

THE SOLUTION OF HUNGARIAN COMPANY LAW IN CONNECTION WITH DUTY OF CARE AND DUTY OF LOYALTY¹

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Abstract: The tasks and duties of a company's directors are diverse and varied in companies. Among these, the duty of care and duty of loyalty is generally widespread in European company law. Our contribution to this topic focuses on company law provisions, legal practice, and professional opinions in Hungary. We do not deal with the sanctioning harmful activity of the director in bankruptcy and compelled cancellation procedures.

Keywords: liability for breach of contract; piercing of the corporate veil; acting with care and diligence; responsibility for internal governance

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1. INTRODUCTION

Companies (business associations) are classic examples of principal-agent situations. During the life of a company, special attention should be paid to whose interests are the primary consideration.² The executive officer³ (director) is the agent in the company who's careful diligent action is expected.⁴ Towards whom is this care directed? Can the law guarantee that a director will put the interests of the company first? Monetary compensation paid by the director is an *ex post* type of legal strategy to agency problems.⁵ The paper presents the Hungarian corporate law solution to the ge-

¹ The paper is published within the framework of the ELKH-PTE-NKE Research Group of Comparative and European Employment Policy and Labour Law.

² KRAAKMAN, R. et al. Consider delegated management with a board structure as a key element of the company. In: KRAAKMAN, R. et al. *The Anatomy of Corporate Law*. 3rd ed. Oxford: Oxford University Press, 2017, p. 11.

³ Resulting from the general rules on legal person of the Hungarian Civil Code the Hungarian company law uses the phrase of executive officer for the managing organ of legal person, and the expressions managing director at general and limited partnerships, also at limited liability company, and board of directors at private company limited by shares, and also board of directors at two-tier system and management board at uniform management system at public companies limited by shares.

⁴ The general issue of duty of care see DAVIES, P. *Introduction to Company Law*. 2nd ed. Oxford: Oxford University Press, 2010, pp. 150–151.

⁵ KRAAMAN, c. d., p. 43; see: GERNER-BEUERLE, C. The duty of care and the business judgment rule: a case study in legal transplants and local narratives. In: AFSHARIPOUR, A. – GELTER, M. *Comparative Corporate Governance*. Cheltenham, Northampton: Edward Elgar Publishing, 2021, pp. 220–241;

neral duty of care, the legal context, the legal literature debates, and the judicial practice governing the issue.

2. THE FRAME OF THINKING ABOUT THE DUTY OF CARE AND THE DUTY OF LOYALTY IN HUNGARY

In the meaning of The European Model Company Act (EMCA)⁶ and Aktiengesetz in Germany,⁷ Hungarian company law regulation does not contain a duty of care requirement, only a general duty⁸ and duty of loyalty⁹ (but not in its full sense) from the company's director.¹⁰ Hungarian company law has no rules for the duty of care nor for the duty of loyalty, neither *expressis verbis*, nor implicitly, the Hungarian case law does not use these legal terms either. Therefore, we can deduce these legal institutions from the principles of the Hungarian Civil Code and from the liability provisions for directors.

The Hungarian system is based on the incentive for proper behaviour, which has its roots in the general principles of the Hungarian private law: principles of good faith, fair dealing,¹¹ generally expected standard of conduct,¹² and prohibition of abuse of rights.¹³

HOPT, K. J. Directors' Duties and Shareholders' Rights in the European Union: Mandatory and/or Default Rules? *ECGI – Law Working Papers* [online]. 2016, No. 312, p. 16 [cit. 2021-10-01]. Available at: <http://ssrn.com/abstract=2749237>.

⁶ EMCA Section 9.03 Duty of Care: A director of a company must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has [online]. [cit. 2021-10-14]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2929348&download=yes.

⁷ Aktiengesetz Section 76 Leitung der Aktiengesellschaft: (1) Der Vorstand hat unter eigener Verantwortung die Gesellschaft zu leiten.

⁸ EMCA Section 9.01 General Duties: (1) The company's directors are responsible for the management of the company's affairs [online]. [cit. 2021-10-14]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2929348&download=yes.

⁹ EMCA Section 9.04 Duty of Loyalty: Directors must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so the director should have regard to a range of factors such as the long-term interests of the company, the interests of the company's employees, the interest of company's creditors and the impact of the company's operations on the community and the environment [online]. [cit. 2021-10-14]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2929348&download=yes.

¹⁰ Hungarian Civil Code (HCC) Section 3:21(1) Decisions related to the management of a legal person that fall outside the powers of the members or founders shall be adopted by a director or directors or by a body of directors. (2) Directors shall perform their management duties in the interests of the legal person.

