targets set for 2020. Austria, Bulgaria and Romania have recently released their national action plans. Austria has committed to the very ambitious target of a 34% share of renewable energy, while Bulgaria's and Romania's targets have been set at 16% and 24% respectively.

### EU

In 2007, when the EU decided that 20% of the EU's final energy consumption should come from renewable energy, each member state had to increase its production and use of renewables. In order to reach that overall goal, the RES Directive was passed. It sets binding national targets for each member state to be met by 2020 as well as interim targets for monitoring the progress of the development of renewables. In order to facilitate monitoring, the Directive requires member states to submit National Renewable Energy Action Plans (NREAP) to the Commission.

### Austria

Austria, which started from a comparatively high level, pledged to an ambitious target of a 34% share of renewable energy. Only Sweden, Latvia and Finland have higher targets. Austria presented its NREAP in early July 2010, which is mainly based on the National Energy Strategy. It intends to reach its 34% renewables target by a 13% reduction of energy consumption and an 18% increase of renewable energy (compared to 2008). Energy consumption shall be reduced mainly in

the traffic sector through the promotion of public transportation and fuel-efficient cars. Moreover, measures like thermal refurbishment are to reduce energy consumption for heating and cooling. The introduction of smart-metering is to contribute to a reduction of electricity consumption.

Additionally, power generation through hydropower, wind, photovoltaic, and biogas as well as heat production through solar heat, wood, woodchips and pellets shall be strengthened. In 2010, subsidies to promote technologies which are not yet fully marketable (like wind and photovoltaics) amounted to a total of EUR 340 mln.

### Bulgaria

The Bulgarian NREAP was filed for approval with the European Commission on 30 June 2010 following heated public discussions and intensive reconsiderations of the government's renewable energy policy. It is meant to be a general strategy only while the specific commitments (with a few exceptions) are left for the scheduled legislative amendments. With that caveat in mind, the key elements are outlined below:

- Adoption of a new law on renewable energy intended to codify the regulation of the RES industry. The draft is already under preparation. Along with the measures envisaged by NREAP, the new law will also implement the respective EU Directives from the Third Energy packages and the Climate Change Package.
- Agency for Sustainable Energy Development. The new government body will replace the current Energy Efficiency Agency. It will provide centralised regulation of the RES industry, maintain up-to-date information and monitor the development of the industry.
- Forecast of expected share of the energy production by the various types of RES. According to the NREAP, by 2020 hydro power plants will be the main contributor (56.2 %) whereas the allocation altogether will be as follows: 2,549 MW of hydro power, 303 MW of solar power, 1,256 MW of wind power (no off-shore expected) and 158 MW of power plants working on biomass. Regarding bio-fuels, the NREAP refers to the national long-term programme for the promotion of bio-fuel consumption in the transport sector, which has sets a 10% target for 2020.
- Grid upgrade and smart grids. The NREAP sets as a priority the grid upgrade in order to facilitate the connection of RES power plants in the future and the use of smart grids by energy producers. Specific steps are to be further developed via legislation.
- Mechanism for filtering the applications for grid connection of RES plants based on “investment guarantee”. The NREAP does not specify further the criteria for filtering.

It should be noted that the NREAP provides only general principles for development of the renewable energy industry in Bulgaria while relying heavily on specific legislative amendments and appropriate policy on the part of the competent authorities.

### Romania

Romania's target of renewable energy was set at 24%. Although the country will not need any transfers from other member states, it will likewise not be in a position to pursue statistical transfers to other member states given that it is expected to barely reach the target.

From a regulation point of view, Romania aims to develop the incentives scheme for renewable energy – mandatory quota system combined with green certificates trading – targeting mainly hydropower generated in small units (less than 10 MW), as well as wind and solar energy. In addition, it is intended to better organise the functioning of the green certificates competitive market so as to support a greater number of transactions. On a separate account, regulations should also determine the targets for use and promotion of biofuels and of renewable fuels mixed with conventional fuels, with a 2020 horizon.

The NREAP foresees regional state aid for renewable energy, co-financing and a national programme for increasing energy efficiency and use of renewable energy in the public sector as the main financing mechanisms.

