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CORPORATE DEVELOPMENT IN EMERGING NATIONS: HUNGARY

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I. HEAVY DUTY IN HUNGARY

We have set forth below a summary history of Heavy Duty, in which we have imagined what might have happened to a typical Hungarian company through the political changes of the last decade.

Heavy Duty is a meat processing company. Its most famous product is a classic Hungarian salami, made according to a secret formula. Heavy Duty ships its salamis, sausages and other meat products worldwide. It is also involved in domestic production of fresh pork and beef, raising livestock, operating a slaughterhouse and processing meat products.

Heavy Duty was formed in 1926 by the Heavy Duty family. It was set up as a company limited by shares under the Hungarian Commercial Code of 1875. The Heavy Duty family contributed all of the capital and controlled all of the outstanding shares.

In 1948, after the Communist Party came to power in Hungary, Heavy Duty was nationalized and became a state-owned enterprise. From 1948 to 1990, virtually all business in Hungary was performed through state-owned enterprises. The Heavy Duty family left Hungary and settled in the United States.

In 1977, all Hungarian state-owned enterprises became managed by workers' councils. The workers' council was the ultimate governing body of Heavy Duty. The council had forty members, twenty of whom were elected by the employees. The remaining twenty were appointed by the Minister of Agriculture, who was the government official responsible for supervising all agricultural enterprises. Heavy Duty had one general manager and several deputy directors.

After the fall of Communism in 1990, the State Property Agency (the "SPA") was created as a government agency to hold the government's

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interest in many of its assets.[1] The SPA's explicit objective was to transform state-owned enterprises into business entities and then to privatize them.[2]

Effective January 1, 1991, the SPA transformed Heavy Duty from a state-owned enterprise into a limited liability company, named Heavy Duty Ltd. The transformation was carried out in accordance with the Transformation Act,[3] which set forth detailed procedures to be followed for such a transformation. Heavy Duty was established pursuant to Act VI of 1988 on Business Entities (the "Companies Act") with a registered capital of Hungarian forints ("HUF") 2.5 billion (approximately U.S. $16.7 million).

As required by the Transformation Act, all the interests, known as quotas, of Heavy Duty Ltd. were initially acquired by the SPA.[4] However, the SPA was then required to transfer a quota to the City of Hope equivalent in value to the land owned by Heavy Duty Ltd. and located in the City of Hope.[5] The City of Hope's quota then represented twelve percent of Heavy Duty Ltd.'s registered capital.

As a limited liability company under the Companies Act, the capital of Heavy Duty Ltd. was represented by quotas rather than shares.[6] Heavy Duty Ltd. had two quotaholders; the SPA and the City of Hope. The liability of the holders was limited to the value of their quotas.[7] The meeting of quotaholders was the supreme body of corporate governance.[8] The quotaholders meeting had exclusive competence to make decisions on the approval of balance sheets and the distribution of profits; the increase or decrease of the registered capital; any amendment of the constituent document (which was called a Contract of Association); the appointment

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1. Act VII of 1990 on the State Property Agency and on the Management and Utilization of Property Belonging to its Scope, as amended by Act LIII of 1990, *translated in* 2 Hungarian Rules of Law in Force, Issue 3-4, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter State Property Act].

2. *Id.*

3. Act XIII of 1989 on the Conversion of Economic Organizations and Business Associations [hereinafter Transformation Act]. In 1992, the Transformation Act was incorporated into Act VI of 1988 of Business Associations, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Companies Act].

4. Transformation Act, § 21(1).

5. Transformation Act, § 21(2).

6. Companies Act, § 169.

7. Companies Act, § 169(1).

8. Companies Act § 183(2)(1).

and removal of the managing director, members of the supervisory board and the statutory auditor and the amount of their remuneration; the expulsion of any quotaholder; the merger, demerger, termination or liquidation of Heavy Duty Ltd.; and any contracts with a value in excess of twenty-five percent of Heavy Duty Ltd.'s registered capital.[9] While most of the above decisions could be determined by a majority vote, some of the above decisions required the affirmative vote of seventy-five percent of the votes of the quotaholders.[10] Because the quota of the City of Hope amounted to only twelve percent of the registered capital, it was unable to block even those decisions requiring a super-majority and the SPA effectively controlled all decisions.