¹¹ HCC Section 1:3(1) Parties shall act upon the requirement of good faith and fair dealing when exercising rights and fulfilling obligations. (2) The requirement of good faith and fair dealing is also breached by the person whose exercise of rights is contrary to his previous conduct upon which the other party could reasonably rely on.

¹² HCC Section 1:4(1) Unless otherwise provided in this Act, in civil law relations, one shall proceed with the care that is generally expected under the given circumstances. (2) No one can rely on his own fault for gains. (3) A person who is at fault himself may also rely on the fault of the other party.

¹³ HCC Section 1:5(1) Abuse of rights shall be prohibited by an Act. (2) If the abuse of rights consists of refusing to give a statement required by law, and this conduct harms an overriding public interest or a personal

These principles reflect in the Hungarian Civil Code relating to liability: the legislator distinguishes between the obligation to fulfil commitments and liability. Regarding liability, we can differentiate, in a legal sense, between contractual¹⁴ (liability for a breach of contract) and delictual¹⁵ (tortious liability) liabilities. In both these types of liability the courts do not measure the care of the legal entity, but the measurement is the causality and foreseeability, or the general expectation in the given legal situation.

Also, the outgrowths of these fundamental principles and liabilities can be found in Hungarian company law:

- a) for the member of company (at both partnerships and limited companies) with the membership's commitment (for cooperation)¹⁶ and liability (for causing damage to a third party),¹⁷
- b) for all directors of company (at both partnerships and limited companies) with the general duty, the duty of loyalty and the liability.¹⁸

The legal consequences of a breach of obligations/duties and damages are compensation, the exclusion of member¹⁹ or unilateral termination of membership at the general and limited partnerships,²⁰ and the dismissal of director.²¹

Among the other Hungarian legal persons²² a similar provision is located in the regulation of cooperative in the Hungarian Civil Code.²³

interest requiring special consideration, this statement may be substituted with the judgment of the court, provided that the harm to interests cannot be averted by other means.

¹⁴ HCC Section 6:142 A person causing damage to the other party by breaching the contract shall be required to compensate for it. He shall be exempted from liability if he proves that the breach of contract was caused by a circumstance that was outside of his control and was not foreseeable at the time of concluding the contract, and he could not be expected to have avoided that circumstance or averted the damage.

¹⁵ HCC Section 6:519 A person causing unlawfully damage to another shall compensate for the damage caused. The person causing damage shall be exempted from liability if he proves that he was not at fault.

¹⁶ HCC Section 3:88(3) Members shall cooperate with each other and with the bodies of the business organisation, and they shall not engage in activities that jeopardise the achievement of the objectives of the company.

¹⁷ HCC Section 6:540(2) If a member of a legal person causes damage to a third party in connection with his membership relationship, the legal person shall be liable towards the injured party. (3) The member shall have joint and several liability with the legal person, respectively, if the damage was caused intentionally.

¹⁸ HCC Section 3:24(1) The director shall be liable to the legal person for the damage caused to it during his management activities according to the rules on liability for damage caused by breach of contract. (2) The legal person shall be liable for any damage caused to a third party by the director acting in his competence. The director and the legal person shall be jointly and severally liable if the director caused the damage intentionally.

¹⁹ HCC Section 3:107(1) The member of a company may be excluded from the company by a court decision based on an action brought by the company against the member concerned if his remaining in the company seriously jeopardised the objectives of the company.

²⁰ HCC Section 3:147(2) Members may unilaterally terminate their membership in writing, indicating its reason if any other member of the partnership seriously breaches the memorandum of association or engages in a conduct that seriously jeopardises further cooperation between him and the other members or the achievement of the objectives of the partnership.

²¹ HCC Section 3.25(1)(c).

²² Association, cooperative, grouping and foundation.

²³ HCC Section 3:347(1) Directors shall manage the operations of cooperatives autonomously, complying with the overriding priority of the interests of the cooperative. In this capacity, the director shall be bound by the law, the articles of association and the resolutions of the general meeting. Directors shall not be instructed by the members of the cooperative and the general meeting shall not relieve him of his powers.

2.1 THE LIABILITY OF A DIRECTOR²⁴

In Hungarian company law, the liability of a director is regulated by several acts and in several ways; for this reason, we shall classify the respective established facts in accordance with a number of criteria in the following.