 In 2007, when the EU decided that 20% of the EU's final energy consumption should come from renewable energy, each member state had to increase its production and use of renewables.

## Slovakia: New Photovoltaics on Hold



Šimon Gmitterko

In accordance with the Directive of the European Parliament and Council 2009/28/EC of 23 April 2009 on the promotion of renewable energy sources, the Slovak Republic committed to a level of 14% of gross energy consumption from such sources by 2010. However, certain legal and administrative changes have limited the development of photovoltaic power.

### The 2009 Act promoting renewable energy

On 19 June 2009, with the aim of complying with this ambitious commitment and to manage duties under the respective Directives of the European Parliament and Council<sup>1</sup>, the National Council of the Slovak Republic passed Act no. 309/2009 Coll. on the promotion of renewable energy sources and of high efficiency co-generation production (the Act). It came into force on 1 September 2009.

The Act regulates the methods and requirements of the promotion of electric power from renewable energy sources, in particular (i) the right of priority connection of electricity production plants to the distribution network; (ii) the mandatory import of produced electrical energy by regional distribution system operators; and notably (iii) the guarantee of feed-in tariffs for a period of 15 years from the energy installations becoming operational (with the exception of facilities with capacity under 1MW, where no such limit applies). Furthermore, the regional distribution system operator assumes liability for deviations (ie the difference between the production of electricity and demand), but this applies only to plants with an output up to 4MW.

With the passing of the Act, Slovak legal regulation in the field of renewable energy sources came closer to the

legislation of countries such as Germany and the Czech Republic, both of which recently reported a huge upswing in photovoltaic (PV) power plants. However, after the Act was passed, other legislative and administrative changes were adopted that significantly limit the development of PV power plants.

### Certificate of compliance

Within the interpretation of Act No. 656/2004 Coll. on the energy sector (Energy Act), PV power plants may be constructed only on the basis of a Certificate on the investment plan's compliance with the long-term concept of the Slovak Republic's energy policy (Certificate), as issued by the Ministry of Economy of the Slovak Republic.

This Certificate is the basic document for planning and construction proceedings as regards the construction of PV power plants, as well as for the issuance of permits for doing business in the electricity sector. The Certificate is also required to be filed along with the application for connection of the PV power plant to the distribution network.

The newest amendment of the Slovak Energy Act, effective from 1 May 2010, restricts the limits of installed capacities of photovoltaic power plants the construction of which does not require the prior obtaining of the

<sup>1</sup> Directive of the European Parliament and Council 2004/8/EC and Directive of the European Parliament and Council 2001/77/EC.

Certificate. The current applicable installed capacity cap of 1 MW in the case of PV facilities is reduced to 100 kW. Thus recently it has only been small PV facilities with total capacity not exceeding 100 kW (installed on building roofs) in relation to which the Ministry consent requirement is waived.

### Approval from the Slovak Electricity Transmission System

The prerequisite for the issuance of the Certificate is an affirmative "Standpoint" of the Slovak Electricity Transmission System (SEPS). As the transmission system operator, in June 2010 SEPS issued a statement that it would not issue affirmative Standpoints for the construction of solar and wind power plants that are required for the issuance of the Certificate.

SEPS anticipates that by the end of 2011 there will be approximately 700 MW of installed output of solar power plants in Slovakia. According to SEPS, the unchecked construction of PV or wind power plants in Slovakia may jeopardise the operational safety and reliability of the electricity transmission system.

These concerns probably arise out of the strong development of PV renewable sources in the Czech Republic, where, according to an estimate by the Czech regulatory authority, the total installed output of energy facilities utilising renewable energy sources will represent between 1200 and 1400 MW by the end of 2010.

SEPS also stated that after evaluating the experience from the influence of all types of renewable sources of energy for generating electricity on the electricity grid of the Slovak Republic, including solar energy sources, the situation will be reviewed again at the beginning of 2012 and a new procedure for the issuance of Standpoints will be issued.

