

## Corporate governance in state-owned companies in Hungary<sup>1</sup>

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### **Abstract**

*At the development and to the comprehension of the regulation it is necessary to ascertain that in our view, the subject of the regulation is the operation of the company. The regulation regulates the problems arising specifically during the course of the operation of the company, as an „ex ante” tool and by the avoidance of that upon the cessation of the public company, any unjustified or inconcievable costs (social costs) should rise. As an example, there are the infamous earlier corporate scandals (Enron, Parmalat, Vivendi Universal), the infringements of which drew critical social (budget) costs, as they left behind unsettled creditors' claims, plenty of workplaces got terminated, etc. To prevent this, one of the techniques is corporate governance, as it focuses on such mechanisms during the course of the operation of the company as direction and control. With this, the cessation of the company can presumably be avoided, as it is publicly acknowledged that the majority of corporate scandals descend from the faults of leadership, direction and control. Based on the above, we may ascertain that in our perception, under 'corporate governance' it's the legal facts or interests relevant in the course of the operation of the company what become regulated in terms of corporate law.*

**Keywords:** *company law, business law, corporate governance, state-owned company*

**JEL Classification:** K20, K22

The phenomenon, the subject of corporate governance is one such topic on corporate law, that has received a distinguished attention for the past decade from professional literature and the side of policy makers. The legal definition of corporate governance was set by the Cadbury Report in 1991 as: Corporate governance is the system by which companies are directed and controlled. Abstract as needed, this definition is appropriate to be applicable to define corporate governance in all parts of the world, yet further approaches are required to the unfolding of the content of the topic.

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## 1. What is regulated by corporate governance?

At the development and to the comprehension of the regulation it is necessary to ascertain that in our view, the subject of the regulation is the operation of the company. The regulation regulates the problems arising specifically during the course of the operation of the company, as an „ex ante” tool and by the avoidance of that upon the cessation of the public company, any unjustified or inconceivable costs (social costs) should rise. As an example, there are the infamous earlier corporate scandals (Enron, Parmalat, Vivendi Universal), the infringements of which drew critical social (budget) costs, as they left behind unsettled creditors' claims, plenty of workplaces got terminated, etc. To prevent this, one of the techniques is corporate governance, as it focuses on such mechanisms during the course of the operation of the company as direction and control. With this, the cessation of the company can presumably be avoided, as it is publicly acknowledged that the majority of corporate scandals descend from the faults of leadership, direction and control. Based on the above, we may ascertain that in our perception, under 'corporate governance' it's the legal facts or interests relevant in the course of the operation of the company what become regulated in terms of corporate law.

### *1.1. The subject of corporate governance regulations*

The first key-term generated from the above approach is which situations, state of affairs, interests are regulated by law? Having reviewed the corporate governance rules (codes on best practices), we may constatae that such situations are regulated by law as state of affairs, which cannot traditionally be considered as a field of corporate law. For instance how to (technically) summon the general assembly, what instruments should be applied for the efficient conduction of the general assembly.<sup>4</sup> What sort of legal powers the company should assign to the nomination committee, how it should regulate the standing orders and daily work-schedule of the managing directorship, what HR selection criteria should be applied.<sup>5</sup> None of these fields have formed the set of regulations to corporate law before. This statement certainly needs fine adjustments made, as the set of rules on corporate law can alter by eras and economic settlements. The continuous expansion of the rules of responsibility in Hungary can serve as an example to the continuous development.<sup>6</sup> At the examination of the classical fields of regulation of corporate law, we may claim that the rules of corporate law have covered the categories of economic companies (numerus clausus), the foundation mechanism (company procedure), and rules of the same branch applied to the termination as well: especially to the procedures of liquidation and bankruptcy as linked with

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<sup>4</sup> E.g. the Corporate Governance Recommendations [hereinafter: FVA] of the Hungarian National Assets Management plc as per recommendations no.15-33, especially 17 and 18

<sup>5</sup> MNV Zrt.'s FVA recommendations on supervisory-board no.59-77, on HR criteria 13

<sup>6</sup> To this as a summary see: Papp (ed.): „Társasági jog”, Lectum, (Szeged, 2011) pp. 249-251.

insolvency. These are the terrains, where legal regulations give no choice of an option, allow for not any private autonomy, but provide and entirely exhaustive, flawless legal governance instead. Certainly, the assurances of a 'rule-of-law' state to the company's operation are implemented by the acts of law, providing a standard rule for the operation in several cases, such as: the scope of authority as of the principal organ, conference general assembly, voting by post.

The exhaustive regulation upon the operation of the company (the period from the registry of the business association until the decision on its termination was made) was one of the terrains, where the private autonomy of the members used to be of the broadest spectrum. Yet, assumably to the numbers of corporate infringements the legal regulation had to react, and was required to provide sufficient solution to the occurrences during the course of operation. Since corporate infringements could be traced back to organizational operation, the recommendations of corporate governance apply by nature to the operational period of the company.

