

HUNGARY INTRODUCES FOREIGN INVESTMENT RESTRICTIONS USING THE PRETEXT OF THE CORONAVIRUS – IMMEDIATE IMPACT ON M&A DEALS

The Hungarian Government issued a new decree on 25 May 2020 (the “**Decree**”), which requires both notification to and acknowledgement by the Minister of Innovation and Technology (the “**Minister**”) as a precondition to implementing foreign investment into Hungarian companies operating in a large number of sectors.

WHAT IS THE BASIS OF THE NEW RESTRICTIONS?

The new measures, introduced with reference to the COVID-19 related state of emergency, are based on the broad parliamentary authorizing act passed on 30 March 2020 (i.e. the ‘**Authorization Act**’, which enables the Government to deviate from normally applicable legislation and legislative procedures).

The Decree is not based on the pre-existing Hungarian legislation on the screening of foreign investment (Hungarian Act LVII of 2018,) but establishes an additional, broader framework.

WHEN DO THE RESTRICTIONS APPLY FROM AND UNTIL WHEN?

The new restrictions are applicable immediately, from 26 May until 31 December 2020. A draft bill submitted to the Parliament by the Government on 26 May 2020 suggests that the restrictions may remain in place after 1 January 2021.

WHO QUALIFIES AS A ‘FOREIGN INVESTOR’?

For the purposes of the new provisions, foreign investors are (natural or legal) persons or organisations who are resident / registered in (i) a country which is outside of the EU, EEA or Switzerland; or (ii) the EU, EEA or Switzerland, if they are under the majority control of (natural or legal) persons or organisations resident / registered in a country which is outside of the EU, EEA or Switzerland. (If the legislation remains after 31 December 2020 and the UK has not agreed terms of its continuing membership of the EEA, UK investors could be caught by this.) The language of the new provisions include ambiguities which may result in persons or organisations who are resident / registered in the EU, EEA or Switzerland being also affected which raises questions about the compatibility of the Decree with EU law.

WHAT COMPANIES AND SECTORS ARE COVERED?

- A new vague definition of ‘strategic companies’ is introduced, which covers public and private companies (Nyrt. Zrt. or Kft.) having their registered seat in Hungary and
- whose registered principal or ancillary activities fall into the list of activities listed in the new Government decree (see [Annex](#)), which activities are
 - ⇒ pursued in the energy, transport or communication sectors or
 - ⇒ fall within a sector that qualifies as a sector of strategic importance, which is determined by using the EU law criteria whether a foreign direct investment is likely to affect security or public order (see box to the right on the next page) The Decree specifies that financial, credit and insurance activities fall into such category.

M&A considerations

- ◆ Uncertainty damages deal environment and may impact deal pricing
- ◆ Simultaneous signing and completion is not possible
- ◆ A new condition precedent to completion is needed and more complex documentation
- ◆ The lack of deemed approval delays transaction timing
- ◆ Transaction costs increase
- ◆ Already progressing or signed deals need to be reviewed and completion is likely to be delayed
- ◆ Internal restructuring is also caught, no exemption applies

Other potential consequences

- ◆ Creating and enforcing security may not work (e.g. share pledge) – banks may require new security
- ◆ Potential events of default may be triggered
- ◆ Typical shareholders’ agreements provisions may be impacted (e.g. provisions covering control rights, call options, anti-dilution etc.)
- ◆ Hostile takeovers may be frustrated.



Péter Lakatos
Managing Partner
peter.lakatos@lakatoskoves.hu



Péter Köves
Senior Partner
peter.koves@lakatoskoves.hu



Richard Lock
Partner
richard.lock@lakatoskoves.hu



Pál Rahóty
Counsel
pal.rahoty@lakatoskoves.hu

Lakatos, Köves and Partners
1075 Budapest
Madách Imre út 14.
Tel: +36 (1) 429 1300
Fax: +36 (1) 429 1390
www.lakatoskoves.hu

WHAT TYPE OF INVESTMENTS ARE COVERED?

The following transaction types require both notification to and acknowledgement by the Minister:

- Acquisition of ownership interest;
- Capital increase;
- Mergers, demergers, transformations to another company form;
- Issuance of bonds which are convertible or convert to equity or provide preferential subscription rights;
- Establishing usufruct over equity,

provided that as a result the foreign investor would acquire directly or indirectly

- i) majority control (by way of ownership, voting rights, appointing management or otherwise); or
- ii) at least 10% ownership interest, if the investment reaches or exceeds HUF 350 million (approx. EUR 1 million); or
- iii) any level of interest which, if computed together with any other foreign investors' interest, exceeds 25 %

In addition, irrespective of ownership thresholds or transaction sizes, the transfer of using / operational rights of infrastructures and assets that are 'indispensable for the operation of strategic companies' (including the pledging of these assets and infrastructures) require both notification and acknowledgement by the Minister.