### Obstacle

This SEPS decision represents an obstacle to the future development of photovoltaics in Slovakia. In June 2010, the prepared National Action Plan for renewable energy sources assumed that the Slovak Republic would meet its commitment primarily by way of supporting the generation of heat by electricity using biomass. According to the Action Plan, in 2020 the share of renewable energies in the generation of electricity should represent 25%, but the share of solar energy in electricity from renewable sources should be just 3%, ie about 1% of all electricity production. Serious criticism was raised against this Action Plan, especially from photovoltaic producers of electricity, who regard the current conditions as unsustainable for the photovoltaic sector.

Considering the fairly ambitious 14% commitment regarding the share of renewable sources in the final consumption of energy (the current share is 7%), and considering the replacement of the Board of Directors at SEPS with the arrival of the new government, it is quite possible that SEPS will reassess its position regarding photovoltaic facilities.

 With the passing of the Act, Slovak legal regulation in the field of renewable energy sources came closer to the legislation of countries such as Germany and the Czech Republic, both of which recently reported a huge upswing in photovoltaic power plants. However, after the Act was passed, other legislative and administrative changes were adopted that significantly limit the development of photovoltaic power plants.

# Regulatory Tools to Support Renewable Energy Generation in Hungary



János Juhász

Enhanced utilisation of renewable energy sources is a main concern in Hungary. In 2009, the electricity generated from renewable resources amounted to approximately 7.3% of total energy consumption. The longer term goal is to reach 13% by 2020, as set out in the Renewable Energy Directive.

Measures to promote the use of RES are justified by various factors. One of the most significant is that renewable energy is not as cost-effective as energy generated from fossil energy sources. This is due to the novelty of renewable energy technologies, the initial high capital costs and the market risks. The most common tools in the EU member states to support renewable energy generation are the feed-in-tariff model, the tender system and the system of green certificates.

## Feed-in-tariff system

Pursuant to the Hungarian Electricity Act, a feed-in-tariff system (in Hungary it is called a mandatory off-take regime) is in force to support investments in RES projects. Participation in the mandatory off-take regime means that the entitled generators (RES Generators) may sell their electricity at a price regulated by law for a term and in an amount determined by the Hungarian Energy Office (HEO) in the individual operation licences of the generators. Pursuant to this regime, a certain part of electricity generated from renewable sources must be taken off by MAVIR (the Hungarian TSO) at regulated prices, calculated based on a relevant government decree. MAVIR was also required to establish a separate balance circle (the RES Balancing Circle) for the administration of the mandatory off-take and allocation of electricity produced by RES Generators. Membership of RES Generators in the RES Balancing Circle is mandatory; therefore, RES

Generators shall conclude a balancing circle agreement with MAVIR. Electricity traders – including universal service providers, power generators and electricity importers – must purchase from the TSO electricity generated from renewable energy sources according to a fixed percentage of their total electricity turnover/consumption.

## Certificates of origin

Upon a request from the producer, HEO certifies the quantity of electricity produced from renewable energy sources by the so-called certificates of origin. RES Generators are obliged to certify after each year that the electricity sold in the framework of the mandatory off-take regime was produced pursuant to the relevant legal requirements. If HEO in its control process discovers a lack of certificates of origin or a violation of the relevant laws, then it adopts a resolution in which it (i) defines the amount sold by violating the law; (ii) defines the conditions of further production in the framework of the mandatory off-take regime; and (iii) imposes a fine and other legal consequences on the RES Generators.

## Tender system regarding wind parks

The regulation regarding wind power generation is different from the general rules relating to RES Generators. The establishment of wind power generation capacities requires a so-called integrated small power plant licence

issued by the HEO. However, under the Electricity Act, only those entities may apply for the HEO's integrated small power plant licence which have first obtained capacities and the right to apply for the license in a public tender process organised by the HEO. Under the current regulatory framework, wind parks may sell their electricity (i) under the mandatory off-take regime, or (ii) under free market conditions. The right to participate in the mandatory off-take regime may only be obtained at a tender. The HEO is required to carry out an analysis each year in order to determine, in its discretion, whether it is possible (primarily on the basis of system requirements) to establish and allocate new wind power capacities in Hungary.<sup>1</sup>

### System of green certificates

As the wording of the Electricity Act suggests, the current regime of mandatory off-take may be substituted in the future by a system of green certificates on the basis of the recommendation of the HEO. In its latest report of 2008, the HEO did not recommend the introduction of a system of green certificates. Under such system, generators of green energy would receive so-called green certificates, whereas end-users and/or traders would be obliged to cover a certain part of the consumption/turn-over by such certificates.