### *1.2. The legal feature of corporate governance rules*

Another examined conceptual element of corporate governance is: the legal assessment on the quality of the regulation. Corporate governance has known two types of rules in accordance with international trends: recommendations (for example for the companies listed on stock exchange in Lithuania, Poland, Romania and Hungary)<sup>7</sup> and suggestions. Corporate governance comprises genuinely self-regulatory, non-binding prescriptions, however, in Central and Eastern Europe there exists one peculiar line of it, demonstrated by that the to-be regulated topic in terms of corporate governance rules appears defined by acts of law (typically in act) instead of codes and self-regulatory documents. In the process of the codification of corporate governance rules it can also be observed, that part of the recommendations is not realized in the terrains of the recommendations, but on the level of law (e.g.: Romania, Slovenia and Hungary), when regulating a given corporate governance topic-area the policy-maker genuinely privileges the change in the rule of law (e.g.: in Slovenia and Romania in terms of organizational rules).<sup>8</sup> Certainly, this can be found in the Hungarian corporate governance practice, for example in the case of the publicly owned business associations it is the matter of remuneration as per Act CXXII of 2009.

The system of comply or explain commenced from Great-Britain, where the requirement was specified that public disclosure qualifies a sanction, which

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<sup>7</sup> International workshop: „Corporate governance in state-owned companies”, 11. 04. 2016., Gdansk, University Gdansk Faculty of Law and Administration, Societas CEE Company Law Research Network

<sup>8</sup> DJOKIC, Danila: „The Corporate Governance Statement and Audit Committee in the European Union and Republic of Slovenia.” *Croatian Yearbook of European Law & Policy*, (2009/5 pp.283-289), MANOLESCU, Maria – ROMAN, Aureliana Geta – ROMAN Constantin: „Corporate Governance of Romanian Public Interest Entities.” *DAAAM International*, (2010/1.) pp. 1127-1128, 1127

encourages the company to align with the practice defined by itself.<sup>9</sup> The proper standards in accordance with the recommendation are applied, yet it is at once questionable to set forth an optimum in the matter of the headcount for the board of directors or the supervisory board to operate. The term „comply or explain” means that in case a company shall not apply a given recommendation, then an explicit explanation must be supplied upon the reason why, more precisely it must publicly disclose the practices that are followed. In the EU member states it was the directives to introduce the technique of „comply or explain”, thus this is setting the directive to stock-exchange companies in Hungary.<sup>10</sup> The regulation of comply or explain does not equal the traditional denotation of an act of law, as it lacks the potential of state enforcement capability, and legal enforcement does only rely on the applicable prescriptions of mandatory public disclosure of the corporate governance report. This indeed is no regulative mistake, but the conceptual element to corporate governance, in which the regulation on the stock-exchange alongside the respective publicity is a sufficient sanction. The question of course is, whether or not an enforcement-potential is required, or is publicity itself a sufficient sanction? As we see it, it depends on stock-exchange culture, stock-exchange investors’ discipline. The impacts of stock-exchange culture and strictness can effectuate, if the stock-exchange’s trading turnover takes up a decisive segment off the economy. Consequentially, the enforcement potential would be necessary to establish in Hungary, as the scope of the economy is not the stock-exchange.

From the aspect of the topic of this study, the question arises more intensely within the field of state-owned enterprises as their property is no private but public property.<sup>11</sup>

## 2. Corporate governance in the public sector.

In our view, the previously mentioned general assumptions on corporate governance are applicable to state-owned enterprises. Special weight is granted to this field by that the state as a proprietor raises the duplicity as well as the turning into each other of the principal-agent relations. If the state is the proprietor, then behind it are the tax-payers. If the company ceases, then it will also result in consequences upon the budget, thus behind it are also the tax-payments of the citizens. These two areas are interconnected, so it is a theory of a duplex commissioner-agent that applies, which results in one triangular process as they turn into each other.

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<sup>9</sup> Martin WINNER: „Der UK Corporate Governance Code.” ZGR, (2-3/2012), pp.246-272, 252 and Janet DINE: „A new look at corporate governance,”(Company Lawyer; 5/2003); pp. 130-131; 130

<sup>10</sup> It is also a legal regulation minimum, that acts must regulate the public disclosure of the affidavit. This prescription in Hungary is also included in the Accountancy Act and the Civil Code.

<sup>11</sup> In Hungary, The Fundamental Law of Hungary decrees the principle of responsible and transparent management of the public finances. The Fundamental Law of Hungary article N), article 39 (2)

### 2.1. The definition of state-owned enterprises

Rules over state-owned public companies in Hungary must be divided into two. State-owned enterprises are certainly forming a part of the notion. On the other hand, there's the municipalities that may also hold corporate property.

As per The Fundamental Law of Hungary (formerly: The Constitution) the economy of Hungary is founded on value-adding work as well as the freedom of enterprises.<sup>12</sup> Everyone possesses the right to select work and occupation freely, and to enterprise, however, everyone is obligated to contribute by his or her capabilities and circumstances to the growth of the community.<sup>13</sup> Besides the freedom of occupation and enterprises everyone possesses the right to own property, that is bound by social responsibility.<sup>14</sup> Relating especially to this the Fundamental Law of Hungary decrees that the properties of both the state and the municipalities comprise the national property.<sup>15</sup> The Fundamental Law of Hungary decrees that any legal entity established upon the basis of acts of law is entitled to hold such fundamental rights and is subject to such liabilities that are not only applicable to humans by their nature.<sup>16</sup> In terms of the national fortune, The Fundamental Law of Hungary regulates the fortune of the state and the municipalities, and also the principles of economy in a unified manner; specifically highlighting that the economic organizations owned by the state and the municipalities conduct their economy in a manner determined by acts of law, independently and responsibly, in accordance with the demands imposed by legality, appropriateness and productivity.<sup>17</sup> The National Assets Act as of 2011. CXCVI. [hereinafter: Nvtv.] also keeps this duplicity, and alongside the state property it marks the property of the local self-government as well. For this reason, at the study of the economic organizations operating through state-involvement, we must expand the notion to the local self-governments, too.<sup>18</sup>

