Changes in Hungarian corporate law in the new Civil Code

The New Civil Code (Act No. V of 2013), which enters into force on 15 March 2014, will regulate corporate law. Companies that are already registered or under registration when the New Civil Code enters into force will have to decide on continuing operations in accordance with the provisions of the New Civil Code and submit such resolution to the court of registration upon the first modification of their instrument of constitution (e.g. articles of association) following the entry into force of the New Civil Code, however general partnerships and limited partnerships must comply with this obligation until 15 March 2015, while limited liability companies, limited companies and groupings must do so until 15 March 2016 at the latest.

In the following we briefly summarize the new rules applicable to companies. The summary is not all-encompassing; it is only a “first” information document. We highlighted those changes that in our opinion may be of special importance to the management.

One of the consequences of including corporate law in the New Civil Code is that it will no longer be regulated by a separate Act. The rules on corporate law are henceforth to be found in Third Book of the New Civil Code.
1. **General rules applicable to legal persons and companies:**

1.1. As a very important new rule, the New Civil Code stipulates the *dispositivity (optionality)* of corporate law, i.e. states as a general rule that persons have the freedom of establishment of a legal person, and may *themselves decide* on (i) the relations between themselves, (ii) between them and the legal person, (iii) the organizational structure and (iv) operational arrangements of the legal person and that they may derogate from the provisions of the New Civil Code. This is a significant departure from the current law, as the provisions of the now applicable Companies Act are generally *cogent* (i.e. may not be derogated from).

It may pose a problem in the future that the New Civil Code does not exactly specify the provisions which may not be derogated from despite the general dispositivity (optionality). Exceptions from the rule of dispositivity (optionality) – excluding the case where derogation is precluded by law - are only set out as generalities: the provisions of the New Civil Code may not be derogated from if the derogation would clearly violate the interests of the legal person’s creditors, employees and minority members, or it would likely prevent the exercise of effective supervision over legal persons.

1.2. A significant difference compared to previous legislation is that rules applicable to companies are spread into several levels. The Third Book of the New Civil Code is about legal persons. Legal persons include entities other than companies (such as associations, cooperative societies, groupings and foundations). The third part of the Third Book of the New Civil Code contains the regulation on companies, and includes very detailed
general provisions, applicable to all types of companies. Consequently, the chapters on each type of company only contain the provisions which are not included among the general rules relating to legal persons and to companies. Therefore, in order to establish the provisions applicable to a certain type of company, the general provisions relating to legal persons, the general provisions relating to companies and the provisions specific to that given company type are to be taken into account.

1.3 The New Civil Code differs from previous law in that after the registration of a legal person by binding decision, nullity of the instrument of constitution (e.g. articles of association) of the legal person may no longer be referred as grounds for removal from the registry. As regards the decision-making by members or founders of a legal person, there are general provisions applicable to all types of legal persons regulating direct and indirect (by way of so-called „college of delegates“) exercising of rights, and also adopting resolutions out of session. The Code sets out the cases in which the members or the founders of a legal person may not participate in voting and thus may not be taken into account when establishing quorum.

1.4 The category of „company without legal personality“ has been abolished, i.e. general and limited partnerships are now considered legal persons as well. As regards the foundation of companies, the New Civil Code did not uphold the previous provision of the Companies Act which stipulated that a pre-company cannot carry out any activity subject to a regulatory authorization. The New Civil Code does not regulate the manner of indicating pre-company status.
1.5 The New Civil Code sets out that any person who is under the effect of prohibition from practicing a profession may not be a member in a company, other than a public limited company.

1.6 As an important new rule, the New Civil Code stipulates a rebuttable legal presumption regarding the date of delivery of a registered mail with return receipt within Hungary. Furthermore, the New Civil Code establishes as a general rule that legal statements are to be made in writing. According to the New Civil Code, legal statements relating to the company may be made or delivered by means of electronic communications only if so permitted by the company’s instrument of constitution, which must also provide for the relevant conditions and the means thereof.

1.7 The instrument of constitution (e.g. articles of association) may only be modified by a 3/4 majority. This is a general rule, applicable to all types of companies. However, the New Civil Code specifies the cases which require a unanimous vote (if the modification would harm the rights of some members or make their status more onerous). In voting for such issue members without the right to vote may also participate.

1.8 Contrary to the current rules according to which a shareholder cannot be excluded from the limited company, the New Civil Code prohibits exclusion of a shareholder of a public limited company only.

1.9 Contrary to currently applicable law, the company’s place of business and branch must be indicated in the instrument of constitution, only if the company requests the registration thereof.
1.10 The New Civil Code establishes new grounds for the liability of executive officers. Instead of the currently applicable rules on liability set out in the Companies Act – which in essence amount to a fault-based liability – the New Civil Code stipulates that the executive officers are liable to the legal person in accordance with the rules relating to damages caused by a breach of contract. “Damages caused by a breach of contract” is a new legal concept of liability introduced by the New Civil Code: a party is relieved of liability if able to prove that the damage occurred in consequence of circumstances unforeseen at the time of conclusion of the contract and beyond his control, and there had been no reasonable cause to take action for preventing or mitigating the damage.

In the scope of non-contractual liability for damages caused to third parties, the New Civil Code stipulates the liability of executive officers as a brand new rule. (Such rule did not exist previously.) The New Civil Code sets out that if an executive officer of a legal person causes damage to a third party in connection with his office, liability in relation to the injured person lies with the executive officer and the legal person jointly and severally.

According to the commentary of the New Civil Code (hvgorac 2013), in the case of both types of liability (i.e. liability to the legal person and liability to third persons) the principles of finding executives officers liable or relieving them from liability are to be established by court practice.

