CENTRAL EUROPEAN JOURNAL OF
COMPARATIVE LAW

CENTRAL EUROPEAN JOURNAL OF COMPARATIVE LAW

VOLUME I ▪ 2020 ▪ 1

FERENC MÁDL
INSTITUTE OF COMPARATIVE LAW

Central European Journal of Comparative Law
HU ISSN 2732–0707 (Print)
DOI prefix: 10.47078

Publisher:
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Limited Liability Companies in Poland

ABSTRACT: *This study discusses the construction of a limited liability company (LLC) under Polish law. Due to the short length of the article and the large scale of the issue, this study is limited to the presentation of basic concepts. The construction of an LLC under Polish law is flexible and has been modernised, as a result of a number of amendments, including a fast registration path.*

KEYWORDS: company, limited liability company, shareholder, share, share capital, Polish law.

1. General issues

1.1. History of the regulation of limited liability companies under Polish law

Poland regained its independence after World War I on 11 November 1918.[2] Almost immediately, regulations regarding limited liability companies (LLCs)[3] appeared in the legislation of the reborn state.[4]

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2 Before the reunification of the law in Poland there were Russian, German, Austrian, French (the former Duchy of Warsaw), and Hungarian (in a part of Spisz and Orawa) regulations in force.

3 The operating rules of limited liability companies were developed 'at a green table' and were regulated for the first time in Germany (under the German name 'Gesellschaft mit beschränkter Haftung', abbreviated GmbH) by the Act of 20 April 1892 (Gesetz betreffend die Gesellschaften mit beschränkter Haftung), which is still in force. German standards were also adopted in Austria-Hungary (1906), in England (1907, as a private limited company), and later in other legal systems (e.g., in France in 1925). Szajkowski and Tarska, 2010, p. 128.

4 Namitkiewicz, 1925, p. 12; Namitkiewicz, 1927, p. 312; Rymar, 1938, p. 8.

https://doi.org/10.47078/2020.1.7-25

	Name of the legal act	Publication	Date of entry into force	Date of repeal	Remarks
1.	Decree of 8 February 1919 on limited liability companies (Articles 1- 20)	Journal of Laws, 1919, No. 15, item 201	8 May 1919	1 July 1934	Applicable in the territories of the former Russian occupation territory where the French Commercial Code had been in force
2.	Regulation of the President of the Republic of Poland of 10 December 1924 on the merger of joint-stock companies and limited liability companies (paragraphs 1-12)	Official Journal, 1924, No. 107, item 968	17 December 1924	1 July 1934	
3.	Regulation of the President of the Republic of Poland of 27 October 1933 — Law on limited liability companies (Articles 1-157)	Official Journal, 1933, No. 82, item 602	1 January 1934	1 July 1934	
4.	Regulation of the President of the Republic of Poland of 27 June 1934 — Commercial Code (Articles 158-306)	OJ, 1934, No. 57, item 502	1 July 1934	1 January 2001	

Legal invention, or the creation of a LLC, enjoyed tremendous popularity in the free market economy system during the years 1918–1939. From 1945 to 1989, in the centrally-controlled economy system and with the economic domination of the State Treasury, state-owned enterprises were the dominant legal entities. After 1989, state-owned enterprises were massively commercialised and became LLCs or joint-stock companies. Currently, state-owned companies and companies owned by local government units take the form of either LLCs or joint-stock companies. Due to the benefits of their legal personality, as well their relatively deformalised and elastic nature (compared to joint-stock companies), LLCs enjoy great popularity in the private sector.

■ *1.2. Present sources of regulation regarding limited liability companies*

In Poland, *de lege lata* (the law as it exists) applies the principle of uniformity of civil law.[5] That is, there is no normative division into civil law and commercial law. The basic source of Polish law concerning LLCs[6] is the Act of 15 September 2000, also known

5 Kidyba, 2009, p. 3; Safjan, 2007, p. 55.
6 Kidyba, 2009, p. 7.

as the Commercial Companies Code (Articles 151-300).[7] In matters not covered by the Commercial Companies Code, the Civil Code shall be applied. If required by the nature of the commercial company's legal relationship, the provisions of the Civil Code shall apply accordingly (Article 2).[8] In addition, there are a number of separate Acts regarding LLCs according to the subject of their activities (e.g., sports companies) or due to the status of their shareholders (i.e., whether the shareholder is the State Treasury or a local government unit).[9]

■ *1.3. Legal status of a limited liability company*

There are three categories of person in Polish civil law: a) natural persons; b) incomplete legal entities, that is, organizational units with legal capacities, whose members are jointly and severally liable for the obligations of the legal entity; and c) legal entities. LLCs are legal entities.[10] An LLC acquires legal personality upon entry into the court register. It loses its legal personality upon removal from the register. The LLC has its own assets, separate from the assets of the shareholders. The company itself is responsible for its obligations. The company may create branches. The company's branch has no separate legal personality.

The name of the LLC can be chosen freely; however, it should include the additional designation 'spółka z ograniczoną odpowiedzialnością' (limited liability company).[11] The abbreviation 'spółka z o.o.' or 'sp. z o.o.' (LLC) is also allowed (Article 160). The Civil Code and other laws shape certain requirements for the company name: the principle of unity of the name, the principle of the truth of the name, the principle of uniqueness of the name, and so on.

■ *1.4. Legal status of shareholders*

Shareholders may be natural persons, incomplete legal entities, or legal entities.[12] There is no censorship of nationality, citizenship, or place of seat. One can become a shareholder in an original manner as a founder of the company or in a consequential manner (following the acquisition of shares, transformation of companies, inheritance, etc.). In external relations, the shareholders are not responsible for the company's obligations (Article 151 § 4). In internal relations, shareholders are required only to perform the duties specified in the articles of association (Article 151 § 3).[13]

7 Unless otherwise stated, all articles come from the Commercial Companies Code by its legal status as at 1 December 2019.
8 Nita-Jagielski, 2010, p. 150; Sołtysiński, 2001, p. 19.
9 Kopaczyńska-Pieczniak, 2010, p. 32; Nita-Jagielski, 2010, p. 149.
10 Kopaczyńska-Pieczniak, 2010, p. 67; Szajkowski and Tarska, 2010, p. 121.
11 Kopaczyńska-Pieczniak, 2010, p. 54.
12 Kidyba, 2002, p. 15.
13 Kidyba, 2002, p. 35; Kopaczyńska-Pieczniak, 2010, p. 279.

■ *1.5. Public register for the company*

LLCs are subject to entry in the Register of Entrepreneurs of the National Court Register, and obtain legal personality upon entry into this register.[14] Data regarding the LLC disclosed in the register are, among others, the following: name of the company; registered office and address; company branches (if any), as well as their registered offices and addresses; the amount of the share capital, and if the shareholders make in-kind contributions — an indication of this circumstance; the value of shares; whether shareholders may have one or more shares; designation of shareholders holding, solely or jointly with others, at least 10% of the share capital, the number of shares held by those partners, and their total amount; if the company has only one shareholder, confirmation that they are the company's only shareholder; designation of the body authorised to represent the company and its members, indicating the method of representation; designation of supervisory authorities and their composition.

■ *1.6. Admissibility of a sole proprietorship of a limited liability company*

The company's essence is based on *affectio societatis*.[15] However, the legislation explicitly allows a sole proprietorship.[16] A sole proprietorship may be formed in a primary or successive manner as a result of accumulation of shares by one person, for example, by means of a purchase transaction or as a result of the redemption of other partners' shares.[17] Moreover, an entrepreneur who is a natural person conducting business activities on his or her own behalf within the bounds of the Act of 6 March 6 2018, also known as the Entrepreneurs' Law, may transform the form of activity being conducted into a sole proprietorship (Article 551 § 5).

In a sole proprietorship, the sole shareholder exercises all rights vested in the shareholders' meeting, and the provisions regarding the meeting of shareholders shall apply accordingly (Article 156). If all of the company's shares are vested in the sole shareholder or in the sole shareholder and the company, such a shareholder's declaration of intent requires a written form to be submitted to the company, otherwise it is null and void, unless the law stipulates otherwise (Article 173).

■ *1.7. Holding structures with the participation of a limited liability company*

Under Polish law, the regulations regarding holding companies (groups of companies) are still rudimentary.[18] An LLC may participate in a holding structure. However, in accordance with Article 151 § 2, an LLC cannot be established solely by another sole-proprietorship LLC.

14 Kidyba, 2009, p. 68; Nita-Jagielski, 2010, p. 171.
15 Szajkowski and Tarska, 2010, p. 132.
16 Kidyba, 2002, p. 15; Kopaczyńska-Pieczniak, 2010, p. 250.; Nita-Jagielski, 2010, p. 156; Szajkowski and Tarska, 2010, p. 130.
17 Kidyba, 2001, passim.
18 Kidyba 2009, p. 230; Opalski, 2012, passim; Szumański, 2010, p. 675.

■ ***1.8. Participation of a limited liability company in a limited partnership***

An LLC (including a sole-proprietorship LLC) may participate in atypical constructions. An LLC may be a partner in a limited partnership, which is responsible with all its assets for the obligations of this limited partnership (as the so-called general partner). A natural person — the sole partner of an LLC — may be a partner in a limited partnership which: a) is responsible for the limited partnership's obligations up to a specified amount, the so-called 'limited amount'; and b) shall not be liable within the limits of its contribution into the partnership (as the so-called limited partner).[19]

■ ***1.9. A ban on a limited liability company acquiring its own shares***

Neither an LLC — nor its subsidiary — can: a) subscribe shares in its own share capital; b) acquire its own shares; or c) pledge its own shares. However, exceptions include: a) the acquisition of its own shares by way of execution to satisfy the company's claims, which cannot be satisfied by other assets of the partner; b) the acquisition for redemption of shares; or c) the acquisition or subscription for shares in other cases allowed by law (Article 200 § 1).[20] If shares acquired by way of execution are not disposed of within one year of the acquisition date, they should be redeemed in accordance with the provisions regarding the reduction of the share capital, unless a special reserve capital was created in the company for redemption of shares (Article 200 § 2).

2. Flexibility of a limited liability company

■ ***2.1. The limited liability company's goals***

In accordance with Article 151 § 1, an LLC may be established for any legally permissible purpose, unless the law stipulates otherwise.[21] This means that an LLC may be created for a purely non-profit goal, rather than for profit. Thus, the construction of an LLC may compete with the construction of a foundation, an association with legal personality, a cooperative, and so on. Some economic purposes are reserved for joint-stock companies (e.g., banking and insurance).[22]

■ ***2.2. Codex regulation: Ius cogens and ius disposituvum standards***

Construction of an LLC is flexible and deformalised, in contrast to the construction of a joint-stock company.[23] Most of the provisions regarding the sphere of internal relations (*forum internum*) in an LLC are disposable in nature (*ius dispositivum*). The provisions regarding external relations (*forum externum*) in an LLC and on issues concerning responsibility are mainly built by mandatory provisions (*ius cogens*).

19 Kidyba, 2002, p. 23.
20 Herbet, 2010, p. 251; Kopaczyńska-Pieczniak, 2010, p. 166.
21 Kidyba, 2002, p. 16; Kopaczyńska-Pieczniak, 2010, p. 23.
22 Kidyba, 2002, pp. 13-14.
23 Kopaczyńska-Pieczniak, 2010, p. 39; Szajkowski and Tarska, 2010, p. 128; Szumański, 2010, p. 438.

■ *2.3. Limited liability company articles of association in a traditional form*

The articles of association of an LLC should not be complicated and should specify: a) the company name and registered office; b) the subject of the company's business; c) the amount of share capital; d) whether a shareholder may have more than one share; e) the number and nominal value of shares taken up by individual shareholders; and f) the duration of the company, if marked (Article 156 § 1). The articles of association of an LLC should be concluded in the form of a notarial deed (Article 156 § 2).[24]

■ *2.4. Standard company agreement in the ICT system. Quick company registration*

The legislation has provided for a simplified formula (with typical provisions) for the conclusion of a company agreement and an accelerated registration procedure. The conclusion of an LLC's articles of association is possible using the template agreement. This requires completing the contract form available in the ICT system, and providing the contract with a qualified electronic signature, trusted signature, or personal signature (Article 157[1]). Only cash contributions are made to cover the share capital. The share capital should be covered within no more than seven days from the date of its entry in the register.

■ *2.5. Regulation flexibility: From a model similar to a partnership to a model similar to a joint-stock company*

An LLC is a capital company, but in particular cases it can be shaped by its founders to be an entity based more on a personnel substrate, or more on a capital substrate.[25] For instance, trading in shares may be limited to maintaining a permanent composition of shareholders, or it may be completely free, without any control of who buys the shares. The articles of association may exclude or limit the joining of a shareholder's spouse or heirs. The members of the management board (and supervisory board) may only be shareholders, or may be persons from outside the group of shareholders. The members of the management board may be appointed for an indefinite period, without a term of office. The control of the company's activities may take the form of direct and personal control by the shareholders, or may be institutionalised by creating a supervisory board. The articles of association may grant shareholders extra personal rights, or the position of shareholders may be standardised.

