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The Harmonisation of Hungarian Company Law – A Pendular Process

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1. Introduction

Before joining the European Union on 1 May 2004, Hungary entered into an Association Agreement with the European Community and its Member States on 16 December 1991. One of the most important aims of this Agreement (also known as the Europe Agreement) was to establish a free trade area between the parties to the Agreement, covering all trade between them, and to make progress towards realising the other economic freedoms on which the Community is based.[1] As a tool for achieving these aims, Chapter III of the Europe Agreement prescribed the approximation of legal regulations. Of course, this approximation did not imply a two-way movement, but the one-sided approach of Hungarian

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[1] Art. 1 of the Europe Agreement.

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law to the legal rules of the Community.[2] The parties to the Agreement held that one of the basic conditions of Hungary's economic integration was to approximate the country's present and future laws to the laws of the Community. Hungary therefore undertook that as far as possible Hungarian legislation would be brought into accordance with the laws of the Community. The Europe Agreement indicated the main areas for the approximation of laws. Under Article 68 of the Agreement, approximation was also meant to take place in the area of company law.

The Europe Agreement was incorporated into the legal system of the Republic of Hungary as a legislative act,[3] making it a legal obligation to approximate Hungarian company law to European company law and to establish a company law system harmonised with European company law requirements. However, complying with this legal obligation was not a single act. The harmonisation of Hungarian company law with EC rules is a process which is still going on – not because European company law changes quickly (it does not) and not because Hungary has not completed the task of approximation (it has not), but mainly because national company law can be harmonised with European rules in different ways.

In this article, I will discuss the process of harmonisation in general (Chapter 2). Following this, I will analyse some characteristic elements of the harmonisation of share capital regulation (Chapter 3). At the end of the article, I will summarise the conclusions (Chapter 4).

It will become apparent from this article that the approximation process is characterised by a rocking motion: the starting point was a national company law the rules of which were only coincidentally in harmony with European company law. Then, in a relatively short time, Hungary completed the harmonisation in a rough-and-ready manner, which resulted in a regulation that was in compliance with European company law, but overshot the target in many respects: even those parts of Hungarian company law to which the European rules are not applicable were subsumed to European company law. The next stage of the harmonisation process consisted of the 'fine tuning' of Hungarian company law. The legislator introduced what in many respects is a more sophisticated, elaborate regulation that is still in full compliance with the European requirements, but is limited to matters falling under European company law. This new wave of regulation utilises the flexibility of EC regulation much more than the previous legislation.

It is not obvious that the present stage of the legal harmonisation process is the last one. The implementation of European company law has created a group of rules in Hungarian company law that is unfamiliar to Hungarian lawyers not

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[2] Art. 67 of the Europe Agreement.

[3] Act No. I of 1994.

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only in substantial sense but also with regard to the method of regulation. It may easily happen that these rules are readjusted to 'traditional' Hungarian company law. If this happens, the contemporary contents of the relevant rules will hopefully be preserved.

2. The harmonisation process

2.1 The starting point

In order to have a correct picture of the harmonisation process, it is necessary to examine the situation at the outset. Hungary has known company law, laid down in different legislative acts, since the middle of the 19th century.[4] In 1875, a Commercial Code was adopted,[5] which regulated four types of commercial company: the business partnership, the limited partnership, the cooperative and the company limited by shares. The choice of commercial companies was widened in 1930, when a separate act introduced the limited liability company and the sleeping partnership.[6] These legislative acts reflected the needs of a capitalistic market economy and shared common features with the company laws of continental Europe at that time. Due to historical and geographical reasons, the Austrian and German influence was the strongest.

After World War II, under the so-called socialist economic and social circumstances, the importance of companies and company law decreased. The national economy was organised mainly in State enterprises and agricultural cooperatives. The logic of the planned economy did not allow the free formation of companies driven by the demands of the market. However, company law did not cease to exist even at this time.[7] On the one hand, some companies – with foreign interests in them – continued their operation in their original legal form and therefore needed adequate legal regulation. Consequently, the regulation of limited liability companies and the rules of the Commercial Code referring to companies limited by shares were maintained through the socialist era, although these rules were not applicable for the formation of new companies. On the other hand, at the end of the 1960s, a reform of economic administration began in Hungary. The essence of the reform was to introduce market relationships into the planned economy to a limited extent. In the new system, the market meant not only the market of products but also the market of different factors of

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[4] The first act on company law matters – Act No. XVIII – was promulgated in 1840.

[5] Act No. XXXVII of 1875.

[6] Act No. V of 1930.

[7] Tamás Sárközy describes the position of company law in the socialist system as being 'apparently dead'. See Tamás Sárközy, *A magyar társasági jog Európában* [Hungarian Company Law in Europe] (Budapest, HVG-ORAC 2001) p. 39.

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production, including capital. However, the opening on this field was much more limited than in other economic spheres. The introduction of a limited market for capital was carried out partly by implementing a specific socialist company law regulating special types of companies that served the needs of the socialist economic system and provided an institutional framework for the international cooperation of enterprises of socialist countries. The content of the socialist company law was continuously developed in harmony with the changes of the economic reform.

Thus, when Hungary stood on the threshold of the great economic and social changes that characterised the end of the 1980s, there were two different bodies of company law that could have served as a basis for a new system of company law. However, neither of these bodies of law had an explicit connection to the company law of the European Community. There was no European Community when the pre-war company law was enacted, and the socialist company law – even in its reformed version – could ideologically not afford to be associated with the emerging European company law. Nevertheless, as a carrier of some common company law values designed for market economies, the old part of Hungarian company law at least showed a basic harmony with the aims of the European legislation, even in its old-fashioned version.

