GETTING THE DEAL THROUGH

Corporate Governance

Board structures and directors' duties in 42 jurisdictions worldwide

2009

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Published by
GETTING THE DEAL THROUGH
in association with
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Corporate Governance 2009
Published by
Law Business Research Ltd
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ISSN 1476-8127

Printed and distributed by
Encompass Print Solutions.
Tel: 0870 897 3239

Law Business Research

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Hungary

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Sources of corporate governance rules and practices

1 Primary sources of law, regulation and practice

What are the primary sources of law, regulation and practice relating to corporate governance?

The primary source of law for corporate governance is the Companies Act (Act 4 of 2006), which encompasses the legal regulation of all company forms statutorily available to be founded in Hungary (ie, unlimited and limited partnership, limited liability companies, private and public companies limited by shares). Since companies are free to determine their corporate governance structure within the fundamental framework set by the Companies Act, there is no lower ranking (governmental or ministerial) regulation of company law.

Further to the Companies Act, the issuance of shares by a private or public company limited by shares is made subject to the detailed regulation set forth in the Capital Markets Act (Act 120 of 2001). The compulsory public offer to be made by the acquirer of more than 33 per cent of the votes (or 25 per cent, if there is no shareholder holding more than 10 per cent of the votes) in a public company limited by shares is also regulated by the Capital Markets Act.

Hungarian company law is harmonised with the related legal regulations of the EU.

2 Responsible entities

What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder activist groups whose views are often considered?

The Hungarian parliament qualifies as prime legislator.

The registration of the foundation of the company, as well as of any subsequent change in its registered corporate data (name, seat, equity capital, management, supervisory board, auditor etc) is assigned to the sole competence of the Companies Court, which is organised and proceeds on a county level. The Financial Supervisory Authority (PSZÁF) has certain licensing powers in procedures aimed at the issuance of shares by a public company limited by shares and at the acquisition of 33 per cent of the votes (or 25 per cent, if there is no other shareholder holding more than 10 per cent of the votes) in such companies.

Rights and equitable treatment of shareholders

3 Shareholder powers

What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action?

Directors can be appointed by the shareholders' meeting either for the definite period of no more than five years, or for an indefinite period. In either case, the appointed director can be removed at any time and without cause by the shareholders. Directors can also be reappointed without any restriction. The shareholders of a limited liability company as well as of a private company limited by shares are entitled to assign the task of appointing and removing the directors to the competences of the supervisory board.

The board (and, in general, the executives) shall fully comply with all statutory regulations, the charter of the company and the resolutions of the shareholders' meeting, but with the exception of one-shareholder companies they cannot be directly instructed by the shareholders of the company. Hence, the sole shareholder of a one-man company can give written instructions to the board directly, but the board is statutorily released from its liability for executing actions based on such written instructions.

4 Shareholder decisions

What decisions must be reserved to the shareholders?

The Companies Act provides a list of decisions that are reserved for the sole competence of the company's shareholders. Essentially, all strategic, non-operative decisions are statutorily assigned to the exclusive sphere of competence of the shareholders' meeting. These decisions include adopting the company's annual report, resolving on the transformation or termination of the company, increasing or decreasing the equity capital. The shareholders can further expand the statutory catalogue of 'reserved competences' in the charter of the company.

5 Disproportionate voting rights

To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Disproportionate voting rights can be set in the charter of limited and unlimited partnerships, the only statutory restraint being that each shareholder shall have at least one vote. With limited liability companies, as a general rule, voting rights are set proportional to the capital contribution effected by each shareholder, but in the charter disproportional voting rights can be attached to certain shares. With companies limited by shares it is possible to issue shares with priority voting rights. Such priority voting right cannot exceed ten times the voting right attached to the face value of such share.

Concerning limitations on voting rights, the charter of the company can restrict or exclude the voting rights of certain shareholders in regard of particular subjects. Further to such contractual limitations, the Companies Act sets forth some mandatory limitations, on the basis of which the shareholder is statutorily not allowed to cast its vote if the resolution proposed aims at:

- exempting him from any obligation or liability vis-à-vis the company;

- granting him any other advantage at the expense of the company;
- approving the conclusion of an agreement between him and the company;
- initiating a lawsuit against him by the company (including lawsuit for exclusion from the company): or
- establishing or terminating his legal shareholding relationship with the company.