24 Kopaczyńska-Pieczniak, 2010, p. 235.

25 Kopaczyńska-Pieczniak, 2010, p. 40; Szajkowski and Tarska, 2010, p. 128; Szumański, 2010, p. 436.

3. The share capital. Contributions to the company. Shares

■ *3.1. The company's share capital and its functions*

An LLC has its 'own capitals'.[26] Belonging to them are: a) obligatory share capital; b) voluntary supplementary capital; and c) voluntary reserve capital. The share capital is obligatory.[27] Its minimum amount is PLN 5,000[28] (Article 154 § 1). The company's share capital is divided into shares of equal or unequal nominal value (Article 152). The share capital has a legal function.[29] It is divided into shares and determines which company position a stockholder occupies.[30] However, this guarantee function[31] of the share capital is illusory in practice. The symbolic minimum amount of share capital gives no realistic guarantee to creditors of the company. Because the share capital is only a provision on the liabilities side in the balance sheet, even if it is high, its protective functions are limited. The law protects share capital. During the duration of the company, shareholders may not be refunded their contributions in whole or in part, unless the provisions of this section stipulate otherwise (Article 189 § 1). Shareholders may not receive, on any account, payments of the company's assets needed to fully cover the share capital (Article 189 § 2), and so on.

■ *3.2. Changes in share capital: Increase and reduction*

The share capital may be increased by either increasing the nominal value of existing shares or establishing new shares (Article 257 § 2).[32] The entry of share capital increase into the register is constitutive in effect. The share capital may be increased either under the existing provisions of the company's articles of association, providing for the maximum amount of share capital increase and the date of the increase, or pursuant to an amendment to the articles of association (Article 257 § 1). The share capital is increased by making external contributions to the company. There is the possibility of increasing the share capital from the company's own resources. The share capital may be increased by allocating funds from supplementary capital or reserve capital (funds) created from the company's profit by resolution of the shareholders to amend the articles of association. In such a case, the shareholders have new shares in addition to their existing shares, and their subscription is not required (Article 260 § 1, 2).[33]

26 Herbet, 2010, p. 185, 192; Kidyba, 2009, p. 352; Nita-Jagielski, 2010, p. 169.
27 Kopaczyńska-Pieczniak, 2010, p. 97.
28 About 1150 EUR. For comparison, the minimum share capital in a joint-stock company is PLN 100,000.
29 Herbet, 2010, p. 195; Kidyba, 2002, p. 35.
30 Herbet, 2010, p. 187; Kidyba, 2002, p. 37.
31 Herbet, 2010, p. 196; Kidyba, 2002, p. 40.
32 Herbet, 2010, p. 218; Kidyba, 2009, p. 355; Kopaczyńska-Pieczniak, 2010, p. 123.
33 Herbet, 2010, p. 226.

The share capital may be reduced to a minimum amount.[34] As a rule, a resolution of the shareholders to amend the articles of association is essential. The management board immediately announces the adopted reduction of the share capital, calling on the company's creditors to raise objections, if there are any, within three months from the day of announcement. Creditors who object within this period should be satisfied or secured by the company. Creditors who do not object are considered to agree with reducing the share capital (Article 264 § 1). The above described convocation procedure shall not apply if, despite the reduction of the share capital, the shareholders have not returned to the contributions they had made to the share capital, and at the same time with the reduction of the share capital, it shall be increased at least to the original amount (Article 264 § 2).

■ *3.3. Mandatory contributions to a limited liability company*

A commercial company in Poland may not be 'contribution-free'.[35] Contributions made by shareholders may be non-monetary, or made in cash.[36] Making in-kind contributions[37] requires that the articles of association should specify in detail the subject of the contribution, the identity of the contribution-making shareholder, and the number and nominal value of the shares taken up in exchange (Article 158 § 1). If the value of in-kind contributions is significantly overstated in relation to their sale value on the date of concluding the company's articles of association, the shareholder who made the contribution and the members of the management board who knowingly reported the company to the register, are obliged to jointly and severally equalise the missing value (Article 175). If the issue price is higher than the nominal value of the share, then the surplus (agio) is transferred to supplementary capital. As a rule, all contributions should be made before registering the company.[38]

■ *3.4. A shareholder's maximum number of limited liability company shares*

The articles of association state whether a shareholder may have one or more shares.[39] If a shareholder may have more than one share (which is a common practice), then all shares in the share capital should be equal and indivisible (Article 153). The nominal value of the share may not be lower than PLN 50[40] (Article 154 § 2). Shares may not be subscribed below their nominal value (Article 154 § 3). Neither bearer documents nor personal or commission documents may be issued for shares or rights to profit in a company (Article 174 § 6).

34 Herbet, 2010, p. 233; Kidyba 2009, p. 358; Kopaczyńska-Pieczniak, 2010, p. 127.
35 Herbet, 2010, p. 198; Kidyba, 2009, p. 334.
36 Herbet, 2010, p. 199; Kidyba, 2009, p. 347.
37 Szumański, 1997, passim.
38 Herbet, 2010, p. 197.
39 Herbet, 2010, p. 241; Kidyba, 2009, p. 362.
40 About 11,50 EUR. For comparison, the minimum nominal value of a share in a joint-stock company is PLN 0.01 (one Polish penny).

■ *3.5. Possibility of trading shares*

LLC shares may be sold (as part of both the singular and the general succession), pledged, and encumbered with a right *in rem* (use).[41] The articles of association may stipulate that a pledgee or user of shares may exercise the right to vote (Article 187 § 2). The sale of a share, its part or a fraction of a share and its pledge should be made in writing, with signatures authenticated by a notary public (Article 180 § 1). Share-trading restrictions are unique and may arise from a) the specific provision of law; b) the articles of association; or c) a contract between a shareholder and a third party. The trading of shares can be restricted by the articles of the association in two ways (Article 182): by making the sale of shares subject to the company's approval and/or by granting the existing shareholders pre-emptive rights to shares which are to be sold.[42]

■ *3.6. Cancellation of shares*

Shares in an LLC may be cancelled only after the company has been entered in the register, and only if the articles of association allow.[43] Shares may be cancelled either with the consent of the shareholder through the purchase of shares by the company (voluntary cancellation) or without the consent of the shareholder (compulsory cancellation). The conditions and procedure of compulsory cancellation should be specified in the articles of association (Article 199 § 1). The cancellation of shares requires a resolution of the meeting of shareholders, which should specify in particular the legal basis for the cancellation and the amount of remuneration due to the shareholder for the cancelled shares. This remuneration, in the event of compulsory cancellation, may not be lower than the value attributable to the share of net assets disclosed in the financial statements for the last financial year, less the amount to be distributed among the partners. In the event of compulsory cancellation, the resolution should also contain a statement of reasons (Article 199 § 2). With the shareholder's consent, shares may be cancelled without any remuneration — *volenti non fit iniuria* (Article 199 § 3).

4. Rights and obligations of shareholders

■ *4.1. Rights of shareholders*

Unless the provisions of law or articles of association stipulate otherwise, shareholders have equal rights and obligations in the company (Article 174 § 1).[44] Shareholders have property rights and corporate rights.[45] The basic property right is the right to dividend (Article 191).[46] If the articles of association or resolution on the increase in capital do not stipulate otherwise, shareholders have the pre-emptive right to subscribe for new

41 Herbet, 2010, p. 279; Kopaczyńska-Pieczniak, 2010, p. 151.
42 Herbet, 2010, p. 291.
43 Herbet, 2010, p. 255; Kidyba 2009, p. 360; Kopaczyńska-Pieczniak, 2010, p. 191.
44 Herbet, 2010, p. 349; Kidyba 2009, p. 365; Kopaczyńska-Pieczniak, 2010, p. 292.
45 Herbet, 2010, p. 354.
46 Herbet, 2010, p. 377; Kidyba, 2009, p. 369.

shares[47] in the increased share capital in relation to their existing shares (Article 258 § 1). All shareholders have the right to participate in the meeting of shareholders and the right to vote. Shareholders also have the right to appeal the court resolutions of the meeting of shareholders.[48]

If the articles of association allow for shares with special rights, these rights should be specified therein. These are so-called 'preferred shares' (Article 174 § 2). Preference may relate in particular to: a) voting rights for shares of equal nominal value, at up to 3 votes per share; b) dividend rights (for a preferential share in the scope of the dividend, a dividend may be granted to the entitled person, and it shall not exceed by more than half the dividend due to the non-preferential shares); c) priority rights to receive dividends; and d) special rights to participate in the distribution of assets in the event of the company's liquidation. The articles of association may make the granting of special rights conditional on the fulfilment of additional benefits for the company, the expiry of a fixed period, or the fulfilment of given conditions (Article 174 § 5).

■ *4.2. Minority rights*

There are predicted minority rights of shareholders.[49] A shareholder or shareholders representing at least one-tenth of the share capital may request that an extraordinary meeting of shareholders be convened, and that specific matters be placed on the meeting agenda (Article 236 § 1). A shareholder or shareholders representing at least one-twentieth of the share capital may request that specific matters be placed on the agenda of the next shareholder meeting (Article 236 § 1).[1] The articles of association may grant the abovementioned rights to shareholders representing a lower amount of share in the share capital.

■ *4.3. Obligations of shareholders*

The articles of association may oblige shareholders to make additional payments within an indicated amount in relation to the share. Additional payments should be imposed and paid by partners evenly in relation to their shares (Article 177 § 1, 2).[50] A shareholder may be obliged to make recurring non-cash benefits for the company. In such a case the articles of association must indicate the type and extent of such benefits. A shareholder's remuneration for such benefits for the company shall also be paid by the company when the financial statements show no profit. The remuneration may not exceed the prices or rates accepted in the market.

47 Herbet, 2010, p. 386.
48 Herbet, 2010, p. 397.
49 Herbet, 2010, p. 362; Kidyba, 2009, p. 375; Kopaczyńska-Pieczniak, 2010, p. 340; Radwan, 2016, passim.
50 Herbet, 2010, p. 425; Kopaczyńska-Pieczniak, 2010, p. 356.

■ *4.4. Personal rights granted to shareholders*

The articles of association of the company may grant specific personal rights to shareholders, for example, the right to appoint and remove a certain number of members of the management board or the supervisory board, or the right to convene a meeting of shareholders.[51]

■ *4.5. Loss of shareholders status: Involuntary cancelation of all shares and exclusion of a shareholder from the company*

Shareholders can be forcibly deprived of their status in the company. This can be done through two different channels. In each case, adequate equivalent and the possibility of judicial review of the procedure are ensured. First, a shareholder may have all shares cancelled in a compulsory manner.[52] For this to occur, the resolution of the majority of shareholders is essential. Second, in extenuating circumstances involving a given shareholder, the court may order his or her exclusion from the company at the request of all other partners, if the partners requesting exclusion hold more than half of the share capital (Article 266 § 1).[53] The articles of association may also grant the right to bring the above-described action about if a smaller number of shareholders possess shares constituting more than half of the share capital (Article 266 § 2). The shares of the excluded shareholder must be taken over by shareholders or third parties. The acquisition price is determined by the court based on the actual market value on the day of the claim's delivery (Article 266 § 3).

5. Organs of a limited liability company

■ *5.1. Structure of company organs*

According to the theory of organs, a company operates through its organs.[54] There are three types[55] of possible organs in an LLC: a) organs for managing (management board);[56] b) organs for supervising (supervisory board or audit committee);[57] and c) organs for making decisions about key issues for the company (shareholders' meetings).[58] The management board consists of one or more[59] members (Article 201 § 2). Both shareholders and non-shareholders may be appointed to the management board (Article 201 § 3). The articles of association may establish a supervisory board, commission audit

51 Herbet, 2010, p. 423; Kopaczyńska-Pieczniak, 2010, p. 342.
52 Herbet, 2010, p. 263; Kopaczyńska-Pieczniak, 2010, p. 196.
53 Herbet, 2010, p. 333; Kopaczyńska-Pieczniak, 2010, p. 377.
54 Grzybowski, 1974, p. 373; Klein, 1985, p. 122; Pazdan 1969, pp. 205-206; Wolter, Ignatowicz and Stefaniuk, 1996, p. 196.
55 Kidyba, 2009, p. 381; Szajkowski and Tarska, 2010, p. 135; Szumański, 2010, p. 437..
56 Kidyba, 2009, p. 381; Kopaczyńska-Pieczniak, 2010, p. 396.
57 Kidyba, 2009, p. 395; Kopaczyńska-Pieczniak, 2010, p. 452.
58 Kidyba, 2009, p. 402; Kopaczyńska-Pieczniak, 2010, p. 498.
59 Szumański, 2010, p. 446.

authorities, or both (Article 213 § 1). In practice, the audit committee is generally not appointed. The supervisory board is obligatory[60] only in select companies. In companies whose share capital exceeds PLN 500,000 and there are more than twenty-five shareholders, a supervisory board or an audit committee should be established (Article 213 § 2). The supervisory board consists of at least three members (Article 215 § 1).[61] There are either management or supervisory bodies, not both. Apart from regulations concerning state enterprises that have turned into companies, employees do not have the authority to participate in the management of the company.