2.2 The Companies Act 1988

At the beginning of the 1980s, unmistakable signs of the strengthening of market economy institutions appeared. A relatively wide territory was opened for enterprises run by groups of individuals in special partnerships. It was once again possible to issue bonds as transferable instruments. The independence of State enterprises from the State itself reached a level where the rights of the State towards the wealth handled by the enterprises became nominal. In fact, the enterprises practised the ownership rights. In the majority of State enterprises, the property entrusted to the enterprise could not be withdrawn by the State, and even the directors of enterprises were not nominated by State administrative organs, but were rather elected by the workers of the enterprises.

The independence of self-governed State enterprises in circumstances of developing market relationships demanded legally regulated mechanisms for the combination of capital and other factors of production. In addition, Hungary's economy was fuelled to a great extent by loans, and servicing this debt forced the country to encourage the import of working capital. However, foreign investors were willing to invest in Hungarian economic organisations only if they were transparent, internationally-known institutions. These were the main

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reasons why it was decided to prepare a draft general Companies Act in 1987.[8]

It should not be forgotten that the political system of the country was still unchanged at this time and that nobody could have predicted that after a short time the socialist political and economic system would collapse. The new company law therefore had to take into consideration two quite different requirements. Firstly, it was expected to be a modern company law reflecting market relationships and capable of attracting foreign investors. Secondly, it had to fit into the old economic, political and ideological regime. This double task prevented the legislators from choosing a relatively simple solution, i.e. introducing the company law of the pre-socialist era as general legislation. Later, some former socialist countries resolved the lack of company law regulations conforming to market economy values by reactivating their traditional non-socialist regulations, provided that they had such a traditional body of law.[9] Such a solution was impossible in Hungary, as it would have indicated an express denial of the political system existing at that time.

Under these circumstances, the only possibility of establishing a general company law in Hungary at the end of the 1980s was by implementing a new Companies Act. In accordance with its aims, this new Companies Act[10] had two well-identifiable sources. On the one hand, it followed the patterns of the traditional capitalist company law of Hungary and, on the other hand, it incorporated the maintainable elements of the socialist company law, which, as a result of the reforms of the socialist economic system, were reconcilable with the demands of a market economy.

Of course, it was not an explicit demand at that time to keep the new Hungarian company law in harmony with European company law. Due to the political situation there was no real chance for Hungary to become a member of the European Community, so there was no direct incentive to take the requirements of European company law into consideration. In spite of these facts, the official reasoning in the proposal for the Companies Act 1988 contains the following surprising statement: 'In the course of preparation of the bill, the company law directives of the European Community known at the time of the preparatory works were taken into consideration under the given circumstances.' Was it necessary and logical to deal with European company law in a socialist country like Hungary at that time? In a sense it was. In the field of working capital imports, Hungary could count on the most developed European countries, i.e.

[8] The reasons and circumstances for enacting the Companies Act 1988 are analysed by Tamás Sárközy in Tamás Sárközy, ed., *A társasági és a cégtörvény kommentárja* [Commentary on the Companies Act and the Company Register Act], Vol. I (Budapest, HVG-ORAC 2002) p. 81.

[9] The best example is Poland, where the Commercial Code of 1934 was reintroduced at the time of the change of the economic and political system.

[10] Act No. VI of 1988, hereinafter referred to as Companies Act 1988.

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the Member States of the European Community. It was therefore justifiable to prepare a national company law that as far as possible was in harmony with the common principles of the company laws of these countries. At the same time, the rules of the Companies Act 1988 that had their origin in the traditional pre-socialist legislation were able to accommodate these principles, because – unlike the majority of socialist company law regulations – they were not incompatible with them. As a result of these factors, 'the Western European legislative experience was adopted to a greater extent than could have been expected from a companies act of a socialist country in 1988.'[11]

However, the existence of a set of rules which is not by definition incompatible with European law does not automatically entail a fully harmonised national company law. In the light of the subsequent legislative steps, the above-mentioned official reasoning behind the Companies Act 1988 seems to be an overstatement. It later turned out that Hungarian company law needed a series of amendments in order to bring it into harmony with European company law. Legal harmonisation is too complex a process to be left to spontaneous legal development. It requires a conscious, well thought-out programme.

2.3 The harmonisation programmes

The harmonisation programmes were prepared partly by the European Union and partly by the Hungarian Government. The summit of the European Union held in Cannes on 26-27 June 1995 approved recommendations in order to help the integration of the associated countries into the unified internal market of the Community. The White Paper containing said recommendations divided the harmonisation process into two phases and qualified the community company law instruments as fundamental or non-fundamental instruments from the viewpoint of harmonisation. The implementation of the First and Second Company Law Directives[12] – qualified as fundamental instruments – was recommended for the first phase of the harmonisation, while the implementation of the Third, Eleventh and Twelfth Company Law Directives[13] was left to the second phase of the harmonisation, although these Directives were also qualified as fundamental. The White Paper did not prescribe the obligatory implementation of the

[11] Peter Miskolczi Bodnár, 'A magyar társasági jog harmonizációja' [Harmonisation of Hungarian Company Law], in Peter Miskolczi Bodnár, ed., *Európai Társasági Jog* [European Company Law] (Budapest, KJK-Kerszöv 2000) p. 316.

[12] First Company Law Directive: Council Directive (EEC) 68/151; Second Company Law Directive: Council Directive (EEC) 77/91.

[13] Third Company Law Directive: Council Directive (EEC) 78/855; Eleventh Company Law Directive: Council Directive (EEC) 89/666; Twelfth Company Law Directive: Council Directive (EEC) 89/667.

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Sixth Company Law Directive,[14] qualifying it as a non-fundamental instrument.