The Decree also separately provides that any acquisition of an increased ownership interest reaching 15%, 20% or 50 % needs to be notified.

Affected sectors – assessment of 'strategic' nature

To identify affected sectors within its Annex, the Decree also refers to the criteria defined in the Regulation (EU) 2019/452 establishing a framework for the screening of foreign direct investments into the EU (the "FDI EU Regulation"), which includes the following considerations:

- ◆ operating 'critical infrastructure', including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure;
- ◆ using 'critical technologies' and dual use items including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defence, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
- ◆ supply of 'critical inputs', including energy or raw materials, as well as food security;
- ◆ having access to sensitive information, including personal data, or the ability to control such information or
- ◆ affecting the freedom and pluralism of the media).

WHAT PROCEDURAL STEPS ARE REQUIRED FOR MAKING THE NOTIFICATION AND SEEKING ACKNOWLEDGEMENT?

The notification shall be made by the foreign investor within 10 days from signing the transaction documents. The notification shall include, in addition to the identifying data of the foreign investor (including ownership structure and AML data), a detailed description of the proposed transaction and a full set of the transaction documents. The language of the procedure is Hungarian and legal representation is obligatory.

The Minister has 45 days (which starts from the receipt of all documents and which can be extended by 15 days) from receipt to decide on either issuing an acknowledgement or making a decision forbidding the transaction.

EVALUATION CRITERIA

In its procedure, the Minister is bound to make his decision on the basis of evaluating the following criteria:

- a) whether the proposed transaction endangers or threatens to endanger the national interest, public order, public security of Hungary with particular attention to the safety of catering for the basic needs of the society, in accordance with the relevant articles of the Treaty on the Functioning of the European Union (TFEU Art. 36, 52 (1) and 65 (1), which invoke, among others, public policy, public security or public health issues);

Lakatos, Köves and Partners
1075 Budapest
Madách Imre út 14.
Tel: +36 (1) 429 1300
Fax: +36 (1) 429 1390
www.lakatoskoves.hu

CREATIVE | COMMITTED | CLIENT FOCUSED

This newsletter does not constitute legal advice with respect to any matter or set of facts and may not be relied upon for such purposes. Readers are advised to seek appropriate legal advice before making any determination or taking any action related to matters discussed herein. No part of this newsletter may be copied or quoted without the prior written consent of Lakatos, Köves and Partners.

- b) whether the applicant is directly or indirectly under the control of any administrative agency of any non-EU state (including its ownership structure or financing);
- c) whether the applicant was involved in any activity relating to public security or public order issue in any other member state;
- d) whether there is substantial risk that the applicant will commit any crime or illegal activity.

If the Minister finds that any of the foregoing conditions apply, it shall issue a decision which forbids completion of the contemplated transaction, otherwise the Minister shall acknowledge the notification.

The Minister is obliged to set out the reasons for any negative decision. However the vagueness of the terms of the Decree practically allows the Minister to deliver decisions in a discretionary or arbitrary manner.

LEGAL REMEDIES

The decision of the Minister cannot be appealed, but is subject to a challenge before the Metropolitan Court of Budapest, which has 30 days to deliver its decision.

If the court establishes that the rejecting decision was unlawful, it shall set aside such decision and order the Minister to conduct a new procedure.

SANCTIONS FOR NON-COMPLIANCE

The Decree sets out various sanctions. Any contract, declaration or corporate resolution which breaches the provisions of the Decree or the negative decision of the Minister shall be null and void (albeit a subsequent acknowledging decision made by the Minister may cure such consequence).

In the absence of the acknowledgement of the Minister or in the case of the negative decision by the Minister, foreign investors cannot be registered in the members' list or the shareholder register of the respective company and thus cannot exercise ownership rights. The courts of registration are also required to refuse registering any corresponding change in the corporate data of the respective company regarding any ownership change without filing the acknowledgement of the Minister.

Finally, if the Minister (who is in charge of the implementation of the Decree) establishes that a foreign investor does not comply with the notification / acknowledgement requirement, the Minister may impose a fine. The Decree provides that the amount of the fine shall exceed 1% of the respective target company's net annual turnover in the previous business year. The maximum fine is capped at double the transaction value.