■ *5.2. The method of appointing permanent organs*

Members of the management board are appointed and dismissed by a resolution of shareholders, unless the articles of association stipulate otherwise (Article 201 § 4).[62] The mandate of a member of the management board expires at the end of the fixed term, as well as due to death, resignation, or dismissal from the board (Article 202 § 2, 3).[63] A member of the management board may be dismissed at any time by a resolution of shareholders (Article 203. § 1). The articles of association may contain other provisions, and may in particular limit the right to dismiss a member of the management board to extenuating circumstances only (Article 203 § 2).[64]

Similarly, the supervisory board is appointed and dismissed by a resolution of shareholders (Article 215 § 1). The articles of association may allow for a different way of appointing or dismissing members of the supervisory board (Article 215 § 2).[65]

■ *5.3. Convening organs operating in sessions*

The shareholders' meeting may proceed ordinary (e.g., summarizing the previous financial year) or extraordinarily.[66] The shareholders' meeting is convened a) by the management board (Article 235 § 1); b) by either the supervisory board or the audit committee if the management board fails to convene an ordinary meeting of shareholders within the time limit specified in law or in the articles of association, and an extraordinary meeting of shareholders if it is deemed necessary and if the management board does not convene a meeting of shareholders within two weeks from the date of submission of the relevant request by the supervisory board or the audit committee (Article 235 § 2); or c) by other persons granted entitlement to convene a meeting of shareholders under the articles of association (Article 235 § 3). If, within two weeks of a request being submitted to the management board, the extraordinary shareholders' meeting is not convened with an agenda in accordance with the request, the registry

60 Szumański, 2010, p. 445.
61 Szumański, 2010, p. 447.
62 Szumański, 2010, p. 459, 464.
63 Szumański, 2010, p. 465.
64 Szumański, 2010, p. 467.
65 Szumański, 2010, p. 479.
66 Szumański, 2010, p. 494.

court may authorise the convening of an extraordinary meeting of the partner or partners submitting the request (Article 237 § 2).

■ *5.4. Competence of organs*

The management board conducts the company's affairs and represents the company (Article 201 § 1).[67] The management board has the presumption of competence.[68]

The supervisory board exercises constant supervision over all areas of the company's activity (Article 219 § 1).[69] However, the supervisory board has no right to issue binding instructions to the management board regarding the management of the company's affairs (Article 219 § 2).[70] The specific duties of the supervisory board include: a) the assessment of the annual financial statements and activity reports regarding their compliance with the books and documents, as well as with the facts; and b) the assessment of the management board's annual conclusions regarding distribution of profit or coverage of loss (Article 219 § 3). The articles of association may extend the powers of the supervisory board, and in particular: a) stipulate that the management board is obliged to obtain the consent of the supervisory board before performing the actions specified in the articles of association; and b) delegate to the supervisory board the right to suspend, under extenuating circumstances, an individual member or all members of the management board (art. 220).[71]

Resolutions of shareholders are adopted at the shareholders' meeting (Article 227 § 1). The articles of association may allow participation in the shareholders' meeting to use electronic means of communication (Article 234^1 § 1). Resolutions may be adopted without holding a shareholders' meeting if all shareholders agree in writing or by a written vote to the decision in question (Article 227 § 2). In accordance with Article 228, resolutions of shareholders require,[72] among other things: a) review and approval of the management board's report on the company's operations, the financial statements for the previous financial year, and acknowledgment of the fulfilment of duties by members of the company's governing bodies; b) a decision regarding claims for compensation for damage caused when establishing the company or exercising management or supervision; and 3) sale and lease of the enterprise or its organised part and establishment of a right effective *erga omnes* thereon.

■ *5.5. Representation of a company*

The company may be represented based either on the theory of the organ or on the theory of power of attorney. The right of a management board member to represent the company applies to all court and extrajudicial activities of the company (Article

67 Szumański, 2010, p. 448.
68 Kidyba, 2009, p. 385; Szumański, 2010, p. 447.
69 Szumański, 2010, p. 482.
70 Szumański, 2010, p. 450.
71 Szumański, 2010, p. 486.
72 Szumański, 2010, p. 497.

204 § 1),[73] and cannot be restricted by legal effect to third parties (Article 204 § 2). If the management board is composed of several persons, the manner of representation is specified in the articles of association. If the articles of association do not contain any provisions in this regard, the submission of statements on behalf of the company requires the cooperation of two members of the management board, or one member of the management board together with a commercial proxy-holder (Article 205 § 1). Statements submitted to the company and the delivery of letters to the company (passive representation) may be made to one member of the management board or to a proxy (Article 205 § 2). In any contract between the company and a member of the management board or in a dispute between the two, the company is represented by the supervisory board or a proxy appointed by resolution of the meeting of shareholders (Article 210 § 1).

6. Establishment, liquidation, transformation, insolvency, and restructuring of a limited liability company

■ *6.1. Establishment of a company*

In accordance with Article 163, the establishment of an LLC requires: a) conclusion of the articles of association; b) contributions by shareholders to cover the entire share capital, and in the event of taking up a share for a price higher than the nominal value, to create a surplus; c) appointment of the board; d) establishment of a supervisory board or an audit committee, if required by statute or articles of association; and e) entry in the register.[74]

■ *6.2. A limited liability company in organization*

Upon the conclusion of the articles of association, an LLC in organization is established (Article 161 § 1).[75] An LLC in organization is represented by the management board or a proxy-holder appointed by a unanimous resolution of the founders (Article 161 § 2). The liability of persons acting for an LLC in organization ceases as soon as their activities are approved by a meeting of shareholders (Article 161 § 1).[76]

■ *6.3. Merger, division, and transformation capability of a limited liability company*

Capital companies may merge with each other and with partnerships; a partnership cannot, however, be an acquiring company or a newly formed company (Article 491 § 1). An LLC may merge with a foreign company, as is referred to in Article 2 § 1 of Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005

73 Kidyba, 2009, p. 385; Kopaczyńska-Pieczniak, 2010, p. 425..
74 Kidyba, 2009, p. 336; Kopaczyńska-Pieczniak, 2010, p. 235.; Nita-Jagielski, 2010, p. 163..
75 Kopaczyńska-Pieczniak, 2010, p. 48; Nita-Jagielski, 2010, p. 163.
76 Kidyba, 2009, p. 237.

on the cross-border merger of LLCs. An LLC may be divided into two or more capital companies (Article 528 § 1) or may be transformed into another commercial company (Articles 551 § 1).[77]

■ *6.4. Liquidation of a company. Bankruptcy and restructuring*

The dissolution of a company[78] is caused by: a) the reasons provided for in the articles of association; b) a resolution of the shareholders on the dissolution of the company or on the transfer of the company's registered office abroad, confirmed by a report drawn up by a notary public; c) the company's declaration of bankruptcy; or d) other reasons provided by law (Article 270). The court may, by judgment, order the dissolution of the company: a) at the request of a shareholder or member of the company's governing body, if achieving the company's purpose has become impossible or if there are other extenuating circumstances caused by the company's relations; or b) at the request of a state body designated in a separate act, if the company's activity infringes on the law and threatens public interest (Article 271). The dissolution of the company takes place after liquidation, when the company is removed from the register (Article 272). The liquidators are the members of the management board, unless the articles of association or a resolution of the shareholders stipulate otherwise (Article 276 § 1). The liquidation activities include terminating the company's current interests, collecting claims, fulfilling obligations, and liquidating the company's assets. A new business can only be started if it is necessary for completing ongoing cases. Real estate may be sold by public auction, and by free hand (only on the basis of a resolution of the partners), at a price not lower than that adopted by the shareholders (Article 282 § 1). The division of assets remaining after satisfying or securing creditors may only be made beginning at six months after the date of the announcement of the commencement of liquidation and summoning creditors for their claims (Article 286 § 1). The property is divided among shareholders according to their shares. The articles of association may specify other rules for the distribution of assets (Article 286 § 2, 3). An LLC has a bankruptcy and restructuring ability.[79]

7. Civil responsibility in a limited liability company

■ *7.1. Abuse of a company structure by shareholder*

As a rule, an LLC — as a legal person — is itself responsible for its obligations.

Under Polish law, there is no direct regulation regarding the abuse of a company's legal personality by shareholders. Nevertheless, legal doctrine indicates that general provisions regarding, for example, torts, invalidity, and so on, allow for 'piercing the corporate veil'. In practice, courts often ignore the company's legal personality in

77 Kidyba, 2009, p. 502; Nita-Jagielski, 2010, p. 160..

78 Kidyba, 2009, p. 415; Kopaczyńska-Pieczniak, 2010, p. 68; Michalski, 2010, p. 511.

79 Adamus, 2019, p. 19; Kopaczyńska-Pieczniak, 2010, p. 92; Michalski, 2010, p. 534..

matters of social security, and charge its shareholders with liability for social security contributions. In such situations, the courts ignore the fact that a natural person works in the management board of the company, and instead treat each shareholder as if it were a natural person conducting business activity.[80]

■ ***7.2. Liability of members of the company's management board to creditors***

Under Polish law, there are a number of provisions regarding the liability of management board members for the company's obligations.[81] If enforcement against the company proves ineffective, members of the management board shall be jointly and severally liable for its obligations. A member of the management board may be released from liability if he/she demonstrates that: a) the bankruptcy petition was filed without delay; b) at the same time, a court's decision was issued to open the restructuring procedure or to approve the arrangement in the proceedings regarding approval of the arrangement; c) failure to file for bankruptcy was not his/her fault; or d) despite failure to file for bankruptcy, failure to issue a resolution to open restructuring proceedings, or failure to approve the arrangement in proceedings regarding approval of the arrangement, the creditor did not suffer damages (Article 299).[82]

■ ***7.3. Liability of management board members to the company***

Members of the management board, supervisory board, and audit committee, as well as liquidators, shall be liable to the company for damage caused by an act or omission contrary to the law or the provisions of the articles of association, unless he/she is not at fault. Members of the management board, supervisory board, and audit committee, as well as liquidators should, when performing their duties, exercise due diligence because of the professional nature of those duties (Article 293).[83]

■ ***7.4. Actio pro socio***

If the company does not bring an action to repair damages caused to it within one year from the date of disclosure of the damaging act, any shareholder may bring a claim for compensation of the damages caused to the company.[84]

8. Future of limited liability companies in Poland

National LLCs in the European Union do not yet have a 'competitor' in the form of a European private company. Work on this EU construction has not been completed.[85]

80 Kopaczyńska-Pieczniak, 2010, p. 608; Siemiątkowski, 2010, p. 568.
81 Kopaczyńska-Pieczniak, 2010, p. 586; Osajda, 2014, passim; Siemiątkowski, 2010, p. 625.
82 Siemiątkowski, 2010, p. 635.
83 Kopaczyńska-Pieczniak, 2010, p. 570; Siemiątkowski, 2010, p. 582.
84 Bilewska, 2008, passim; Siemiątkowski, 2010, p. 671.
85 Opalski, 2010, p. 604.

In the Polish legal system, there recently appeared a mutation of a joint-stock company: a 'simple joint-stock company'. It may prove to be a competitor to LLCs.

It should be noted here that there was an interesting debate in Poland about the introduction into company law of the admissibility of zero share capital.[86] Though this concept has been seriously criticised in the doctrine of law, it did have some supporters.[87] Ultimately, however, this idea was not implemented.

9. Summary

In the conditions of a common market, the construction of an LLC should be able to compete with similar institutions in other countries. The more amenable the laws regarding LLCs are, the greater the chance of facilitating the development of domestic business, attracting investment, and achieving the so-called 'Delaware effect' in the global market.

Under current Polish law, regulations regarding LLCs are modern and elastic. Of course, there is no 'end of history', and the construction of LLCs is subject to change. Further attempts should be made to simplify the functioning of this type of company.

86 Herbet, 2010, p. 217.

87 Frąckowiak, 2011, p. 5; Katner, Kappes and Janeta, 2011, p. 13; Kidyba and Kopaczyńska-Pieczniak, 2011, p. 9; Opalski, 2011, p. 11; Oplustil, 2011, p. 31; Osajda, 2011, p. 25; Romanowski, 2010, p. 5; Sobolewski, 2011, p. 54.

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CSEMÁNÉ VÁRADI ERIKA[1]

Harmful Effects of Imprisonment, Overcrowding in Prisons – Facts, Reasons, and the Way Forward

ABSTRACT: *High prison occupancy – regardless of the type of violation – is a serious problem and a significant obstacle to reformatory, reintegrational, and educational work. Neither the negative side effects of imprisonment, nor the harmful effect of overcrowding are uniquely Hungarian, but according to Eurostat data on the prison population between 2015 and 2017, the highest level of prison overcrowding was observed in Hungary. What could be the reason for this? Are there any peculiarities that could serve as an explanation and that make domestic conditions so different? Can repressive criminal policy really be the cause, or strict sentencing practices, or new rules in the Criminal Code, such as mid-scale sentencing? Or will the change in civic attitudes and the associated criminal policy affect professionals? Is it that public security is becoming a political issue? Maybe historical roots or other objective reasons (such as the nature of the buildings) lead us here? This study seeks answers to this situation.*

KEYWORDS: harmful effects of imprisonment, overcrowding, risk factors, criminal policy, sentencing practice, mid-scale sentencing, good practice, diversion.