The Fourth, Seventh and Eighth Company Law Directives,[15] dealing with annual accounts, consolidated annual accounts and statutory audits, do not belong to the area of company law in terms of the Hungarian legal system. The rules of accounting law produce legal relationships which are outside the parties' private autonomy. In these relationships, the State is in a superior position towards the companies and other business organisations. Such hierarchical relations are foreign to private law, and accounting law therefore belongs to the sphere of financial law, where the subjects and methods of regulation are quite different from civil law. Consequently, the White Paper did not require the incorporation of these Directives into Hungarian company law. They were treated in a separate chapter under the heading of accounting law. The implementation of the Fourth and Eighth Company Law Directives was scheduled for the first phase of approximation and the implementation of the Seventh Company Law Directive was scheduled for the second phase. Obviously, there was no obligation to implement directives that had not yet been enacted. However, the White Paper did identify proposed Company Law Directives[16] as non-fundamental measures.

European company law does not only consist of Directives. At the time of the conclusion of the Europe Agreement, the Council Regulation on the European Economic Interest Grouping[17] was already in force and there was also a proposal for a Council Regulation on the Statute for a European company.[18] Although Regulations do not need national legislative acts for their incorporation into national legal systems, because they are directly applicable, the White Paper referred to the Regulation on the European Economic Interest Grouping as a regulation that Hungary had to implement in the second phase of the legal harmonisation. The proposal for a Regulation on the Statute for a European company was also mentioned in the White Paper, but only as a non-fundamental measure.

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[14] Council Directive (EEC) 82/891.

[15] Fourth Company Law Directive: Council Directive (EEC) 78/660; Seventh Company Law Directive: Council Directive (EEC) 83/349; Eighth Company Law Directive: Council Directive (EEC) 84/253.

[16] Proposals for a Fifth Company Law Directive concerning the structure of public limited companies and the powers and obligations of their organs; Proposal for a Tenth Company Law Directive concerning cross-border mergers of public limited companies; Proposal for a Thirteenth Company Law Directive concerning takeover and other general bids.

[17] Council Regulation (EEC) 2137/85.

[18] In the meantime, this Proposal has been approved by Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).

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The Hungarian Government did not follow the harmonisation timetable proposed by the European Union. There was no need to split the procedure into two phases, as Hungarian company law was ready to take in the majority of the elements of European company law in one step. It is true that the first official Hungarian programme of pre-accession legal harmonisation[19] – which was approved before the acceptance of the White Paper – referred to two five-year periods, but the first period embraced all European company law legislation except for the regulation of affiliates, branches and representative offices of foreign enterprises.

In the same year, a five-year legal harmonisation programme was adopted by the Hungarian Government.[20] This programme established a more detailed schedule for the harmonisation of Hungarian company law, including the legislator's annual tasks deriving from the Europe Agreement. The plan was to implement all the Company Law Directives, except for the Eighth and Eleventh Company Law Directives, by 1997. The implementation of the Eleventh Company Law Directive was postponed until 1998. After the White Paper had come out, the Hungarian Government laid down its own tasks in connection with integration into the internal market in a new resolution.[21] In this programme, the harmonisation of Hungarian company law was set out in harmony with the White Paper. This means that the Council Regulation on the European Economic Interest Grouping appeared in the harmonisation programmes as a measure that needed to be implemented for the first time.

The above-mentioned harmonisation programmes clearly show that Hungarian legislation had quite a lot to do in order to harmonise national law with EC law and the statement that the Companies Act 1988 was in harmony with EC legislation was a slight exaggeration.

2.4 The Companies Act 1997

In 1997, the Hungarian Parliament enacted a new Companies Act.[22] Why was it necessary to replace the Companies Act 1988 by brand new legislation after less than ten years? It was not because the earlier legislation suffered from fundamental mistakes. On the contrary, it was stressed that its basic elements had satisfied expectations.[23] The new codification was justified by the legislator as follows:

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[19] Government Decree No. 2004/1995 (I. 20).

[20] Government Decree No. 2174/1995 (VI. 15).

[21] Government Decree No. 2043/1995 (XII. 12).

[22] Act No. CXLIV of 1997, hereinafter referred to as Companies Act 1997.

[23] See, for example, Tamás Sárközy, ed., *Társasági törvény, cégtörvény* [Companies Act and the Company Register Act] (Budapest, HVG-ORAC 1997) p. 14; Tamás Sárközy, op. cit. n. 7, at pp. 221-222.

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1. The Companies Act 1988 was drafted purely on theoretical basis, without any practical experience, since the companies that were to be regulated did not exist at that time. During the ten-year period of the existence and implementation of the Companies Act 1988, several new questions emerged which were answered by the courts. Some of the principles elaborated by the courts were ripe enough to be transformed into positive norms. The courts' practice also revealed that some provisions of the Companies Act 1988 were unworkable and therefore needed to be changed.
2. As already noted, the Companies Act 1988 was one of the first legislative acts to be adopted after the economic changes that laid the foundations for the complete transformation of the economic and political system. Consequently, a great number of fundamental laws influencing the legal environment of companies[24] were enacted after the adoption of the Companies Act 1988. The result of this situation was that some of the later legislative acts were not in harmony with the new company law legislation. This contradiction should have been resolved partly by amending the existing company law.
3. Among the reasons for the new Act, it was also mentioned that full compliance with European company law made further adjustment of national company law rules necessary. The main areas of adjustment included the regulation of one-man companies and the conditions applying to companies for obtaining their own shares. The aim of the new Act was to strengthen the protection of creditors in said field of regulation.

As a result of the above-mentioned reasons, the legislator came to the conclusion that a new Companies Act was necessary, although the basic principles and structure of the earlier Act should be preserved. As far as legal harmonisation is concerned, the new Companies Act aimed to implement all the Company Law Directives belonging to the field of company law as defined in the Hungarian legal system. The results can be found in Section 321 of the Companies Act 1997, which provides that the Act contains rules consistent with the First, Second, Third, Sixth and Twelfth Company Law Directives, i.e. with all Company Law Directives in force except those which were implemented by means of national financial law regulations (i.e. the Fourth, Seventh and Eighth Company Law Directives).