With companies limited by shares, it is further feasible to limit or exclude the voting right attached to shares providing preferred dividends, preferred liquidation rights or pre-emption rights. Reasonably, the company is statutorily not allowed to exercise voting rights on own shares that the company acquired by itself.

Statutory limitations on the exercise of voting rights are also set by the Capital Markets Act in respect of public companies limited by shares. Such limitations are connected to the shareholder's failing to comply with statutory obligations following the acquisition of a particular ratio of voting rights. For example, the shareholder shall report to the company itself as well as to the Financial Supervisory Authority the acquisition of shares as a result of which its voting rights reach or exceed 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 75, 80, 85, 90, 91, 92, 93, 94, 95, 96, 97, 98 or 99 per cent of the total voting rights, or the disposal of shares as a result of which its voting rights decrease under any of the before mentioned ratios. Moreover, upon acquiring 33 per cent of the voting rights (or 25 per cent if there is no shareholder holding more than 10 per cent of the votes) the shareholder is obliged, apart from the above reporting obligation, to make a public offer to all other shareholders and such bid is to be approved by the Financial Supervisory Authority. The shareholder, who defaults either the above reporting or the bidding obligation, cannot exercise its voting rights in the company until complying with statutory requirements.

6 Shareholders' meetings and voting

Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote?

There is no statutory requirement for shareholders to participate or vote in shareholder's meetings. Generally only registered shareholders are entitled to participate in general meeting through their lawfully authorised representatives. With companies limited by shares, only such shareholders can vote whose names have been entered into the Register of Shareholders.

7 Shareholders and the board

Are shareholders able to require meetings of shareholders to be convened, resolutions to be put to shareholders against the wishes of the board or the board to circulate statements by dissident shareholders?

Normally, the shareholders' meeting is convened by the board. Nonetheless, shareholders holding at least 5 per cent of the voting rights can statutorily request the board to convene the shareholders' meeting, by indicating the reason and the purpose of such meeting. The charter of the company can grant this minority right to an even smaller ratio of voting rights. If the board does not comply with such demand within 30 days after delivery, the minority shareholders can request the Companies Court to convene the meeting, but are required to advance the costs and provide all the conditions of such meeting.

8 Controlling shareholders' duties

Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action against controlling shareholders for breach of these duties be brought?

In public companies limited by shares, after it has lawfully acquired its majority stake in the company, the controlling shareholder does not owe any statutory duties to non-controlling shareholders. Yet, prior to the lawful acquisition of controlling influence, it is required to make a public offer to all the other shareholders (in this regard, see question 5). In private companies limited by shares, limited liability companies and partnerships there is no statutory obligation vis-à-vis non-controlling shareholders, rather non-controlling shareholders are entitled to specific monitory rights. Yet, the charter of the company can set such obligations.

As a special enforcement action, the company can initiate an exclusion lawsuit against the shareholder who endangers the achievement of the company's purpose. The shareholders are statutorily required to pass a resolution on the initiation of such lawsuit with a 75 per cent majority of the votes, provided that the shareholder who is to be excluded from the company cannot vote (in this regard, see question 5). However, a shareholder having 75 per cent of the voting rights is statutorily not allowed to be excluded from the company (to balance this rule, the Companies Act provides put option to minority shareholders that can be exercised within 60 days after the acquisition of the 75 per cent or more shareholding has been made public). Moreover, in the case of companies limited by shares, a shareholder cannot be excluded at all, irrespective of the total of its voting rights.

9 Shareholder responsibility

Can shareholders ever be held responsible for the acts or omissions of the company?

Hungarian company law acknowledges the doctrine of 'piercing the corporate veil', implying that, in certain cases, misconduct by the company, for which the shareholder can directly be held responsible, can trigger the shareholder's unlimited liability for the company's obligations.

The court can declare that the shareholders, who passed a resolution, in respect of which they knew or should have known that such resolution was obviously contrary to the significant interest of the company, bear unlimited, joint and several liability for the resulting damages towards the company. However, even in such a case the shareholders' liability is limited against third persons for the act or omission of the company.

The court can declare that the shareholders of a company, who abused their limited liability to the detriment of creditors (eg, disposed over the assets of the company as if such were their own or clearly committed fraudulent conveyance in regard of the assets), bear unlimited, joint and several liability for the unsatisfied obligations of the company.

