

# SOME QUESTION MARKS OF PRIVATE LAW ON THE STATE-OWNED COMPANIES IN HUNGARY

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**ABSTRACT:** *The state can be an actor in Hungarian private law in several ways: on the one hand, by its organs (e.g. the Office of the National Assembly, ministries), on the other hand, by the organs of public law the state creates (e.g. budgetary organs), thirdly, through business associations operating with the participation of the state, fourthly, exceptionally, the state itself can also act as a subject of private law<sup>2</sup> (AUER, 2017). In this study we call the attention to that the terminology used in case of business associations operating with state/local government participation is not sustainable and we focus on some issues where the private and public law discrepancy can be found in Hungary.*

**KEY WORDS:** *state/local government membership in companies; terminological and legal anomalies*

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## 1. ANOMALIES IN THE TERMINOLOGY

The literature in economy (DOMOKOS et al., 2016, pp. 185-204) and public administration (HORVÁTH M., 2015) universally applies the expression ‘enterprise’ when it comes to companies operating with state/local government participation though the Hungarian Civil Code doesn’t acknowledge this legal person, nor does the Act on Firm<sup>3</sup>. Besides, the word ‘enterprise’ also recalls the business association form (public enterprise) before the transition in the early ‘90s.

Similarly to the expression ‘enterprise’, in case of business associations operating with state/local government participation, ‘public undertaking’,<sup>4</sup> ‘publicly owned companies’ (PÉNTEK, 2010, pp. 263-275), ‘public owned business associations’ (DOMOKOS et al., 2016, p. 185) also seem to be often used and overall categories.

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<sup>2</sup>Act V of 2013 on the Hungarian Civil Code 3:405. para. (1)

<sup>3</sup>Act v of 2006 on public company information, firm registration and winding-up proceedings

<sup>4</sup>Act cxxii of 2009 on the efficient operation of the state-owned companies; 3009/2012. National tax and customs administration of Hungary directive

In connection with companies operating with state/local government membership, norms of public law most commonly refer to their capacity as owner: 'owned by',<sup>5</sup> 'owner',<sup>6</sup> 'ownership' (HAJDU, 2006, pp. 666-680),<sup>7</sup> 'proprietary',<sup>8</sup> and by applying these, there is a difference made between the companies founded differently or with different types of membership.

These terminologies used in public law have a questionable relation to one another as well: which is broader or may involve the others, whether these circles of meanings partially overlap or crosses the other, or rather one meaning is part of the other, furthermore if all the expressions mentioned above can be substituted with one another? In the end, from private law aspect, can these words (especially those referring to the special ownership) be applied in connection with companies operating with state/local government membership? (DOMOKOS et al., 2016, p. 193)<sup>9</sup>

## 2. CRITIQUE ON THE PUBLIC LAW TERMINOLOGY FROM THE ASPECT OF PRIVATE LAW

„A possible approach to the definition of the publicly owned goods is to start out of the special public law status of the subject of the property law" and those "objects to ownerships that have a destination – other than the generally accepted function of property law providing domination that is above the goods and excludes others – to serve social aims directly or indirectly or to be accessible for anyone. The public administration – if not provided otherwise – decides freely whether it chooses the private law or the public administration way when providing the use of publicly owned goods." (MENYHÁRD, 2005, p. 6, p. 8) Nonetheless, if there is an administrative decision, the practitioner and who applies the law shall follow either the private (NASZLADI, 2016, pp. 65-66)<sup>10</sup> or the public law consequently, and they mustn't combine or mix the institutions and the definitions of the two branches of law (AUER - PAPP, 2017, p. 219).

a. *Based on the legal personality of companies* (PAPP, 2017)<sup>11</sup>

Business associations are legal subjects with legal personality. The legal person has a separate asset: the property of the legal person is not equal to the property, assets of its creators/members (principle of separation of ownership). The independent pecuniary liability of the legal person derives from its separate assets: for the obligations, debts of the legal person, the legal person shall fulfil its obligations, not its creators/members.

When creating a legal person, the founders, by limiting their own assets, create a new organization, a new legal subject. By providing contribution (they limit, reduce their own assets with the amount of the contribution) they create the assets of the new legal entity.

<sup>5</sup>Fundamental law of Hungary; act clxxxix of 2011 on the local governments of Hungary; act cxxii of 2009 on the efficient operation of the publicly owned companies; act cxv of 2011 on the economic stability of Hungary

<sup>6</sup>Act clxxxix of 2011 on self-government

<sup>7</sup>Act cxv of 2011 on public finance

<sup>8</sup>Act cxv of 2011 on national assets; organizational and operational regulation of the Hungarian National Asset Management Inc. (official bulletin.32/2017.)