1.11 The New Civil Code regulates the so-called “hold-harmless warrant”, which acknowledges the executive officer’s management activities. A “hold-harmless
“warrant” may only be issued if so permitted by the instrument of constitution (e.g. articles of association). If the company’s supreme body provides a hold-harmless warrant to an executive officer, the company may only bring action against the executive officer on the grounds of breaching management obligations in a claim for damages if the facts and information underlying the hold-harmless warrant proved to be false or incomplete.

1.12 In the event of a company’s dissolution without succession, creditors may bring action for damages up to their claims outstanding against the company’s executive officers on the grounds of non-contractual liability, should the executive officer affected fail to take the creditors’ interests into account in the event of an imminent threat to the company’s solvency. This provision is not applicable in the case where the company is wound up without going into liquidation.

1.13 If the company is not required by law to have a supervisory board, or its supervisory board is not a peremptory supervisory board, the supervisory board may consist of less than three members.

1.14 A company may also be converted into a grouping or cooperative society.

**Important changes relating to certain company forms:**

2. **General and limited partnerships (in Hungarian közkereseti társaság - “Kkt.” and betéti társaság - “Bt.”):**

The most important change from legal point of view relating to general and limited partnerships is that they will have legal personality, but in practice this change would not mean change in merit.
3. **Limited liability company (in Hungarian Korlátolt felelősségű társaság – “Kft.”):**

3.1 In the case of the limited liability company, the minimum amount of the initial capital has been raised from HUF 500,000 to HUF 3 million (approx. EUR 9,000). Companies already registered in the company registry are obligated to increase their initial capital to the new minimum until 15 March 2016 or convert into another company form. The New Civil Code did not keep the rule contained in the current Companies Act, which prescribes that at least half of all cash contributions to the company must be paid before the application for registration of the company is submitted. The memorandum of association may also provide a deadline longer than 1-year for the payment of cash contributions. It is a „safeguarding rule” that the company is not allowed to pay any dividend insofar as the unpaid profit calculated relative to the members’ core deposits according to the provisions on the payment of dividends reaches the initial capital together with the cash contributions which the members have already paid up. It is also a „safeguarding rule” that members bear liability for the company’s debts up to the unpaid part of their cash contribution.

3.2 The New Civil Code does not detail which services, under which conditions may be regarded as auxiliary services. The New Civil Code makes clear that if a member is personally involved in the company’s activities in his/her capacity as a member, compensation may only be requested for such involvement if provided for in the memorandum of association.

3.3 The New Civil Code does not contain the requirement that the members’ meeting must be convened at least once a year.
According to the new rules, the members may decide by a resolution adopted by at least a three-quarters majority to increase the initial capital.

3.4 The invitation to the members’ meeting must be sent at least 15 days in advance. Should the members derogate from this provision, the New Civil Code sets out that a time limit of less than three days cannot be validly set out in the memorandum of association. If the members’ meeting fails to have a quorum, the reconvened members’ meeting is to be called for a date following the original time by not less than three and not more than fifteen days. Any provision of the memorandum of association providing for a convocation time limit of less than three days is null and void.

3.5 The New Civil Code does not require as a condition for the payment of interim dividend that such a possibility be included in the memorandum of association. Similarly, the New Civil Code does not require the members to make a declaration in which they undertake to return the distributed interim dividend if it subsequently becomes apparent that there was no justification for payment of dividends. The obligation of returning the distributed interim dividends is now prescribed by the New Civil Code.

4. **Limited company (in Hungarian részvénytársaság – “Rt.”):**

4.1 One of the most important novelties regarding limited companies is that the form of public limited company is attached to the listing of its shares on a stock exchange. For the purposes of the New Civil Code, any market - authorized by the competent authority of the state where
the company has its registered seat - where securities are traded is deemed a stock exchange. The New Civil Code states that any limited company whose shares are listed on a stock exchange shall be recognized as a public limited company. It follows from this provision that a limited company may only be founded as a private limited company; foundation by public offering of shares is not possible.

4.2 The amount of cash contributions at the time of foundation may not be less than thirty per cent of the share capital. Asset contributions must be provided within 3 years from the date of registration.

4.3 The New Civil Code does not detail or specify the cases of assignment of ownership by means other than transfer. The New Civil Code highlights that registering the change of ownership by the management board is part of the endorsement chain. In connection with own shares, the New Civil Code states as a new rule that if the quantity of unlawfully acquired own shares cannot be determined, all of the company’s own shares must be withdrawn.

4.4 The New Civil Code specifies as a cogent rule (which may not be derogated from) only with regard to the public limited company that the voting rights attached to one share may not exceed the voting rights corresponding to the nominal value of the share by a factor of ten.

4.5 A limited company may only acquire up to 25% of its own shares.

4.6 The New Civil Code does not mention the nominee among the data to be entered into the register of shareholders. The New Civil Code clarifies that the
omission of admission into the register of shareholders shall not affect the shareholder’s right of ownership of his shares.

4.7 The New Civil Code specifies that if a person other than the auditor is involved in the valuation of an asset contribution, such person must be an expert qualified for the valuation of the asset in question.

In connection with distributions to shareholders, the New Civil Code states that a distribution cannot be made if it would jeopardize the limited company’s solvency.

4.8 The New Civil Code does not require as a condition for the payment of interim dividend that such a possibility be included in the articles of association (statutes). According to the new rules, the general meeting or, by authorization of the articles of association, the management board may adopt a decision for the payment of interim dividends.

4.9 The New Civil Code does not contain the requirement that the general meeting must be convened at least once a year. The decision making obligations prescribed by the New Civil Code may be complied with by adopting resolutions without holding a general meeting.

4.9 If according to the articles of association shareholders are allowed to participate in the general meeting by way of electronic communications equipment instead of appearing in person, shareholders may freely decide the way in which they wish to participate.