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Private Liability in Hungarian Company Law – some current liability issues

A decade and a half ago I had a vision in my monograph, "The Ways of Private Liability in Company Law," which was soon fulfilled[2]. As I predicted, since then, domestic theory, legislation, and case law have found several new paths to civil liability in the context of corporate law breaches. At the same time, there are also popular company law groves and reserves for private law liability, which are based on centuries-old traditions. For example, the need to limit member liability, the recognition of a breach of liability as a sanction for unlawful conduct, the different directions of executive liability, the nature of the memorandum of association or, in some cases, the justification for joint liability and liability.

The authors have further developed the main directions of civil liability I have outlined in line with the requirements of economic and social changes, and expanded the liability dome created by the establishment and operation of companies, under which, in addition to civil law, there are several legal responsibilities. As a result, the cross-border problems of public and private law (including, in particular, criminal and civil law) liability have increasingly appeared in the domestic legal literature and case law in connection with the misconduct of members, senior executives and members of other corporate bodies. The social pathways of responsibility sometimes "branch out" and because of its danger to society, the conduct can also constitute a crime. Qualification issues arising from the interplay of different forms of legal liability have been constantly raised in legislation, case law and theory over the past decade and a half, indicating that liability law dilemmas are increasingly delimitation problems affecting certain branches of law[3].

The new Civil Code (Act V of 2013), which also integrates private economic law, has also opened new avenues in company law. In the Civil Code, the scope of liability for damages has been further expanded, and by separating contractual and

1 University Professor, Department of Civil Law and Roman Law

2 Tibor Nochta, The Ways of Private Liability in Company Law, Dialog Campus, Budapest-Pécs 2005

3 M. Tóth - G. Török: The Impact of the Changing Criteria of Bankruptcy Law on the Regulation of Criminal Law, in: Economic Criminal Law Studies, ed. Tóth M. - Gál I. L., Pécs 2005, Csőke A.: The Complex-CD Library Cstv. 33/A. Gula J. PhD: Certain aspects of the relationship between insolvency proceedings and insolvency offenses, in: Studies in honor of Professor Mihály Tóth's 60th birthday, Pécs 2011.

delictual (non-contractual) liability, the strands of liability in the direction of the company, members and third parties can be better separated. In addition, professional attention was paid to the corporate legal contexts of quasi-contractual and quasi-delictive liability forms.

In the last decade and a half, liability issues have not given equal weight to the various stages of a company's existence. An important change is that in the case of insolvent companies, the noisy route of liability to bankruptcy law, the diversity of responsibilities of senior executives, is surrounded by tremendous professional interest and attention. The expansion of liability breakdown cases, the strengthening of the risk-sharing role of liability, and the placing of expectations on an objective basis have become an increasingly important means of protecting the interests of companies' creditors.

I. Some trends that also affect corporate liability:

The examination of civil liability in the company law environment does not simply mean that we automatically apply its principles, institutions and general rules. Rather, it means the purposes for which and the protection of a legal person (company) operating as a business enterprise, the establishment of its organization, the establishment of its operation and the termination of its operation, and the sanctioning of illegal conduct. This connection links the general issues of liability with inseparable threads to the specific liability problems that also arise in company law. The following trends also play an important role in this interaction:

1. There has been an important paradigm shift in liability for damages, thanks to which the personalization of this liability created by natural law has been replaced by the distribution of technical and economic risks and, increasingly, by insurance. The imprints of this are also marked in company law[4].
2. The increasing economic definition of civil liability, the signs of which are clearly visible in terms of prevention, apportionment of costs and cost optimization, can hardly be disputed. The inevitability of an economic analysis of the effectiveness of the law of liability can be justified nowadays, especially in terms of business activity[5]. A trend that is increasingly characteristic of modern economic research is the recognition of mechanisms to reduce the likelihood of breach of contract in the context of illegality. Research and practice show that agreements in private sanctions and their enforcement, the analysis of benefits and costs sometimes lead

4 H. Kötz, Deliktrecht. Frankfurt am Main 1983. 19-20. old, Vö. Emmerich, Das Recht der Leistungsstörungen. 3.. Aufl. Verlag C. H. Beck. Munchen 1991, 88sk.

5 P. Behrens: *Die* ökonomischen *Grundlagen des Rechts*. J.C.B. Mohr (Paul Siebeck) Tübingen 1986. 310-312. G. Calabresi, *Some Thougths on Risk Distribution and the Law of Torts*, Yale L.J., 1961/70. 499-540.old, Hans-Bernd Schäfer-Claus Ott: *Lehrbuch der* ökonomischen *Analyse des Zivilrechts*. Berlin-Heidelberg-New York-London-Tokyo 1986 96-115.

to a reduction in breaches of contract in the same way as legal, judicial enforcement.