<sup>9</sup>Clarifying the question and using the right expression affect a big sector: among the OECD countries in 2009 Hungary was the third in the list out of those who employed people by companies with majority interest of the government, in the Hungarian labour market every 25th employee worked at a company like this in 2009.

<sup>10</sup>Constitutional Court Decision No. 3091/2016. (12. 05.)

<sup>11</sup>This sub-section was based on this work.

The asset provided by the founders belongs to the new organization and not to them, it will be owned by the legal person. All the financial contributions provided at the foundation will be the separate asset of the new, independent legal subject.

As a compensation of limiting their own assets (providing the financial contribution to the company) the founders of the legal person can be given rights applicable in a certain way and level: for example membership rights in case of companies, the grouping, the co-operative and the association, and founder's rights in case of the foundation.

When founding a legal person, the aim of the founders is to create a new legal entity by separating a part of their asset and by allocating an independent organization to it. By separating the amount of the financial asset, the legal object becomes legal person (personification), in this process the former owner(s) – usually – transform to be member(s) (CSEHI, 2006, p. 2). The founders, the members are not the owners of the legal person since the private law regulation in force doesn't make it possible to have and practice the rights of the owner in case of a legal subject.<sup>12</sup> Besides, a legal subject (organizational form) cannot be the object of market trade as intangible property either.<sup>13</sup> The legal person decides upon the asset obtained during its operation or accumulated by its activity.

Business associations are legal persons that are companies as well, therefore, the principle of firm protection refer to them as well. The business association, based on the principle of the firm protection, is an independent legal subject: it may obtain rights under its own company name, may undertake obligations, thus especially have property, it may conclude a contract, may sue and may be sued.<sup>14</sup> What follows the independent legal subject is that the company is separate from its founding members; changes in the members doesn't affect the existence of the company; the rights/obligations of the members are not the rights/obligations of the company (PAPP ed., 2011, p. 41).

Both the civil law and the company law approach result in the same conclusion: based on the private law dogmatics and judicatory, it is inappropriate to use expressions referring to ownership in order to designate or differentiate between business associations.

*b. Based on the Rights in Rem (LEHOCZKI, 2017)<sup>15</sup>*

The most obvious approach to the expressions relating to the ownership mentioned in point 1, is given by the analysis whether certain rights of the owner (right to possess, right to use, right of beneficial enjoyment and the right to dispose over property) (VÉKÁS – GÁRDOS ed., 2014, pp. 927-928; WELLMANN ed., 2013, pp. 53-54; SÁNDOR, 2014, pp. 501-502, pp. 525-527, p. 534)<sup>16</sup> can be applied to the companies.

The right to possess refers to the objects of property law<sup>17</sup>, but the companies – given that they are legal persons, so legal fictions – don't exist in physical sense (they don't have physical body), therefore, there cannot be gained and maintained control over them.

Utilization means to use the thing, the indirect object property law, in case of companies it is impossible since, on the one hand, they are not things and on the other

<sup>12</sup>Court of Budapest 6. G. 40.132/2002/3.; Recommendation of the Court of Appeal of Szeged 2/2005. (17. 06.)

<sup>13</sup>Casebook of the Courts 2001. 166.; Casebook of Courts 2001. 165.; Recommendation of the Court of Appeal of Szeged 2/2005. (17. 06.)

<sup>14</sup>Firm Act 2. para. (1)

<sup>15</sup> See this work for this sub-section.

<sup>16</sup> Civil Code 5:21. para., 5:22. para., 5:30. para.

<sup>17</sup> Civil Code 5:14. para.

hand, it would mean the use of its founders (members), those in contact with it (employees, those in civil law relation with it). In connection with this the question raises, whether the activity of the company can be regarded as use? Among the characteristics of the legal person, the permanent structure and operating under its own name leads to the "will-articulation" happening via a natural person. The legal entity – due to the legal nature of its personality (fiction and it consists of natural persons) (KEMENES, 2000, p. 315) – can operate via natural persons and their actions are considered to be actions of the legal person. Activities of a leader, member of a work organization or a board member of the legal person done in the name of the legal person is considered to be the activity of the legal person. When concluding a transaction by the legal person, the natural person acting in the name of the legal person doesn't have independent transactional will, the decision of the board that gives the transactional authorization cannot be considered as an aggregate of individual contractual will; this is the principle of imputability (PAPP, 2017).<sup>18</sup>In consequence of the principle of imputability, it is not the members or those in other legal relation with the legal person who use the company, but the company uses them.