2.1.1 THE GENERAL LEGAL GROUNDS FOR THE LIABILITY OF A DIRECTOR TOWARDS THE COMPANY AND THE CREDITORS

A director must be held liable for the damages caused to the company²⁵ by their management activities, in accordance with the provisions on the liability for damages caused by a breach of a contractual obligation.²⁶

The legal person shall be liable for any damage caused to a third party by a director acting in their competence. A director and legal person shall be jointly and severally liable if the director caused the damage intentionally.²⁷

(2) After the termination without succession of the cooperative, those who were members at the time of deleting the cooperative from the register may enforce their claim for damages with respect to any damage caused to the cooperative by the directors acting in that capacity within a term of preclusion of one year from the deletion. Members may assert their claim for damages in proportion to their rightful share of the assets distributed upon termination of the cooperative. (3) In the event of a cooperative terminating without succession, creditors may bring action for damages up to the amount of their outstanding claims against the director of the cooperative according to the rules on extra-contractual liability if the director concerned failed to take the interests of the creditors into account when a condition threatening to cause insolvency in the cooperative emerged. This provision shall not apply to termination by winding up.

²⁴ AUER, Á. Vezető tisztviselő felelőssége [Liability of director]. In: DÜL, J. – LEHOCZKI, Z. Z. – PAPP, T. – VERESS, E. (eds.). *On the basis of Társasági jogi lexikon* [Company law encyclopedia]. Budapest: Dialóg Campus Kiadó, 2019, pp. 315–319; see more in: NOCHTA, T. A polgári jogi felelősség változásairól a társasági jogban [On changes of private law liability in company law]. *Gazdaság és Jog*. 2019, No. 7–8, pp. 12–18; NOCHTA, T. A vezető tisztviselők magánjogi felelősségének mércéjéről és irányairól az új Ptk. alapján [The standard and direction of the private law liability of directors are set out in the new Civil Code]. *Gazdaság és Jog*. 2013, No. 6, pp. 3–8; BODZÁSI, B. A jogi személyek körében felmerülő felelősségi kérdésekről, különös tekintettel a vezető tisztviselőkre [On liability issues among legal persons, in particular to directors]. *Gazdaság és Jog*. 2013, No. 6, pp. 8–14; GÁL, J. A vezető tisztviselő felelősségének egyes kérdései a gazdasági társaságoknál [Certain issues of the liability of director in companies]. *Céghírnök*. 2014, No. 6, pp. 3–6; GÁL, J. A vezető tisztviselő felelősségének egyes kérdései a gazdasági társaságoknál [Certain issues of the liability of director in companies]. *Céghírnök*. 2014, No. 7, pp. 3–4; BARTA, J. A gazdasági társaság vezető tisztviselőjének felelősségi rendszere és a vezetői felelősségbiztosítás [Liability system of the company's director and the liability insurance]. In: HOMICSKÓ, Á. O. – SZUCHY, R. (eds.). *60 studia in honorem Péter Miskolczi-Bodnár, de iuris peritorum meritis II*. Budapest: KRE ÁJK, 2017, pp. 25–37; BARTA, J. – MAJOROS, T. A vezető tisztviselő gazdasági társasággal szembeni és harmadik személyeknek okozott károkért való felelősségének neuralgikus kérdései [Neuralgical issues of the liability of an director for damages to a company and to third parties]. *Miskolci Jogi Szemle*. 2015, No. 2, pp. 5–16; KISFALUDI, A. Anyagi és eljárási szabályok a gazdasági társaságok vezető tisztviselőinek hitelezőkkel szembeni felelőssége körében [Substantive and procedural rules on the liability of company's directors towards creditors]. In: HOMICSKÓ, Á. O. – SZUCHY, R. (eds.). *60 studia in honorem Péter Miskolczi-Bodnár, de iuris peritorum meritis II*. Budapest: KRE ÁJK, 2017, pp. 321–336.

²⁵ The threat of the damage does not establish the director's liability, the damage must occur; BDT 2020. 4253. (Casebook of the Courts).

²⁶ HCC Section 3:24(1) and 6:142; BDT 2019. 3994.; BDT 2019. 4011. (Casebook of the Courts).

²⁷ HCC Section 3:24(2); see in: MISKOLCZI-BODNÁR, P. A társasági jog egyes problémái [Some problems of company law]. *Gazdaság és Jog*. 2019. No. 3, pp. 7–14.