2.5 After the Companies Act 1997

One could be forgiven for thinking that after two Companies Acts, both of which were deemed compatible with European company law, Hungarian legis-

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[24] For example, the Securities and Stock Exchange Law and the Accounting Law.

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lators would have nothing left to do in the field of the approximation of company law. However, it turned out that the harmonisation was still not perfect. Government Decree No. 2099/2002 (III.29) ordered a revision of the Companies Act 1997 in order to achieve full harmony between Hungarian and European company law. This project qualifies the results of the Companies Act 1997 and questions whether the full compliance referred to in Section 321 was real.

Incompleteness of harmonisation appeared partly in rules that were in direct conflict with the European Company Law Directives and partly in rules overshooting the target, i.e. which also applied the requirements of European company law to those types of companies that were originally outside the scope of the Directives.[25] The necessary amendments of the Companies Act 1997 were carried out in 2003.[26]

One might think that with these amendments the harmonisation of Hungarian company law came to an end. Such a presumption would be wrong, however, as Hungary is currently in the process of elaborating a new Companies Act.[27] The situation is quite similar to the introduction of the Companies Act 1997. In spite of the fact that there is no need to alter the principles and basic institutions of current company law, a new Companies Act will be enacted simply because of the relatively large number of norms that need to be modified. This modification will also touch rules that serve the implementation of European company law. Of course, the new companies act will fulfil all the European requirements, but in certain fields of regulation the implementation of European Directives will take place in another way. It may also happen that some modifications introduced by the previous Companies Acts will be abolished and that previous regulations will be reintroduced by the new Act.

3. Share capital regulation

One of the most important areas of the harmonisation of company law regulations within the European Community is the regulation of the share capital of public limited liability companies. It was widely believed that freedom of establishment would only obtain if the requirements of the Member States in connection with the formation, maintenance, increase or decrease of share capital were

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[25] On the inadequacy of the Companies Act 1997, see Gábor Gadó, 'A társasági vagyon szolgáltatására és védelmére vonatkozó közösségi jogi követelmények – Javaslatok a hazai részvényjog módosítására' [Community Requirements in Connection with Providing and Maintaining Share Capital – Proposals for Modification of National Regulation on Companies Limited by Shares], 11 *Gazdaság és Jog* (2003) pp. 3-4.

[26] Act No. XLIX of 2003.

[27] A codification committee was set up in 2003. This committee prepared a draft version of the new Act.

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coordinated. The scope of the coordination established by the Second Company Law Directive was limited to public limited liability companies, because the activity of these companies predominated in the economy of the Member States and because such companies pursued cross-border economic activity. These factors made share capital regulation a primary object of harmonisation in the European Union and provides a good illustration of how Hungarian company law was approximated to European company law.

Of course, the harmonisation process could be traced in any area of European company law, since Hungarian company law has now completed the approximation process. However, an examination of all aspects of company law harmonisation or even all aspects of the harmonisation of share capital regulation would exceed the scope of this article.[28] I believe that share capital regulation provides a good illustration of the approximation process because:

- it is a central aspect of the European company law regulation;
- it went through several modifications in national legislation; and
- the information concerning some of the current Hungarian rules in this area may shed some light on certain characteristics of Hungarian company law as a whole and may be of practical importance.

3.1 **Minimum capital requirements**

One possible way to establish equilibrium between the advantage of the limited liability of the companies' members and the interests of company creditors is to introduce minimum capital requirements. However, if one country applies this tool while the other does not, or if the amounts vary significantly in the different Member States of the Community, then the divergent requirements can adversely affect the freedom of establishment.

The minimum capital requirement of the Second Company Law Directive (Article 6) was not unfamiliar for Hungary, as traditional Hungarian company law already contained rules on the minimum capital of companies limited by shares and limited liability companies. Thus the Companies Act 1988 not only accepted the European rules, but continued the national legal tradition when it

[28] For a more comprehensive description and evaluation of Hungarian company law harmonisation, see András Kisfaludi, 'Jogharmonizáció a kereskedelmi társaságok jogában' [Harmonisation of Company Law], in Lajos Vékás, ed., *Európai Közösségi jogi elemek a magyar magán és kereskedelmi jogban* [Some Elements of European Community Law in Hungarian Private and Commercial Law] (Budapest, KJK-Kerszöv 2001) pp. 99-246; or András Kisfaludi, 'Harmonisierung im Recht der Handelsgesellschaften', in Lajos Vékás and Marian Paschke, eds., *Europäisches Recht im ungarischen Privat- und Wirtschaftsrecht* (Münster, LIT Verlag 2004) pp. 85-267.

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prescribed that companies limited by shares and limited liability companies must have a certain minimum amount of capital. The Companies Act 1997 introduced a two-level regulation. Demonstrating the characteristics of a classical codex, the Act has a general part that contains rules applicable to all forms of companies, while the remaining parts of the Act regulate special types of companies. In 1997, a rule on the minimum capital appeared in the general part. This rule was an enabling one, stating that any act can determine a minimum capital requirement in connection with companies operating under the limited liability of its members.[29] In this norm, the Act expressed a clear link between liability regimes and minimum capital requirements. Nevertheless, this link was quite clear from the judicial practice even before the new Companies Act.

For example, there were attempts by first instance courts of registration to use a capital adequacy test in the case of limited partnerships to and refuse the incorporation of those firms that had less capital than would have been desirable in the court's opinion, taking into consideration the scope of the activity of the firm in question. However, the Supreme Court put an end to this, arguing that the court of registration only had the right to decide whether the company had complied with all the statutory rules,[30] but that it was outside the court's competence to examine whether the capital provided by the partners was enough for carrying out the company's activity.[31] Consequently, under-capitalisation is not a basis for refusing the registration of a company having at least one member who bears unlimited liability for the company's debts. The logic of this limitation is that, in the case of a company's failure, the creditors can claim the payment from the members and in this way their interests are sufficiently protected.