'...what the punishment is: the society must have a goal in its hands,
that punishment must be the coercive power of reason.
There is no purpose in vengeance,
for there is no reason in it, only pure temper.'[2]

'In recognition of the key aspect that the protection of society is the aim for that the criminal law there shall stand, and for that treatment to be followed against criminals is defined: according to the views of the Committee it is not simply in harmony with this aim, but is a necessary requirement to make personal development of prisoners the main purpose of prison

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2 Szemere, 1841, p. 40.

https://doi.org/10.47078/2020.1.27-50

discipline. And for this goal to be achieved: hope must be made a more powerful spring than fear, and for this reason we must awaken hope in the bosom of the prisoner by the prospect of a reward for good behaviour and diligence; this reward can be either the shortening of the sentenced imprisonment, a gain after work or in the gradual easing of restrictions on leave'.[3] The First International Congress on the Prevention and Repression of Crime held in London in 1872 clearly advocated the importance of nurture. In this regard, the importance of maintaining moral forces and reasons was emphasized in making the offender capable of understanding the unlawful and harmful nature against society by their acts, and that during the crime prevention process real results can be achieved only with their active involvement: '*Therefore every prison system should be directed to contribute to the prisoners' efforts; because disciplines can never really work for the better if the will of the prisoner is not won.*'

Nearly *150 years* have passed since the recording of the ideas unanimously adopted by the representatives of the states participating in the Congress, and the successful realization of these has depended on the offender who stands in the central focus of the measures. Has the world of prisons quintessentially changed over a few generations: the behavioural attitudes, emotional reactions, self-image, operating mechanisms (e.g. neutralization techniques) or the interactions of those convicted who are deprived of their liberty and possibly choice? And if so, in this light, has the enforcement of the detention become more effective, and has there been a decrease in the recidivism rate?

'*So we can see*' – writes Péter Ruzsonyi – '*that* prison is axiomatically harmful for the detainees, *but we must strive to reduce these effects as much as possible'.* In light of the questions above, this statement may seem less encouraging. *'... it should be noted that the harmful effects of imprisonment – precisely because of the total nature of prison – cannot be completely eliminated and make the reintegration process significantly more difficult.'*[4]

Fact: Inevitably, offenders have been excluded from normal life experiences (possibly school, integration, peer group problems, failures, or victim experiences) before they reach the age of criminal responsibility, and thus cannot be blamed for their mental health, psychological and social disadvantages, psychosomatic symptoms, or neurotic reactions to situations. At the same time, they already fall within the influence of the criminal justice system, and thus there is a greater chance of eliminating those prison offences that can be managed by expanding the horizons of prison staff and developing their competencies.

3 Tobiás Löw cites a unanimously adopted report by an executive committee of members of the nations represented at the Congress in London in 1872 in support of the progressive system: A magyar büntetőtörvénykönyv a büntettekről és vétségekről (1878:5. tcz.) és teljes anyaggyűjteménye. Első kötet. Pesti könyvnyomda-részvény-társaság, Budapest, 1880. pp. 54–55.
For more information on the Congress, see Wines, 1873, pp. 185–187.

4 Ruzsonyi, 2015. p. 33.

1. Facts

Neither the negative side effects, nor the harmful effect of overcrowding are uniquely Hungarian. Nevertheless, special attention should be paid in the case of Hungary as, due to its nature, it directly or indirectly multiplies the other negative impacts of imprisonment, while at the same time its treatment seems to be a less complex issue.

In 2017[5] there was one prisoner per 865 EU citizens. This was the lowest ratio since the turn of the twenty-first century (116 detainees per 100,000 inhabitants). However, individual countries showed significant differences. For example, while in Scandinavia this ratio was around 50 – in Denmark 59, Sweden 57, and Finland 56 per 100,000 citizens – the ex-socialist member states also in the north were four times higher: in Lithuania 232, Estonia 207, and Latvia 193 detainees per 100,000 inhabitants. Hungary was at seventh place in this ranking, with a ratio of 177 detainees per 100,000 citizens. By 2020, the domestic situation has further improved: at this time the incarceration rate[6] was 167 detainees per 100,000 inhabitants. The inmate ratio per 100,000 inhabitants in OECD countries confirms the experiences so far; the Czech Republic, Poland, Slovakia, and Estonia are ahead of Hungary which is currently in eleventh place.

The inmate rate per 100,000 inhabitants is not the same as the occupancy rate of prison places. The latter case provides a more accurate picture of the conditions in which detainees live, as services (e.g. number of psychologists, sports facilities) are planned on a per-seat basis.

According to the Eurostat data on the prison population[7] between 2015 and 2017, the highest prison overcrowding was observed in Hungary (127.9), France (115.3), Cyprus (114.1), Italy (110.7), and Portugal and Belgium (110.5). Eighteen countries had some extra capacity or 'empty cells'. It is important, however, to also point out that the domestic average rates also conceal any significant national differences; for example overcrowding is 152% in the Budapest Prison Service and 155% in Sátoraljaújhely high and medium security prisons.[8] Prison overcrowding varies – partly by institutions and partly by levels of criminal enforcement. In the year under review, for example a total of 7,253 detainees were being held in the five largest institutions – the Szeged High- and Medium Security Prisons, the Budapest-Capital Prison Service, the Budapest High- and Medium Security Prisons, the Szombathely National Prison Service and the Pálhalma National Prison Service. In 2017 these five institutions held more than 40% of the total prison population of around forty institutions in Hungary. However, a high number of inmates itself does not mean a high overcrowding rate.

5 Prisoners by 100,000 inhabitants, 2017 (10/05/2020) Online: https://ec.europa.eu/eurostat/statistics-explained/index .php ? Title = File: Prisoners_by_100_000_inhabitants_2017_.png

6 Incarceration rates in OECD countries as of May 2020. In: statista (10/05/2020) Online: https://www.statista.com/statistics/300986/incarceration-rates-in-oecd-countries /

7 Eurostat. Statistics Explained . (01/05/2020) Online: https://ec.europa.eu/eurostat/statistics-explained/index.php ? title = File: Prison_occupancy_rate, _average_2015–2017.png

8 Data referenced by Forgács, 2018, p. 230.

Hungary is one of the countries with the highest prison occupancy rate, and despite the decline in the number of inmates and other introduced measures, it is still at the forefront in Europe.

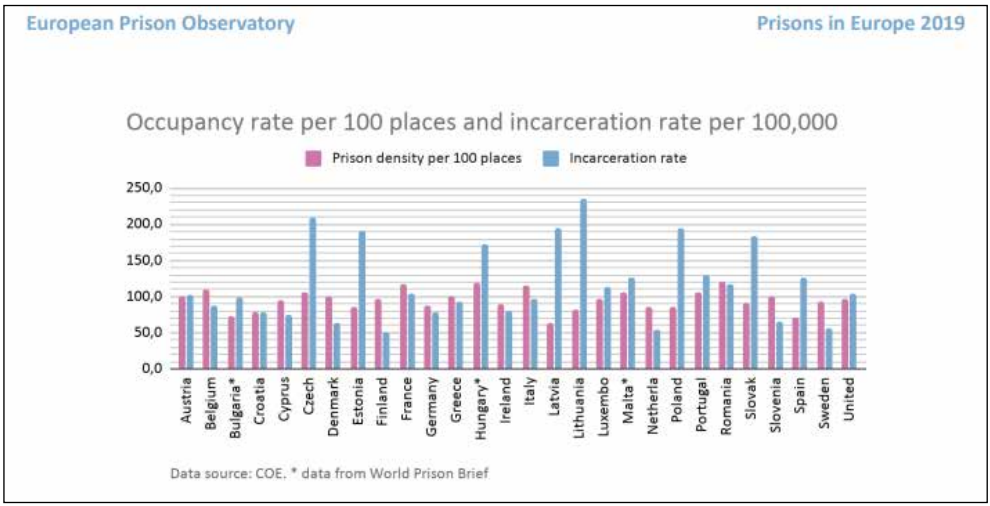

Figure 1. Prison capacity utilization rate
Source: European prison Observatory: Prisons in Europe. 2019 report on European prisons and penitentiary systems. p.8.

It is worth noting that of the countries with the highest number of inmates per 100,000 inhabitants, only Italian and French institutions are among those with the highest overpopulation of prisons – although Belgium is not far behind the first group in this respect.

The utilization rate of prison places, as the previous example shows, does not automatically mean an actual breach of the relevant international treaties. This happens if the deprivation of liberty is in conflict with the provision of Article 3 of Chapter I (Rights and Freedoms) of the European Convention on Human Rights, which prohibits torture,[9] according to which, no one shall be subjected to torture or to inhumane or degrading treatment or punishment.

High prison occupancy – regardless of the violation – is a serious problem and a significant obstacle to reformatory work. Overcrowding affects everyone in the institution – whether they are connected to the system as a prisoner or as a professional. Such is the effect of dehumanization or depersonalization, which can occur on both sides and is a serious problem in reintegration activities based on individualization.

9 Convention for the Protection of Human Rights and Fundamental Freedoms. Rome, 4 November 1950.

Prison overcrowding not only increases the risk of psychological stress and psychosomatic, mental, and physical illnesses but is also a serious risk factor for interpersonal communication difficulties and, therefore, the proliferation of conflict situations which, if not managed properly, can lead to anxiety, frustration, aggression, deviant behaviour, and even violent behaviour against a person.

The risk of violence between detainees increases both directly and indirectly if they do not have sufficient private space. The findings of a domestic study suggest that 'overcrowding is a significant problem in criminal enforcement area, which in itself creates a significant conflict-generating prisoner life situation.'[10] However, prolonged placement in a single cell also carries the risk of affecting the convicted person's mental health.

A high overpopulation rate further means an objective security risk, which is increased further by psychological and physical increases in staff workload and a deterioration in their working conditions. This is a serious inhibitory factor to counter prison violence, while in these communities, latency[11] is particularly high anyway.

These negative impacts are strengthened by the extremely heterogeneous nature of the national prison population. This is reflected in the difference between the situations of those convicted and those deprived of their liberty due to other legal provisions, in the varying proportions of prisoners living in each of the prison levels, as well as in the specifics of the acts committed.[12]

In 2017 for example, 27.16% of inmates served their sentences in a maximum security prison, 42.24% in a medium security prison, and 4.42% in a minimum security prison. This ratio is similar to previous years and by 2018 had hardly changed (28.99%, 43.26%, 4.45%).

Typically, 80% of convicted persons are incarcerated in prison, while the proportion of community service, conversion of fines to imprisonment, confinement or criminal confinement, and placing in a psychiatric institution lags behind the number of (pre-) detainees.

The heterogeneity of convicted persons can also be described according to the different levels of threat against society, expressed in the varying durations of imprisonment. The proportion of those serving a relatively short period of imprisonment, that

10 This issue was partially addressed by the National Prison Service in examination No. 30500/5242/2017 about 'Description of the mediation procedures used and possibly to be applied within the organization'. Described by Nagy and Dobos, 2019, p. 305.

11 There is a lack of trust in the institution; prisoners do not believe that they have access to real protection from the power of the others with an extensive system of relationships. At the same time, there is strong coercion to join a gang. All in all, this leads to a high degree of latency in intra-cell attacks. Thus, for example, in 2018, only 113 counts of serious bodily harm, 56 of coercion, and 29 of extortion were reported. In: Várkonyi, 2018, p. 17.

12 Thus, according to Péter Ruzsonyi, it is a constant threat that, for example, on 25 June 2015, the number of people sentenced to life imprisonment was 305, the number of people sentenced to life imprisonment without the possibility of parole was 49, and the number of 'serial killers' was 20; otherwise, those affected by imprisonment on 31 December 2014 have committed a total of 1,340 killings. See: Ruzsonyi, 2015. p. 28.

is, between one and three years, is 34%, while 17% serve between three and five years, and 25.6% five to ten years.[13]

2. Reasons

Domestic enforcement statistics have confirmed the high overcrowding rate for decades, but even international documents have shown that Hungary is among the leading member states in this respect; that is, there is no other country with such a high prison overpopulation rate in the European Union. This is true despite the fact that several countries are ahead of Hungary in terms of the number of prisoners per 100,000 inhabitants.

What could be the reason for this? Are there any peculiarities that could provide an explanation that make the domestic conditions in Hungary so different to other countries?

Can repressive criminal policy really be the cause? Perhaps there are strict sentencing practices, or new rules in the Criminal Code, such as mid-scale sentencing which are having an effect? Will the change in civic attitudes and the associated criminal policy affect professionals? Or is it that public security is becoming a political issue? Maybe historical roots or other objective reasons (such as the type of the buildings) lead us here?

Examples from other EU member states for any of these issues can be provided in the form of even more stringent solutions.

3. Repressive criminal policy, stricter penal policy?

The preventive or repressive nature of criminal policy approaches in themselves does not imply any value judgement, neither does it automatically generate overcrowding; in fact, it cannot really be identified with either the political right or left. While in the second half of the twentieth century the right wing shared mainly the findings of preventive criminal policy, this significantly transformed in the twenty-first century.