When making a judgement upon the damage caused by a director, the membership of the director in the company does not count, for it is not the fact of the membership, but the fact of having violated the duties of a director and what carries the liability.²⁸

2.1.2 SPECIAL LIABILITY OF A DIRECTOR TOWARDS THE COMPANY AND THE CREDITORS IN RESPECT TO THE FOUNDATION, OPERATION, AND THE TERMINATION OF THE COMPANY

The person appointed to represent the legal person shall be responsible²⁹ for submitting the request for the registration of the legal person to be established, so the representative shall be liable to the founders according to the provisions on the liability for damages caused by breaching a contractual obligation for damage caused by their failure to either submit the request or the submission thereof in due time, or if they did it in a deficient or erroneous form.³⁰

In case the registration of the company (at the pre-company period) has been rejected by virtue of a decision with binding force, the company under registration must terminate its operation without delay, having gained knowledge about the decision. For damage caused by a breach of this obligation, the directors of a registered company are liable, according to the provisions on the liability for damage caused by breaching a contractual obligation.³¹ If the operation of a registered company (at the pre-company period) shall become terminated, the obligations undertaken until that time shall be settled from the assets made available to the pre-company; if the liability of the members of the pre-company for the obligations of the company was limited, and if certain claims have still remained unsettled despite the proper fulfilment of the members, then the directors of the pre-company shall bear unlimited responsibility (fiduciary duty) as joint and several, against third parties.³² These provisions are also applicable if the company shall withdraw its request for registration.³³

During the operation of company, in case the supreme body of the company shall grant the director a certificate of discharge from the compliance of their management activities realized in the previous financial year at the same time with their approving of the financial report upon the request from the managing director. The company may only enforce its claim against a director for damage they have caused by the violation of their director's obligations, if the facts and data that served as the basis for the granting a discharge were false or defective.³⁴

²⁸ BDT 2018. 3959.; BDT 2019. 4011. (Casebook of the Courts).

²⁹ For the responsibility and liability of the director see: MISKOLCZI-BODNÁR, P. Felelősség és helytállás [Liability and responsibility]. *Glossa Iuridica*. 2017, No. 1–2, pp. 111–145; MISKOLCZI-BODNÁR, P. Helytállás a társaság tartozásaiért [Responsibility for the debts of company]. In: BENKE, J. – FABÓ, T. (eds.). *A puro pura defluit aqua, Ünnepi tanulmányok Nochta Tibor professzor 60. születésnapja tiszteletére* [Festive studies in honor of Professor Tibor Nochta's 60th birthday]. Pécs: PTE ÁJK, 2018, pp. 197–209.

³⁰ HCC Section 3:12.

³¹ HCC Section 3:101(4); A pre-company which may enter into contracts and carry out an economic activity (other than an activity subject to official authorization) shall be represented by a director who has an agency or employment relationship with the pre-company.

³² HCC Section 3:101(5).

³³ HCC Section 3:101(6).

³⁴ HCC Section 3:117.

In a group of companies, a director of a controlled company shall manage the controlled company in accordance with the controlling contract, under the governance of the dominant company, based on the primacy of the business policy of the group of corporations as a whole. The director shall be exempt from the liability of members if their conduct is found to be in compliance with the provisions set out in the relevant legislation and in the controlling contract.³⁵

After the termination of the company without succession, those who were members at the date of the deletion of the company, may enforce their claim for the damages against the directors within a term of preclusion of one year from the date of dissolution of the company; the members are entitled to lay such claims for such damages to the extent of their rightful share in the assets distributed.³⁶

If the company is terminated without succession, the creditors may enforce their claims for damages up to the amount of their unsettled claims against the directors of the company, based on the rules on the liability to be borne for the damages caused under extra-contractual obligations,³⁷ if the director involved did fail to take into account the interests of the creditors when the circumstance endangering the company with insolvency did set in;³⁸ this provision is non-applicable in the event of termination by winding-up.³⁹

2.1.3 SUMMARY REMARKS

The legal grounds for the liability of a director can be

- objective: under the scope of an objective liability, there is no exculpation for the director (full and unconditional liability),⁴⁰ or
- subjective: regarding the subjective liability, the director may exculpate their conduct on the basis of legislative means (they proceeded with the care that is generally expected under the given circumstances at director's position ≈ no fault). But the legislature is not consistent: the equiponderant acts of the director, nevertheless, are judged differently.

The next factors create more difficulties in respect to the qualification of the liability that falls upon a director: the managing directors can act either on the grounds of their

³⁵ HCC Section 3:5 (4).

³⁶ HCC Section 3:117(1), (3).

³⁷ HCC Section 6:519.

³⁸ BH 2022. 50. (Periodical collection of the decisions of the Hungarian Supreme Court; the Curia): In a situation threatened with insolvency, the management of the debtor and the consequent reduction of their assets do not automatically lead to a finding of liability on the part of a director; this is only possible in the event of a reduction in assets due to the reprehensible conduct of the director. Such reprehensible conduct is if the director makes an unreasonable decision or a reduction in assets that is economically unreasonable occurs.

³⁹ HCC Section 3:118.

