



Current amendments to Hungarian Civil Law

Newsletter Hungary
Issue February 2014

In this issue:

- > Major amendments to the law of obligations
- > New codification of default rules in company law
- > Stricter D&O liability provisions
- > Regulations on capital requirements for a Hungarian limited liability company
- > Effective date of the Civil Code and transitional

Dear Reader,

we wish to inform you that the **new Hungarian Civil Code** adopted by the Hungarian Parliament in February last year will become **effective on 15 March 2014**.

The new Hungarian Civil Code introduced amendments not only to the branches of civil law (law of obligations, property law, family law, law of

succession) but also to company law that was codified anew. With this newsletter we wish to provide you with an overview of the amendments to the new Hungarian Civil Code that we believe are the most significant, but the list is not exhaustive.

➤ Major amendments to the law of obligations

One of the most important amendments relates to **liability law**: more specifically the unified liability regime previously in effect, according to which basically very similar liability rules applied to both breach of contract and non-contractual damage (tort). The new Hungarian Civil Code imposes stricter sanctions for the breach of contract. While it is still the non-breaching party who is bound to prove the essential elements justifying a claim for damages (unlawful conduct of the breaching party, damage suffered by the non-breaching party, causation), the possibility of exemption from liability for damage

caused by a breach of contract will be now very limited. Currently, the provisions governing liability for causing damage as a result of the breach of contract and those governing liability in non-contractual liability cases differ, whereas stricter rules apply to liability for the breach of contract. In contrast, a ceiling was set for damages in cases of

¹ According to the (previous) version of the Hungarian Civil Code, the party causing the damage [or: the breaching party in

cases of breach of contract] could be exempted from liability if they proved that their conduct was not imputable to them, i.e. that they acted in a way that is generally expected. In the future, exempting the breaching party from liability will be possible only when such party proves that the breach of contract was caused by an event that was beyond their control and unforeseeable at the time of signing the contract and they could not be expected to prevent the event from occurring or remedy the damage.

consequential damage and possibilities for capping contractual liability were expanded.

One of the important novelties is, among other things, the fact that the new Hungarian Civil Code allows **transferring contractual positions**, which previously was allowable only in (often extremely complex) cases of debt take-overs and assignment.

Important amendments were introduced also in the area of **contractual securities**. Emphasised should be for example the new regulation of the right of lien and its incorporation into property law, or the new regulation of suretyship, or the possibility of signing guarantee agreements.

Another novelty is that the new Hungarian Civil Code will now include fundamental regulations on a range of **non-standard contracts** (e.g. factoring, franchise, and finance lease agreements) that were

not regulated before but have long been used in practice. New is also the introduction of the legal institution of a **fiduciary**, which was not enshrined in Hungarian law before.

In addition, the new Hungarian Civil Code will now make it possible to grant **general powers of attorney**, something that was ambiguous and debatable before although certain demand has long existed in this regard.

Significant changes were made also to **consumer protection rules**: on the one hand, the new Civil Code narrows down the group of consumers to private individuals, which was not the case in the previous regulations. On the other hand, the fundamental consumer protection guidelines set out in related currently effective EU Directives were incorporated into the Civil Code, whereas many special regulations were implemented in special Acts.

➤ New codification of default rules in company law

As already mentioned, company law provisions previously included in the separate Hungarian Business Associations Act were also codified anew and integrated into the new Civil Code. In order to allow companies and other organisations a high degree of freedom in structuring and organising their business, the legislator has introduced **a system of default rules** in place of mandatory rules that were applied previously. This means that company founders or shareholders will now be able to basically deviate from statutory provisions of the

Civil Code in their constitutional documents as regards regulations on their mutual legal relationships and legal relationships with the company, or the organisation and operation of the company, as long as such deviation is not prohibited or restricted by law. In addition, the new Hungarian Civil Code generally limits the scope of [allowable] deviations from statutory provisions in order to protect the interests of creditors, employees and minority shareholders, or to safeguard supervision of lawful company operation.

➤ Stricter D&O liability provisions

Various regulations apply to liability of directors and executive officers as part of the internal relationship with the company or shareholders (so-called liability towards the company) and the external relationship with company's creditors and other third parties (so-called liability towards third parties). The new Hungarian Civil Code introduces significant changes also in these areas. The above-mentioned fundamental amendment to liability regulations and the separation of the previously unified liability

regime led to the necessity of **regulating D&O liability towards the company anew**.

