

LAKATOS, KÖVES ÉS TÁRSAI  
ÜGYVÉDI IRODA

# LKT NEWS

CORPORATE  
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## UPDATE – GOVERNMENT USES EMERGENCY POWERS TO TAKE OVER MANAGEMENT OF A PUBLIC COMPANY

### WHAT HAS HAPPENED?

The Hungarian Government has passed a decree and appointed a government commissioner for a listed company (Kartonpack NyRt.) The commissioner is given powers to exercise certain shareholders' rights, including replacing the members of the board of directors and the supervisory board, and also to exercise certain ownership rights, including powers to terminate agreements of the company and to participate in negotiations with lenders.

### HOW DO THESE DEVELOPMENTS RELATE TO THE EARLIER LEGISLATION LISTING COMPANIES FOR POTENTIAL REQUISITION?

The current measures are independent from and supplement the measures announced previously, on 17 March 2020, under which a military task force was established to oversee the operation of a growing list of companies (see our previous newsletter at [http://www.lakatoskoves.hu/img/news/Newsletter\\_corp\\_regarding%20temporary%20requisition%20%28003%29.pdf](http://www.lakatoskoves.hu/img/news/Newsletter_corp_regarding%20temporary%20requisition%20%28003%29.pdf)). To date, companies on that list have been required to produce operating plans and to provide contact persons for the military task force. Kartonpack was never placed on that list.

### SO WHAT IS THE BASIS OF THE GOVERNMENT'S CURRENT PROCEDURE?

The new measures are specific to a single company, Kartonpack. A new government decree has been issued, based on both the recent general parliamentary authorizing act passed on 30 March 2020 (the Authorization Act, which enables the Government to deviate from normally applicable legislation and legislative procedures) and also on the pre-existing 2011 Emergency Management Act.

### DOES CORPORATE LAW GIVE PROTECTION?

The starting point, from a corporate law perspective, is that decisions involving the exercise of ownership rights, including changing the management, are reserved for shareholders. However, Corporate law, is overridden by the 2011 Emergency Management Act which, in emergency situations, allows the Government to appoint a commissioner to exercise the powers of the shareholders' meeting, to the extent that is required directly to fend off the emergency or to mitigate its impact. Arguably, the change of the management is unlikely to satisfy this test and, therefore, it appears that the Government thus relied on the 2020 Authorization Act which allows it to deviate from the provisions of legislation in force. This means that the steps made by the Government take their basis from far outside the realm of corporate law, which significantly reduces the chances of a successful challenge based on shareholders' rights.

The broader corporate law perspective is therefore that investors and management needs to be prepared for the possibility that ownership and management rights may be taken over by the Government in any company, and that the corporate law position is disregarded.

### WHAT IS THE SECURITIES LAW PERSPECTIVE?

A fundamental principle of securities law is that taking control and management rights over a listed company requires the making of a public offer to all shareholders, so that they can decide whether they keep their shareholder position or sell their shares. While the 2011 Emergency Management Act is silent about the foregoing basic principle, the current broad application by the Government of its emergency powers means that in effect such principle is overridden. It remains yet to be seen whether any shareholder objections would be supported by the courts or the regulator - possibly not, as the Government is using powers under the 2020 Authorisation Act.



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The position of minority shareholders is further complicated by pre-existing controversy surrounding the company (which may also be used by the government to justify their action, although no such link has yet been formally made). As the press reported, a shareholder holding over 30% is accused of acquiring his shares as a result of insider trading and is therefore prevented from exercising shareholder rights, and the shares of the majority shareholder (over 60%) were previously seized in a criminal procedure, but the seizure has not been enforced -- even if it was, only the proceeds, not the shares themselves would be due to the Hungarian State, and pending a sale of such shares by the bailiff the management formerly appointed by and connected to the majority shareholder would have remained in control. There is a potential reading of the situation that the Government (ab)used the emergency legislation both to cut through an unresolved seizure/dispute and also to avoid making a takeover offer.

### IS COMPENSATION DUE AND PAYABLE – INVESTMENT PROTECTION ISSUES?

Under the relevant legislation full and prompt compensation must be paid to the effected companies, i.e. in this case to Kartonpack and/or the shareholders of Kartonpack. The level of compensation is, however, subject to a certain level of discretion as the authority ordering the measures is the one who is competent in accepting the claims for compensation. If no or not full compensation is paid at local level, the person affected by the measure may file a lawsuit at the national courts of Hungary seeking full compensation or the review of the measure on expropriation and nationalisation. Hungarian courts, however, tend to refuse compensation for damage caused by legislation (i.e. in the absence of a civil law relationship) unless the Constitutional Court establishes a breach of Hungarian or EU law. Even in these cases the injured party must evidence that there is a direct causal link between the damage and the actions taken by the Government. It is yet unforeseen whether the courts would change their earlier well established practice now that the obligation to pay compensation is stemming from the 2011 Emergency Management Act. Accordingly, it is likely that in addition to starting a civil lawsuit a plaintiff would also need to file a separate complaint to the Constitutional Court requesting the establishment of the unlawful nature of the Government's measures which, in current circumstances, is unlikely to be given. In the worst case scenario investors suffering damage may try seeking recovery on the grounds of bilateral investment agreements (BIT) or turn to the European Court of Human Rights as the expropriation without fair compensation is deemed as a violation to the right to property.

### CONCLUSION

Time will tell how this situation plays out. In any event it is hard to see these actions not being damaging to the faith in the markets and in the integrity of the Government's actions.

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