3. The examination of civil liability in the "external" (economic, social, sociological) dimensions sets an indispensable scientific direction. (socio-economic aspect). On the other hand, in order to preserve the "internal" consistency of private law, it is also important to ensure that the conditions of liability are free from dogmatic contradictions[6]. This imposes a dual task on theory, legislation and case law: it is necessary to ensure that the interactions between the "external" and the "internal" legal dogmatics of responsibility affecting responsibility are taken into account.
4. Causality in our age dissolves in crucibles of probability, frequency, predictability[7]. The premise of fair, just and resonable has become a real test of the risk-compensating compensation function, especially in the business contracts in which companies are also involved[8].
5. The current liability regime in Anglo-Saxon and Continental law is increasingly a tool for calculating and deploying risks. This is particularly clear in the assessment of the liability of senior executives in company law. Managers are particularly exposed to business risk. They must first and foremost recognize the risks of doing business (signs of bankruptcy, the pitfalls inherent in corporate transactions), because this is the only way to ensure the company's efficiency (compliance management system)[9]
6. Opinions are divided on the question of what to consider today as a central element of civil liability. The so-called behavioral approach focuses on illegality, while a results-oriented approach focuses on the outcome (harm) that occurs. Recent Hungarian private law research defines illegality as a measure of behavior, based on the teachings of the Martoni school, on the basis of which illegality classifies the perpetrator, while imputability classifies the perpetrator[10].

II. On some specific corporate liability issues

1) Is there correctness and / or liability in company law?

The new Civil Code distinguishes between duty and liability. This (more or less successfully) separates the facts of a liability for damages for unlawful damage from the facts on the basis of which a legal or natural person must be liable for a debt[11].

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6 F.Wieacker: *Privatrechts-Geschichte der Neuzeit*. 2. unveränderte Nachdruck, Göttingen 1996.

7 UN Convention on Contracts for the International Sale of Goods Art 82. 86 EKG. Schack: *der Schutzweck als Mittel der Haftungsbegrenzung im Vertragsrecht* JZ 86.206 fn.29. 507skk.

8 J. G Fleming, *The Law of Torts*. The Lawbook of Australasia, Sydney. The Law Book. 1965.

9 S. Grudmann: *European Company Law (Organization, Finance and Capital Markets)*. Intersentia, Cambridge-Antwerpen-Portland 2012, 44skk.

10 Landi B. Z.: Thinking Responsibly (Illegality as a Standard of Behavioral Review of Liability for Non-Contractual Damage), PhD Dissertation, Bp. 2014, 205-213.

11 The last published study: Peter Bodnár Miskolczi, entitled For the Debt of the Company,

Due to its sanctional nature, the obligation to comply is close to liability, but all the less so because liability is the excess that accompanies property (compensation) as a sanction for breach of an obligation[12]. So the penalty for liability for damages, which may be based on a breach of contract or imputability, is damages, the risk of liability, or a legal consequence of damages.

Liability is mostly separated from the obligation to comply by the fact that liability is always conditional on the omission or breach of a specific obligation that can be influenced by a sanction for damages (breach of the general prohibition of damages) (breach of contract)[13].

However, the standstill obligation is not a direct legal consequence of a breach of an obligation, but the secondary imposition on a member of the company of a risk arising from the non-performance of the primary obligor. In the case of business companies, the aim is to ensure the satisfaction of the property claims of creditors and third parties vis-à-vis the company, and at the same time to reduce the risk that this demand will remain unsatisfied.

The obligation of the members to comply is based on their contractual commitment, which also varies by type of company, in the case of the conditions specified by law, by signing the memorandum of association.

The multi-layered nature of civil sanctions can explain why we recognize the obligation to comply as a specific legal consequence. Approached from the company's creditors' point of view, the statutory statement that the member is liable for the company's outstanding debts (unless there is a breach of liability that results in a primary liability basis) creates the possibility that the primary debtor will be liable to a presumably performing person. The question is, is this enough protection for the company's creditors? Does it indicate that there is still a risk that the creditor's demand will remain unsatisfied because the member also has no (perhaps deliberately) assets, i.e. risk sharing (deployment) does not actually achieve its purpose.

2) Responsibility for breakthrough problem

In my opinion, it is not necessary to differentiate between the breakthrough of responsibility and the transfer of responsibility - although remarkable domestic theoretical work has also been done in this regard[14].