The day-to-day management of Heavy Duty Ltd. was carried out by the managing director.[11] The SPA appointed the person who had served as general manager of the former state-owned enterprise to be the managing director. Since the registered capital of Heavy Duty Ltd. was more than HUF 20 million, the Companies Act required the establishment of a supervisory board.[12] The supervisory board had three members, of whom one was elected by the employees of Heavy Duty Ltd., as required for any limited liability company with more than 200 employees.[13] The supervisory board oversaw the management of Heavy Duty Ltd. and reported to the quotaholders.[14] It reviewed the financial statements, including the balance sheet and made an annual recommendation as to the distribution of profits. Because Heavy Duty Ltd.'s registered capital exceeded HUF 50 million, the Companies Act also required appointment of an independent statutory auditor.[15]

In sharp contrast to other formerly Communist countries of Central and Eastern Europe, Hungarian law generally does not allow former owners of nationalized property the right to reclaim their lost property.[16] Former owners or their heirs were, however, given compensation coupons,

9. Companies Act § 183(2)(a)-(d),(g),(j).

10. Companies Act § 182(1).

11. Companies Act § 197(1).

12. Companies Act § 34(2)(b).

13. Companies Act § 13(2).

14. Companies Act § 36(1).

15. State Property Act, § 7(1)(b), *translated in* 2 Hungarian Rules of Law in Force, Issue 3-4, *available in* LEXIS, Intlaw Library, Hulaw File.

16. *See generally,* Act XXV of 1991 on Partial Compensation for Damages Unlawfully Caused by the State to Properties Owned by Citizens in the Interest of Settling Ownership Relations, as amended by Act L of 1991, *translated in* 2 Hungarian Rules of Law in Force, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Compensation Act].

representing a set percentage of the value of their nationalized property.[17] These compensation coupons could then be exchanged for shares or quotas in companies privatized by the SPA.[18] Under the Compensation Act, the SPA was obliged to offer twenty percent of its quota in Heavy Duty Ltd. in exchange for compensation coupons in connection with the privatization of Heavy Duty Ltd.[19]

The Heavy Duty family, after it left Hungary in 1948, had formed a successful company in the United States under the name U.S. Heavy Duty. In 1995, when the SPA offered its interest in Heavy Duty Ltd. for sale, U.S. Heavy Duty purchased eighty percent of the SPA's quota. The remaining twenty percent was sold in exchange for compensation coupons. The SPA contributed twenty percent of the total purchase price received from U.S. Heavy Duty to Heavy Duty Ltd, as required by law.[20] After its privatization, the quotaholders of Heavy Duty Ltd. were thus U.S. Heavy Duty (70.4%), City of Hope (12%) and compensation coupon holders (17.6%).

U.S. Heavy Duty appointed a member of the Heavy Duty family to be the managing director of Heavy Duty Ltd. Since he was not an employee, he did not hold the title of chief executive officer. After the acquisition, U.S. Heavy Duty contributed a further $5 million to the registered capital of Heavy Duty Ltd., with the consent of the other quotaholders,[21] and in return the face value of its quota was increased, thus diluting the total quotaholding of the compensation coupon holders and the City of Hope below the blocking minority of twenty-five percent.

At the time of the acquisition by U.S. Heavy Duty, Heavy Duty Ltd. employed 350 administrative staff and 1,950 blue-collar workers. Retired people employed in Hungary receive pension benefits from the central pension fund of the social security administration[22] and thus Heavy Duty Ltd. had no pension or similar obligations.

In Hungary, as in other civil law countries, the owner of land generally owns any building located upon the land.[23] Thus, the land

17. Compensation Act § 2(2),(3),(4).

18. Compensation Act § 8(3).

19. Compensation Act § 8(4).

20. Transformation Act, § 21(1).

21. Companies Act, §§ 218, 219, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

22. Companies Act, § 142(2).

23. Act IV of 1959 on Civil Law, § 97, *translated in* 3 Hungarian Rules of Law in Force, Issue 9-10, *available in* LEXIS, Intlaw Library, Hulaw File.

underlying the headquarters of Heavy Duty Ltd. and its manufacturing facility is owned by Heavy Duty Ltd. The dock facilities (together with the underlying land) are leased from the City of Hope under a ninety-nine year lease. Although commercial leases in Hungary are usually for an indefinite period, with termination upon notice of a year or more, definite periods are legal and may be for as long as the parties wish. A ninety-nine year lease term is very unusual, but is technically possible.