### Problems with the current support scheme

Although the regulated mandatory off-take prices of RES energy are differentiated, there are maximum prices. This means that certain units that can only be operated at

costs above the maximum prices (geothermal, solar) are ousted from the system. Even in the case of biomass (considered to be the most significant element of the Hungarian renewable energy strategy on the way to reaching the 13% target), the current off-take prices can only ensure the economic operation of biomass power plants with more than 10 MW installed capacity. Partly due to the financial crisis, the economic efficiency of biomass projects has deteriorated to such an extent that only half of the earlier planned 200 MW installed capacity may be established by 2020, in a best case scenario. Additionally, there is another problem with the price differentiation of the system. Older power plants (combined-fired) that can use biomass as well have been established/retrofitted at significantly lower investment costs.<sup>2</sup> Therefore, they can realise extra profit and are able to buy up cheap raw materials on the biomass market because of their stronger bargaining position.

### The possible future of the domestic support scheme

Although the current green energy support scheme needs to be reconsidered, this does not necessarily mean that the feed-in-tariff system needs to be replaced by green certificates. However, the current support scheme should differentiate between technologies to a greater extent. During such differentiation, it would be suitable to support technologies that can maximise the domestic economic and social benefits during their exploitation. For the time being, biomass and geothermal technologies appear to be most beneficial in this respect.

 Participation in the mandatory off-take regime means that the entitled generators (RES Generators) may sell their electricity at a price regulated by law for a term and in an amount determined by the Hungarian Energy Office in the individual operation licences of the generators.

<sup>1</sup> HEO carried out its first analysis in 2009 and, as a result of its analysis announced the first wind power capacity Tender in August 2009 for the establishment of wind power capacities up to 410 MW. However, the new Hungarian Government (Ministry of National Development) amended the applicable ministerial decree at the end of June 2010 and, partly on the basis of the amendment, HEO finally rescinded the tender.

<sup>2</sup> Even if the system differentiates between new and old entrants, i.e. the operational license of the project was issued before or after the entry into force of the Electricity Act on 1 January 2008.





11



# The New Double Taxation Avoidance Treaty between Austria and Serbia



Matija Vojnović / Petar Kojdić

Although Austria is a prime investor in Serbia and has invested almost EUR 2 bln there, a double taxation treaty between the two countries has been long-awaited. It is expected that the treaty will facilitate the business activities of Serbian citizens in Austria and the investments of Austrian companies in Serbia, thereby enhance economic and financial cooperation between the two countries.

## Introduction

On 28 July 2010 the Serbian Parliament ratified the Double Taxation Avoidance Treaty on Income and Capital between Serbia and Austria (DTT), which was signed on 7 May 2010. The DTT will enter into force once ratified by Austria and will be effective as of 1 January of the calendar year following its entry into force.

The DTT is largely based on the OECD Model Tax Convention on Income and Capital with minor exemptions inspired by the UN Model Tax Convention.

## Persons and taxes covered

The DTT will apply to persons who are residents of Austria or Serbia (or both). The ultimate criterion for determining residency of a company is where effective management is located.

The taxes covered by the DTT in Austria are:

- (i) income tax (*Einkommensteuer*);
- (ii) corporation tax (*Körperschaftsteuer*);
- (iii) land tax (*Grundsteuer*);
- (iv) tax on agricultural and forestry enterprises (*Abgabe von land- und forstwirtschaftlichen Betrieben*) and

- (v) tax on the value of vacant plots (*Abgabe vom Bodenwert bei unbebauten Grundstücken*).

The Serbian taxes covered are:

- (i) corporate income tax (*porez na dobit preduzeća*);
- (ii) personal income tax (*porez na dohodak građana*) and
- (iii) property tax (*porez na imovinu*).

## Division of tax jurisdictions

According to the DTT, in certain cases, Austria or Serbia may, without limit, tax incomes and capital the source of which is situated on their territory (the source state).