⁴⁰ For example: if the liability of the members of the pre-company for the obligations of the company was limited, and if certain claims have still remained unsettled despite the proper fulfilment of the members, then the directors of the pre-company shall bear responsibility against the creditors.

employment⁴¹ relationship⁴² (mixed obligation: diligence, and achieving certain results) or their agency relationship⁴³ (diligence obligation: duty of care as agent), and they can exercise their acts together or independently. Lastly, the jurisprudence is not unified in the matter of joint and several liability (can it also apply to the director's independent actions?).⁴⁴

3. THE DUTY OF CARE IN CONNECTION WITH A DIRECTOR'S LIABILITY IN THE HUNGARIAN LEGAL LITERATURE

After presenting the legal environment in which the liability of directors is addressed, we briefly review the legal literature on the subject. In the Hungarian legal literature, the issue of director's liability has been extensively discussed, resulting in both comprehensive works and sources interpreting current legislative changes.⁴⁵ The latter is the most relevant for our topic. There have been two sources of debate in the literature, as the provisions governing the liability of a director have been significantly modified on two points in the last decade. It can be concluded that the literature debate has contributed to a rethinking of the fundamental issues related to the liability of directors.

3.1 THE POTENTIAL CONSEQUENCES OF THE NEW PARADIGM OF CONTRACTUAL LIABILITY

The first amendment, which was a general civil law amendment, was a change to the liability provisions of HCC, which separated the tort, non-contractual (delictual) liability rules from the contractual, breach of contract liability rules. This situation arises when a company is damaged by a director and the company wants to claim against said director. The general exculpatory rule for liability for breach of contract has been tightened and made objective, which can be summarised as the foreseeability rule.⁴⁶ There has been a heated debate in the legal literature as to the element of the

⁴¹ HCC Section 3:112 [Autonomy of executive officers] (1) The executive officer shall manage the operations of the company under an agency contract or an employment contract, according to his agreement with the company.

⁴² Section 6:540(1) of the HCC: If an employee causes damage to a third party in connection with his employment relationship, his employer shall be liable towards the injured party. (3) The employee [...] shall bear joint and several liability with the employer..., respectively, if the damage was caused intentionally.

⁴³ Section 6:542(1) of the HCC: If an agent causes damage to a third party in his capacity as an agent, the agent and the principal shall have joint and several liability towards the injured party. The principal shall be exempted from liability if he proves that he cannot be at fault with respect to selecting the agent, providing him with instructions and supervising him. (2) In the case of an agentive relationship of permanent nature, the injured party may also enforce his claim for the reparation of his damages in accordance with the rules on liability for damages caused by employees.

⁴⁴ SZÍT Gf. III.30.185/2017/4. (Decision of the High Court of Appeal of Szeged).

⁴⁵ TÖRÖK, T. *Felelősség a társasági jogban* [Liability in company law]. Budapest: HVGORAC, 2015; and FUGLINSZKY, Á. *Kártérítési jog* [Tort law]. Budapest: HVGORAC, 2015.

⁴⁶ See above Point 2.

foreseeability rule in which the date of conclusion of the contract is considered to be the relevant date for the purposes of exculpation: the contract between the company and the director or the contract on which the damage is based. As regards the other conditions, there was general disagreement, since it is not only applicable to the legal relationship of a director but is also applied in general in the case of breach of contract. A transaction (contract) entered into in the course of a director's activity, or a transaction entered into at the time of the creation of a director's relationship, or possibly a combination of the two. Several solutions to this situation have been put forward in the literature. The central issue being from what point in time, in the case of a possible wrongful act, can a director be expected to have foreseen the harmful consequences of the wrongful act. The obvious one is the date when the contract is concluded between a director and the company giving the mandate of directorship; it has also been suggested that, beyond that date, the relevant criterion in the case of continuous activity is whether the interests of the company were taken into account, i.e., whether this is a precondition for the specific tort, and, somewhat similarly but differently from the wording of the law, the date the contract concluded during the course of the director's specific activity.⁴⁷ However, this debate is not yet settled, as there is no consensus in the literature on this issue due to a lack of current case law.

In our view, the debate has revealed an opinion that is a prerequisite for the potential exculpation: whether there has been a breach of contract at all. The first thing to be examined when considering the liability of a director is the fact of a breach of director's duty. In other words, it is necessary to prove whether a breach of contract has occurred before the exculpation. If so, the other conditions can be examined; if not, this in itself prevents liability.⁴⁸ However, this latter view has been presented in several places.⁴⁹ The essence of this position is that the first question to be proved is the fact of a breach of contract and the breach is caused by the conduct or failure of a director. This would appear to avoid the problem of foreseeability, but provides an answer to the question of how the new contractual liability rule should be applied to the liability of the director.