Although average wages in Hungary are low compared to the United States, related costs are high because of the high social security contributions payable by the employer. Currently, an amount equaling 48.2% of the salary paid to any employee must be paid by the employer to the central health and pension funds of the Hungarian social security service.[24] Heavy Duty Ltd. must also pay various local taxes to the City of Hope and corporate income tax to the central tax authority at an effective rate of approximately thirty-six percent of its pre-tax profits.[25] Heavy Duty Ltd. has several other additional payment obligations to the central state budget.

After the acquisition, U.S. Heavy Duty introduced new management techniques and tried to improve Heavy Duty Ltd.'s financial position. These efforts could not, however, counteract the loss of traditional markets after the collapse of COMECON. Heavy Duty Ltd. was also hurt by the imposition of EEC tariff barriers,[26] which protected European Union agricultural producers. As a result, Heavy Duty Ltd. declared bankruptcy in 1995.

A declaration of bankruptcy has to be approved by a three-quarters majority of a limited liability company's quotaholders.[27] After the declaration, creditors whose claims represented two-thirds of the total debts of Heavy Duty Ltd. consented to a moratorium of its debts. The County Court then granted a ninety-day moratorium to Heavy Duty Ltd. and

24. Act II of 1975 on Social Insurance, § 103(1) and (2), *translated in* 2 Hungarian Rules of Law in Force, Issue 17-20, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Social Security Act].

25. Act LXXXVI of 1991 on Corporate Tax and the Amendments thereof, *translated in* 5 Hungarian Rules of Law in Force, Issue 3, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Corporate Tax Law].

26. Interim Agreement on Trade and Trade-Related Matters between the European Economic Community and the European Coal and Steel Community, of the one Part, and the Republic of Hungary, of the other Part, 1992 O.J. (L 116) 2.

27. Act IL of 1991 on Bankruptcy Proceedings, Liquidation Proceedings and Final Accounting, § (6)(3), *translated in* 4 Hungarian Rules of Law in Force, Issue 19, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Bankruptcy Act]; Companies Act, § 183(2)(j).

appointed a trustee. Thereafter, an agreement (the "Settlement") was reached with creditors representing at least two-thirds of all claims, whereupon the Settlement became binding upon all other creditors of Heavy Duty Ltd.[28] The Settlement was then submitted to the County Court for approval, which was duly received, and the bankruptcy procedure was closed.

II. CHOOSING A CORPORATE STRUCTURE

In the Settlement, the parties agreed to transform Heavy Duty Ltd. into a company limited by shares. Under the Companies Act, the parties had four choices as to the form of the business: an unlimited partnership,[29] a deposit partnership,[30] a limited liability company[31] and a company limited by shares.[32]

Neither an unlimited partnership nor a deposit partnership would be suitable for Heavy Duty. In an unlimited partnership, the partners have unlimited liability, which is obviously undesirable. In a deposit partnership, at least one member must have unlimited liability and the liability of all others is limited to their deposits.[33] Interests in either form of partnership are by statute non-transferable.[34] If a partner wants to sell or transfer its interest, the contract of association must be amended and a settlement must be agreed with the former partner.[35] All partners in an unlimited partnership and those partners who are unlimitedly liable in a deposit partnership have great influence in the management of the entity.[36] Finally, partnerships are not transparent for tax purposes: they are taxed at the entity level while partners continue to be taxed on their earnings.[37]

28. Bankruptcy Act, § 19(5).

29. Companies Act, § 55-93, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

30. Companies Act §§ 94-102.

31. Companies Act §§ 155-231.

32. Companies Act §§ 232-330.

33. Companies Act § 94(1).

34. Companies Act, § 77.

35. Companies Act, § 102, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

36. Companies Act §§ 63, 65.

37. Corporate Tax Law, § (2)(1)(a), *translated in* 5 Hungarian Rules of Law in Force, Issue 3, *available in* LEXIS, Intlaw Library, Hulaw File.