Preventive and repressive criminal policy cannot therefore be combined with any single political position, as all of these use the elements to varying degrees and over different periods. However 'neither is it true, that one is scientifically justified, appropriate for the ideals of constitutionalism and committed to humanism, and the other is proactive, denying the theory, populist, authoritarian and inhuman' – underlines Géza Finszter.[14]

Criminal policy consists of law enforcement, crime prevention, victim policy, and penal policy. Thus repressive criminal policy may be formed through a stricter

13 Lévay, 2019, p. 111.
14 Finszter, 2003. p. 40.

penal policy. The justification of the current Criminal Code proposal places strong emphasis on policy tightening, citing the National Cooperation Program:[15] 'the rigour of the law, the increase of sentences, the repeated use of life imprisonment, the protection of victims will curb criminals and make it clear to all members of society that Hungary is not a paradise for criminals (...) and consequently (...) strict laws are enacted that guarantee protection to all law-abiding citizens, but provide for effective and dissuasive punishment for offenders'.[16]

Is there consensus among experts on how strictly the practical implementation followed the (criminal) political messages? According to Mihály Tóth[17] the new code is 'characterized not by a desire to innovate at all costs, not by a compulsion to break with previous principles and institutions'. Moreover, he speaks about 'the moderate and inevitable correction of the former criminal code'. Miklós Hollán[18] refers to 'reviewing the mitigations and restrictions it is not even certain that more criminal code provisions would be stricter than milder'. While Tamás Jávorszky[19] notes that 'one of the most important requirements towards the new criminal code – in the light of the ministerial explanatory memorandum to the Act – is the rigour. Looking at some of the provisions of the General Part, we can see that this rigour applies indirectly and, in addition to the many changes that have resulted in more serious assessments, we find many provisions whose mitigating effect is indisputable. Examining each particular part of the state of affairs gives us a further nuanced picture'.

4. Peculiarity of imprisonment – mid-scale sentencing and case law

It is often argued that the regulation of prison sentences is behind the high overpopulation data. The so-called mid-scale sentencing is neither unique nor unprecedented in the history of Hungarian criminal law.

The first Hungarian Criminal Code, Act No. 5 of 1878 states: 'When imposing *penalties* both the aggravating and mitigating circumstances that have influence on the degree of guilt should be considered'. With regard to the provisions which may be regarded as a precedent of the model of mid-scale sentencing, Löw asserts that the Csemegi Code 'may provide for a penalty for the offence between two to five or three to five years. As a result when imposing penalties, and in accordance with the instructions contained in Sections 88 and 89, the rule is that in general, if neither aggravating nor mitigating circumstances exist or are mutually balanced, the median between the maximum and the minimum is the time to be determined for the duration

15 National Cooperation Program. work, home, family, health, order. Office of the National Assembly (document number: H/47) 22 May 2010 Online: https://www.parlament.hu/irom39/00047/00047.pdf (01/06/2020).
16 Hollán, 2017. p. 366.
17 Tóth, 2013, p. 534.
18 Hollán, 2017. p. 357.
19 Jávorszki, 2013, p. 64.

of the sentence. So if two to five years of punishment is determined by law, in this case three years and six months will be pronounced by the judge. This number may be increased for five years due to aggravating circumstances or for two years due to mitigating circumstances'.[20]

The provisions came back into criminal law from 1 March 1999, after the current governing party's election victory (known as the first Orbán government), as the explanatory memorandum to Act No. 87 of 1998[21] states that 'legislation on sentencing method means sharing competence between the legislature and the judiciary. The more legal constraints may allow for the development of a more coherent case law, greater legal certainty as to broadening the possibilities of judicial discretion. At the same time, undifferentiated judgement necessarily results in injustice while assessing life phenomena with large differences. There is a need to ensure judicial discretion and free operation, which the law keeps within certain limits, and the court is not completely without legal support for its activities within these limits'.

Accordingly, Section 83 of Act No. 4 of 1978, the Criminal Code in force at that time, declared that '(2) Where a sentence of imprisonment is delivered for a fixed term, the median of the prescribed scale of penalties shall be applicable. The median shall be set like half of the sum of the lowest and highest penalties to be imposed [and] shall be added to the minimum penalty threshold'.

The provision has neither made the penalty system absolutely definite, nor narrowed the margin of judicial discretion, or resulted in sentencing constraints. According to the authors, this provided more clues, a 'realistic basis of reference' for considering statutory rules and other mitigating and aggravating circumstances. That is, 'nothing precludes (nor will preclude in the future) the court from comparing and evaluating individual circumstances at its own discretion, since the circumstances will still not be exhaustively listed or weighted at the statutory level'. However, exhaustive reasoning was a condition; although this is a natural and legitimate expectation from the point of view of both those involved in the proceedings and society and also important as a guarantee, it indirectly not only helps to curb unjustified disparities in sentencing practices but also increases citizens' trust in criminal justice.

The explanation of the law also refers to the fact that nothing other than the principles connected to the imposition of penalties established at statutory level are supplemented with the aspects that already exist in the judicial practice.

Following the 2002 elections, the new socialist-liberal government (lead by Medgyessy and then Gyurcsány) amended the Criminal Code again. Act No. 2 of 2003 which amended the criminal legislation and certain related laws did not share the principal considerations on which Act No. 87 of 1998 was based regarding the

20 Löw, 1880, p. 71.

21 Explanatory memorandum to Section 1. In: T/25 számú törvényjavaslat A Büntető Törvénykönyvről szóló 1978. évi IV. törvény módosításáról. (Előterjesztők: Fidesz — Magyar Polgári Szövetség Képviselőcsoportja és a Kereszténydemokrata Néppárt Képviselőcsoportja) Budapest, 2010. május Online: https://www.parlament.hu/irom39/00025/00025.pdf (1/6/2020)

question of sentencing.[22] In particular, neither the view that crime is expected to reduce with more stringent penalties, nor the view that fundamentally seeks to reorganize the traditional proportions that have developed between legal regulation and judicial individualization in the recent history of Hungarian criminal law.

The Act repealed the provisions, with the exception of paragraph (1), concerning the imposition of penalties, including the provisions on the median of the prescribed scale of penalties [Section 83 paragraphs (2)–(3)]. The aim of these amendments – as explained in point I.5. – is to ensure the correct ratio between statutory definition of penalties and freedom of judicial discretion, as well as guarantee that prison sentences are only imposed by the courts in cases when the penalty goals set in Section 37 of the Criminal Code cannot be realized through other means. The problem of the high overpopulation of prisons has already appeared in the explanatory memorandum, as there was also a stronger emphasis on the 'ultima ratio' nature of custodial sentences.

In 2010, the conservative parties led by Viktor Orbán were returned to power and the second Orbán government (the 'Government of National Cooperation') passed Act No. 56 of 2010 amending Act No. 4 of 1978 of the Criminal Code, reintroducing the principle of mid-scale sentencing. 'Section 83 paragraph (2) Where a sentence of imprisonment is delivered for a fixed term, the median of the prescribed scale of penalties shall be applicable. The median shall be set like half of the sum of the lowest and highest penalties to be imposed shall be added to the minimum penalty threshold'.

The general explanatory memorandum for the amendment stipulated that '(The) voters will manifested in the 2010 general elections clearly obliges the National Assembly that criminal policy measures drafted in the election programs and supported by the voters[23] should become law as soon as possible'. The political motivation of this conforms to what has previously been declared: 'it gives legislative interpretation for the correct application of the penal system of the Criminal Code'.

Act No. 100 of 2012 (our Criminal Code currently in force) maintains the legal institution in connection with penalty imposition.[24] Section 80 states that '(2) Where a sentence of imprisonment is delivered for a fixed term, the median of the prescribed scale of penalties shall be applicable. The median constitutes half of the sum of the lowest and highest penalties to be imposed'.

In connection with the mid-scale sentencing pattern – in addition to the characteristic appearance of the opposing professional (political) conception – it is interesting

22 General explanatory memorandum to the draft amendments to Criminal Law and Certain Related Laws. I. Act No. 4 of 1978 on amending the Criminal Code, Item 5 In: T/1218. számú törvényjavaslat a büntető jogszabályok és a hozzájuk kapcsolódó egyes törvények módosításáról (Előadó: Dr. Bárándy Péter igazságügy-miniszter) Budapest, 2002. október Online: https://www.parlament.hu/irom37/1218/1218.htm (1/6/2020)

23 The 'three strikes' rule, already in force in several US member states and the EU member state Slovakia, has been introduced as an amendment backed by hundreds of thousands of citizens' signatures. The legal institute means a significant increase in the punishment of repeating offenders who commit a series of violent crimes against a person, which in the most serious case could be life imprisonment.

24 The law is also related to the previous regulation (see Section 80 of the Criminal Code).

to explore to what extent this has affected the judicial practice; could the existence of the provision have led to overcrowding in prisons? It is worth referring here to the explanatory memorandum of Act No. 2 of 2003. According to the proposal for this law made by the Minister of Justice, Dr Péter Bárándy stated:

'[I]n our country the number of crimes [which] became known increased over the past two decades at an alarming rate, and also adverse changes have taken place in the structure of crime. The number of convicted persons increased, while the sentencing practice of the courts became restructured. In international comparison, crime data in Hungary regarding most of the offense-groups designate our place in the European [at] middle-rank. In the penitentiary practice of the courts, the reorganization was in favor of penalties not involving actual deprivation of liberty. At the same time, the number of detainees has been steadily increasing since 1995, reaching 17,275 in 2001. This means [there are] more than 170 detainees per 100,000 inhabitants and [this] is high in European comparison; the European Union average is around 80 per capita. The Hungarian prisons are overcrowded, the creation of new places in this field has not been able to bring about a fundamental change either. The degree of overcrowding has been described in the literature as "difficult" and "worrying". This rating is given to countries with more than 150 convicts per 100 places.'

During that period – from 1994 to 1998 – the country was led by the socialist–liberal Horn government; that is, even without a change in criminal policy attitudes, the case law has become stricter regarding the enforcement of custodial sentences.

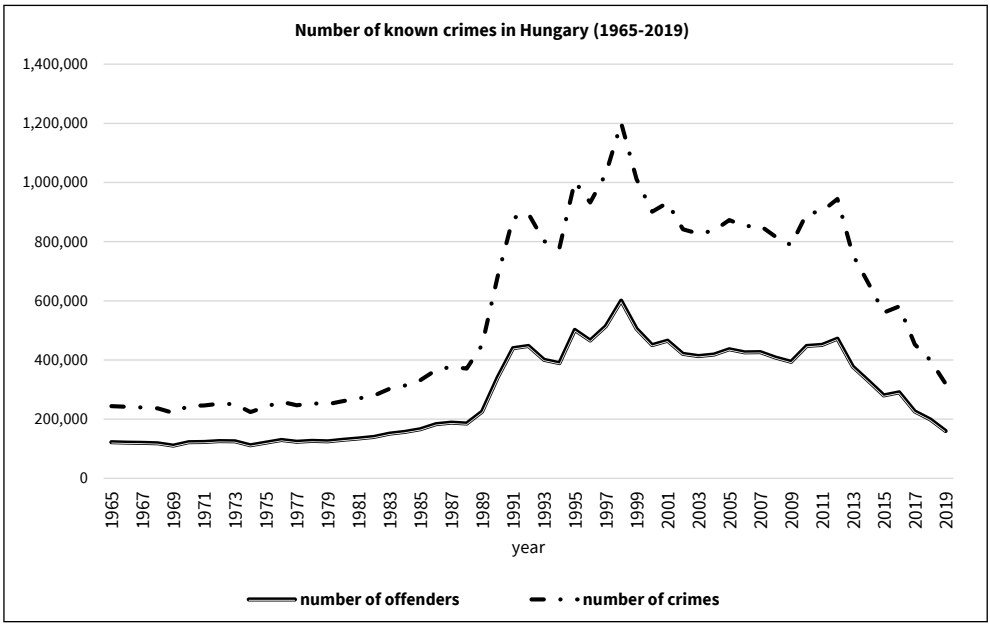

Figure 2 Number of known crimes in Hungary (1965–2019) (Source: own editing)

Since the change of regime, that is, from 1989–90, the number of known crimes has increased significantly. The number of known cases in 1979 was 125,267, which had increased by 1985 to 165,816, in 1989 to 225,393, and in 1998 already 600,621 cases were reported. As the number of delicts against high-latency assets have risen in particular, this means the 'tip of the iceberg'.

If the value measured in 1979 is considered to be 100%, the number of known infringements rose to 479.5 % by 1998. All this is accompanied by the fact that while the number of known delicts per 100,000 inhabitants was 174.8 in the last year before the change of regime, by 1998 it was already 592.6!