⁴⁷ BARTA – MAJOROS, *c. d.*, p. 12; BODZÁSI, *c. d.*; and in summary: FUGLINSZKY, Á. Az előreláthatósági klauzula értelmezésének újabb dilemmái [New dilemmas in the interpretation of the foreseeability clause]. *Gazdaság és Jog*, 2019, No. 7–8, pp. 1–7; TERCSÁK, T. Vezető tisztségviselő jogállása, felelőssége [The legal status and liability of director]. In: LŐRINCZ, G. (ed.). *A vezető tisztségviselő jogállása és felelőssége* [The legal status and liability of directors]. Budapest: HVG-ORAC, 2017, pp. 105–106.

⁴⁸ KEMENES, I. A kontraktuális kártérítés egyes kérdései [Certain issues of contractual liability]. *Magyar Jog*, 2017, No. 1, pp. 1–10.

⁴⁹ KISFALUDI, A. 3:24. § kommentárja [Commentary on § 3:24]. In: VÉKÁS, L. – GÁRDOS, P. (eds.). *Kommentár a Polgári Törvénykönyvhöz* [Commentary to the Civil Code]. Budapest: Wolters Kluwer, 2021 [via database]; TÖRÖK, G. 3:24. § kommentárja [Commentary on § 3:24]. In: GADÓ, G. (ed.). *Az új Ptk. magyarázata* [Explanation of the new CC]. Budapest: HVGORAC, 2021 [via database]; KEMENES, *c. d.*, p. 9; FUGLINSZKY, *Az előreláthatósági klauzula értelmezésének újabb dilemmái*, p. 5; Opinion of the Advisory Board of the Curia on the interpretation of the Civil Code HCC § 3:24.

3.2 THE (UN)LIMITED LIABILITY TO THIRD PARTIES

The other issue was the institution of the transfer of liability to a director (piercing of the corporate veil, *Haftungsdurchgriff*).⁵⁰ The text of HCC, in force until 2016, was regulated as a delictual form (extra contractual) of compensation that a director is jointly and severally liable with the company if they cause damage to a third party in the context of this legal relationship. The literature has kept this issue constantly on the agenda, the main question being whether there is then any independent liability of the company and whether this rule does not mean that any action of a director gives rise to a creditor suing the director directly.⁵¹ Thus, this would result in an inadequate number of suited directors, because they would not be able to take such a position due to liability risks. The issue was finally clarified by the legislature in 2016, and the above-quoted HCC 3:24 states that the possibility of liability shifting is only possible if the damage was caused intentionally by the director of company. No new point of contention has subsequently emerged in the literature, this amendment has clarified the original legislative objective and therefore does not provide grounds to question the basis of the liability of a director.⁵²

4. THE JUDICIAL PRACTICE OF THE DUTY OF CARE OF A DIRECTOR

4.1 THE NATURE OF THE LEGAL RELATIONSHIP

Judicial practice has been faced with the question of whether the difference in the legal status of a director: employment contract or agency contract, makes any difference to liability. The two normative regimes differ in a number of respects, but the case law shows that there is no difference in the standard of liability, and that the company law regime, as described in the first part of this study, applies to any relationship. Liability is *sui generis* corporate liability the legal relationship has no influence on it.

The question of whether the breach of the legal relationship of a director constitutes a situation which results in said director being held liable has already been touched upon in the legal literature discussion. According to the view expressed in the literature and in judicial practice, the legal relationship of a director is most similar to that of a diligent agent under an agency contract. A director is expected by civil law to act with care and

⁵⁰ Piercing of the corporate veil doctrine can apply both to the conduct of the member and to the conduct of a director in Hungary.

⁵¹ SÁRKÖZY, T. Még egyszer a vezető tisztségviselők kártérítési felelősségéről [Once again on the liability of directors]. *Gazdaság és Jog*. 2015, No. 2, pp. 3–11; KISFALUDI, A. A jogi személy vezető tisztségviselőinek felelőssége az új Polgári Törvénykönyvben [The liability of the directors of the legal person in the new Hungarian Civil Code]. In: CSEHI, Z. – KOLTAY, A. – LANDI, B. – POGÁCSÁS, A. (eds.). *(L) ex Cathedra et Praxis – Ünnepi kötet Lábady Tamás 70. születésnapja alkalmából* [Festive volume on the occasion of the 70th birthday of Tamás Lábady]. Budapest: Pázmány Press, 2014, pp. 307–338; TÖRÖK, 3:24. § *kommentárja*.