There is no minimum capital requirement for either form of partnership and they are thus usually used for small ventures.[38]

The two corporate forms that would be practical for Heavy Duty are the limited liability company (the form in which Heavy Duty Ltd. was constituted) and a company limited by shares, or *reszvenytarsasag* ("Rt."). A limited liability company has certain characteristics in common with partnerships. For example, a limited liability company is created by a contract of association;[39] ownership in a limited liability company is purely contractual and no share certificates are issued in respect of the quota interests;[40] a quotaholder with whom no further cooperation is possible may be expelled by the other quotaholders;[41] and, perhaps most significantly, all quotaholders, the company itself and any person designated by the company have mandatory rights of first refusal to buy any other quotaholder's interest.[42] On the other hand, a limited liability company differs from partnerships in other respects, such as the limited liability of each quotaholder.[43] Quotas are transferable, subject to the mandatory rights of first refusal, and a change in the composition of quotaholders does not require an amendment to the contract of association.[44] Managerial responsibility is typically placed on one person, the managing director. (It is possible, however, to appoint more than one managing director.)[45] The minimum capital requirement for establishment of a limited liability company is HUF 1 million (approximately U.S. $8000),[46] which is relatively low, even by Hungarian standards. Of this amount, at least thirty percent should be provided in cash and the remainder may be provided by in-kind contribution or cash.[47]

38. Companies Act, §§ 55, 56, 94, 95.

39. Companies Act §§ 19(1), 21(1), 157.

40. Companies Act, § 14, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

41. Companies Act § 182.

42. Companies Act § 171.

43. Companies Act § 155(1).

44. Companies Act § 174(2).

45. Companies Act, § 197(1), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

46. Companies Act § 158(2).

47. Companies Act § 160.

An Rt. is created by a deed of association (in case of private formation)[48] or by articles of association (in case of public formation).[49] Public formation of an Rt. entails an initial public offering of shares. Although this model procedure is set forth in the Companies Act[50] it is extremely unusual (and, as described below, is likely to be eliminated). The interests in an Rt. are represented by shares[51] and share certificates must be printed.[52] Shareholders are obliged to provide no more than their stated contribution for their shares and are not otherwise liable for the liabilities of the Rt.[53] Shares are freely transferable[54] (although the Supreme Court has ruled that, if desired, a right of first refusal may be granted in respect of shares in an Rt., if so stated in the articles or deed of association and printed on the share certificates). Shares may be in bearer or registered form.[55] Non-Hungarians may hold only registered shares.[56] Therefore, if a non-Hungarian acquires bearer shares, they must be transformed into registered form.

The supreme body of corporate governance in an Rt. is the meeting of shareholders.[57] The shareholders have exclusive competence to decide issues such as the approval and amendment of the articles or deed of association; any increase or decrease of the registered capital; any change of rights associated with the shares; the merger, demerger, dissolution, liquidation or bankruptcy of the company (all of the foregoing requiring at least a three-quarter majority of votes);[58] the election of the members of the board of directors and of the supervisory board and their remuneration and dismissal; and the approval of the annual balance sheet and the distribution of profits (all of the foregoing requiring at least a simple majority of votes).[59] Hungarian accounting law stipulates that a company's fiscal year

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48. Companies Act § 260(1).

49. Companies Act § 261.

50. Companies Act, §§ 250-259, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

51. Companies Act § 234.

52. Companies Act §§ 236-37.

53. Companies Act § 232(1).

54. Companies Act § 240.

55. Companies Act, § 240(1), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

56. Companies Act § 240(3).

57. Companies Act § 277.

58. Companies Act §§ 278(1)(a)-(d), 282.

59. Companies Act §§ 278(1)(e)-(i), 282.

must coincide with the calendar year.[60] At least one shareholders' meeting must be held each year to approve the report of the board of directors and the balance sheet and to decide upon the distribution of profits.[61] Votes at a shareholders' meeting are proportionate to the number of shares held,[62] except that preferred shares may have disproportionate voting rights or be non-voting.[63]

The managing body of an Rt. is the board of directors, which may have anywhere from three to eleven members.[64] Directors are elected for a specified period that may not exceed five years.[65] Directors may be re-elected or dismissed, in accordance with the provisions set forth in the articles or deed of association.[66] The management of an Rt. is supervised by a supervisory board and a statutory auditor.[67]