For the creditors of companies limited by shares and limited liability companies share capital – instead of shareholders' liability – can provide some security. It therefore becomes a crucial question how much share capital there is. According to the Companies Act 1988, a newly formed company limited by shares must have at least HUF 10,000,000 as share capital, while the minimum for limited liability companies was HUF 1,000,000. The amounts of minimum capital were increased by the Companies Act 1997 to HUF 20,000,000 and HUF 3,000,000 respectively.

If we want to answer the question whether these sums are too low, adequate or too high, we have to find a proper basis for comparison. The amount of minimum capital is adequate only if it reflects the scope of the business activities carried out in a certain type of company. The problem is that companies with limited shareholder liability are quite a flexible form of business organisation.

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[29] Section 12(2) of the Companies Act 1997.

[30] See Section 11 of the Companies Act 1988 or Section 46 of the Companies Act 1997.

[31] Hungarian Supreme Court, Cgf. II. 30848/1992, *Bírósági Határozatok* [Court Reports] 1994/92.

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Enterprises of very different sizes can choose the same company form and – exploiting the flexible legal rules – operate successfully. How is it possible then to find a proper amount of minimum share capital which could be applied universally to all companies that have adopted the same form? The problem is even greater when examined from an international dimension, because the structure of economic systems of different countries are different, with some company forms playing traditionally different roles in different country. Is it possible then to determine a uniform minimum capital requirement which has real meaning in all countries where such a requirement is applicable? I am afraid that it is not entirely possible. In Hungary, there has been no profound research to determine the real basis of minimum capital requirements. The first amounts were determined more or less arbitrarily.[32] The increase in the minimum amounts introduced by the Companies Act 1997 hardly compensated for the effects of the inflation between 1988 and 1997, so it did not reflect a change of attitude towards minimum capital requirements.

From the viewpoint of the European Community, the Hungarian regulation was in harmony with the requirements of the Second Company Law Directive. Among Hungarian companies, the Directive is applicable only to companies limited by shares. The minimum capital of these companies was set so high by both Companies Acts that it exceeded the sum of €25,000.[33] However, even this relatively high sum cannot provide sufficient guarantees to the creditors of all companies limited by shares. There are some special activities in relation to which the legislator cannot be content with the general requirements and requires a much higher sum of minimum capital. For example, a bank operating in the form of company limited by shares must have share capital of at least HUF 2,000,000,000.[34]

3.2 What kind of assets can cover the share capital?

It would be useless to regulate the minimum amount of capital if the nature of the assets that can make up this capital are left put of consideration. Furthermore, if companies in the Member States were allowed to base their share capital on different assets, then countries with less strict regulations would attract companies, while countries with more demanding rules would discourage the foundation of companies. As a result, freedom of establishment would be harmed.

[32] The amounts determined in the former regulation were simply doubled without giving any valid explanation for these changes.

[33] €25,000 is worth less than HUF 7,000,000 under the current official foreign exchange rate fixed by the Hungarian National Bank.

[34] Section 9(1) of Act No. CXII of 1996 on credit institutions and financial enterprises.

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The Second Company Law Directive defines what kind of assets can be accepted as share capital in a company limited by shares and deals specifically with the problem of in-kind contributions. It is easy to understand that, in the case of companies where the shareholders bear only limited liability, the company's creditors can find coverage for their claims exclusively in the assets of the company. Therefore, it is a sensible question what kind of assets the shareholders can transform into company assets. With regard to the other types of company, one might think that the liability of the members for the company's debts makes it unnecessary to regulate what can be transferred to the company as a contribution to share capital, since the whole private wealth of the members serves as coverage for the creditors' claims, regardless of whether certain parts of the members' property were given to the company or not. However, Hungarian company law had to regulate the question of contribution to share capital in connection with all types of company for at least two reasons. Firstly, though the regulation has primary importance for the relations between shareholders and creditors, it is also relevant to inter-shareholder relations, as it makes a difference to a shareholder what the other shareholders' contributions consist of. Secondly, it was foreseeable that the economic situation in Hungary would be characterised by deficiency in the capital available to companies. The nature of the assets acceptable as capital contributions therefore needed to be determined by law.

The original version of the Companies Act 1988 contained only one general rule on the nature of the capital contributions. It stated that apart from monetary contributions members could transfer to the company transferable objects having material value, intellectual property or rights having material value.[35] This norm was applicable to all types of company, in particular companies limited by shares. Thus, the requirement determined by Article 7 of the Second Company Law Directive was met by the Hungarian Companies Act 1988 at least from the viewpoint of creditor protection. The Hungarian regulation did not allow more than the Directive, but I do not think that the national regulation was more restrictive. It is true that the Directive applies only one general criterion in relation to capital contributions, i.e. the capability of economic assessment, while the Hungarian regulation introduces more elements to the definition. Nevertheless, the effects of the two regulations were more or less the same. The Hungarian regulation emphasises the criterion of transferability, but this is somewhat self-evident, since the capital contribution must be transferred by the shareholder to the company. Assets that are not transferable can thus not be used as capital contributions. Furthermore, the notion of assets, excluding undertakings to perform work or supply services, covers the entire range of objects and rights, i.e. the elements of the Hungarian definition.

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[35] Section 22(2) of the Companies Act 1988.