Such incomes and capital are: those derived from real estate and capital gains derived from the alienation of the said real estate; profits of a non-resident's permanent establishment situated in the source state, business property of the permanent establishment and capital gains from the alienation of such permanent establishment; directors' fees paid by a company which is resident of the source state; salaries and wages derived from employment in the private sector in the source state (except cases where the employee was present in the source state for a period not exceeding 183 days in any 12 month period).

In other cases, the source state has a right to tax incomes and capital only on a limited basis (dividends, interests and royalties) or tax jurisdiction is fully given only to the residence state (eg cases related to civil service salaries, certain cases of capital gains, foreign sourced payments to students, business profits where the business is not carried out through a permanent establishment and other incomes and capital not specially mentioned by the DTT, etc).

### Dividends, interest and royalties

In Serbia, a withholding tax of 20% is levied on dividends as well as on payments of interest and royalty to non-resident companies unless otherwise provided by an applicable double taxation treaty. According to the DTT, dividends, interests and royalties are primarily taxed in the state of residency of their beneficiary.

However, dividends, interest and royalties may also be subject to withholding tax in the state where the company paying the dividends is a resident or in the state in which interest or royalties arise (the source state). However, such tax cannot exceed:

- 5% of the gross amount of dividends in cases where the beneficiary is a company (other than a partnership) which directly holds at least 25% of the capital of the company paying the dividends or, in all other cases, 15% of the gross amount of the dividends;

- 10% of the gross amount of the interest;
- 5% (for copyrights) or 10% (for patents, trade marks) of the gross amount of the royalties.

### Capital gains

In Serbia, unless otherwise provided by an applicable double taxation treaty, a withholding tax of 20% is levied on capital gains. The DTT provides a general rule that capital gains from alienation of property are taxable only in the state where the alienator is a resident. There are exemptions from this rule pertaining to gains derived from the alienation of the non-resident's real estate or permanent establishment, alienation of ships or aircrafts and gains derived from the alienation of shares (in joint stock companies; *akcije*) or "comparable interests" deriving more than 50% of their value directly or indirectly from real estate situated in the state of which the alienator is not a resident.

By introducing the phrase "shares or comparable interests", which was not previously contained in double taxation treaties concluded by Serbia, the DTT will give way to the interpretation that, subject to certain conditions, gains from alienation of shares in limited liability companies (*udeli*) may be taxed (as comparable interests) in the state where the alienator is not a resident. If this interpretation prevails, Austrian investors selling shares in Serbian limited liability companies will be the most common taxpayers of this tax in day to day practice.

 According to the DTT, in certain cases, Austria or Serbia may, without limit, tax incomes and capital the source of which is situated on their territory (the source state).

# Austria: Cash-Box Import Mergers – Fictitious Distributions



Herbert Buzanich

Inbound dividends from low-tax jurisdictions may not be exempt from Austrian corporate income tax under the Austrian international participation exemption but may be subject to a switch-over to the credit method. In the past, such profits could be repatriated by way of a tax neutral import merger instead. However, a recent amendment to the Austrian Reorganisation Tax Act may lead to a fictitious distribution in such cases.

## Switch-over for inbound dividends

Under the (Austrian) international participation exemption (at least 10% shareholding held for at least one year), foreign source dividends received by the Austrian parent corporation are generally exempt from Austrian corporate income tax. However, under a statutory assumption of misuse the exemption does not apply if (simplified) the predominant business purpose of the foreign corporation is the generation of passive income (passive-income test) and the income of the foreign corporation is subject to taxation that is not comparable to Austrian corporate income taxation (no-comparable-taxation test).

If misuse is assumed under these tests, a switch-over from the exemption method to the credit method applies. That is, the foreign dividends are not exempt from Austrian corporate income tax at the level of the Austrian parent corporation but the foreign tax is credited against the Austrian corporate income tax liability.

## Repatriation of profits by import merger

Due to this switch-over rule, the repatriation by way of a dividend of profits from a subsidiary generating predominantly passive income (eg interest or royalties) in a low-tax jurisdiction would be subject to Austrian corporate income tax and there would only be a credit for the (low) foreign tax on the distributed amount. As a consequence,

such profits were not distributed but retained in the foreign subsidiary (cash-box).