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was last published on the topic. Published by: PVRO PVRA DEFLVIT AQVA Festive Studies in honor of Professor Tibor Nochta's 60th birthday, edited by Benke J.- Fabó T. Pécs 2018, 197-201.

12 T. Lábady, General Part of Hungarian Private Law (Civil Law), Bp.-Pécs 2000, 278sk.

13 "liability arises if the consequences of failure to comply with a duty or obligation have to be settled". Marton G.: Civil Liability, Bp. 1993, 14skk

14 The problem was summarized mostly in Papp T.: Transfer of responsibility, breakthrough responsibility-quo vadis ius societatum. In. Legal entities in the new Civil Code, Miskolc

The limited liability member or shareholder of the company who has fulfilled his / her capital contribution - with the exceptions specified by law - has no liability towards third parties (creditors). Exceptionally, the rules imposing an obligation to satisfy the debts of the company in respect of such members are in fact liability rules because they are based on some unlawful and reprehensible conduct. In addition to Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings (Company Registration Act) and Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (Bankruptcy Act), the Civil Code includes these cases of liability (transfer of liability, breach of liability)

The following shall be considered as breaches of obligations of a member establishing unlimited liability towards creditors:

- conduct of a member which abuses his or her own limited liability and thereby creditors' claims remain unsatisfied[15]
- conduct of a member which intentionally causes damage to the creditor, for which the member is jointly and severally liable to the creditor with the legal person[16]
- the controlled member who becomes insolvent as a result of the unified business policy of the group establishes the liability of the dominant member for the unsatisfied creditors (actually the dominant member's liability under the Civil Code).[17]
- The continuation of an unfavorable business policy is assessed by the legislator as conduct which establishes a duty of standing (in fact, liability) of a qualified majority or sole member[18].
- If a limited liability company is removed from the register of companies by way of involuntary de-registration procedure, the company's former member – registered at the time of de-registration – bears unlimited liability for the outstanding claims of the company's creditors, if found to have abused his or her limited liability. If there is more than one such member, their liability shall be joint and several.[19]
- If a limited liability company is removed from the register of companies by way of involuntary de-registration procedure, any former member who transferred his or her share within a period of three years before the opening of involuntary de-registration bears unlimited liability for the outstanding claims of the company's creditors if found to have abused his or her limited liability or acted in bad faith in transferring his or her share.[20]
- In the case of liquidation proceedings, if the debtor has accumulated debts in excess

Conferences 2012, Miskolc 2013, 167-185.

15 Civil Code, Article 3:2 (2).

16 Civil Code Article 6:540 (3)

17 Civil Code, Article 3:59

18 Civil Code, Article 3:324 (3) and Bankruptcy Act, Article 63 (2)

19 Company Registration Act, Article 118/A (1).

20 Company Registration Act, Article 118/A (3)

of 50 per cent of its equity capital, upon the request lodged by a creditor, the court may establish that a former member with majority control, who transferred his or her share within three years before the opening date of the liquidation procedure, is subject to unlimited liability for the debtor's outstanding liabilities[21].

3) The civil liability of senior executives of companies

a) Damage caused in the capacity of a senior official

According to the Hungarian legislation in force – also applicable to companies – a legal person is liable for damage caused by a senior official if the latter causes the damage by acting in this capacity. This is the so-called principle of knowledge.

In making a company liable for the damage caused exclusively by a senior executive, the mere classification of conduct is not the governing principle, but the relationship between the conduct of the senior executive and the authority of the senior executive, i.e. whether the senior executive's harmful conduct was conducted in the exercise of his or her functions as a senior official.

If the damage was not caused by the manager in the exercise of his or her functions as a senior official in the strict sense, but as a result of this legal relationship he was in a situation where there was a possibility of damage, the liability of the legal person shall be established. However, in the following cases, there is no place to hold the legal person liable: if the manager does not act in the interests of the legal person, does not perform his / her duties arising from his / her official duties, his / her activities are not related to his /her obligation to perform the tasks specified in his / her assignment contract or employment contract or in the law.

Thus, a senior official can be held personally liable if the harmful conduct cannot be classified as damage caused by the legal person due to its nature, or if the damage was caused intentionally, even by committing a criminal offense, acting in his / her managerial capacity.

b) The responsibility of the senior executive towards the company

In the Part entitled General Rules for Legal Persons (including companies in the same sense)[22], the Civil Code provides that the senior official shall be liable to the legal person for the damage caused to the legal person in the course of his / her administrative activities in accordance with the rules on liability for damage caused by breach of contract.