The right to use, right of beneficial enjoyment mean the benefits deriving from the thing, the indirect object property law; in case of companies this is equivalent to the profit-share. In case of non-profit companies the profit cannot be distributed,<sup>19</sup>but this is one of the general characteristics of the profit companies. Nonetheless, the right to dividend and to interim dividend is not an automatic membership right, but it can be provided under certain conditions.<sup>20</sup> Due to the prohibition and restrictions drafted above, the right to use, right of beneficial enjoyment cannot be applied in case of companies generally.

From the sub-authorizations of the right of disposition the assignment and the surrender of the possession cannot be interpreted in connection with companies: based on the above-mentioned, if the right of possession and right to use cannot be fulfilled with content, the right of beneficial enjoyment can only be fulfilled conditionally, the right of assignment and of the surrender of the possession have no relevance (there is nothing to assign or surrender). Other parts of the right of disposition (cannot be used in connection with the legal entity, because it shall be regarded as contracts with impossible object, these shall be considered null and void.<sup>21</sup>

The dogmatic analysis above has a consequence in the judicatory as well: the case law is also inconsistent from the aspect of rights in rem

- it regards the state as a member and the company operating with its participation, as a direct manager of the state asset,<sup>22</sup>
- or, contrary to this, it considers the state as an owner and the company with the participation of the state doesn't manage state asset because of that;<sup>23</sup> in the first case the

<sup>18</sup>Resolution for the uniformity of private law 2017. 8.; Court of Appeal, Budapest 17. Pf. 20 237/2012/10.; Court of Appeal, Szeged Pf. 20 104/2007.; Court of Appeal, Pécs Pf. I. 20 370/2009/4.; Court of Appeal, Pécs Pf. II. 20 470/2010/4.

<sup>19</sup>Firm Act 9/F. para. (2)

<sup>20</sup>See: Civil Code 3:109. para. (2); Act C of 2000 on accounting 39. para. (3)

<sup>21</sup>Csongrád County Court 1.Gf.40.116/1999/3.; Csongrád County Court 1. Gf. 40.134/1999/3.; Recommendation of the Court of Appeal of Szeged 2/2005. (17. 06.)

<sup>22</sup>Court of Appeal, Budapest 2.Pf.21.465/2011/4.; K-H-PJ-2012-323.

<sup>23</sup>Central District Court of Pest 2.P.91.917/2011/4.

state doesn't have general liability to fulfil its obligation in case of legal dispute, while in the second case – as an owner – it has (AUER – PAPP, 2017, p. 219).

### 3. THE COMPANY PROPERTY IN THE PERCEPTION OF THE HUNGARIAN CONSTITUTIONAL COURT

The Hungarian Fundamental Law<sup>24</sup> doesn't make difference between public and private property, it considers every type of property to be equal and provides equal protection (principle of equality of the different types of properties) (BENCZE, 2006, pp. 882-901).<sup>25</sup> "Under the circumstances of the market economy, in the competitive sphere we must consistently make a difference between the state as public authority and the state as a proprietor and also between the state (state administration) and the entrepreneur–management sphere... In this field the state is considered to be as an actor of the economy and not as an organization of public administration, in addition, a clear distinction shall be made between the rights and obligations of the state as a subject of management and the authorisations (as public authority) as instruments to influence the management by the state."<sup>26</sup> This conclusion of the Constitutional Court can be found in the private case law as well:<sup>27</sup>"in consequence of the horizontal relationship and equality of the parties in civil law relations, the procedures, measures, possible omissions deriving from the public administration and public law function of the state affect the state as a legal entity in the same way as it affects the other parties of the legal relation." In conclusion, if we differentiate between the legal subjects and the forms of property – even with using an unreasonable private law terminology – we also discriminate them.

Nonetheless, company law is sector-neutral:<sup>28</sup> there is no reason for differentiation that strengthens the position a state has in company law or lawfully provides the domination of the state in a certain form of business association (joint-stock company). Nowadays, in the British, French and the German company law the management-approach replaces the owner-approach, the member doesn't practice the rights of the owner (ARMOUR et al., 2017, pp. 14-17; KRAAKMAN et al., 2009, pp. 14-16).<sup>29</sup> Being a member in a company doesn't lead to the position of the owner: the legal relation of membership is 'all the legal relation adding from organizational, co-operational, contractual rights and obligations, fitting into the member's asset.<sup>30</sup> Therefore, the membership is not a right in rem legal institution, the property law doesn't describe the rights deriving from the membership (except for the business share and stock providing priority to liquidations surplus, since they have a right in rem entitlement character.) Based on the reasons mentioned before, the shareholder is not an owner of the joint-stock company by his share, his ownership is only indicated on the securities which ceases to continue with the transfer or withdrawal of the share.<sup>31</sup>

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<sup>24</sup> Article XIII.