Instead of the repatriation of profits by way of a dividend, the retained foreign profits could be repatriated by a tax neutral (import) merger of the cash-box corporation into the Austrian parent corporation within the scope of the Austrian International Reorganisation Tax Act. In this case, the difference between the book value of the shareholding and the received net assets (including the retained profits) resulted in a tax neutral book profit at the level of the Austrian parent corporation.

## Fictitious distributions

With the Tax Amendment Act 2010, a new provision was introduced that applies to mergers resolved after 30 June 2010. According to this provision, there shall be a fictitious distribution in the case of an import merger if, at the effective date of the merger, the prerequisites for a switch-over under the Austrian international participation exemption are met. The new provision also covers the special switch-over rules for certain foreign portfolio shareholdings (less than 10% shareholdings). However, portfolio shareholdings should not be practically relevant within the present context.

If the prerequisites for the switch-over are met, the difference between the net assets accounted for in the

balance sheet of the foreign subsidiary and the paid-in registered capital are deemed distributed as an overt distribution at the beginning of the day following the effective date of the merger.

### Amount of fictitious distribution

The above-mentioned calculation of the fictitiously distributed amount (net assets reduced by paid-in registered capital) does not take into account other contributions than those made on registered capital. Under Austrian accounting law, such other contributions would be accounted for as a capital reserve. Consequently, if the prerequisites for the switch-over are met, the import merger may result in a taxable (fictitious) distribution of previous contributions accounted for as a capital reserve.

Disregarding contributions to capital reserves for present purposes was reasoned with the suspicion that there is not always a clear distinction between profit reserves and capital reserves in low tax jurisdictions.

However, under the Decree of the Austrian Federal Ministry of Finance on the Repayment of Contributions, the principles of contributions and repayments of contributions shall also apply to comparable foreign corporations to the extent proof is provided that a certain payment is a repayment of a contribution. On that basis, the general restriction to paid-in registered capital seems unreasonable in cases where proof of repayment of a contribution can be provided.

Further, not the entire registered capital reduces the amount of the fictitious distribution, but only paid-in registered capital. In contrast, registered capital due to a capital increase that is funded out of the profits of the foreign corporation would not be taken into account (because such registered capital is not considered "paid-in").

### Assessment at the effective date of the merger

The business purpose of a corporation may change over time. As a consequence, the retained profits of the foreign corporation may consist of profits from both periods with a predominantly passive business purpose and periods with a predominantly active business purpose. Equally, changes in the applicable local tax regime may result in profits that were subject to a tax comparable to Austrian corporate income tax and profits which were not.

When applying the passive-income test and the no-comparable-taxation test under the international participation exemption, such changes are taken into consideration. As a result, certain portions of a dividend may fall under the exemption while other portions are subject to the switch-over.

Under the new provision for import mergers, the facts and circumstances at the effective date of the merger are decisive as to whether the retained profits are deemed distributed. If the prerequisites for the switch-over are met at this time, the fictitious distribution is triggered. However, if a fictitious distribution is triggered, the exemption method should apply to portions of the fictitious distribution that were not generated under circumstances that would lead to a switch-over.

### Conformity with union law?

Commentators have questioned the new provision in light of the freedom of establishment and the Merger Directive. Arguments were brought forward both for and against conformity with union law. These considerations may be relevant with respect to the import merger of a foreign subsidiary resident in another EU member state, particularly Ireland or Cyprus, however not in low-tax jurisdictions outside the EU.

 Disregarding contributions to capital reserves for present purposes was reasoned with the suspicion that there is not always a clear distinction between profit reserves and capital reserves in low tax jurisdictions. Under the new provision for import mergers, the facts and circumstances at the effective date of the merger are decisive as to whether the retained profits are deemed distributed.





**artworks**



by

Born in **1978** in Vienna. First film education at the New York University in the summer of **1996**, followed by a series of independent film productions as a cameraman.