Not only has the absolute number and rate of crime increased, but so has criminal activity. 'However, data on successfully detected cases show that in 1979 there were 122 crimes per 100 offenders, and in 1998 there were already 225 crimes'.[25]

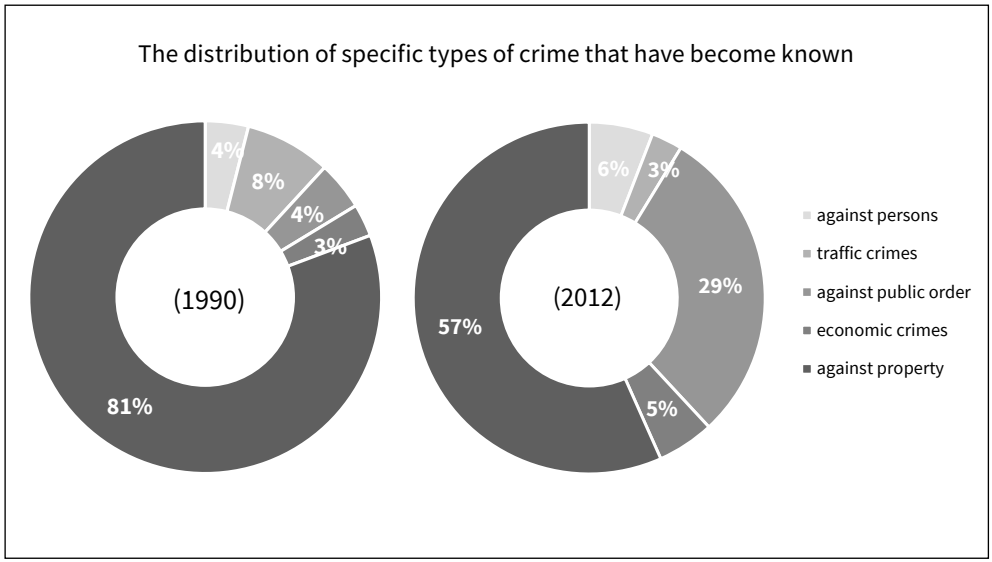

Figure 3 The distribution of specific crimes that have become known (Source: own editing)

There has also been a significant rearrangement in the structure of crime. The proportion of crimes against property (which means less danger to society) has been steadily declining, while the proportion of behaviour of a more dangerous nature or stricter social judgement has increased.

Thus, the proportion of attacks on a person, crimes causing a major social conflict, white-collar or economic crimes causing major damage or property damage, and crimes against public order that significantly undermine citizens' sense of public security have solidly increased; the latter from the former 4% to 29%.

25 Vavró, 2000, p. 24.

All these processes, even without the restrictions of criminal policy, affect case law for objective reasons. But can the growing number of custodial sentences being carried out in itself lead to overcrowding in prisons?

Based on ten years of court statistics, it can be stated that 'the increase in the prison population cannot be explained by the supposedly increasing proportion of those sentenced to imprisonment'.[26] Within the total number of convictions, the proportion of those sentenced to imprisonment – albeit to a very small extent – has been increasing every year. This, however, is not commensurate with the growth rate, which can be observed in respect of the imprisoned. Compared to 2010–2016, this rate increase is 1.1%, while for those who actually serve prison sentences, it is 5.5%. This is possible if the duration of the imprisonment has increased.

Nevertheless, it is worth noting that domestic sentencing practices have often been criticized by professionals. Among others, László Fayer, condemns judges for long-term custodial sentences, stating that 'The Hungarian Criminal Code is a strict code. The judicial practice, which is well established on the basis of this, is even stricter than the code itself. It is undoubtedly strict for Hungary, while it transferred the very mild, rather patriarchal justice that was typical before 1880 to be strict to the letter at once and without any transition. Our courts do not appreciate enough the harm of long-term custodial sentences'.[27] He considers such punishments to be dangerous, as

'[…] most crimes stem from a lack of self-discipline and willpower. And there is no opportunity for strengthening in prisons. Where everything is done by command and direct means of power [to] ensure obedience, there is a constant weakening of character. The long-time imprisonment therefore utterly dulls and breaks the men and when released from captivity they are unable to cope with the difficulties of free life and withstand temptation. It follows that the judge must examine the question of punishment with the utmost care so as not to impose more than is absolutely necessary, for the state destroys its own foundations when it renders its citizens incapable of bearing the burden of social order. The courts miss this when they keep in mind neither the man, nor the states aim of punishment, but only the committed act, the forceful reaction and the text of the law'.

5. Change in attitude? Or the strengthening of civil criminal demand

Repressive criminal policy is also present in the European Union; although its prevalence in criminal law varies and, in European terms as a whole, it lags significantly behind the US, which serves as a classic model. Developments in European societies have led to citizens' feelings of insecurity and a desire for order being more strongly

26 Tóth, 2018, p. 108.
27 Fayer, 1889, pp. 12–13.

expressed, which is partly due to rising crime figures and partly to a loss of trust in public institutions, heavily and negatively influenced by the media.

Fear of crime may have been heightened not only by public security characteristics supported by actual statistics; as the fourth estate mainstream media has clearly had a distorting effect on perceptions of the criminal situation. The rise of the Internet, apostrophized as the fifth estate, has even further eroded the still existing order of values and norms in everyday life. As a direct consequence, there is a real need for protection against crime, which is articulated by citizens towards the state which it could not and did not want to assume.

The media has played a significant role in raising awareness of so-called enemy criminal law[28] in both the US and Europe. The essential difference from civil criminal law is that while a perpetrator who is the subject of criminal proceedings is entitled to the presumption of innocence and other procedural and human rights guarantees, enemy criminal law considers the perpetrator as a risk factor endangering society. Thus, the community's right to defence takes precedence over the perpetrator's rights. In this way, the subject of the proceedings becomes the object of it against whom – in view of the potential risk factor – there are no obstacles to taking action. States governed by the rule of law basically apply civil criminal law, but various events or causes can knock processes off balance. Such was 9/11, but several steps in this direction can be observed in other countries during the action taken against ISIS as a result of the terror attacks sweeping through Europe. Functioning as a security state requires stricter action, which also affects criminal law and sentencing practices.

Although the explanatory memorandum for our current Criminal Code highlights certain groups of perpetrators (e.g. violent multiple recidivists) to whom it allows for strict action, both the Criminal Code and Act No. 90 of 2017 make provision for substantive and procedural law guarantees. Our Code of Criminal Procedure specifically mentions the fundamental right to a fair trial, an effective and reasonable time limit, and the obligation to ensure that the truth is established by the state exercising exclusive criminal power. Thus, it can be said that in Hungary, despite the stricter a ction against perpetrators who particularly pose a greater danger to society, enemy criminal law has not gained ground.

6. Raising the issue of public security on the political scene

The changes were driven by the rise of public security as a political issue and, in part, by the perceived needs of citizens (potential voters). In this respect, Hungary is also a good example of the possible subordination of professional policy to current politics.

In her work, Klára Kerezsi shows with numerous concrete facts that while criminal policy changed is emphasized by the change of governments as well as regimes,

28 See this in more details: Nagy, 2016. p. 16.

in the period between 2002–2010 the left-liberal government significantly altered its criminal political convictions as a result of the activities of opposition parties in this field and public interest.[29] (Tibor Draskovics, candidate for Minister of Justice and Law Enforcement: 'if we stick to the slogan of "three-strikes", then I think that in the current situation, not three, but at least thirteen strikes are needed'.[30]).

The advancement of the political approach is reflected in the National Cooperation Program (Nemzeti Együttműködés Programja – NEP), which was launched after the election victory of the second Orbán government in 2010. Although the number of criminal offences in 1998 had dropped by the second half of the 2000s, citizens' sense of public security deteriorated significantly. In particular, a greater number of attacks were perpetrated in smaller towns (some by children and young people) within offence value or against property of lesser value, to which the state although responded by its own means, but were not visible or traceable to the society and did not improve the security situation, too. The media have consistently reported 'intolerable' situations, as well as violent behaviour against property (robbery, pillaging), or crimes mainly against single elderly people (driven by profit considerations or committed with particular cruelty). Naming the supposed or actual responsible people who escape conviction has stimulated intolerance, encouraging certain sections of the population to either take direct action or, in the absence thereof, to express sympathy with those who did so. This resulted in several political parties and other groups becoming involved in events.

In response to this situation, the new government promised a number of changes, 'tidying up', and strict action. Political messages concerning criminal policy included equality before the law, strong, respectable laws, the exclusive right and opportunity of the state to restore order, the right to protection for all, and laws to protect victims.

Many of the promises came about and the idea of austerity was disseminated so well that professional discussion about the current Criminal Code as the strictest in Europe ensued.[31]

At the same time, mitigation, which further served the implementation of the dual-track criminal policy, although not in the focus of interest can also be found in examples. It may seem that outlining this one-sided image could not have run

29 Thus 1990–1994 conservative government had a liberal criminal policy; 1994–1998 had a socialist-liberal government with a drifting criminal policy; 1998–2002 had center-right governance with hardline criminal policy; 2002–2006 saw a socialist-liberal governance with a dual track criminal policy; 2006–2010 had a socialistliberal governance, followed by social justice, THEN a tightening of policy ('Light and Shadow'). See more on this: Kerezsi, Klára: Kriminálpolitikai törekvések és reformok In: A rendszerváltás húsz éve: állam, jog, társadalom. In: Jogtörténeti Szemle, 2010/2. pp. 57–60. The reason: the opposition at the time regularly spoke out about the poor public security situation, forcing the government to respond increasingly decisively. (This was because while the opposition proved the need to introduce the three strikes, Tibor Draskovics had already spoken of 13 strikes.)

30 Minutes of the meeting of the Parliamentary Committee on Defense and Law Enforcement held on Wednesday, 15 April 2009 at 9 am in the 93rd room of Parliament. HRB 6/2009. (HRB 1-89/2006–2010.) (6/5/2020) Online: https://www.parlament.hu/biz38/bizjkv38/HOB/0904151.htm. See also: Csemáné, 2012. pp. 2–3.

31 Weidinger, 2020.

counter to the will of the government either. As Miklós Hollán ironically remarks: the numerous mitigating amendments or new legal institutions[32] '... have not been given such a prominent role in the general explanatory memorandum, as it is not referred to in the NEP, and it can be much less... exchanged for political benefits'.[33] That is, the symbolic messages regarding austerity did not distort the Criminal Code, causing an outstanding level of imprisonment.

7. A common heritage – the specificities of the countries of Central-Eastern Europe

International criticism of prison overcrowding has often focused on Central-Eastern European countries. This, in turn, has also increasingly raised the issue of the execution of a custodial sentence. The data show that although the proportion of prison population is the highest in the successor states of the former Soviet Union, it is also high in former socialist countries, such as Poland, Slovakia, the Czech Republic, and Hungary, compared to Western European countries – however, the 'number of people affected by custodial sentences in Europe now exceeds the number of people serving prison sentences'.[34]

In light of the number of convictions, the interesting question is whether there are any common roots among the former socialist countries? In fact, almost every state in the region has an extremely high prison population rate above the EU average. A common explanation for this is that these countries define suspended imprisonment often as an alternative to effective imprisonment, and in addition to this type of penalty, other legal consequences (e.g. fines or various community sanctions, restorative measures) play only a background role. This significant discrepancy, experts say, could be the result of a rapid increase in crime accompanied by political, economic, and social transformation. However, this fact alone cannot explain the deviation from Western European characteristics. In this, elements of the inheritance of professional ideologies and the former, particularly strict, crime control policy may play a more prominent role[35] and the fact that 'the greater the degree of inequality that characterizes a society, the stronger its indicators of punitivity'.[36]

32 For example, in the case of the daily amount of a fine, a lowering of the minimum limit or an earlier determination of the earliest date of parole from a fixed-term custodial sentence. Overall, the latter may be a more favorable option for more perpetrators than the number of offenders who may encounter an increased qualified case-by-case penalty limit for certain specific facts (e.g. counterfeiting).

33 Hollán, 2017. p. 357.

34 Lévay, 2019, p. 119.

35 A detailed derivation of this through the Polish example is presented in the study by Krajewsky Krzysztof "Punishment in Poland: Attempts to Reduce Punitivity", which is described by Miklós Lévay. In: Lévay, 2018, pp. 602–604.

36 Borbíró, 2011, p. 80.

What is also of interest to professionals behind the higher prison population in Central-Eastern European countries is to what extent a punitive practice that appears to be stricter, but with a different focus has the support of the public, and to what extent can its attitude towards sentencing influence this fact? To what extent could the impact of the shock experienced during the period of regime change in the countries of the said region play a role in an increase in the demand for punishment? In addition to newly introduced negative phenomena affecting a significant part of society (e.g. unemployment, unstable working and living conditions) (or against them), there has been a spectacular enrichment of the few who do not follow the rules (or for whom they are flexible), ineffective operation by the police and the judiciary (with ethically and/or legally questionable privatizations and contracts, 'oil-bleaching' cheated government support, 'bankrupted' businesses) and a high level of disappointment resulting in total mistrust.

8. Not new and not unique?

Fact: Among the citizens of Central-Eastern European countries, Hungarians have experienced the worst regime change, and what is also true is that the turnaround has negatively affected the greater part of the population. However, this still does not provide an answer to the examined question: can there be any other reason for the exceptional Hungarian statistics?