In line with the new framework, directors and executive officers are held liable to the company for damage caused to the company when acting in the capacity of directors and executive officers (i.e. as part of the so-called internal relationship) according to the letter of civil law and stricter **rules on breach of contract**. Based on those liability regulations, exempting directors and executive officers from

liability within the internal relationship will be possible only in a limited scope.² As opposed to the liability rules previously in force³, the new liability rules to be applied will mean much stricter provisions on D&O liability. However, a range of possibilities are offered to respond to these stricter provisions on D&O liability, such as e.g.: liability limitation, a vote of acceptance confirming the fulfilment of D&O duties granted by the General Meeting of Shareholders, or conclusion of a D&O liability insurance contract.

One of the major changes introduced by the new Hungarian Civil Code with regard to D&O liability is that the scope of **liability of directors and executive officers towards third parties** was extended. While pursuant to the provisions applicable before the amendment, directors and executive officers were held liable only in exceptional cases and especially to creditors if a company became insolvent, now they will have to accept stricter liability regime also towards third parties. The new Civil Code provides for the scope of liability going beyond the above-mentioned liability in insolvency cases. **Directors and executive officers will now bear joint and several liability (together with the company)** towards third parties for damage caused to such third parties in connection with their service as directors and executive officers.

This amendment modifies thus the liability scheme applicable to D&Os. Previously, it was basically only the company that could be held liable for such damage to third parties and, in the best case scenario, it could then hold such a director or executive officer accountable within the internal relationship (recourse).

The principles according to which the liability is to be assessed in particular cases are yet to be established by case law in the years to come.

If the executive board consists of several persons, directors are granted – not least due to the stricter liability regime – the **right of objection** against the measures of other executive board members, whereas in cases where such an objection is raised, it

is the General Meeting that resolves on the proposed measure. Pursuant to the previously applicable provisions, executive board members acted as the so-called "managers" (executive office holders at Hungarian limited liability companies). From 15.03.2014, also Hungarian limited partnerships will be allowed to be managed by executive board members.

The stricter liability regime applies also to liability of executive board members and general directors (in Hungarian joint stock companies) both towards the company and towards third parties.

➤ Effective date of the Civil Code and transitional provisions

The new Civil Code enters into force on **15 March 2014** and its provisions are generally applicable to all legal relationships established after this date. The contractual parties are free to adjust contracts concluded before the effective date of the new Civil Code to the provisions of the new Civil Code. Since the new Hungarian Civil Code will introduce a considerable number of changes, it is recommended to generally review and adjust all existing contracts.

Special transitional provisions apply to legal entities established before 15 March 2014: these entities are obliged to adjust their constitutional documents to the provisions of the new Civil Code when **introducing the first amendment to the constitutional document** after the Civil Code becomes effective, however **no later than 15 March 2015** in the case of general partnerships and limited partnerships, and **no later than 15 March 2016** – in the case of limited liability companies and joint stock companies.

A relief applies, however, to limited liability companies whose share capital does not reach the level of HUF 3,000,000 at the date when the new Civil Code becomes effective: these companies are not necessarily required to increase their share capital on the first amendment to their constitutional they are not required

² See footnote 1.

³ According to the previously effective liability rules, the criterion of objective due care of a prudent businessman was applied, which means that, to be exempted from liability, the director/executive officer had to prove that they "acted with the level of due care that would have been generally expected from persons holding such office".

to immediately adjust their constitutional documents when introducing the first amendment, but are allowed to operate based on the (old) provisions of the Hungarian Business Associations Act rather than the provisions of the (new) BGB. Nevertheless, these companies are obliged to increase their share capital and adjust their constitutional documents, or pass requisite resolutions in this regard, no later than **15 March 2016**; before that date, they are allowed, however, to make amendments to their constitutional documents without being required to adjust them to the new Civil Code or to increase the share capital. In order to make it easier for

companies to comply with the new provisions on capital requirements, the legislator offered the possibility to carry out the mandatory share capital increase by merely applying the provisions of the new Civil Code (including the above-mentioned alternative of "topping-up" the share capital).

The uncertainties concerning interpretation and the wide variety of possible interpretations of the individual provisions resulting from the newly introduced regulations and higher abstraction level of the new wording of the Civil Code will have to be resolved or clarified by case law in the future.

Dr. Sándor Sárközy

Attorney at Law
(Hungary)
Partner

Phone: +36 (1) 814 98 80

E-Mail: sandor.sarkozy@roedl.hu

Stefan Sieferer

Attorney at Law
Partner

Phone: +36 (1) 814 98 80

E-Mail: stefan.sieferer@roedl.hu