Litigation - Hungary

Piercing the corporate veil revisited

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Introduction

The corporate veil is rarely pierced in Hungarian company law. Statutes enumerate the few legal grounds on which a shareholder may be held liable for the debts of its company. One such ground is for a so-called 'long-term detrimental business policy': a series of unreasonable decisions made by the controlling shareholder concerning the controlled company that ultimately ruin the controlled company. Whether a decision is reasonable or not, it should always be regarded from the perspective of the subsidiary. Save for special circumstances, not even group interests may justify decisions that ultimately lead to the involuntary liquidation of the controlled company.

The Supreme Court recently considered(1) the statutory provision that provides for the piercing of the corporate veil in such an event.(2)

Issue

Under a strict reading of the law, only the majority shareholder at the point when involuntary liquidation proceedings were commenced against the controlled company may be subject to a claim on the basis of alleged long-term detrimental business policy. If all other conditions are met, such a shareholder is held liable for the unsettled debt of the company after its winding-up. The claimant argued that even former shareholders are caught by the provision.

Facts

Parties
The claimant was a creditor of the company that went into involuntary liquidation. The three defendants were corporations that consecutively held a majority stake in the company under liquidation. Only one of the corporations was a shareholder at the time that the liquidation proceedings commenced. All three parent companies were held by the same state-owned holding company.

Claim
The claimant sought for the court to establish the defendants' liability for the company's debt. It submitted that the shareholders' actions amounted to what is referred to in the statute as 'long-term detrimental business policy'.

Decisions of the lower courts
The Metropolitan Court of Budapest dismissed the case against the former shareholders on the grounds that the wording of the relevant provision did not justify a wide interpretation.(3) Only a shareholder that holds the shares when liquidation proceedings are commenced may be held liable for the controlled company's debt. Reference was made to a previous Supreme Court decision to the same effect.(4)

On appeal, the Budapest High Court of Appeal upheld this judgment. It reasoned that in lack of an explicit statutory authorisation, liability may not be extended to former shareholders.(5)

Supreme Court judicial review
In a motion for judicial review, the claimant framed the question as follows: does Hungarian law allow a parent company to disengage of liability by simply selling the shares to another company?

Decision

The Supreme Court, sitting in a panel of five instead of the usual three, overruled its previous decision. It extended the scope of the provision to former shareholders, quashed the decisions of the lower courts and ordered that the case be reopened against the former shareholders.

The court clarified that a parent company's liability based on long-term detrimental business policy is similar to tort liability – that is, if the claimant shows that the parent company's misconduct led to the liquidation of the subsidiary, liability may be established (provided that other conditions are also met). Therefore, causality – and causality only – determines whether a one-off shareholder may be held liable, irrespective of when such a shareholder held the shares.

The Supreme Court did not seem to have considered the fact that the three consecutive shareholders were owned by the same holding company.

Comment

The Supreme Court's decision is a turning point in Hungarian company law. It opened the door to sue a former majority shareholder and to hold it liable for its subsidiary's debt on the basis of long-term detrimental business policy. Such a claim was previously available only against a majority shareholder that owned the shares when the liquidation proceedings of the subsidiary commenced.

While the Supreme Court's wider interpretation abolished this time barrier,(6) it also presented potential claimants with some difficulties. If consecutive shareholders engage in conduct that qualifies as long-term detrimental business policy, each shareholder may be held liable only for its own conduct that contributed to a long-term detrimental business policy.

The burden of proof to show cause and effect in such cases is an arduous – and almost impossible – task for any claimant, especially since there is no discovery in Hungarian court proceedings. Lifting the corporate veil thus remains one of the most difficult challenges for Hungarian claimants and litigators.

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Endnotes

(1) Decision Pfv.VII.20.499/2012/16, unreported; press release available (in Hungarian) at www.lb.hu/hu/sajto/tajekoztato-kuria-pfvvii20499201216-szamu-ugyeben-konszernjogi-felelosseg-kerdeseben-hozott.

(2) Section 54(2) of Act 4/2006 on Business Associations.

(3) Decision 22.G.40.070/2008/68.

(4) Decision Gfv.X.30.456/2007/4.

(5) Decision 16.Gf.40.246/2011/6.

(6) However, claims become time barred after a five-year term and further time-bar rules are applicable only to these specific claims.