'Our prisons housed 2,674 more individuals than the capacity to accommodate. Yet the average figures show the situation partly even more favorable than it was in reality at the time, as the number of detainees in the winter period far exceeds the full-year average. In such cases, the overcrowding of prisons is even clearer than it seems by the average number of prisoners per year'.[37] (Revealed by the head of the Royal Hungarian Statistical Office, József Jekelfalussy in his work titled, 'The State of our Prisons. 1872–1886'.) Examining the number and location of prisons, the institutes and their equipment, the amount of air cubic metres per prisoner, ventilation, lighting and heating, and the quality of drinking water, explain the impact of these factors on the health of prisoners. Significant investments have been made during the reviewed fifteen years, but as the number of prisoners has increased, no significant improvement could be identified.[38]

The 'overstuffing' of maximum, medium, and minimum security level prisons, which was considered a serious problem almost 150 years ago, has generated continuous criticism and professional debates in Hungary. 'There are 30% more individuals placed in our institutions than could reasonably be accommodated with the most primitive needs; that due to overcrowding, employment cannot be established in many places; that the age classification established expressly by Section 86 of the Criminal

37 Jekelfalussy, 1887.

38 Kovacsicsné Nagy, 2006, p. 88.

Code, in most places it is impossible to think of; that even remand prisoners are mixed with convicts'.[39] László Fayer lists the problems. Thus, in addition to the general problems, overpopulation has so far hampered the implementation of the guarantee rules of criminal procedure.

The capacity of prisons and the degree of overcrowding also depends on the nature of the institution. From the exposition in the House of Representatives on 29 May 1889 by the Minister of Justice Dezső Szilágyi,[40] it transpires that institutes for enforcement of 'freedom-penalties' are different both in the sense of control, material conditions, and other characteristics. Institutions supervised by the Attorney General's Office were not characterized by overcrowding, while institutions subordinate to the ministry made it impossible to enforce statutory custodial provisions such as segregation.

Has this difference between the two groups of prison institutions persisted to this day? Although the organization is now unified, it is a fact that national and regional institutes ('serving houses') are more likely to house convicts, while county-level institutes are more likely to house detainees.

9. Objective reasons

There is also a difference in the objective characteristics of each institute. Most of today's institutes, especially at county level, were built mainly as a result of work initiated under the influence of the Csemegi Code, and their function was primarily to serve the work of the judiciary. Therefore, as the venues for court work were usually the generally imposing buildings of the cities in a central location, most of the institutes are located in the city centre. For example, in 1884 the Pécs Royal Detention House, in 1891 the Nyíregyháza Royal Detention House, and in 1904 the Kecskemét Tribunal Palace and the Tribunal Detention House were opened; then the Hungarian Royal Tribunal and the detention house in Szolnok were built around 1895, the Royal Tribunal Detention House with the Royal Judicial House around 1906–08, and the Sátoraljaújhely Royal Judicial House in 1905, although in Győr the institute also operated from 1886. After the great wave of institution building, examples from the 1930s, 1950s, etc. of buildings being handed over can also be found, but their number was significantly lower than before.

However, as pointed out by Péter Ruzsonyi, the disadvantage of the beautifully renovated, imposing buildings from the outside is that '[The] contemporary architectural philosophy reflects the penal philosophy of the time (typically large-space cells designed to isolate prisoners from each other). The transformations of the first hundred years were almost without exception aimed at increasing the number of people that

39 Fayer, 1889, p. 10.

40 Szilágyi Dezső, Minister of Justice exposé made for the House of Representatives (29 May 1889) cited by Fayer, 1889, pp. 10–11.

could be accommodated; the improvement of hygienic conditions, ventilation and the creation of free space were only multifaceted aspects'.[41]

However, at the time of being built, they were modern and represented a major shift from previous conditions and circumstances. Jekelfalussy praised the legislature's break with the medieval conception of seeing prisons as 'places of horror, the graves of the living'.[42] It has defined as an important goal that they should be designed in both their structure and internal equipment so as not to be harmful to the physical and mental health of the prisoners in accordance with the Csemegi Code.[43]

The poor system of objective conditions and obstacles to further development affect the living conditions of the detainees, such as providing detachable water blocks or limited periods outdoors. The absence of these could easily justify a violation of Article 3 and the liability of the state.

10. Opportunities for progress – good practices, successful programmes, paradigm shift

The Hungarian penitentiary system has long been committed to performing its task even more effectively. Thus, numerous good practices in both codification and other activities can be linked to the institutional system.

The largest and most complex crime prevention project in Hungary was launched in 2010 with the Ministry of Interior as project owner an in collaboration with its consortium partners (the University of Miskolc, the Judicial Service of the Ministry of Administration and Justice, the National Prison Service, and the Employment Services of government offices in Baranya County and Jász-Nagykun-Szolnok County). The 'TEtt programme for the victims and the perpetrators', that is, 'The methodological basis for strengthening social cohesion through crime prevention and reintegration programs' is a prioritized project (Social Renewal Operational Program 5.6.2. 10/1-2010–0001) and was realized with the support of the European Union, co-financed by the European Social Fund.

The multi-module, mutually reinforcing, practice-oriented project involved all actors relevant to crime, thereby increasing social cohesion and supporting reintegration and crime prevention. The training module provided goal-oriented, multi-level output, presence and online training about community crime deterrence as well as the prevention of the victimization of offenders of children and young people, new directions for victim assistance and reintegration of offenders for both professionals and their supporters, facilitators, and representatives of relevant organizations or the

41 Ruzsonyi, 2015. p. 27.

42 Kovacsicsné Nagy, 2006, p. 88.

43 This was not always the case and would have required a lot of money. However, the author dealt with this as a personally special issue, creating a detailed database of light and dark, dry and wet, and well-ventilated and non-ventilated prison rooms.

alarming system. The mixed groups provided an opportunity for professionals and volunteers with various qualifications related to crime, crime prevention, and victim assistance to become familiar with each other's work, and to establish living relationships between them, on which they could also rely during the course of their work.

A voluntary victim support network covering three regions has been set up as part of victim support services, including a 24-hour helpline with the support of volunteers for home help, or with the contribution of a psychologist. Victims are also given the opportunity to participate in various alternative conflict resolution procedures. Programmes for perpetrators have not been limited to vocational training and social inclusion programmes; for those convicted with conditions the Green House in Miskolc operates a Community Activity Room where programmes are organized with an aggression manager, team builder, etc. Group activities have been organized for convicts to enforce community service punishment in a more effective way (e.g. in wildlife parks, schools), primarily on a community compensation basis. As part of the social and labour market reintegration of prisoners, competence-building trainings are held in the same way as family group conferences or mediation meetings but, in addition, they also receive reintegration and aftercare support and attempts have been made to provide them with employment by the time of their release. All this complex work has been complemented by research and studies to explore quality assurance and performance indicators with follow up, as well as the supply of methodological guides, protocol descriptions, textbooks, information materials, methodological films, etc.

Among the numerous overlapping projects, we can highlight the project EFOP-1.3.3-16-2016–00001, Reintegration of Prisoners[44] which was launched jointly by the Ministry of Interior and the BvOP.[45] The aim of the HUF 4.2 billion EU-funded programme is to strengthen the social and labour market reintegration of convicts and pre-trial detainees, thereby reducing the risk of recidivism. Continuing the practices of the previous project, the aim is to prepare detainees for the labour market and social reintegration with support before their release.

Legislative amendments relating to the reintegration custody have also further expanded the work of probation officers in law enforcement.[46] The results are very positive: 82% of those currently under probation and aftercare are employed with the assistance of probation officers. (In 2017, there were 1,201 people involved in the public service, while in 2018, this number had reduced to only 566.)

A number of other tools have also been developed that directly and indirectly affect the prison population. During the development of the Predictive Measuring Tool (Prediktív MérőEszköz – PME),[47] an infrastructural background suitable for recording PME data was created, so in 2017 the data of 1,600 people were recorded

44 Várkonyi, 2017, p. 24.
45 BvOP – National Prison Service.
46 Várkonyi, 2017, p. 26.
47 Várkonyi, 2017, p. 29.

(increased to 5,249 in 2018[48]), the analysis of which has resulted in the development of professional standards for detention risks and the ability to classify those concerned into risk groups. The Risk Analysis and Management System[49] was introduced to domestic practice by Act No. 240 of 2013. Its two main elements are the assessment of individual detention risks and the provision of risk management programmes that respond to them. In the affected prisons, 150 reintegration officers and social assistants have received training on drug prevention, aggression management and assertiveness (self-assertion) programmes. The involvement of convicts in programmes is ensured on an ongoing basis.

With the Secretariat of Prisoncursillo,[50] the cursillo course was launched in 2017 in five institutions with ninety-five inmates participating, with the aim of providing Christian-based support for their individual moral development, and the development and strengthening of family and social relationships, in addition to community building.

Equally important competence development programmes could be implemented by the National Crime Prevention Council.[51] For example, 370 art therapy programmes took place in 2017 involving 5,880 detainees, while a right brain drawing course was organized for both professionals and inmates. The success of this is evidenced by the fact that a total of 943 people attended the 828 courses. The third National Prison Theater Meeting in the summer of 2018 provided an opportunity for 150 members in sixteen institutional theatre companies.

These myriad activities that have permeated the penitentiary system for decades, with an ever-widening range of services, are increasingly present. Numerous good practices and solutions that have been successfully implemented or integrated into day-to-day operations prove this, even sometimes under objective reasons or impediments.

Attitudes towards the enforcement of deprivation of liberty are also much changed. Socially accepted attitudes ('skill') and teaching methodologies that require competency have replaced the former paternalistic teaching methods which focused on specific knowledge. Peer counselling and volunteer work is increasingly appearing in more and more institutions. Civilians (university students, formerly released), outsiders, and fellow prisoners can particiate.

The Hungarian regulations have brought to life numerous values and good practices, but at the same time (especially with regard to the objective system of conditions for the enforcement of imprisonment) further changes are needed. The high overpopulation rate in addition to the non-prominent prison population, as showed by Professor Mihály Tóth, does not seem to be justified by the not necessarily strict Criminal Code or the 'increase in the proportion excluded from parole'. In his view, the emerging case

48 Várkonyi, 2017, p. 29.
49 Várkonyi, 2018, p. 29.
50 Várkonyi, 2017, p. 29.
51 Várkonyi, 2018, p. 24.

law in the early 2010s (in the context of mid-scale sentencing) had a significant impact on the high prison population in the European context in 2010 as well and other factors such as stricter regulations on violent recidivism are present to a much lesser extent'.[52] Although prison overcrowding has long been part of domestic conditions, hampered by a number of factors ranging from the highly chaotic, sometimes earthquake-like political events of the past 100 years to the limitations of inherited architectural solutions, recent improvements shown by the data suggest a positive shift.

Enforcement of the aims declared in the Criminal Code and strict adherence to its substantive elements not only results in wider application of the already available palette of sanctions and legal institutions (through which a further reduction in the prison population may be triggered), but also ensures that the criminal law always guarantees the enforcement aspects as well as the offender's reintegration and the protection of victims and society.

In addition to the complex response to imprisonment as a key problem, it is an important substantive shift that in July 2020 a total of 2,750 new places were handed over in the new wings of ten Hungarian penitentiary institutions.[53] Minister of Justice Judit Varga stressed that the government's goal is to eliminate overcrowding in prisons by 30 September, 2020. She emphasized that 'a prison in the 21st century must already meet different expectations than in the time of St. Stephen. A "complex" site that speaks of both punishment and bringing the perpetrator back into society after the sentence has expired. Employment, education, participation in compensation programs all help'.

52 Tóth, 2018, p. 114.

53 The government aims to end the overcrowding in prisons. Ministry of Justice. 13 July 2020 (14/7/2020) Online: https://www.kormany.hu/hu/igazsagugyi-miniszterium/hirek/varga-judit-a-kormany-celja-hogy-megszuntesse-a-bortonokben-uralkodo-tulzsufoltsagot

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Limited Liability Companies in Slovenia

ABSTRACT: *The basic legal source for Slovenian corporate law is the Companies Act (Slovenian Zakon o gospodarskih družbah (ZGD-1)), which regulates among Limited Liability Companies (LLC) as well as other commercial companies. Slovenian legislators took the German LLC as a framework when regulating the Slovenian LLC. LLC's are widely established in Slovenia primarily because they can be founded with relatively little capital (7,500 EUR) and the members are not personally liable for the LLC's debts. An LLC may also be formed by only one natural or legal person, therefore it has become very popular in Slovenia among entrepreneurs who want to conduct business solo, but don't want to be liable for any debt incurred by the LLC. This article presents the concept of the LLC and its regulation in Slovenian legislation.*

KEYWORDS: Slovenia, commercial companies, limited liability company, formation of an LLC, relations between an LLC and its members, managing an LLC, piercing the corporate veil.

1. Introduction

The basic legal source for Slovenian corporate law is the Companies Act (*Slovenian Zakon o gospodarskih družbah, hereinafter: ZGD-1*).[2] It defines the basic rules of the incorporation and operation of companies, private entrepreneurs, affiliated entities, commercial associations, and foreign subsidiaries, as well as changes to their status.[3] When composing the ZGD-1, the Slovenian legislator referred to the German corporate legislation as a framework.[4]

A commercial company, as defined by the ZGD-1, is a legal person which independently pursues an activity with a view to profit in the market as its exclusive

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2 Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 65/09, 33/11, 91/11, 32/12, 57/12, 44/13, 82/13, 55/15, 15/17, 22/19.