<sup>12</sup> The Fundamental Law of Hungary, article M) (1)

<sup>13</sup> The Fundamental Law of Hungary, article XII (1)

<sup>14</sup> The Fundamental Law of Hungary, article XIII (1) The constitutional legal status of the state property demonstrates a clear system in The Basic Law, yet the earlier Constitution – not only in it's authentic text, but also after the change of regime – decreed upon the status of public property. § 9 (1) of the Constitution decreed, that the economy of Hungary is such market-economy, in which the public property and the private property share the same rank.<sup>14</sup> The Constitutional Court evaluated this as the expansion of the discrimination interdict to the property right, which in essence defines a discrimination interdict to any forms of property. § 70/A. of the Constitution, Const. Court Provision 1990. 81. To the dismantling of the privileges of the state property See: SÓLYOM László: „Az alkotmánybíráskodás kezdetei Magyarországon”. Osiris, (Budapest, 2001) pp. 128-130

<sup>15</sup> The Fundamental Law of Hungary, article 38

<sup>16</sup> The Fundamental Law of Hungary, article I. (4), which decree equals the earlier provisions of the Constitutional Court (first 21/1990. (X. 4.) Const.Court Provision, 7/1991. (II. 28.) Const. Court Provision, with laid principles.

<sup>17</sup> The Fundamental Law of Hungary, article 38

<sup>18</sup> To the property of the local self-governments see: András Patyi – Ádám Rixer (Eds.): „Hungarian Public Administration and Administrativ Law”, (Schenk Verlag, Passau, 2014) pp. 342-345

Act CVI of 2007 on the fortune of the state that is the State Property Act [hereinafter: Ávtv.] came into force after the termination of the institutional privatization, and regulated the property conditions of the state arranged in a new frame.<sup>19</sup> As per the prescriptions of the Ávtv., the following items are the constituents of the property in the proprietorship of the Hungarian state: the things in the proprietorship of the state, and also the natural forces that can be utilized like things; other than this all of such property, respective of which the act specifies the exclusive proprietor's right of the state, such stock-paper in the proprietorship of the state which identifies membership rights, and also any other corporate shares that are due to the state, any such immaterial rights bearing property value that are due to the state, which are specified by an act as a right of property value, the monetary assets in the proprietorship of the state.<sup>20</sup>

The duty of the exercising of proprietorial rights and assets management examined from the aspect of our topic is: to ensure the efficient, cost-saving, value-preserving, value-adding application (direct application) of the state-property in compliance with its function – necessary for the fulfilment of state duties, sufficing of social necessities, and fostering the realization of the economy-policy of the Government, based on unified principles and appearing as an individual branch –, as well as the indirect utilization (including its sale resulting in the change of the property index), and also the enhancement of state property (including the expansion of the property index).<sup>21</sup> Rules of law designate the Hungarian National Assets Management plc (hereinafter: MNV Zrt.) to exercise the proprietorship rights.

Beside the companies operating through state-involvement in the case of the local self-governments, the board of representatives holds the right to found various types of organizations, in order to conduct the public services that are forming its scope of duties.<sup>22</sup> Examples to that may be budget organs, economic organs, nonprofit organs and other organs.<sup>23</sup>

Based on the above, we can declare that „public property” can be segmented into two, due to the Hungarian constitutional traditions and also according to the effective system of law: first to the property of the state, and then to the property of the municipalities. Regarding the property of the state, it can be declared, that it can be segmented further: to treasury property and business

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<sup>19</sup> Property, obviously covers a broader range as compared to propriety, yet the chapter only analyzes the rules included in the portfolio of economic companies.

<sup>20</sup> Ávtv. 1. § (2)

<sup>21</sup> Ávtv. 2. § (1)

<sup>22</sup> Act CLXXXIX of 2011. § 41. (6)

<sup>23</sup> To the topic-area of the corporate governance of the local self-government see: HORVÁTH M. Tamás: „Felelős társaságirányítás – közszektorban?” (Gazdaság és Jog, 2013/1.) pp. 12-16., and: „Vállalati részesedés igazgatása – köztulajdoni körben” In: Lapsánszky A.- Patyi A.: „Ünnepi kötet Verebéli Imre 70. születésnapjára. Rendszerváltás, demokrácia és államreform az elmúlt 25 évben”. (Akadémiai, Wolters Kluwer, Budapest 2014.) pp. 221-229.

property.<sup>24</sup> The function of treasury property is of the exclusively state-owned property, the restrictedly negotiable property, the national property of highly distinguished concern from a national economy's perspective, all of which are itemized in the Act on National Assets.<sup>25</sup> The business property is the property that forms no part of the whole of the treasury property.<sup>26</sup> Following this scheme, Sárközy Tamás argues the existence of business property, yet acknowledging meanwhile that it can still exist, like: the backup companies of the state (for instance companies pursuing educational, research activities), companies of strategic interest, which are in the permanent proprietorship of the state as they are facilitating the fulfilment of public duties.<sup>27</sup> Nonetheless, this system in this composition does not work immaculately, but both the existence and the scope of the business property are in perpetual change, aligning with the ever up-to-date tendencies of economy-politics.