Shareholders representing at least ten percent of the registered capital of an Rt. may request the convocation of a shareholders' meeting[68] and the submission of certain issues to the shareholders' meeting.[69] They may request an investigation of the management, in certain circumstances.[70] Any shareholder in an Rt. may challenge in court the validity of a purportedly illegal decision of the shareholders or the supervisory board of an Rt.[71]

The minimum equity requirement for an Rt. is HUF 10 million.[72] Shares in an Rt. may be publicly offered and traded on a stock exchange, unlike quotas in a limited liability company. The parties to the Settlement decided to transform Heavy Duty Ltd. into an Rt. The Rt. form is more flexible and interests in an Rt. are generally more liquid. The Rt. form

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60. Act XVIII of 1991 on Accounting, § 4(1).

61. Companies Act, § 279, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

62. Companies Act § 269.

63. Companies Act § 242.

64. Companies Act § 285.

65. Companies Act § 30(1).

66. Companies Act, § 30(1), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

67. Companies Act §§ 34(2), 39(2).

68. Companies Act § 273.

69. Companies Act § 274.

70. Companies Act § 275.

71. Companies Act, § 44, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

72. Companies Act § 251.

also permits a more suitable type of management through a board of directors, rather than a single manager. In general, an Rt. is more suitable for the operation of a business as large as that of Heavy Duty.

III. RESTRUCTURING HEAVY DUTY II

In the Settlement, Heavy Duty Ltd. agreed to transform into an Rt. The transformation decision will need to be passed by a three-quarters majority of votes of the meeting of the quotaholders.[73] U.S. Heavy Duty, which holds more than this percentage, will be able to ensure passage of the decision, but the City of Hope and the former compensation coupon holders will also be asked to vote.

As well as the transformation plan, the quotaholders' meeting has to approve the draft transformation balance sheet of Heavy Duty Ltd.[74] The transformation plan will be prepared by the management of Heavy Duty Ltd., which may retain advisers for that purpose, including accountants and lawyers. The plan will specify the registered capital, the number and type of shares and their distribution among the shareholders and other issues connected with the transformation.[75]

The deed of association of the succeeding Rt. is attached to and forms part of the transformation plan.[76] The deed of association must be prepared by an attorney admitted to practice in one of the bars of Hungary,[77] which are organized in counties and in Budapest.

The draft transformation balance sheet is a pro forma balance sheet as of the transformation date, and must be signed by the managing director of Heavy Duty Ltd. and by Heavy Duty Ltd.'s statutory auditor.[78] The balance sheet must be also approved by the supervisory board of Heavy Duty Ltd. and by an independent auditor.[79] In the draft transformation balance sheet, the assets and liabilities may, at the company's option, be re-valued to reflect current market value more accurately.[80] If the re-valuation means an aggregate increase in asset value, the company will be

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73. Companies Act §§ 183(2)(j), 336(1).

74. Companies Act § 336(1).

75. Companies Act §§ 333, 345(1).

76. Companies Act, § 333(c), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

77. Companies Act § 19(2).

78. Companies Act § 334.

79. Companies Act § 334(3).

80. Companies Act § 335.

obliged to pay corporate tax on the surplus.[81] After the transformation is registered by the court of registration, Heavy Duty will have ninety days to put the transformation balance sheet in final form and submit it to the court of registration and the tax authorities.[82]

The resolution of the quotaholders of Heavy Duty Ltd. approving the transformation, together with the most important data from the draft transformation balance sheet, is published twice in the Hungarian official gazette, with the second publication at least fifteen days after the first.[83] The management of Heavy Duty must also inform the representative bodies of the employees—such as the relevant trade unions and the workers' council—of the transformation decision.[84] The employee representatives are given fifteen days in which to express their views, but they do not in practical terms have much influence on the transformation. Heavy Duty will then submit the required documentation to the competent court of registration, which, if the documents are in order, must then register the transformation.