WHO TO CONTACT?

This Decree has potentially major impact on investors and transactions. Many provisions of the Decree are unclear and questions of interpretation and implementation arise.

If your business may be affected by the above Decree or by the state of emergency, please do not hesitate to contact any member of our team:

Péter Lakatos	peter.lakatos@lakatoskoves.hu	+36 20 952 8799
Péter Köves	peter.koves@lakatoskoves.hu	+36 20 931 4578
Richard Lock	richard.lock@lakatoskoves.hu	+36 20 921 5035
Pál Rahóty	pal.rahoty@lakatoskoves.hu	+36 20 946 2519

Lakatos, Köves and Partners
1075 Budapest
Madách Imre út 14.
Tel: +36 (1) 429 1300
Fax: +36 (1) 429 1390
www.lakatoskoves.hu

CREATIVE | COMMITTED | CLIENT FOCUSED

This newsletter does not constitute legal advice with respect to any matter or set of facts and may not be relied upon for such purposes.

Readers are advised to seek appropriate legal advice before making any determination or taking any action related to matters discussed herein. No part of this newsletter may be copied or quoted without the prior written consent of Lakatos, Köves and Partners.

ANNEX - LIST OF SECTORS AND ACTIVITIES

	Sector	NACE code	Division
1	Chemical sector	19	Manufacture of coke and refined petroleum products
		20	Manufacture of chemicals and chemical products
		21	Manufacture of basic pharmaceutical products and pharmaceutical preparations
2	Commercial facilities	45	Wholesale and retail trade and repair of motor vehicles and motorcycles
		47	Retail trade, except of motor vehicles and motorcycles
		46	Wholesale trade, except of motor vehicles and motorcycles
3	Communication sector	61	Telecommunications
4	Critical industrial sector (including electronics, machinery, steel making and manufacture of transport equipment)	26	Manufacture of computer, electronic and optical products
		27	Manufacture of electrical equipment
		28	Manufacture of machinery and equipment not elsewhere classified
		29	Manufacture of motor vehicles, trailers and semi-trailers
		30	Manufacture of other transport equipment
		24	Manufacture of basic metals
		25	Manufacture of fabricated metal products, except machinery and equipment
5	Security industry	25.4	Manufacture of weapons and ammunition
		30.4	Manufacture of military fighting vehicles
6	Barrages	42.91	Construction of water projects
7	Energy sector	35	Electricity, gas, steam and air conditioning supply
8	Emergency services	84.22	Defence activities
		84.24	Public order and safety activities
		84.25	Fire service activities
9	Finance industry	64	Financial service activities, except insurance and pension funding
		65	Insurance, reinsurance and pension funding, except compulsory social security
		66	Activities auxiliary to financial services and insurance activities

ANNEX - LIST OF SECTORS AND ACTIVITIES

10	Food sector and agriculture	10	Manufacture of food products
		11	Manufacture of beverages
		12	Manufacture of tobacco products
		1	Crop and animal production, hunting and related service activities
		2	Forestry and logging
		3	Fishing and aquaculture
11	Government facilities	84	Public administration and defence; compulsory social security
12	Health	86	Human health activities
		87	Residential care activities
		88	Social work activities without accommodation
13	Information technology	62	Computer programming, consultancy and related activities
		63	Information service activities
14	Nuclear sector	24.46	Processing of nuclear fuel
15	Building sector	41	Construction of buildings
		42	Civil engineering
		43	Specialised construction activities
16	Water supply and sewerage service	36	Water collection, treatment and supply
		37	Sewerage
17	Waste management	38	Waste collection, treatment and disposal activities; materials recovery
		39	Remediation activities and other waste management services
18	Building materials industry	8.1	Quarrying of stone, sand and clay
		23	Manufacture of other non-metallic mineral products
19	Traffic, transportation, logistics	49	Land transport and transport via pipelines
		50	Water transport
		51	Air transport
		52	Warehousing and support activities for transportation
		53	Postal and courier activities
20	Manufacture of medical and dental instruments and supplies	32.5	Manufacture of medical and dental instruments and supplies
21	Tourism	55	Accommodation
		56	Food and beverage service activities

CREATIVE | COMMITTED | CLIENT FOCUSED

This newsletter does not constitute legal advice with respect to any matter or set of facts and may not be relied upon for such purposes. Readers are advised to seek appropriate legal advice before making any determination or taking any action related to matters discussed herein. No part of this newsletter may be copied or quoted without the prior written consent of Lakatos, Köves and Partners.