From an administrative perspective, based on Act CVI of 2007 in terms of the state property, the entirety of all rights and liabilities of proprietorship due to the Hungarian state shall be designated to exercise by the Hungarian National Assets Management plc. (hereinafter: MNV Zrt.).<sup>28</sup> The MNV Zrt. is a one-man joint-stock (public) company founded by the state, and the stock of which is non-negotiable.<sup>29</sup> From among the items of state property included in the duties of the MNV Zrt., the Ávtv. specifically mentions the stock-paper in the proprietorship of the state, which identifies membership rights, and other company shareholdings, that are due to the state.<sup>30</sup>

In Hungary, there are no such special company forms as to conduct publicly-owned economic activities, however, the state applies the company forms regulated by the Civil Code while conducting these activities.

It's not only that the Hungarian legal system is unfamiliar with any peculiar company types, but also that it fulfils many public duties in the form a public business associations. These companies have peculiar public-law relevance, status, such as Hungary's central bank, The Hungarian National Bank (MNB), as an example. The Hungarian National Bank is a legal entity, operating in the form of a joint-stock (public) company. In our view, the MNV Zrt. falls in the same category as well, which is a one-man joint-stock (public) company founded by the state, and the stock of which is non-negotiable. The Hungarian National Assets

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<sup>24</sup> TORMA András: „A nemzetgazdaság igazgatása.” In: Közigazgatási jog II. - Fejezetek szakigazgatásaink köréből. Lapsánszky András (Ed.) (Complex, Budapest, 2013) pp.23-59. 43. Analyzes the notion of business property: SÁRKÖZY Tamás: „A korai privatizációtól a késői vagyontörvényig”. (Hvgorac, Budapest. 2009) pp.192-195.

<sup>25</sup> TORMA A.: *op.cit.* 43.

<sup>26</sup> Uo.

<sup>27</sup> SÁRKÖZY: *op.cit.* 193.

<sup>28</sup> Act CVI of 2007 § 1 (6a)

<sup>29</sup> The approval as well as the amendment of the foundation deed of the MNV Zrt. forms the competence of the minister. The MNV Zrt. may not transform, may not disunite, may not unite with another company. Upon its termination the Parliament may decree in Ávtv. § 18 (1)

<sup>30</sup> Ávtv. § 1 (2) c)

Management PLC. pursues state service, among others it executes proprietary rights over the state fortune. However, the realization of the general prescriptions of civil law varies with respect to each one of the scenarios, and in fact the specific prescriptions affect relevant elements of the regulation.

### *2.2. The corporate governance question*

In our perception, regarding the companies owned by the state, the realization of corporate governance shall be differentiated depending on the economic profile that they bear.

The first (1) are the activities conducted by the state through its a monopolist position, with the formation of the regulation. More precisely it does not permit any other market-players to enter, yet the activity itself is profitable. Second (2) is the economic situation, when the activity itself is non-profitable, but it couldn't even be, as it identifies the social function of the state. The sector of public services is an example to this. The (3) last one is the marketplace situation, which means that the state as a player in the economic competition is involved in the competition. In this case, only the membership position can be linked with the state. Each one of the above economic situations connects with a different governance problem scenario. In the first case (1), the demands for the transparency on the operation of the management can come forth. The second (2) is a special case, as this field of the economy has been blending with the legal system of the European Union, at the arrangement of the activity specific requirements must be justified, so the membership position of the state and the internal operation of the company may just as well be the subject of corporate governance rules. The role of the state can appear the most conspicuously in the third (3) case, when the state may not create a more advantageous situation against other market-players.

We assume, that the variant economic grounds impose variant emphases upon the fields of corporate governance, yet none of the economic grounds can overshadow the relevance of corporate governance. By the question of the state-property, we believe, the real corporate governance question is that whether the state- as a member, the state- as a member of the company possesses more-, or any different rights than a traditional company does? Are these, at all, ensured by corporate law even as an option, or not?

For the sake of entirety, let us note that it qualifies a situation to differentiate from the above aspect, when as a special state-intervention, the public company becomes designated by the Government as of a strategically outstanding concern. This has a relevance when the activity of the company is distinctive (for instance it conducts public services, it has a connectivity to national defence). This designation only matters when it comes to the condition of insolvency, as those procedures prescribe peculiar rules.



### 3. The applicable rules to state (public) companies

Corporate governance can be scrutinized in two angles in the case of economic organizations operating through state-, or municipality involvement. One of them is the intern relations, namely that how do the principles of corporate governance become implemented in economic organizations established by the state or the municipality. In answer to this there are the principles developed by the OECD. The collection of recommendations was first issued by the OECD in 2005, then it was in 2015, when during the general review on corporate governance the new code was introduced. The recommendations are applicable to such business associations as legal persons, in which the state executes the proprietorship rights – and holds an influential-, a sovereign role –, and also to such public-law legal subjects, which have an economic role.<sup>31</sup> Here, in our view, the emphasis falls on that whether the state as a shareholder has got relevant influence on the decision-making of the company. Certain forms of influencing (golden share, majority shareholder etc.) draw different governance-issues, and with this different resolutions, too. According to the recommendation, the performance of this sector makes a competitiveness factor.

The explanation for the creation of the recommendations directive to the economic organizations operating through state-, or municipality involvement is the aim to professionalize the ownership function of the state, the implementation of efficiency, transparency and mandatory reporting to the degree of the private economy, and to ensure equal treatment rules in such cases when the state-owned company is active on the same marketplace with the competition-field.<sup>32</sup> Corporate governance plays a vital role in the development of these warranties, furthermore, the recommendation highlights that the utilization of corporate governance practices is an essential prerequisite to a financially effective privatization as well. Special relevance must be attributed to this particular objective in Hungary and in Central and Eastern Europe, although after the privatizations accomplished in the past, it is now the utilization of recommendations directive to the state as a role-player of the active economy that can be detected.