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However, the Hungarian regulation did not reflect the differences between companies with limited and unlimited shareholder liability. In practice, it turned out very quickly that the above-mentioned rule was too permissive in the context of the existing Hungarian economic and social circumstances. It often happened that newly formed companies went bankrupt after a short period of activity, and it then emerged that the assets of the company were not fit for providing coverage for the creditors' claims. The need for a more efficient protection of creditor interests led to the modification of the Companies Act 1988. The amendment came into force in 1992.[36] The regulation of limited liability companies and companies limited by shares was then amended by a uniform provision stating that in these companies only those assets could constitute share capital which, in addition to complying with the general requirements (which were left unchanged), could be made subject to the judicial enforcement of awards and which, after having been transferred to the company, the company has an unlimited right to transfer to a third party without the need for a licence or the consent of any other party.[37]

After this amendment, the rule applicable to companies limited by shares, which consisted of a mixture of the general and special additional rules, became stricter than anticipated by the Directive, since the criteria introduced by the amendment implied restrictions on the assets acceptable as capital contributions. These restrictions were deliberate and were aimed at the protection of creditors. The restrictive regulation was eased a little by the judicial practice of saying that if the third party whose consent is needed for the transfer of the asset that had been transferred to the company by a shareholder as a capital contribution gives its consent in advance, i.e. before the transfer of the asset to the company, then the asset in question can be accepted as a capital contribution.[38] However, this relaxation did not end the deviation of Hungarian legislation from the Directive.

The new Companies Act did not bring crucial changes in the field of the regulation of in-kind contributions, though the technique of codification was altered. The criteria governing contributions to the share capital of companies limited by shares were determined by an independent special rule,[39] which combined in itself the general and special rule of the previous Companies Act. The rule was supplemented by the principle that an asset can be accepted as a share capital contribution if the third party who has some right to this asset gives its consent in advance. The existing court practice thus became positive law. It is

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[36] Act No. LXV of 1991 on the modification of the Companies Act 1988 came into force on 1 January 1992.

[37] Sections 161(3) and 253(1) of the Companies Act 1988, as amended by Act No. LXV of 1991.

[38] Tamás Sárközy, ed., *A társasági törvény magyarázata* [Commentary on the Companies Act] (Budapest, Közgazdasági és Jogi Könyvkiadó 1993) p. 367.

[39] Section 208(2) of the Companies Act 1997.

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also worth noting that the regulation was the same for limited liability companies and companies limited by shares.[40]

It is quite obvious that the character of the regulation focused on restriction, in order to provide as much security as possible for company creditors. The restrictive character of the Act oozed through the courts' practice. In 2000, the Supreme Court published an award[41] in which it refused to register a company whose corporate contract contained a provision under which one of the parties was obliged to transfer to the company a claim for money which was based on a contract. The Court argued that such a claim was so uncertain that it could not form part of the share capital because, if the company did not succeed in collecting the money, the creditors of the company would have no coverage for their claims against the company. In my opinion, this award could not be deduced from the words of the Act. The uncertainty of the above-mentioned claim could have been taken into consideration in the valuation of the in-kind contribution, but not in the qualification of the asset, because a contractual claim for money meets all the requirements established by the law concerning share capital contributions.

As described above, the changes in the regulation and practice of share capital contributions indicated a permanent move towards rigidity, while the relevant rule in the Company Law Directives remained unchanged. Can this process be justified and was it acceptable in the light of the European regulation? This question had not been asked before 2003, when the last great modification of the Companies Act 1997 took place, but a new approach subsequently emerged which urged a more subtle examination of the real meaning of the Directive. It was thus asked whether Article 7 of the relevant Company Law Directive contained a so-called minimum rule determining only a minimum level of creditor protection, leaving the Member States ample room for manoeuvre to make laws stricter than the minimum standard.[42] The answer was that Article 7 is not a minimum rule and that the national regulation of in-kind contributions therefore cannot be as strict as the Member States would like.[43]

Since the Hungarian regulation was more restrictive than the Directive, the modification of national rules became inevitable. At the same time, the legislator decided to break with the tradition of regulating the in-kind capital contributions of limited liability companies and companies limited by shares in the same

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[40] See Section 124(3) of the Companies Act 1997, which is identical word for word with Section 208(2).

[41] *Bírósági Határozatok* [Court Reports] 2000/5, 213. The case was connected to a limited liability company. However, since the rules are the same for limited liability companies and companies limited by shares, the findings of this award are also valid for companies limited by shares.

[42] See Gábor Gadó, loc. cit. n. 25, at p. 4.

[43] The argument was based on Case C-83/91 [1992] of the European Court of Justice, in which the Advocate General expressed this view. See Gábor Gadó, loc. cit. n. 25, at p. 4.

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way. Since the Directive is applicable only to companies limited by shares, the national regulation was adjusted to the Directive only in respect of this type of company. The new rule of the Companies Act 1997[44] provides that the shareholders of a company limited by shares can transfer to the company as a capital contribution only objects having material value, intellectual property, rights having material value and claims recognised by the debtor or established by an effective court award. However, the same rule states that commitments made by the shareholders or by the promoters to perform work, other forms of personal cooperation or services cannot be accepted as share capital contributions. It is striking that the Hungarian rule became very similar to the wording of the Directive, but there is a small difference. The Directive does not specify whose undertaking to perform work or supply services cannot be accepted as capital contributions, while the Hungarian Companies Act 1997 narrows the scope of the rule to the undertakings of shareholders or promoters. Does it mean that work or services offered by other persons could be accepted as share capital contributions? Since the rule is quite new, we do not yet have an answer from the court practice. However, such an interpretation would give too wide a range of opportunities to form share capital from assets which cannot provide real coverage for company creditors. This would certainly run counter to the intention of the Directive. I therefore believe a restrictive interpretation of the new national rule would be the proper solution to this new contradiction between European and Hungarian company law. It should be noted that the new regulation was intended to put an end to the situation in which the Hungarian rule was stricter than the Directive, but in doing so it has introduced a rule that allows room for an interpretation under which the national rule is again in contradiction with the Directive. However, the deviation is now in the opposite direction: the rule is not stricter, but less restrictive than anticipated by the Directive. This situation could be resolved by means of an appropriate court practice.