The court can declare, upon the request of a creditor lodged in the course of liquidation procedure, the unlimited, full and direct liability of the shareholder having at least 75 per cent of the votes for the obligations of the controlled company if, as a result of such dominant shareholder's influence, the controlled company has pursued a permanently detrimental business policy and, therefore, the assets of the controlled company fall short of covering creditors' claims.

Naturally, unlimited shareholders of partnerships have unlimited liability without resorting to piercing the corporate veil.

Corporate control

10 Anti-takeover devices

Are anti-takeover devices permitted?

Anti-takeover devices are permitted for limited liability companies as well as for companies limited by shares within the boundaries of statutory law. The Companies Act remains silent on anti-takeover provisions regarding partnerships, as such corporate forms bear less economical significance and are not characterised by hostile takeovers.

11 Restrictions on the transfer of fully paid shares

Are restrictions on the transfer of fully paid shares permitted, and if so what restrictions are commonly adopted?

Shares that are fully paid but not yet issued shall not be subject to transfer. In limited liability companies, a wide range of anti-takeover devices are permitted by law. If a shareholder is willing to transfer its share by way of a sale and purchase arrangement, the Companies Act provides statutory pre-emption rights to the other shareholders, the company itself and third parties appointed by the shareholders' meeting, in this very order, unless this pre-emption right is expressly excluded in the charter of the company. On the other side, the charter can also impose restrictions and bans on the transfer of shares to third parties.

In private companies limited by shares, the transfer of shares can be restricted in the charter and/or be made subject to the approval of the board or any other corporate body of the company. The granting of the latter approval can be refused only if the shares are to be transferred to the competitor of the company, or if the company's significant interests require such refusal.

In case of public companies limited by shares, the above restrictions shall not apply.

12 Compulsory repurchase rules

Are compulsory share repurchase rules allowed? Can they be made mandatory in certain circumstances?

Until the company is not terminated without legal successor, the shareholders cannot require the company to purchase their shares, except for the following two cases:

- if the company is to be merged, demerged or transformed to another corporate form, shareholders not willing to participate in the legal successor company can request their shares to be purchased; and
- in companies limited by shares, it is possible to issue redeemable shares providing call option for the company and/or put option for the shareholder.

Responsibilities of the board (supervisory)

13 Board structure

Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure in Hungary is currently the two-tier system (ie, separate management board and supervisory board). The one-tier board system has just been introduced as an alternative possibility to the two-tier system by the new Companies Act, enacted in July 2006. The one-tier system does not have a tradition in Hungarian company law and it can only be selected by public companies limited by shares.

14 Board's legal responsibilities

What are the board's primary legal responsibilities?

Generally, 'management' shall be responsible for passing all decisions other than those conferred by the charter under the competence of the supreme body or other company organ, and which are necessary in connection with the company's operations.

The fundamental legal responsibility of the management board is to fulfil its management obligation in the best interest of the company. Further main statutory responsibilities of the management board include preparing the annual report of the company as well as proposals on dividend distribution, reporting to the Companies Court the foundation of the company and any subsequent change in its registered data, keeping the company's business secrets confidential, providing the shareholders of the company with any information they require, exercising the employer's rights regarding the company's employees and representing the company against third parties and authorities.

The supervisory board has a monitoring role regarding the management board, implying that it is statutorily obliged to convene the shareholders' extraordinary meeting if it observes that the actions of the management board violate the legal regulations, the company's charter or the shareholders' resolutions, or infringes the interests of the company or the shareholders in any other way. The supervisory board is also required to comment on the annual report of the company prepared by the management board, prior to its adoption by the shareholders.

15 Board obligees

Whom does the board represent and to whom does it owe legal duties?

The management board represents and owes legal duties to the company itself, as long as the company is not threatened to become insolvent, upon which event the management board shall proceed in the best interest of the company's creditors.

The supervisory board represents and owes legal duties to the shareholders (although it is the company that can initiate a lawsuit against supervisory board members for the breach of their duties).

16 Enforcement action against directors

Can an enforcement action against directors be brought on behalf of those to whom duties are owed?