In the recommendations directive to state companies, it is recorded that the document includes specific prescriptions, complementary requirements against the document on general corporate governance,<sup>33</sup> thus the efficient system of corporate governance can be composed by the concurrent reading of the two recommendations.

On the basis of the recommendations, throughout the involvement of the state a distinctive attention must be paid to that the state should provide an efficient legal regulation framework to the market-players, without distorting the competition by its presence. With respect to the regulation, the state must avoid the creation of special, merely self-applicable rules, as that would demonstrate a market-distorting

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<sup>31</sup> OECD 2015. 15.

<sup>32</sup> OECD 2015. 11.

<sup>33</sup> OECD/G20 Corporate Governance Principles

impact, moreover, it must be aiming at the standardization of legal subject categories whilst avoiding the establishment of the peculiar type of a state company.<sup>34</sup> The state as the owner is advised to develop such a procedure, that can fulfil the obligation of accounting by means of transparency, without any distortion. All through this, the following must be considered with: exercising the voting right, transparency of the nomination of the directorship board, ensuring independent and impartial decision-making to all participants of the decision-making. Beyond these, the recommendations also affect the obligations of the board, the stakeholders, the requirements of transparency, and the enforcement of the demands of equital treatment, yet with respect to these, the prescriptions do not include special provisions against general rules, but the collection of recommendations itself refers back to general rules.<sup>35</sup>

We claim, that there is another possible way and concept to the application of corporate governance: this means the extern processes, namely those, in which the state participates as a contracting party. One point of connectivity is that the Act on National Assets has introduced the notion of transparency, meaning fundamentally the analysis via tax-liability criteria and the revelation of membership.<sup>36</sup> The core principle of the management of the national property is that an agreement can only be concluded by an organization, if it is transparent.<sup>37</sup> In our view, the state may just as well apply such principles in its procurements, in the course of public procurement. Investments and procurements accomplished under the course of public procurement can be compatible to take into account further aspects besides profit, thus the utilization and enforcement of corporate governance principles can appear as a requirement equivalent to this.<sup>38</sup>

### *3.1. The corporate governance recommendations by the MNV Zrt*

The MNV Zrt. has issued a document alongside the international standards of the corporate governance, to reinforce the Hungarian corporate governance practice. By this, we believe, that it has taken a regionally prominent place in terms of corporate governance thinking.

The Hungarian National Assets Management plc (MNV Zrt.) has issued a recommendation to the companies in the ownership of the state, inclusive of recommendations and guidelines in a complex system, addressing the society of economic organizations operating through state-involvement.

The code was proclaimed in the spring of 2013 by the MNV Zrt. The corporate governance ground directive to the companies constituted of several parts:<sup>39</sup>

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<sup>34</sup> OECD 2015. 38.

<sup>35</sup> To these see: PAPP Tekla (Ed.): „*Társasági jog*”, (Lectum, Szeged, 2011) pp. 532-533.

<sup>36</sup> Nvtv. § 3 (1)

<sup>37</sup> This aspect appears in the Nemzetivtv. among others in: 8. § (1), 12. § (13)

<sup>38</sup> See European Court of Justice C-368/10 European Commission – Dutch Kingdom case

<sup>39</sup> Available at: [http://www.mnvzrt.hu/vallalatiranyitasi\\_ajanlasok/vallalatiranyitasi\\_ajanlasok.html](http://www.mnvzrt.hu/vallalatiranyitasi_ajanlasok/vallalatiranyitasi_ajanlasok.html)

- Corporate Governance Recommendations
- Code of Ethics, according to the initial idea of which to the employees of the public service, it is ethical norms of higher level than the average that are setting the directives, and they are also required to comply with such professional ethic principles that apply exclusively to those in the public service.
- Risk-management Manual, the target of which is to promote the recognition of direction problems, the shaping of the propositions for a sound resolution beyond a risk-management methodology, grounded on an analysis of abilities to direct, and the familiarization with the applicable control-models.
- Investment policy -related recommendation. The target of the recommendation is to provide support in terms of the utilization of free monetary assets and currency rate risk-management, by the application of which the regulations of the companies can be compiled.
- Liquidity planning recommendation. In the case of the companies owned by the state it projects the operation of a so-called four-week rolling liquidity planning system. Primarily, the collection of recommendations reinforces the stream of information towards the leadership of the company, it provides alternatives for the management on liquidity-problems, and cornerstones to elicit the selection of proper investment options, given a liquidity surplus.