The new rule dropped the earlier requirement of transferability from the definition of in-kind capital contributions. In my opinion, as already mentioned, an asset which is not transferable cannot form a share capital contribution, because it cannot become the property of the company. Transferability is therefore still an implied requirement in relation to in-kind contributions, irrespective of the fact that the relevant rule does not refer to it expressly. In contrast, the conditions of suitability as a subject of the judicial enforcement of court awards and the capability of being transferred without the consent of any third party was really left out of the new rule. However, the presence or lack of these characteristics can be taken into consideration in the valuation of in-kind contributions.[45]

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[44] Section 208(2), as amended by Act No. XLIX of 2003, effective as of 1 January 2004.
[45] See Gábor Gadó, loc. cit. n. 25, at pp. 5-6.

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As a result of the new regulation, one more discrepancy has emerged. It was a conscious ambition of the legislator not to apply European company law regulation to those forms of company which are not subject to it. Therefore, the new regulation of in-kind capital contributions is valid only in relation to companies limited by shares, while the relevant regulation concerning limited liability companies remains unchanged. This has resulted in a situation in which stricter rules are applied to a small, family-owned limited liability company than to a company limited by shares with a huge amount of capital and a wide range of economic activities that can run up large company debts and consequently poses a much greater risk to creditors than small companies. The elimination of this difference is already on the agenda. The Principles and Proposals for a new Companies Act have already identified this aim. However, for lack of concrete proposals on how this aim is to be achieved, we cannot predict whether the regulation of the limited liability companies will be eased or whether the regulation of companies limited by shares will become stricter again.

3.3 The time of payment and transfer of share capital contributions

In the case of companies operating without the personal liability of shareholders, the assets of the company provide the only coverage for creditors' claims. At the time of the foundation of the company, these assets come from the shareholders, so it is of great importance when shareholders are obliged to perform their capital contributions. Article 9 of the Second Company Law Directive provides that shares issued for a consideration must be paid up at the time the company is incorporated or is authorised to commence business at not less than 25 per cent of their nominal value or, in the absence of a nominal value, their accountable par.[46] In the case of shares issued for a consideration other than in cash, the consideration must be transferred in full within five years of the time of incorporation or authorisation to commence business.

From the outset, the Hungarian legislation was stricter than the Directive, although the level of deviation has changed. The Companies Acts determined the minimum amount of capital paid in at the time of the foundation of the company, by offering shares to the public at the time of incorporation, and the final time limit for transferring the total share capital in respect of cash and non-cash contributions. Within the statutory time limits, the shareholders had the right to fix the time of payment or transfer in the articles of association. The Companies Act 1988 prescribed the payment of at least 30 per cent of cash considerations by the time of incorporation. The shareholders were obliged to pay in the remaining sum and transfer the non-cash contributions within one

[46] Under Hungarian company law, only shares with a nominal value can be issued.

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year after the incorporation of the company.[47] In this respect, companies limited by shares differed to a great extent from limited liability companies, where shareholders had to transfer non-cash contributions in full prior to the incorporation. The reason for allowing the transfer of in-kind capital contributions after the incorporation was that a newly formed company normally expands its economic activity gradually and that it therefore does not need all the assets coming from the shareholders at the time it commences its business.

Although the cited provisions of the Companies Act 1988 went through some modifications, the basic structure remained unchanged: payment of 30 per cent of cash contributions was a condition of incorporation, but the remaining part of the subscribed capital was payable within one year after the incorporation. Taking into consideration that the proportion of in-kind contributions could extend to as much as 70 per cent of the share capital, this regulation gave shareholders a relatively wide latitude in scheduling the transfer of share capital contributions. This situation was altered by the Companies Act 1997. In order to strengthen the position of the company's creditors, the new Act introduced a regime under which companies limited by shares could be incorporated only if at least 30 per cent of the cash capital contribution or HUF 10,000,000 – if 30 per cent is less than this sum – was paid in and if the non-cash contributions were transferred to the company in full.[48] This was a great step backwards. It was not justifiable from economic point of view, because for a company coming into motion gradually, it was a burden to handle the total amount of in-kind capital contributions from the very beginning. As to European company law, the new Companies Act moved away from the common standards. Earlier, the Hungarian regulation had granted one year instead of a maximum of five years after incorporation for transferring non-cash contributions. The new rule even removed even shorter period.[49]

The realisation of the drawbacks of this unduly rigid regulation made it necessary to think about some modification. It was held that the introduction of a regulation giving as much freedom to shareholders in this field as allowed by the Directive would cause an unbearable shock in Hungary and that it would therefore be more advisable to approach this end step by step.[50] The first step was taken in 2003, when an amendment of the Companies Act 1997 made it possible for shareholders to transfer in-kind share capital contributions within five years of the incorporation of the company, provided that the proportion of

[47] Sections 262(2)b and 264(1) of the Companies Act 1988.
[48] Sections 211, 216(3), 219(2) and 222(1) of the Companies Act 1997.
[49] I have criticised this new regulation using detailed arguments in Lajos Vékás (2001), op. cit. n. 28, at pp. 158-159.
[50] See Gábor Gadó, loc. cit. n. 25, at p. 8.

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such contributions in the total share capital is less than 25 per cent.[51] In my opinion, this is an important development, although it seems a little contradictory that if the non-cash contributions exceed the above-mentioned figure of 25 per cent by the smallest amount, the advantage of postponed transfer is lost completely. If the conditions of the advantageous rule do not apply, the total in-kind contribution must be transferred before the incorporation of the company.

I can only hope that the rule introduced by the amendment was really just the first step in a process that will be continued by other steps towards achieving the maximum freedom allowed by the Directive.

3.4 Acquiring assets from shareholders

It would be useless to make efforts to determine the amount and nature of share capital contributions and to fix a deadline for their transfer to companies if after the foundation of the company it was possible to exchange the company's assets for shareholders' assets, which are not acceptable as a capital contribution during the formation of the company. Article 11 of the Second Company Law Directive established certain limitations in this respect. The essence of the regulation is that some transactions between the company, on the one hand, and natural or legal persons or companies or firms by whom or in whose name the statutes or the instrument of incorporation (or their drafts if the company was not formed at the same time) have been signed or the shareholders or any other person specified by the national legislation, on the other hand, are subject to the approval of the general meeting if the company by this transaction aims to acquire assets for consideration of no less than one-tenth of the subscribed capital. In such cases, the assets to be transferred by the transaction shall be examined and details of them shall be published in the same way as provided for in the case of capital contributions in the course of the foundation of a company. This regulation is valid only within a certain time limit that can be determined by national legislation but may not be less than two years.