After the transformation, the new Rt., named Heavy Duty II, will be the legal successor to all rights and obligations of Heavy Duty Ltd.[85] All permits and other licenses which were issued to Heavy Duty Ltd. will belong to Heavy Duty II;[86] every contract which was entered into by Heavy Duty automatically and without further action will be assumed by Heavy Duty II.[87]

IV. CHOOSING A CAPITAL STRUCTURE

In the Settlement, the parties agreed upon a new financing structure. The leading creditor bank of Heavy Duty Ltd. will subscribe for new common shares in Heavy Duty II, giving the bank an equity interest and Heavy Duty II much-needed additional capital. The public shareholders, who are the former compensation coupon holders, agree to receive preference shares with a guaranteed annual dividend of five percent. In

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81. Companies Act § 335, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

82. Companies Act § 368(3).

83. Companies Act § 337.

84. Companies Act § 336(2).

85. Companies Act § 338.

86. Companies Act, § 339, *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

87. Companies Act § 338.

return for the guaranteed dividends, their shares will be non-voting, and they will thus no longer participate in the governance of Heavy Duty. U.S. Heavy Duty will subscribe for newly-issued convertible bonds of Heavy Duty II. U.S. Heavy Duty does not want to be diluted by the bank, but does not currently have funds to supply the equity injection needed by Heavy Duty II. The convertible bond structure was devised because U.S. Heavy Duty believes it will be able in the future to contribute additional funds to Heavy Duty II and it will at that point wish to regain control of Heavy Duty II. Therefore, the terms of the bonds are set so that they may be converted into common shares of Heavy Duty II over the following five years in equal annual installments and, upon conversion, U.S. Heavy Duty will be required to pay the difference between the nominal value of the bonds and the issue price of the shares.

Since 1988, there have been no significant legal constraints on foreign investment in Hungary. In 1988, an act[88] was passed by the Hungarian Parliament which gave a full government guarantee against any nationalization or seizing of assets belonging to foreign investors.[89] This act also liberalized foreign equity investments.[90] It generally eliminated the need for any permit from any authority to make an equity investment of any size in a Hungarian company.[91] It stipulated that foreign investments and any gain on them may be freely repatriated in the currency of the original investment.[92] In the early 1990s, Hungary encouraged foreign investments by granting generous tax benefits to joint ventures over a specified equity amount and with a certain percentage of foreign participation.[93] Hungary also permitted joint ventures to import goods free of transport duty and value-added tax, in certain circumstances. These tax benefits have since been repealed, despite the desired effect in substantially encouraging foreign investment.

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88. Act XXIV of 1988 on the Investment of Foreigners in Hungary, *translated in* 4 Hungarian Rules of Law in Force, Issue 3-5, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Foreign Investment Act].

89. Foreign Investment Act § 1.

90. Foreign Investment Act § 3.

91. Foreign Investment Act § 9(2).

92. Foreign Investment Act § 32(1). This Article has been replaced by new and equivalent regulation in Act XCV of 1995 on Foreign Exchange, *translated in* 7 Hungarian Rules of Law in Force, Issue 1, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Act XCV of 1995].

93. Act XCV of 1995 § 14.

The Hungarian forint has recently become convertible for most purposes under a new law on foreign exchange.[94] Loan financing, which was strictly controlled by the National Bank of Hungary until 1995, is still somewhat under the control of the state.[95] Hard currency loans with a term shorter than one year must be approved by the National Bank of Hungary.[96] Loans with a longer term and with an aggregate principal amount in excess of U.S. $50 million must be declared to the National Bank of Hungary at least sixty days before the execution of the loan agreement.[97] If for an amount of less than U.S. $50 million, a long-term loan must be declared to the National Bank of Hungary within eight days after the execution of the loan agreement.[98]

Public offerings are regulated by the securities act,[99] which provides that new shares of an Rt. may be offered to the public only if the issuer has been in existence for at least one year. The same requirement applies to any issuance of bonds to the public. Illogically, the Companies Act, as described above, currently allows public formation of an Rt.,[100] which would circumvent the one-year rule. A pending amendment of the Securities Act would prohibit public formation altogether and would extend the currently required one year to two years.

V. POTENTIAL LIABILITIES AND FORMS OF PROTECTION

As discussed before, the liability of the shareholders of Heavy Duty II is limited.[101] They are not liable for the liabilities of the company beyond their capital contributions.[102] This would be the same for an Rt. or

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94. Act XCV of 1995, § 39, 40; Act XXIV of 1988, § 12(1).