⁵² In the Hungarian legal literature, evaluations of the liability of directors are currently focused on the insolvency proceedings, which are not the subject of this study.

diligence (duty of care) in the management of the company. The main rule for such due diligence of the director is laid down in the HCC 1:4 of the general duty of care and its variation that a director must perform the director's duties diligently and with the care expected of a person holding in a such position.⁵³

4.2 THE REASONABLE BUSINESS RISK (BUSINESS JUDGEMENT RULE)

In the case of business decisions, Hungarian judicial practice also applies the business judgement rule. In making their decisions, a director must, as stated above, act in the course of their management activities based on the primacy of the interests of the company, with the care expected of directors and in accordance with the requirements of what is generally to be expected. According to the case law, a wrong decision does not in itself give rise to liability on the part of a director, even if the company suffers damage as a result.⁵⁴ Nor is the civil liability of a director based on their criminal conduct *per se*. Thus, judicial practice emphasises the need to take reasonable decisions and to give priority to the interests of the company.⁵⁵ In this context, in a case law decision, the reconstructibility and traceability of decisions was also identified as an aspect that proves that a director acted diligently, while its absence may give rise to liability.⁵⁶

The Hungarian judicial practice has established the liability of a director towards a company in cases where there was no justification behind the director's decision to take a potentially wrong decision in the context of business risk.

In one of decision of the Curia, which is still authoritative today, Hungarian case law set out three criteria in relation to the liability of a director.⁵⁷ The court must examine whether (a) the economic situation of the company justified the risk they took, (b) the market environment justified the risk, and (c) the risk was foreseeable and manifestly unreasonable. The Curia stated that *"the liability of a director may be established if the director took a foreseeable and manifestly unreasonable risk, having made a wholly erroneous assessment of the situation of the company and the market environment"*. The Curia underlined that a director cannot claim to be exempt from liability if they conclude a contract in a foreign language with which they are not familiar and therefore they were insecure in the content of the contract. The liability of a director is established as well, if they transfer money to a contracting party without requesting any security in the event of performance or impossibility of performance, or they did not take any necessary measures to enforce its claim for breach of contract, without taking the necessary measures to recover its receivables.⁵⁸

In another case, the court found that there was an unjustified risk in concluding a loan transaction in which the company had granted a loan at an interest rate equal to the rate of inflation, with a negative balance sheet and without any additional security.

⁵³ KISFALUDI, 3:24. § *kommentárja*; TÖRÖK, 3:24. § *kommentárja*.

⁵⁴ BH 2004. 372. (Periodical collection of the decisions of the Hungarian Supreme Court; the Curia).

⁵⁵ BDT 2004. 959. (Casebook of the Courts); BDT 2017. 3718. (Casebook of the Courts).

⁵⁶ BDT 2004. 959. (Casebook of the Courts).

⁵⁷ EBH 2011. 1417. (Periodical collection of the decisions of the Hungarian Supreme Court; the Curia).

⁵⁸ *Ibid.*

The director did not take any action to recover the debt when the loan fell due. According to the court, the conduct of a director is not compatible with the duty of care expected of a director and the primacy of the interests of a company.⁵⁹

5. LIABILITY TO THIRD PARTIES (PIERCING OF THE CORPORATE VEIL)

In the course of the operation of a company, there are several types of conflicts of interest, the legal consequences of which must be created by the legal system. In company law, there is an increased demand for compensation from creditors for unsatisfied debts that have been created by abusive behaviour on the part of directors. The legislature can only introduce this instrument with due caution, since it is a matter of applying rules which break with the separate legal personality of the company. These rules may block the assumption of business risks by management and members during its operation: liability rules must therefore be drawn up which deter and repair wrongful conduct and do not reduce the assumption of risks. Following the solutions examined in foreign legal systems (*Haftungsdurchgriff*, piercing of the corporate veil), the Hungarian legislature has created different rules to sanction such conduct. Under Hungarian law, piercing of the corporate veil can apply both to the conduct of the shareholder⁶⁰ and to the conduct of the director.⁶¹ However, the determination of the liability of a director during the operation of a company has become the civil law norm in force today, primarily as a result of a principle developed by judicial practice.⁶² The model of judicial reasoning was the following: the essence of the breach of liability was that such conduct of the member (for example, using the company to commit a crime or to organise a pyramid scheme) so grossly offended the requirements of good faith and fair dealing of civil law that it constituted an abuse of rights. In this case, the possibility of a direct action against the director is applicable.⁶³ The HCC defines intent as a ground for the liability of a director.