Though this regulation was not unprecedented in Hungarian company law, because the Commercial Code of 1875 contained a similar rule, the Companies Act 1988 did not deal with this problem.[52] This subject matter was only touched upon again in the Companies Act 1997, but then the Hungarian legislation somewhat overshot the target in certain respects. The new rule ordered companies to submit for the approval of the general meeting any transaction between a company limited by shares and its shareholders, or the shareholders' close rela-

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[51] Section 222(1) of the Companies Act 1997, as amended by Act No. XLIX of 2003, effective as of 1 January 2004.

[52] This is one more example of the fact that the Companies Act 1988 was not in full harmony with European company law.

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tives, if by this transaction the company acquires assets for consideration in an amount exceeding one-tenth of the share capital of the company. In the course of the approval of the transaction, the rules on evaluation and expert examination of in-kind contributions shall be applied.[53] At first glance, it is striking that this rule does not contain a time limit, i.e. said transactions are subject to the approval of the shareholders' meeting at any time during the existence of the company. In my opinion, this regulation did not comply with the requirement of the Directive. The Directive envisaged a deadline for applying the rule. Consequently, the absence of such a deadline in the national legislation was against European law. Furthermore, the Hungarian regulation did not implement those exceptional rules which do not allow the application of the general rule of Article 11 of the Directive if the transaction is under administrative or public market control and therefore does not involve any danger of abuse.[54] Another mistake of the Hungarian regulation was that it only covered transactions concluded with the shareholders, while the Directive refers to a broader circle of relevant persons. The promoters of the company are very likely to belong to this broader circle, but the Companies Act 1997 did not include them. Finally, it was not clear from the wording of the rule whether the shareholders' meeting is meant to approve the transaction before or after it is concluded.

As a result of these problems, the need to modify these rules emerged in 2003 and new rules came into force on 1 January 2004. The current regulation establishes a two-year period – commencing on the date of incorporation – during which transactions need the prior consent of the general meeting.[55] This period can be extended by the articles of association for as long as the shareholders like. The new version of the rule is applicable not only to the shareholders' transactions but also to the promoters' transactions. While this amendment broadens the scope of the rule, another amendment constitutes a move in the opposite direction. Under the new regime, not all shareholders are subject to the regulation, but only those that own at least 10 per cent of the voting rights in the company. The reasoning behind this modification was that shareholders with less voting power cannot successfully and decisively influence the company's decision making and that their transactions therefore cannot effect any abuse. The Act allows companies to specify a lower percentage of voting rights under which shareholders' transactions fall under the scope of the statutory rule. With regard to persons whose transactions may involve the application of this rule,

[53] Section 224(3) of the Companies Act 1997.

[54] Art. 11(2) of the Second Company Law Directive specifies the following exceptions:

- acquisitions effected in the normal course of the company's business;
- acquisitions effected at the instance or under the supervision of an administrative or judicial authority; and
- stock exchange acquisitions.

[55] Section 211/A of the Companies Act 1997, as amended by the Act No. XLIX of 2003.

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there is one more innovation. Apart from promoters, shareholders (that have the necessary voting power) and their close relatives, the transactions of companies limited by shares or limited liability companies are also relevant if the promoters or shareholders have direct or indirect influence. Such influence may be based on

- the acquisition of shares representing more than 50 per cent of the voting rights;
- the fact that the shareholder has the right to elect or dismiss the majority of the board of directors or the supervisory board; or
- an agreement concluded by other shareholders that covers more than 50 per cent of the voting rights.[56]

Finally, the new regulation introduces the exceptional provisions of the Directive into Hungarian company law. That means that the above-mentioned rules shall not be applied

- if the transaction is effected in the normal course of the company's business and the value of the transaction does not exceed the normal value of such transactions;
- if the acquisition is ordered by an administrative decision or takes place through auction; or
- if the transaction involves a stock exchange acquisition.[57]

4. Conclusions

I believe that the above analysis proves that the harmonisation of Hungarian company law with European company law was not a straightforward process. The reason for its pendular nature was that the Hungarian legislator had to meet two sets of requirements at the same time: implementing European company law into the Hungarian legal system and resolving specific national problems in the field of company law. This dichotomy of expectations caused relatively quick changes of the same rule in different directions. When the approximation of Hungarian law to European law was accentuated, the legislator tried to implement the norms of the Company Law Directives as precisely as possible. When the demands for more effective creditor protection emerged in the newly established Hungarian market economy, these demands overtook the task of

[56] Section 226/F of the Companies Act 1997, as amended by the Act No. XLIX of 2003.
[57] Section 211/A(4) of the Companies Act 1997, as amended by the Act No. XLIX of 2003.

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harmonisation. This was all the more so, because it was generally held that the aims of the Directives could be achieved by rules pointing at these aims, no matter how rigid they were. It was during the third or fourth wave of company law legislation that a more sophisticated approach appeared, which aimed to meet the specific Hungarian requirements by exploiting the flexible approach of European company law.

It may be concluded from the development of Hungarian company law harmonisation that this process has not been completed once and for all. As the economic and social circumstances change the Hungarian legislator will have to adjust the law to the new requirements. The adaptation process can touch even those areas of company law which are under the influence of European law. Thus, harmonisation is a permanent and dynamic process, in which national law complies with European law in different ways. The different rules laid down in national law do not necessarily satisfy the European requirements on the same level, even if the legislator endeavours to find Euro-compatible solutions.

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