<sup>25</sup> Constitutional Court Decision No. 59/1191. (19.11.)

<sup>26</sup> Constitutional Court Decision No. 59/1191. (19.11.)

<sup>27</sup> Court Order 2002. 235.

<sup>28</sup> Constitutional Court Decision No. 59/1191. (19.11.)

<sup>29</sup> Constitutional Court Decision No. 935/B/1997.

<sup>30</sup> Constitutional Court Decision No. 935/B/1997.

<sup>31</sup> Constitutional Court Decision No. 645/B/2008.

The Constitutional Court held in connection with the local governments as well that the Civil Code applies to the local government as an owner – with respect to the derogations (restrictions) deriving from the public legal personality, regulated as legal entities by the Act on Local Government – just as it applies to any other owners.

The Constitutional Court – other than the constitutional law interpretation of the right to property as fundamental right and the protection of property<sup>32</sup> – in its perception of company property, shares the view of the private law dogmatic and the case law; based on the decisions of the Constitutional Court the elimination of the anomalies in the public legal terminology is also justified.

#### 4. OTHER POTENTIALLY PROBLEMATIC FOCAL POINTS

Beside the assumptions and misinterpretations deriving from the incorrect terminology, there are several other questions in connection with the companies that have the state/local government among its members, we take a glance at some of these issues:

- Are the administrative asset management forms in conformity with the contract law (asset management contract, cluster, outsourcing, spin off companies etc.) and the common rules referring to legal entities (local government associations are also legal entities)<sup>33,34</sup>?
- If the owner of the share providing veto right<sup>35</sup> is the state/local government, is it EU-conform and lawful (is there a lawful public interest in the background that can be justified)? (NAGY BARNA, 2017)<sup>36</sup>
- How conform is the Act on national assets<sup>37</sup> prohibition of forming further associations with the principle of freedom of association and to conduct a business? (PAPP ed., 2011, pp. 27-30)
- Are the rules concerning the limited tradability of the shares in a company and the prohibition of further contributions mentioned in the Act on national assets<sup>38</sup> justified legally and are they proportional?
- In connection with the special rights of the shareholder mentioned in the Act on efficient operation of the state-owned companies<sup>39</sup>, why redeemable share is not suitable?<sup>40</sup>
- Are the organizational restrictions<sup>41</sup> in public law in accordance with the general provisions of company law referring to minority protection?<sup>42</sup>

<sup>32</sup> Constitutional Court Decision No. 64/1993. (XII. 22.)

<sup>33</sup> Act on Local Governments 90. para. (1)

<sup>34</sup> See: Civil Code 6:1. para. (3), 6:59. para., 3:3. para. (2), 3:4. para. (1)-(3)

<sup>35</sup> Civil Code 3:232. para. (2)

<sup>36</sup> With respect to the articles 49., 54. and 63. TFEU, the judgements C-503/99. and C-483/99. of the Court of the European Union and to the Constitutional Court Decisions No 59/1991. (19. 11.) and 1336/B/1997.

<sup>37</sup> 3. para. (1) 1., 16., 17.; 8. para. (1), (6), (8), (9)

<sup>38</sup> 4. para. (6), (8)

<sup>39</sup> 7/A. para. (1)-(3), 7/B. para., 7/F. para. (1)

<sup>40</sup> Civil Code 3:239. para.

<sup>41</sup> Act on efficient operation of the state-owned companies 3. para. (1) bek., 4. para. (1), (2); Act on national assets 3. para. (1) 16., 8. para. (14)

<sup>42</sup> Civil Code 3:103-106. paras.

This can be continued with the regulations referring to business name, limitations of liquidity, restrictions of the movement of capital, provisions referring to restrictions of the legal claim, provisions of remuneration, transparency etc.

In conclusion of the problems analyzed in detail:

- a) instead of the expressions disapproved in point 1, it would be more suitable to use companies operating with state/local government membership (its level can be designated before the word) or participation and applying the word 'public undertaking' is acceptable;
- b) from private law aspect it is worrying if the state/local government as a legal person of private law owns privileges (ZOVÁNYI, 2016, pp. 359-365), though in certain legal situations this cannot be avoided, therefore, if a legal situation like this occurs, the transparent legal background which is coherent with private law is a minimum requirement, failing this, the state/local government serves its own interest instead of the general public interest.

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