The company can initiate a lawsuit against the executive directors (ie, managing directors) for the damages that it incurred due to breach of their duties. Regarding damages caused by the directors to third parties, the company itself is directly liable but the company can thereafter enforce such damage claims against the executive directors. In case the company has two or more executive directors with joint signatory right, or if it has a management board, the executive directors' liability for damages is statutorily set joint and several. The executive directors' liability is unlimited for all damages arising from any false, delayed or omitted reporting to the Companies Court.

The shareholders can grant a discharge of liability to the executive directors for the previous financial year. By granting a discharge of liability the shareholders basically confirm that the executive directors acted in the best interest of the company and did not commit any breach of duty.

The liability of supervisory board members is unlimited, and joint and several for damages caused to the company by any breach of their duties. Such liability can be established in a lawsuit initiated by the company.

17 Care and prudence

Do the board's duties include a care or prudence element?

Board members are obliged to conduct the management of the company with such due care and diligence that can generally be expected from persons in their positions.

18 Board member duties

To what extent do the duties of individual members of the board differ?

Statutory law requires from both management board and supervisory board members to act in a way that is generally expected from officers in their position (see question 17). Hence, the consequences of any breach of their duties that they may individually face will not be different on the basis of their different skills and experiences (see question 16). If the damage results from a decision of the board, any member who did not take part in the decision-making process or voted against it shall be exempt from liability.

19 Delegation of board responsibilities

To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Executive officers shall discharge their duties relating to the company's internal affairs in person; therefore no general delegation of responsibilities is allowed. However, if permitted by the charter, the company's supreme body may decide to appoint one or more managers to assist the executive officers in their work. The activities of company managers shall have no relevance concerning the liability of executive officers regarding the company. The executive officers may delegate their right of representation in regard of specific competences to the employees of the Company.

The members of the supervisory board shall act in person; representation in the supervisory board is not allowed. The supervisory board may entrust any of its members to fulfil certain individual supervisory tasks, or may divide supervisory duties among its members on a permanent basis.

The management board, based on authorisation received from the shareholders, may set up internal bodies for the preparation of decisions. The activities of these non-statutory bodies shall have no relevance concerning the powers and competencies of the board or executive directors specified in the Companies Act.

20 Non-executive and independent directors

Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent directors' and how do their responsibilities differ from executive directors?

With a public limited company having a one-tier board system, statutory provision requires, except for certain cases, that the majority of the board be made up of independent persons, unless the charter prescribes a higher percentage. A board member shall be considered independent, if the board membership qualifies as his exclusive legal relationship to the company.

If the annual average of the number of full-time employees exceeds two hundred, the employees shall have the right to take part in the supervision of the company, unless there is an agreement between the works council and the management of the company to the contrary. In this case the representatives of the employees shall comprise one-third of the members of the supervisory board. On the supervisory board, employees' representatives shall have the same rights and same obligations as all other members. There is no further statutory regulation on 'independent', or non-executive directors.

21 Board chairman and CEO

Do law, regulation, listing rules or practice require separation of the functions of board chairman and CEO? If flexibility on board leadership is allowed what is generally recognised as best practice and what is the common practice?

No, statutory separation rules apply in this regard. It is recognised practice to join the two functions.

22 Board committees

What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Public limited companies shall set up an audit committee consisting of three members elected by the general meeting from the board of directors, or from the independent members of the supervisory board, where applicable. The audit board shall assist, analyse, monitor or make recommendations concerning the annual report of the company and the auditor's activity.

No further committees are statutorily prescribed, but the shareholders meeting is allowed to form further committees it deems necessary.

23 Board meetings

Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum of board meetings regulated by law. Practically the board meeting shall be convened at least once per year.

24 Board practices

Is disclosure of board practices required by law, regulation or listing requirement?

In case of a public company limited by shares, the board shall prepare a report on board practices that shall be submitted to the members' meeting and published on the official website of the company.

25 Remuneration of directors

Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions between the company and any director?

The assignment of executive officers of the company shall be governed by the Civil Code (personal service contract), or by the Labour Act (contract of employment). Regarding the labour contract, the minimum remuneration of an employee is prescribed in Government Decree 321/2008 (XII.29.) on the Mandatory Minimum Wage and the Guaranteed Wage Minimum.