In autumn **1997** enrollment in the International Business Management Program at the University of Vienna and the University Sorbonne in Paris, France. Graduation in the summer of **2002** earning the title "Master of Economic Sciences". During the time at University regular work as a freelance cameraman on short fiction films, extreme sports films (mainly ski and snowboard) as well as music videos in Europe and the USA. In the summer of 1999 participation at the 35mm Cinematography Program at the University of Southern California, followed by numerous music videos and short fiction films in and around Los Angeles. In January **2003** enrollment in the two-year Cinematography Master Program at the National Film & Television School in London, UK. During that time numerous projects as a cameraman in various areas of film & television, including fiction cinema and commercials. Graduation in December **2004** earning the title "Master of Arts Film and Television".

Since January **2005** international work as a freelance cameraman and director. Projects include extreme sports films (ski and snowboard) for ski manufacturer Völkl and TV (ORF, ATV+, Eurosport), music videos for Cinderella, Carouge, Sorgente and renowned dance project "Tanzwerk Wels", documentaries for national and international TV (ORF, 3Sat, ARTE) and clients such as Red Bull ("Kirby Chambliss Portrait") as well as commercials for cinema and TV.

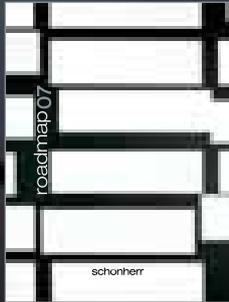
In still photography special focus on advertising and sports, mainly tennis on the international ATP and WTA tour as well as Fed and Davis Cup.

Based in Wels, Austria. Married to Véronique Wolfram-Hauer. Father of Clara Theodora.



**matthias hauer**

**roadmap 11** will be the fifth edition of the roadmap. What started in 2007 has become a highly anticipated annual tradition, helping to set schoenherr apart with its unique and provocative blend of art and law.



# history

## **roadmap 2007 - more**

The theme of roadmap 2007 was more – more information, more knowledge, more success, more contentment. The word is a neutral adjective meaning either good or bad depending on whether it is followed by a positive or negative substantive form. We want to present the positive form – the motivating and helpful “more”.

Artist: Esther Stocker. Structure, laws and rules provide security and enable decisions, judgments and concrete actions. This force of law, however, does not operate in empty space. It knows a horizon before which and towards which it unfolds. The works of Esther Stocker draw from the interplay of rules, structures and laws. She was born in Italy and works in Vienna.

## **roadmap 2008 - diversity**

The theme of roadmap 2008 was diversity. The diversity of schoenherr's area of operation can be seen in the contrast between the ancient rural landscapes of Transylvania and the golden concert hall of the Vienna Musikverein. The firm is defined by diversity, with lawyers of different nationalities, cultural backgrounds and professional talents. This diversity is our strength, enabling us to service the equally diverse nature and needs of our clients.

Artist: Berenice Darrer. In her art, Berenice Darrer takes up the issue of diversity in an understated approach that disrupts conventional views and encourages reflection. Her work is composed of a multitude of component parts that can be arranged in different and diverse ways. She was born in Namibia and lives and works in Vienna.

## **roadmap 2009 - flow**

The theme of roadmap 2009 was flow. We encounter the inconspicuous flow at every turn: cash flow, flow chart, work flow. In modern commercial law, flow implies knowledge of current legal developments, swift adjustment to changing conditions, an optimistic view of the future and determination to take the right decisions at the right time.

Artist: Josef Schwaiger. Josef Schwaiger has been working with the theme of flow for many years. His abstract, often linear art, with its suggestion of movement and change, unmistakably evokes a feeling of flow. He was born in Linz, Austria and lives and works in Vienna.

## **roadmap 2010 - explore**

The theme of roadmap 2010 was explore. The word evokes images of adventure and discovery, of movement and curiosity. Explore also implies an approach and an attitude. The approach is practical, creative, unconventional if necessary. The attitude is positive and proactive, of a desire to move into new territories and a determination to find the way forward.

Artist: Mario Dalpra. Mario Dalpra was born in Austria and spends part of his time there. He also spends large amounts of time in India, which provides him with stimuli and new sources of inspiration for his work. Perhaps this is what gives his work such a fresh, strong element of exploration and discovery.

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STING



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