### ***3.2. The place of the recommendations among the Hungarian corporate government requirements***

The Hungarian rules of law prescribe it to the business associations registered on the regulated market to publicly disclose their corporate governance affidavit. Act LII of 2007 incorporated the mandatory preparation of a corporate governance report into the corporate law, that has been upheld by the Civil Code as well. The board of directors of the publicly-traded joint stock company is mandated to present the report, exposing the corporate governance practice followed by the joint-stock company, which is compiled in the format prescribed for the participants of the given stock-exchange, to the annual ordinary general assembly, the approval of which shall be decided by the general assembly. The provision of the general assembly along with the approved report are mandated to publicly disclose on the website of the joint-stock company.<sup>40</sup>

Then the public disclosure of the corporate governance affidavit was also incorporated into the Accountancy Act – in line with the obligation on the harmonisation of law in the European Union<sup>41</sup> – as regards of such entrepreneurs,

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<sup>40</sup> Act IV of 2006 on business associations (hereinafter: Gt.) § 312 (1)-(2), Civil Code. § 3:289, which is a cogent rule

<sup>41</sup> Act CXXVI of 2007, having served the compliance with the directive 2006/46/EK.

whose tradeable stock-papers have been entered in the regulated market of a state within the European Economic Area.<sup>42</sup>

Besides the corporate governance affidavit, the decrees of the corporate law on the rules of public disclosure were complemented in a special field in 2009 that was: the remuneration, as the publicly-traded joint stock companies entered into the regulated market, were obligated to publicly disclose on an annual basis on their website, at the time of summoning the annual ordinary general assembly, the names of the directorship or the board of directors and, where applicable, also the names of the members of the supervisory-board, along with all monetary and non-monetary remuneration allocated to the members by their membership quality, in a way itemized by member and legal title of the remuneration, in a detailed format. In addition, the joint stock companies had to ensure continuous access to all such data on their websites as well.<sup>43</sup> The rule has been amended by the Civil Code, and the new norm delegates the due definition of the principles upon the longterm remuneration and incentives' system to leading officers, members of the supervisory-board and management employees, into the exclusive competence of the general assembly.<sup>44</sup>

The corporate governance affidavit is to be prepared on the basis of the Hungarian Corporate Governance Recommendations (FTA) issued by the Budapest Stock Exchange in 2004 for the first time. The FTA touches upon four topic-areas: (1) the rights of the shareholders and the respective procedures, (2) the competence of the directorship/ board of directors, and the members of the supervisory-board, (3) the committees, (4) transparency and public disclosure, and the respective recommendations and guidelines. The introduction of the recommendation declares that the alignment with the prescriptions of the document is advised, yet non-mandatory.

According to the FTA, the companies are ordered to testify their governance practice in two ways. The first part of the report must supply a comprehensive elaboration on the corporate governance applied in the targeted business year, also marking the instances of any incidental peculiar circumstances with that. Thereafter, an announcement must be made upon the compliance with the points of the FTA, in a manner identical with the international practice: a public statement is to be given on the basis of the comply or explain principle. This means that whereas the compliance with the recommendation of the FTA must not-, yet the incompliance must well be explained, however, there is no obligation for any explanation regarding the guidelines. The code was significantly revised in 2008, the amendments of which gained force on the 16th of May, 2008. The code was then revised in November, 2012 again, but this time not any relevant, comprehensive changes were drawn.

In the case of the FVA, the recommendation stays unresponsive in this matter. However, we have not traced any references as to whether the companies

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<sup>42</sup> Act C of 2000, § 95/B (1)-(3)

<sup>43</sup> Gt. § 312/A

<sup>44</sup> Civil Code § 3:268 (2)

should issue any form of a statement regarding what is covered by the collection of recommendations. Thus, the question remains open as to what is the form, in which the company may be expected to give an account, and can issue a public statement.

### 3.3. *Specific prescriptions*

Regarding to the regulation of state-owned companies, it can be established that to these companies also, it is the Civil Code, and not special norms that are to be applied in general.<sup>45</sup> We can also assert that to complete any public assignment, to provide any public services may be demonstrated in accordance with the general (Civil Code) regulations and the specific prescriptions are to be applied as a directive only to the organization of state-owned companies.<sup>46</sup>

The corporate governance has relevance at state-owned companies in both intern (a) and extern (b) relations:

- a) how the principles of corporate governance can be effective at the economic organizations founded by state or by local government (see OECD Guidelines on Corporate Governance of State-owned Enterprises 2005, focused examination by Worldbank Group and Act CVI of 2007 on state property in Hungary);
- b) how the state or the self-government contracting party can be (see the aspects in tax law and public procurement in Hungary).<sup>47</sup>

Neither the Hungarian Civil Code,<sup>48</sup> nor the Recommendations of Budapest Stock Exchange for Corporate Governance of Public Company Limited by Shares 2012 contain special provisions for economic enterprises owned by state or by local government. However, the MNV Zrt. has Recommendations for Corporate Governance of Enterprises Owned by State or Self-government, with principles for lawful operation of these companies.<sup>49</sup> The special regulation for state-(or self-government)-owned companies can be basically found in two acts: Act CXXII of 2009 on more economical operation of state-owned companies and Act CXCVI of 2011 on national assets.

<sup>45</sup> ZOVÁNYI Nikolett „Kie a felelősség? A társasági jog útvesztőiben” (Who is responsible? Public enterprises in the labyrinth of company law) (<http://www.kozjavak.hu/hu/kie-felelosseg-kozvallalatok-tarsasagi-jog-utvesztoiben>; 2015. 12.18.9; FÉZER Tamás „Két úr szolgálai – a közvállalatok vezető tisztségviselőinek felelőssége” (Servants of two gentlemen – the liability of executive officers of public enterprises) (<http://www.kozjavak.hu/hu/ket-ur-szolgai-kozvallalatok-vezeto-tisztsegviseloinek-felelossege>; 2016. 02. 19.)