Executive officers shall be elected for a fixed term of maximum five years, or appointed for an indefinite period of time. The establishing of remunerations of executive officers, board members, supervisory board members fall within the exclusive competence of the shareholders' meeting. An executive officer and his close relatives or common-law spouse may not conclude any transactions falling within the scope of the main activities of the business association in his own name and on his own account, unless specifically permitted in the charter.

Update and trends

As of 1 July 2008, all corporate procedures has become electronic in Hungary, meaning that all kinds of corporate applications – either for the registration of new companies or for the registration of corporate changes in an already registered company – shall now be filed with the Companies Court via electronic mail. The legal representative has the obligation to digitalise the document and furnish it with his electronic signature. The legal representative is further obliged to preserve the underlying hard copy corporate documents. The obligation for the electronic submission of the annual financial statements will commence in 2009. Beside exclusive e-administration of corporate matters, one-business-hour express registration of new companies is now also available.

No legislative proposal has so far been put on the agenda in order to have the current corporate regulations changed due to the financial crisis.

Shareholders of limited liability companies, the most common corporate type in Hungary, shall now register with the Companies Court the mortgages established on their shareholdings in a company. As the Companies Register now shows the mortgages on the shareholdings, it provides bigger flexibility for the shareholders to provide collaterals and, parallel with that, bigger safety for the lenders, this way promoting new businesses to be concluded by the shareholders.

The shareholders meeting shall approve contracts between the limited liability company and its executive officer or his close relative.

26 Remuneration of senior management

How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions between the company and senior managers?

There are no statutory regulations on this matter.

27 D&O liability insurance

Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

It is legally permitted to have such insurance; however it is not a common practice. The company can pay the premiums.

28 Indemnification of directors

Are there any constraints on the company indemnifying directors in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

No explicit rule exists on constraining indemnification (possibility to grant discharge of liability is regulated by the Companies Act, see question 16). It is not common to indemnify directors in respect of liabilities.

29 Employees

What role do employees play in corporate governance?

The executive officers can fulfil their tasks by virtue of either an assignment contract or an employment contract concluded with their company. In the latter case, the executive will qualify as 'executive employee' in terms of the Hungarian Labour Code providing for special rules as compared to other employees. A non-executive employee can also be assigned as a manager to assist the executive officers.

In companies with a two-tier board structure, one-third of the supervisory board members shall statutorily be comprised of the delegates of the employees, if the number of full-time employees at the company exceeds 200 on an annual average. Delegates of the employees have rights identical with the non-employee delegated members of the supervisory board. In companies with a one-tier board system, the board shall negotiate with the employees and agree upon the method of employee representation.

Disclosure and transparency

30 Corporate charter and by-laws

Are the corporate charter and by-laws of companies publicly available? If so, where?

In line with the basic statutory principle of company transparency, the charter of the company as well as any and all shareholders' resolutions and other corporate documents, which have been filed with the Companies Court, are publicly available for review at the Companies Court for anyone (photocopies can be made free of charge; official copies can be requested against stamp duty payment). Neither a proxy, nor any other kind of authorisation from the company, nor

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identification is required for access. Online access to the basic data on the company is also possible free of charge, but this free service provides only "recent" data on the company. In order to acquire daily data on the company as well as the corporate documents, a password is required, but the service is subject to charges. Notwithstanding the above, corporate documents not required to be submitted (and therefore not submitted) to the Companies Court (eg, resolutions on the remuneration of board members, by-laws) are accessible only upon the authorisation of the company. However, it must be noted that public companies limited by shares that have shares listed on the Budapest Stock Exchange shall be more transparent, and their data shall also be available on their official website.

31 Company information

What information must companies publicly disclose? How often must disclosure be made?

Companies are statutorily obliged to deposit certain corporate documents and their annual reports at the Companies Court, where everyone has access to them. Companies are also required to publish a notice in the Offical Companies Gazette on the merger, demerger and transformation of the company, on the establishment of a controlled gpoup of companies, as well as on certain other corporate events.

Hot topics

32 Say-on-pay

Do shareholders have an advisory or other vote regarding executive remuneration?

The remuneration of executives is set in the resolution of the shareholders' meeting. Shareholders can also delegate the task of setting executives' remuneration to the supervisory board if such exists.

33 Proxy solicitation

Do shareholders have the ability to nominate directors without incurring the expense of proxy solicitation?

Not applicable in Hungary.

CORPORATE GOVERNANCE 2009 ISSN 1476-8127