21 Bankruptcy Act, Article 63/A

22 Civil Code, Article 3:24.

The liability of a senior official in general, but in particular for claiming damages for breach of contract, has raised a number of legal interpretation problems in recent years. Today, there is a consensus that the relationship between the chief executive officer and the company is a contractual relationship and that the chief executive officer is therefore liable for the damage caused to the company under the rules of contractual liability[23].

By accepting the status, the senior executives of the companies undertake to act in the best interests of the company in the circumstances that would normally be expected in a given situation. Violation of this duty of care will determine whether liability can be established. The measure of increased managerial diligence is an objectified, in many respects risk-based, but reprehensible line measure. The diligence that can be expected in the conduct of a company's affairs must always be assessed in the context of a specific obligation. Failure to exercise due diligence in the performance of your administrative duties shall not constitute a breach of contract. A senior official will breach his / her contract if he / she fails to exercise the due diligence expected of persons holding such a position. Failure to do so does not in itself constitute a breach of contract if the senior official acted with the utmost diligence in general and as expected.

If the driver causes the damage by violating the obligation of the employee, the Labour Code shall apply. The Civil Code is applicable to the company for other damage caused by the breach of its non-employment obligation in accordance with the rules of liability of the Civil Code for damages caused by a breach of contract[24]. With the entry into force of the Civil Code, the question arose whether the liability of the senior official should be assessed under the Labour Code or the Civil Code, if the senior official holds this position under an assignment contract or in an employment relationship. In the latter case, as a senior employee, he / she is liable under the Labour Code[25].

If the company, excluding the case of liquidation, is wound up without a legal successor, the creditors may also, to the extent of their unsatisfied claim, claim damages against the company's senior executives under the rules of non-contractual liability, if the senior official has failed to take account of the interests of creditors after a situation threatening the company's insolvency has arisen.

Not only the Civil Code, but also the relevant provisions of the Bankruptcy Act and the Company Registration Act, as well as court decisions define the "threat of insolvency". According to those standards, from the date on which the company's management foresaw or, with the due diligence expected of a person holding such a position, the management should foresee that the company would not be able to satisfy its claims against it when due, the company is in such a situation. A debtor

23 Ádám Fuglinszky, Tort of law, Bp. 2015, 136sk.

24 István Kemenes, Liability of the Chief Executive Officer. Hungarian Law. 1/2017.

25 Mónika Csöndes, Should the liability of a senior official be assessed on the basis of the Civil Code or the Labour Code if he / she holds his / her position in an employment relationship? Hungarian Law, 5/2017, 280skk.

with a significant debt is in a situation of threat of insolvency if its income is radically reduced and it has no collateral to settle its debts. In such a case, the sale of the debtor's shareholding in another company to a relative for a fraction of the nominal value establishes the property liability of the debtor's manager. It is important that the manager is not responsible for the occurrence of a situation threatening insolvency, or for the bad economic decision that caused it.

Once the situation threatening insolvency has arisen, the chief executive officer must act in the interests of the company, but must also take into account the interests of the creditors. This is confirmed by the fact that the current Bankruptcy Act and Company Registration Act also declare the liability of senior officials (in the presence of other factual elements), if, after the occurrence of a situation threatening insolvency, they have performed their administrative duties not on the basis of the priority of the interests of the company).

c) The liability of senior executives of companies removed from the register of companies by way of involuntary de-registration procedure

If the court of registration has removed the company from the register of companies by way of involuntary de-registration procedure, the senior official of the company, including the senior official removed from the register before the involuntary de-registration procedure, shall be liable for unsatisfied creditors' claims to the extent of his / her contribution to the resulting loss, if found to have failed to properly carry out his / her managerial functions in the wake of any situation of imminent insolvency, in consequence of which the company's assets have diminished or prevented to provide full satisfaction for the creditors' claims.

A senior official shall be released from liability if he or she proves that the threat of insolvency occurred at a time other than his or her term in said executive office or for reasons other than his or her managerial actions, and to have taken all measures within reason, that is to be expected from persons in such positions, upon the occurrence of a situation carrying potential threat of insolvency so as to prevent and mitigate the losses of creditors, and to prompt the supreme body of the company to take action.

If the senior official failed to carry out - for reasons within his or her control - the requirement prior to or during involuntary de-registration for having to deposit and publish the financial report, or - in the case of dissolution - failed to comply with the obligations provided for in Section 98 (3) of the Company Registration Act, or did so improperly, he or she shall be required to evidence that no losses have occurred during his or her tenure in executive office or during his or her activities as a receiver.

The purpose of imposing this additional burden of proof is to prevent a senior official of a company from evading the company through an involuntary de-registration procedure in order to avoid liability.