<sup>46</sup> PAPP Tekla – AUER Ádám „Group Interest in Hungary” (Acta Universitatis Sapientiae; p. 17.; forthcoming)

<sup>47</sup> AUER Ádám „Corporate Governance, Állami részvétellel működő gazdálkodó szervezetek” (Corporate Governance, Economic Organizations Participated by State) (NKE; Budapest; 2015.; p. 13.,41.); AUER Ádám „Corporate Governance az állami vagy önkormányzati részvétellel működő gazdálkodó szervezetek esetében” (Corporate Governance at the Economic Organizations Participated by State and Self-government) (In: Adózási pénzügytan és államháztartási gazdálkodás; ed.: Lentner Csaba; NKE; Budapest; 2015.; pp. 811-812.)

<sup>48</sup> Act V of 2013

<sup>49</sup> AUER I. op.cit. pp. 58-68.; AUER II. op.cit. pp. 816-824.

In the following, we describe the special rules of these two acts for the enterprises of state and local governments on the base of seven aspects.

1) Special prohibitions of further association

Such companies owned in 100% by state or local government, which was founded for performing public duties, mustn't establish another company for these public duties.<sup>50</sup> The state and the self-government mustn't found such company and mustn't get share in such company which is not transparent.<sup>51</sup> Non-profit company with majority control of state/self-government is permitted to create an other non-profit company with majority control of state/self-government – apart from recycling activity -, but this new non-profit company mustn't establish further companies.<sup>52</sup> These provisions also have to apply to the acquisition of share in other business associations by enterprises owned by state or local government.<sup>53</sup>

2) Special issues relating to assets

The share of company providing public service and with majority control of state may be available as contribution in kind or on the ground of other transferring legal title only for companies owned in 100% by state/self-government.<sup>54</sup> The share of company providing public and parking service, with majority control of local government and of Balaton Shipping Private Company Limited by Shares may be available as contribution in kind or on the ground of other transferring legal title only for companies owned in 100% by state/self-government.<sup>55</sup> These mean limited transferability of shares of state/self-government in companies. The share in companies owned by state/self-government mustn't be an object of assets management;<sup>56</sup> it means limited legal title and legal base of privity. In connection with the share in companies owned by state, which is a part of national assets and important from the national economy, only the minister pointed out by act, or a central budgetary agency or an economic enterprises owned in 100% by state may exercise the owner's rights;<sup>57</sup> it means limited circle of exercisers of proprietor's rights. To the increase of capital at company owned in more than 50% by state/self-government which reduces the proportion of state/self-government

- the consent of the exerciser of owner's rights is necessary,
- over 2.000.000 HUF the resolution of government of Hungary or municipal council is required,
- between 5.000.000 HUF and 2.000.000.000 HUF the resolution of the minister, who is responsible for supervision of state assets or municipal council, is needed;<sup>58</sup> it means limited and controlled capital movements.

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<sup>50</sup> Act CXCVI of 2011 §8 (6)

<sup>51</sup> Act CXCVI of 2011 §8 (1)

<sup>52</sup> Act CXCVI of 2011 §8 (8), (9)

<sup>53</sup> Act CXCVI of 2011 §8 (1), (8), (9)

<sup>54</sup> Act CXCVI of 2011 §4 (6)

<sup>55</sup> Act CXCVI of 2011 §5 (8)

<sup>56</sup> Act CXCVI of 2011 §8 (7)

<sup>57</sup> Act CXCVI of 2011 §7/A (3)

<sup>58</sup> Act CXCVI of 2011 §8 (10)

In the name of the state MNV Zrt. and the Hungarian Development Bank Private Company Limited by Shares may give credits and loans to the companies with majority control of state.<sup>59</sup>

The reasonable undertaken business risks are determined by company activity and its background, the market surroundings.<sup>60</sup>

In Poland the ownership rights in state-owned companies were centralized in one organization: Ministry of Treasury, which was dismissed by the prime minister in September 2016.<sup>61</sup> Lithuania has a decentralised SOE ownership structure, with twelve ministries.<sup>62</sup> In Romania there is neither single ownership entity: beside the Authority for Administration of State Assets several authorities, ministries have ownership function.<sup>63</sup>

### 3) Special rules of organization

Among the state-owned companies, at the private limited companies the operative organ usually is the general manager and if the importance, size, type of operation of the company is explained itself, then the operative organ is the board of directors (with 3-5 members).<sup>64</sup> The legislator allows only the two-tier/dualistic system, but not the one-tier/monistic system for organization of state-owned companies;<sup>65</sup> the same refers to in Poland, Czech Republic,<sup>66</sup> Serbia<sup>67</sup> and Lithuania, but the one-tier organizational system is allowed in Romania.<sup>68</sup>

<sup>59</sup> Act CXCIV of 2011 § 45 (1)

<sup>60</sup> FÉZER op.cit.; BH 2004. 372.

<sup>61</sup> *Kaja Zaleska-Korziuk* „Report on corporate governance in state-owned enterprises – the Polish perspective” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>62</sup> *Edvardas Juchnevicius* „The corporate governance of state-owned enterprises in Lithuania” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>63</sup> *Veress Emőd* „The state’s role as owner of enterprises: mandatory rules of corporate governance in Romania” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>64</sup> Act CXXXII of 2009 §3 (1)

<sup>65</sup> About this see more details in: *Papp Tekla* „Corporate governance – felelős társaságirányítás” (Corporate Governance – Responsible Guidance of Companies) (Acta Juridica et Politica; Tomus LXXIII; Fasciculus 1-64.; Szeged; 2008.; pp. 639-653.)

