

Regulations on the status of
executive officers under the
chapter of the new Civil Code
on corporate law
Legal newsletter



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From now on, Szarvas, Falcsik and Partners Law Firm, a member of Deloitte Legal's international network, will provide its clients with a monthly newsletter on the most recent changes and newly adopted regulations in economic law and the most notable legal cases.

As the new Civil Code, the first one drafted since the regime change, will enter into force as of 15 March 2014 and will affect nearly all areas of the economy, in the coming months we will devote several editions of our newsletter to the rules of the new Code.

Deviation from corporate law

As opposed to the binding nature of the currently effective Companies Act, the Civil Code entering into force on 15 March 2014 (which will include regulations on companies as well) will contain non-binding regulations, which means that, apart from certain exceptions, deviations from its provisions will be permitted unless such deviation is expressly forbidden by the Code. This new legislative approach will allow entities to adjust conventional management structures to fit their own needs, for instance.

Board of directors in a limited liability company?

“...the concept of a "management board" in limited liability companies... could become widespread in Hungary as well”

The new Civil Code will adopt the provision of the effective Companies Act which provides that limited liability companies may be represented by a managing director, a company manager or an authorised employee. In particular, many owners of Hungarian companies with foreign parent companies (who are used to systems involving a board of directors) have indicated a need for a corporate body to be allowed to represent limited liability companies, an option that is currently unavailable under the Companies Act. However, the new non-binding regulations allow companies to deviate from certain rules on the representation of companies and, therefore, the concept of a "management board" in limited liability companies (similar to the board of directors in a company limited by shares) could become widespread in Hungary as well.

The option to deviate from the rules in the Civil Code will also mean that companies could appoint company managers who are not employed by the given entity. On the one hand, this opens up another window of opportunity for foreign-owned companies to appoint officers from the parent company as company managers. On the other hand, Hungarian groups of companies may also benefit from this change since an officer employed by one member of the group would not need to be employed by another member of the group simply to allow him/her to act as a company manager in that other member.

Restriction of the representation right

Also, in practice, company owners have often shown a need to ensure that, for certain deals, executive officers require their explicit approval, or, in certain cases, to completely forbid representatives to close deals. Thus, for instance, it is typical that substantial deals can only be signed by an executive officer subject to explicit approval by the company's main decision-making body. Under the currently effective Companies Act, restricting the representation right of executive officers towards third parties with legal force is currently not possible. This means that although the company's owners may require executive officers to obtain their approval before signing a deal, the company will be forced to comply with its contractual obligations even if the representative acted and signed the contract without the necessary approval.

As a general rule, the restriction of the representation right in relation to third parties will remain prohibited under the new Civil Code as well, but with a notable exception: such restriction will be effective if the third person was aware or should have been aware of it. It is expected that this new regulation will raise many questions in terms of interpretation as the law does not provide details on how the third party should learn about such restrictions. This piece of information is not currently recorded in the Company Register, meaning that if business partners want to be on the safe side, they must examine all company papers, which would significantly delay the conclusion of contracts. Foreign partners may find it particularly difficult to obtain company papers and to construe Articles of Association or General Meeting resolutions written in Hungarian.

Thus, the above provision of the Civil Code attempts to address a long-existing need, but without clarification on the details, it could only make deals more difficult to finalise.

Joint and several liability towards third parties

Under the currently effective provisions of the Companies Act, an entity is responsible to third parties for the damages caused by one of its executive officers acting in his/her capacity as such. The judicial practice has already adopted a stricter interpretation of this rule when executive officers were held personally liable in cases when they caused damage by committing a crime.

“...if an executive officer causes damage ... he/she will have joint and several liability with the company”

Under the provisions of the new Civil Code, if an executive officer causes damage to a third party in his/her capacity as such, then he/she will have joint and several liability with the company for such damage, which means that the injured party may claim compensation for damages from either the company or the executive officer. This implies considerably stricter rules for executive officers who, up until now, have been directly liable to third parties for damages caused in their managerial capacity typically in cases of the company's insolvency. This new rule will hopefully foster responsible management, although the widespread use of joint and several liability may, in certain cases, cause corporate officers to become overly careful. It is also possible that management liability insurances, an option widely used in Western countries, will become more common.

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Contact

If you have any questions or comments concerning the above, please contact our experts below:

Dr. Attila Kövesdy

Partner in Charge, Tax

Deloitte Co. Ltd.

Tel : +36-1-428-6800

Email : akovesdy@deloitteCE.com

Dr. Júlia Szarvas

Lawyer – Partner Associate

Szarvas, Falcsik and Partners Law Firm

Tel : +36-1-428-6465

Email : jszarvas@deloitteCE.com

Dr. Anna Katalin Papp

Lawyer – Senior Associate

Szarvas, Falcsik and Partners Law Firm

Tel : +36-1-428-6736

Email : apapp@deloittece.com

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