In the judicial practice, the court examined the conduct of a director and found that his conduct – under the cover of legal personality – constituted a deliberate abuse for the benefit of his own individual interests and property. Without any justification, the director had handed over a verbal promise of approximately HUF 100 million (approximately EUR 380,000) to obtain a bank guarantee for the company from the other party. He gave the false bank guarantee certificate to the contracting party, from whom he resold a large quantity of goods at a substantial loss and deducted the proceeds for himself. The court held that the company, under the guise of its separate legal personality

⁵⁹ BDT 2021. 4321. (Casebook of the Courts).

⁶⁰ HCC Section 3:2.

⁶¹ HCC Section 3:24.

⁶² BH 1999. 465. (Periodical collection of the decisions of the Hungarian Supreme Court; the Curia); BDT 2012. 2727. (Casebook of the Courts); BDT 2012. 2707. (Casebook of the Courts).

⁶³ Where appropriate, against the member as well.

and in abuse of its separate liability, had engaged in conduct which had caused loss to the contracting third party.

6. SOMETHING NEW UNDER THE SUN?

In Hungarian judicial practice, for the time being, this in cases with financial institutions, but a decision of the Curia (Hungarian Supreme Court) has added new elements to the practice regarding the liability of the director in several aspects.⁶⁴

According to a case of Hungarian Supreme Court, Curia, at a financial company, the organ to exercise the activity of financial supervision (the Hungarian National Bank) conducted an *ex officio* proceeding, as the result of which identified several instances of malpractice and, after the permit of the company was withdrawn, liquidation of the company was initiated.

The company intended to enforce the fine as damages caused by the director against the company. During the lawsuit, the court determined that the liability of a member of the board should prevail both in the case of having committed the breach of law directly (the breach of law is the direct result of their own decision, their own instruction), or indirectly (the breach of law is realized by the fault, deficiency of the control system being operated by the leadership), likewise. The jurisprudence has so far not defined director's decisions, a new aspect in our view and a way forward.

However, the responsibility of the director is not only constituted by wording and adopting the bylaws, and the organizational units shall exist, they are also responsible for ensuring that the bylaws are *de facto* kept in practice. According to the decision of the Curia, this responsibility *“does not only apply in the case of active involvement, but also due to the fact that as a member of a board entitled with governance rights, he/she failed to take action for establishing such responsible corporate governance, responsible internal governance, and did not operate, nor did he/she establish such internal defense lines, that should prevent the possibility of committing those heavy breaches of law, which are determined as burden to fall on the company”*.⁶⁵

Even though in this decision the court evaluated a special deed, that was a breach of professional governance duties, in a way that it could ground the liability of a director thereon, this decision shall be considered as a shift from the preceding judicial practice.

The case is, of course, only one case, but in our opinion, it contains general findings, and the above is certainly a gateway to a significant improvement in judicial practice, as there are several sectors where the content of director's duties is prescribed by legal or other binding norms.⁶⁶ However, the above cannot be considered as specific sectoral features that are unique to the financial sector. The “direct” – “indirect” classification of decisions applies to all organisations that are hierarchical at even just one or least two levels. The creation of bylaws and their enforcement is also a general requirement, the amount of which may vary from one company to another.

⁶⁴ BH 2021. 25. (Periodical collection of the decisions of the Hungarian Supreme Court; the Curia).

⁶⁵ Ibid.

⁶⁶ Whereas the general company law rules do not contain such a provision.

7. CONCLUSIONS

On the grounds of Hungarian legal literature and case law we can recognise common and consensual corner points in connection with the duty of care of a director

- a director is liable for damages caused to the company in the course of management activities according to the rules of private law even if they are acting in the frame of employment;
- the liability of a director can be established if they breach their management obligations under the contract concluded with the company and this causes damage of a material disadvantage to the company;
- the breach of contract by a director is necessarily careless;
- they shall perform their duties with due diligence expected of persons holding such positions; and
- they may be released from liability if they prove that they were acting as generally expected under the given circumstances (generally expected in a director's position).⁶⁷

In the future, the creation and operation of differentiated internal company bylaws will be important. The judicial practice may investigate the activity of directors in more detail. The results of our research show that a director's liability can be used as a general sanction for decisions or a damaging activity of a director. This is of course not new under the sun. The general clause of a director's liability provides the opportunity to do so and is being fleshed out by the judicial practice on a case-by-case basis. Although the content of the duty of care is not defined in Hungarian company law, it is possible to deduce from liability cases what the duty of care actually means.

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⁶⁷ KEMENES, *c. d.*, 8–9; Opinion of the Advisory Board of the Curia on the interpretation of the Civil Code HCC  3:24.