<sup>66</sup> *Katerina Eichlerova* „Corporate governance of state-owned enterprises in the Czech Republic” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>67</sup> *Branislav Malagurski* „Challenges of Serbian public enterprises in the light of points II C and F of OECD Guidelines on corporate governance of state-owned enterprises” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>68</sup> International workshop: „Corporate governance in state-owned companies”, 11. 04. 2016., Gdansk, University Gdansk Faculty of Law and Administration, Societas CEE Company Law Research Network

According to the Austrian Public Corporate Governance Code, the state-owned companies with more than 30 employees or with more than 1 million euro turnover shall have a supervisory board consisting of state elected members.<sup>69</sup> At the state-owned companies in Hungary is obligatory to form supervisory board with 3 members (over 200.000.000 HUF between 3 and 6 members).<sup>70</sup>

4) Special provision for decision

At the companies with majority control of state/self-government, the competence of supreme body includes the foundation, the termination of economic association, the acquisition and the transfer of shares in economic association.<sup>71</sup>

5) Special prescriptions for remuneration

The state-owned companies have to create a regulation about the mode, measure, principles and system of allowance of executive officers and of the members of the supervisory board;<sup>72</sup> non-compliance with this regulation is prohibited and unlawful.<sup>73</sup> The executive officer and the member of supervisory board may receive remuneration only in one state-owned company, comparing to the current least wage (sevenfold of current least wage at the president of executive board, fivefold of current least wage at members of board of directors, fivefold at the president of supervisory board and threefold of current least wage at members of supervisory board).<sup>74</sup> In Poland there is a similar situation: the remuneration of executives equals to the index of an average monthly wage in state-owned enterprises as of the last quarter of the previous year announced by the Central Statistical Office, at small state-owned enterprises multiplied by one to three, at the largest state-owned companies multiplied by seven to fifteen.<sup>75</sup>

6) Special regulation of transparency

The state-owned company shall publish the name, the function and the allowances of its executive officers and of its supervisory board members.<sup>76</sup> The head of the state-owned company shall be liable for the publication of these data, for its continuous availability and for the authenticity of publication.<sup>77</sup>

7) Special shareholder's rights

At the state-owned company providing fundamental services, the state may exercise the right of option to purchase shares which are not its property in the interest of safety of supply, of supplying duties, of increasing efficiency, of

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<sup>69</sup> *Martin Winner* „Autonomy and Independence in SOEs” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>70</sup> Act CXXII of 2009 §4 (1)

<sup>71</sup> Act CXCVI of 2011 §8 (14)

<sup>72</sup> Act CXXII of 2009 §5 (3)

<sup>73</sup> Act CXXII of 2009 §5 (4)

<sup>74</sup> Act CXXII of 2009 §6

<sup>75</sup> *Bartłomiej Gliniecki* „Current fundamental changes of the boards members' remuneration in Poland” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>76</sup> Act CXXII of 2009 §2 (1)

<sup>77</sup> Act CXXII of 2009 §2 (1)



national economic strategy.<sup>78</sup> Any shareholders at the state-owned company may request that the shareholder exercised the right of option to purchase shall buy his shares (the selling right).<sup>79</sup> These rights are obligatory and pecuniary rights, not rights in accordance with exercise of classical member's right.

8) Special accounts requirements<sup>80</sup>

The public enterprises have to separate the state subventions in their internal accounting. The public enterprises must keep a record of the dividend, the financial benefits and the waiver of recovery of used state monetary assets. The public enterprises, those net revenue exceeded 250 million euro in the previous business year, shall send to the competent revenue office within six months from the closing of business year

- their account (with the balance sheet report),
- business report,
- statement about accounting policy,
- reports of executive officers,
- data about own shares, own business shares, preference shares, priority bonds,
- data about not-repayable supports, loans, guarantees,
- data about the payed-out dividends and the held-back profit,
- data about any kind of state intervention.

In Serbia the State Aid Institution is legally obliged to conduct annual audits of state-owned companies.<sup>81</sup>

9) Acceptance of discharge state duties of state-owned companies by central budgetary agency

The central budgetary agency may take over the discharge state duties from the companies owned in 100 % by state, then the concerned company must be terminated and for the debts of terminating company there is no liability of company's member (according to the Civil Code).<sup>82</sup> At the time point of acceptance of discharge state duties the assets in the property of company owned in 100 % by state devolve to the state and the trusteeship is due to the central budgetary agency.<sup>83</sup> At the time point of acceptance of discharge state duties the central budgetary agency is the successor of all rights and commitments of the company owned in 100 % by state.<sup>84</sup>

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<sup>78</sup> Act CXXII of 2009 §7/A (1)

<sup>79</sup> Act CXXII of 2009 §7/F (1)

<sup>80</sup> On the ground of 3009/2012. NAV útmutató (Guide of the National Revenue and Customs Office)

<sup>81</sup> *Branislav Malagurski* „Challenges of Serbian public enterprises in the light of points II C and F of OECD Guidelines on corporate governance of state-owned enterprises” (presentation „Corporate governance of state-owned enterprises in Central and Eastern Europe”; 14. 10. 2016.; Budapest; National University of Public Service and Societas CEE Company Law Research Network)

<sup>82</sup> Act CXCV of 2011 § 11/A (1), (1a)

<sup>83</sup> Act CXCV of 2011 § 11/B (2)

<sup>84</sup> Act CXCV of 2011 § 11/C (1)

The Hungarian regulation on state- and self government-owned companies are theoretically keeping with OECD Guidelines, but not so detailed and comprehensive. The above discussed provisions are not so transparent and too general, we – the outsiders – do not have enough information how these rules operate in the practice in Hungary...

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