95. Act XXIV of 1988, § 23, *translated in* 4 Hungarian Rules of Law in Force, Issue 3-5, *available in* in LEXIS, Intlaw Library, Hulaw File.

96. Act XCV of 1995, § 39(1), *translated in* 7 Hungarian Rules of Law in Force, Issue 1, *available in* LEXIS, Intlaw Library, Hulaw File.

97. Act XCV of 1995 § 39(1).

98. Act XCV of 1995 § 39(2)(b).

99. Act VI of 1990 on the Public Issue and Trading of Securities on the Stock Exchange, § 23(3) [hereinafter Securities Act]; *see* Companies Act, § 1, § 301(3), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

100. Companies Act, § 232.

101. Companies Act §155(1).

102. Companies Act, § 232(1), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

a limited liability company; as discussed, unlimited liability applies only in general and deposit partnerships.[103]

The registered capital of a business entity must be composed of at least 30% cash contributions, while the remainder may be made up of contributions in-kind.[104] A party providing an in-kind contribution will remain liable for five years for any discrepancy between the actual value of its in-kind contribution and the value at which it was entered into by the company's registered capital.[105] Intentional misleading of a company in this respect is a crime.[106]

Directors must act with the care generally expected from such officers and have a fiduciary duty to the company.[107] If a director damages the company in breach of his or her obligations, he or she will be liable in accordance with general rules of civil law.[108] This amounts in principle to unlimited liability, despite the limitation on liability set forth in the labour law if the director is an employee of the company. The liability of all members of the board of directors is joint and several, except that a board member who specifically objects to a proposed action will not be liable for any damages caused by that action.[109]

Under applicable law, registration by a court of registration creates a company retroactively back to the date of its formation, when the foundation documents were dated.[110] A company may conduct business while it is awaiting registration (which can take as much as a year). However, anyone who acted on behalf of the company before its registration was completed is jointly and severally liable, without limitation, for the obligations assumed by the company.[111] This obligation is removed only if after the registration is complete the company specifically exempts these persons from such liability.[112]

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103. *See supra* note 33 and accompanying text.

104. *See* Companies Act § 160 (for a Kft.), § 251(2) (for an Rt.).

105. Companies Act § 22(3).

106. Act IV of 1978 of the Criminal Code, § 298(A), *translated in* 6 Hungarian Rules of Law in Force Issue 23-24, *available in* LEXIS, Intlaw Library, Hulaw File.

107. Companies Act, § 32(1), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

108. Companies Act, § 32(1).

109. Companies Act § 32(3).

110. Companies Act § 24(1).

111. Companies Act § 25(1).

112. Companies Act, § 25(2), *translated in* 1 Hungarian Rules of Law in Force, Issue 25, *available in* LEXIS, Intlaw Library, Hulaw File.

Insurance companies offer insurance against the liabilities of the directors and managers. The company may pay the insurance fees; however, direct indemnification by the company for such liability is likely to be unenforceable under Hungarian law.

Certain actions of officers carry criminal penalties. Such actions include illegally impairing registered capital and misleading shareholders with respect to the company's assets.[113]

The liability of employees for damages caused to their employer is regulated by the labour law.[114] An employee's liability for damages caused by negligence is as a general rule limited to fifty percent of one month's salary of the employee, but may amount to as much as six months' salary if the collective bargaining agreement of the employer so provides in specific cases.[115] Employees are unlimitedly liable for damages caused by their intentional misconduct.[116]

VI. CONCLUSION

Our imaginary Heavy Duty, like all Hungarian entities, has undergone many changes in the past ten years. These changes have often been painful, but we hope that they will permit new, streamlined Hungarian companies to compete more effectively in the world market.

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113. Act IV of 1978, ch. XVII, *translated in* 6 Hungarian Rules of Law in Force Issue 23-24, *available in* LEXIS, Intlaw Library, Hulaw File.

114. Act XXII of 1992 on the Labour Code, *translated in* 3 Hungarian Rules of Law in Force, Issue 15, *available in* LEXIS, Intlaw Library, Hulaw File [hereinafter Act XXII of 1992].

115. Act XXII of 1992 § 167.

116. Act XXII of 1992 § 168.