3 Art. 1 of the ZGD-1.

4 Ivanjko, Kocbek and Prelič, 2009, p. 869.

https://doi.org/10.47078/2020.1.51-67

activity. Commercial companies under the ZGD-1 are organised in one of the following forms: (a) "personal companies": an unlimited company or a limited partnership; (b) "companies with share capital": a limited liability company, a public limited company, a limited partnership with share capital, or a European public limited company.[5]

Limited liability companies (hereinafter: LLC) have become widely established in Slovenia primarily because they can be founded with a relatively low subscribed capital and the members are not personally liable for any debts incurred by the LLC. According to the official statistical data, there were 60,803 LLCs in Slovenia in 2018.[6] Currently, there is no debate around changing the LLC regulation that would affect the traditional conceptualisation of the LLC.

2. The Formation of an LLC

An LLC may be formed by one or more natural or legal persons (or by another LLC) who become its members upon the formation of the LLC. An LLC may have a maximum of 50 members. AN LLC may only have more than 50 members with the permission of the minister responsible for the economy.[7]

AN LLC's subscribed capital is made up of subscribed contributions by members. The value of the contributions may differ. A member shall obtain his/her business share on the basis of the subscribed contribution and in proportion to its stake in the subscribed capital, expressed as a percentage. Members may, at the formation of the LLC, contribute only one subscribed contribution and have only one business share. It is not possible to issue securities for the stakes; nevertheless, the LLC may issue a member a certificate as a proof of holding a stake.[8]

AN LLC shall be formed by the contract of its members, which can be concluded in the form of a notary record or a special form, on paper or as an electronic version. The articles of association are made between all the members. The articles of association (in paper version) shall be signed by the LLC's members in the presence of an official from the body responsible for performing the tasks of a single entry point stipulated by the law regulating administrative procedure (hereinafter: point VEM)[9] where the LLC applies for the entry into the register; if they are sent to the point VEM via mail, the signatures must be notarized. The form of the articles of association (in the electronic version) sent to the point VEM or the registration body through electronic channels must be signed by means of a safe electronic signature with a qualified certificate. The

5 Para. 1 and 3 of the ZGD-1.
6 https://pxweb.stat.si/SiStatDb/pxweb/sl/20_Ekonomsko/20_Ekonomsko__14_poslovni_subjekti__01_14188_podjetja/1418803S.px/table/tableViewLayout2/ (Accessed: 26 February 2020).
7 Art. 473 of the ZGD-1.
8 Art. 471 of the ZGD-1.
9 Http://evem.gov.si/evem/drzavljani/zacetna.evem (26 February 2020).

method and the procedure of entering the LLC into the register by the point VEM shall be prescribed by the minister responsible for the economy.[10]

The articles of association must state the name, surname and address or the registered name and registered office of each of the members; the registered name, registered office and activity of the LLC; the amount of the share capital and of each subscribed contribution separately, and the members who invested each subscribed contribution and their business share; the duration of the LLC, if it is formed for a fixed period; any obligations that the members have towards the LLC other than the payment of the subscribed contribution and any obligations which the LLC has towards the members.[11]

If the subscribed capital or part of the subscribed capital is given in the form of a non-cash contribution, the articles of association must state the subject of each non-cash contribution separately, the amount of the basic contribution for which the non-cash contribution is given, and the member who invested the non-cash contribution.[12]

If any of the articles of association are signed on behalf of any of the members by a proxy, the member's authorisation must be submitted. If the articles of association are concluded in the form of a notarial record, the member's authorisation shall be confirmed by a Notary Public, and if the articles of association are concluded on a special form, the member's signature on the authorisation must be notarized. Authorisation shall not be necessary if the representative is already entitled under the law to conclude the articles of association in the name of the members.[13]

The articles of association may also contain other elements in addition to the elements listed above,[14] for example the duration of the LLC may be limited to a certain period, or there may be special rules about the convocation of the general meeting.[15] The articles of association may provide that the LLC shall be obliged to give, perform, permit or relinquish something in favour of one or more of the members,[16] for example it may be required to perform specific services for a member.[17]

The subscribed capital must amount to at least 7,500 EUR and each subscribed contribution must amount to at least 50 EUR. A subscribed contribution must be provided in money or in the form of a non-cash contribution or non-cash acquisition. A non-cash contribution may be provided in the form of movable or immovable property, rights, an enterprise or part of an enterprise, know-how, or goodwill.[18] Non-cash contributions shall also include payment for items of property that the LLC has

10 Para. 1 Art. 474 of the ZGD-1.
11 Para. 3 Art. 474 of the ZGD-1.
12 Para. 4 Art. 474 of the ZGD-1.
13 Para. 1 Art. 474 of the ZGD-1.
14 Para. 5 Art. 474 of the ZGD-1.
15 Ivanjko, Kocbek and Prelič, 2009, p. 875.
16 Art. 493 of the ZGD-1.
17 Ivanjko, Kocbek and Prelič, 2009, p. 919.
18 Zabel, 2007a, p. 88.

acquired and that it treats as a member's contribution. Before the application for entry into the register, each member must pay at least one quarter of the amount of his/her subscribed contribution into the company, and the value of all contributions must amount to at least 7,500 EUR. Non-cash contributions must be delivered in full prior to the application for entry into the register. If the value of a non-cash contribution does not amount to the value of the basic contribution acquired, the member must pay the difference in money. Subscribed contributions must be delivered to the LLC in such manner that a manager of the LLC shall be freely able to dispose of them. Contributions paid in money must be paid to a bank account.[19]

If non-cash contributions are provided for the formation of an LLC, the members must compile and sign a report on the non-cash contributions before applying for entry into the register. The report shall state the objects comprising the non-cash contributions, facts demonstrating that the value of the non-cash contribution is not less than the amount of the subscribed contribution acquired, and any burdens on a non-cash contribution. If an enterprise is invested in an LLC, the balance sheet and profit and loss account of the company for the last two financial years must be submitted together with the report on the non-cash contributions. If the total value for which non-cash contributions are given amounts to the value of more than 100,000 EUR, the partners who invested the non-cash contributions must ensure, at their own cost, that the non-cash contributions are assessed by an auditor; the auditor's report shall be a constituent part of the report on the non-cash contributions.[20] The court may decline entry into the register if the non-cash contributions are assessed to be lower in value than the amount of the subscribed contribution acquired.[21]

The members shall be obliged to provide funds for the formation of the LLC in proportion to the amount of their subscribed contributions. If the members decide that they shall be reimbursed for the costs of the formation the LLC, one or more members may be remunerated for work they carry out in connection with the formation of the LLC. Costs and the remuneration may only be paid to members out of the profit of the LLC; the member may decide that these payments shall have priority over other the claims of the members to participate in the profit.[22]

The LLC may send a written reminder to a member who is delayed in paying the subscribed contribution or a part of the subscribed contribution for him/her to pay his/her obligations within a time limit which may not be less than one month. In that same written reminder, the member shall be notified that he/she will be excluded from the LLC in respect of the business share to which the payment relates. If the time limit of one month expires without the member fulfilling his/her obligation, the member's business share and partial payments already made shall transfer in full to the LLC and the member shall be notified of this in writing. Even after delaying, the member shall

19 Art. 475 of the ZGD-1.
20 Art. 476 of the ZGD-1.
21 Ivanjko, Kocbek and Prelič, 2009, p. 878.
22 Art. 477 of the ZGD-1.

be liable for the payment of the unpaid amount. This shall not exclude his/her liability for damage.[23]

The articles of association may determine that after the formation of the LLC, the members shall be obliged to pay in subsequent payments in addition to the subscribed contributions. Subsequent payments can be in cash or non-cash form, for example, equipment.[24] The articles of association may determine that the resolution of subsequent payments must be adopted by the members. The members must adopt any such resolution unanimously. Subsequent payments by the members shall be in proportion to their business shares, and the articles of association may determine their maximum amount. Subsequent payments shall not increase the subscribed capital, subscribed contributions or business shares.[25]

The members and the managers shall be jointly and severally liable to the LLC for damage caused wilfully or through gross negligence which arose as a result of the failure to deliver or the incorrect delivery of non-cash contributions, an overestimating of these contributions, or as a result of some other detrimental action during the formation of the LLC. AN LLC may not waive a claim for damages under the preceding paragraph, nor may it make a settlement in respect of such a claim if the repayment is necessary in order to settle liabilities to third persons. The period for the time-barring of such a claim shall begin on the day the LLC is entered into the register. Persons for whose account the members have acquired contributions shall also be liable in the same way as members and managers. Such persons may not claim ignorance of any circumstances of which the member acting for their account was aware or, acting as a good manager, should have been aware.[26]

3. Relations between the LLC and its members

■ *3.1. Business share*

A business share may belong to one or more persons. If a business share belongs to more than one person those persons shall jointly exercise the rights and be jointly liable for the obligations deriving from that business share, for example, a business share as the common property of spouses.[27] Members who are holders of the same business share may agree that in relations between themselves they participate in this business share equally or differently. Legal actions by the LLC against the holders of the same business share shall take effect against all of the holders of that share, even if

23 Art. 486 of the ZGD-1.
24 Ivanjko, Kocbek and Prelič, 2009, p. 913.
25 Art. 491 of the ZGD-1.
26 Art. 479 of the ZGD-1.
27 See more in Dugar, 2014, pp. 199-223. Available at: https://hrcak.srce.hr/index.php?show=clanak&id_clanak_jezik=181839.

the actions are only taken against one of them. Holders of the same business share may exercise rights and fulfil obligations through a joint representative.[28]

Business shares may be disposed of and inherited. Usually, the business share is disposed of by a sale or gift contract.[29] If a member acquires one or more business shares to his/her business share, all the business shares shall remain independent. The disposal of a business share shall require a contract drawn up in the form of a notary record. Unless otherwise provided in the articles of association, the members shall have a pre-emptive right under equal conditions in the purchase of a business share ahead of other persons. A member who intends to sell his/her business share must notify the other members in writing of his/her intention to sell and of the conditions of the sale, and invite any potential buyers to notify him/her of their willingness to buy the business share within one month of receipt of the notification. If more than one member is prepared to buy the business share, they shall all become holders of the business share together. The articles of association may determine that the disposal of a business share to persons who are not members shall require the consent of a majority or all of the members and determine the conditions for the issuing of such consent. If none of the members is prepared to buy the business share and the members have not given their consent for the sale of the business share to a person who is not a member, the member may withdraw from the LLC.[30] The articles of association may exclude the pre-emptive rights of members or limit them to certain members of the LLC.[31]

A member may transfer a part of a business share so that a new and independent business share is founded. The value of the remaining business share and the value of the new business share may not be less than the value of 50 EUR. The aforementioned pre-emptive right of other members applies mutatis mutandis to the transfer of a part of a business share. The division of a business share shall not be admissible except in the case of transfer, division of common property of spouses or inheritance. The articles of association may prohibit the division of a business share.[32]

A business share may be used as collateral, which means that claims of personal creditors of members can be enforced against the business share in an LLC.[33] Lien on a business share is not regulated in the ZGD-1, but in the Law of Property Code (*Slovenian Stvarnopravni zakonik; hereinafter: SPZ*)[34] in a special chapter about lien on other property rights. If the creditor enforces lien on the business, the other members of the LLC have a pre-emptive right to buy the share. Regarding the enforcement of a lien on a business, it has to be mentioned that the Slovenian court practice decided in one case about the collision of the compulsory sale of a business share on an auction in a bankruptcy procedure and the articles of association which forbade the transfer

28 Art. 480 of the ZGD-1.
29 Ivanjko, Kocbek and Prelič, 2009, p. 888.
30 Art. 481 of the ZGD-1.
31 Ivanjko, Kocbek and Prelič, 2009, p. 888.
32 Art. 483 of the ZGD-1.
33 Dugar, 2018, p. 241.
34 Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 87/02, 91/13.

of the business share to a non-member. The Slovenian Supreme Court gave priority to rules of enforcement because otherwise the creditors' claims could not be repaid at the highest possible rate.[35]

■ *3.2. Capital protection rules*

The ZGD-1 preserves the subscribed capital with three main rules: (a) the prohibition of paying out the assets which cover the subscribed capital, (b) special rules regarding loans to the LLC instead of own capital and (c) the prohibition of repayment of a loan prior to the commencement of bankruptcy or compulsory settlement.[36]

Assets which are required in order to preserve the subscribed capital may not be paid out to the members. Subsequent payments which do not serve to cover the subscribed capital in the event of a loss may be repaid to members. Such repayments may not be made earlier than three months from the day on which the resolution on the repayment was published in the prescribed manner. In cases involving subsequent payments made prior to the full payment of the subscribed contribution, the repayment of subsequent payments prior to the full payment of the subscribed contribution shall be null and void. Repaid subsequent payments shall be considered not to have been paid in.[37] Payments made in contravention of the aforementioned rules must be repaid to the LLC. Where the recipient acted in good faith, the repayment may only be demanded if it is needed in order to settle the LLC's liabilities to creditors. If it is not possible to demand repayment from the recipient, the other members shall be liable, in proportion to their business share, for the amount which needs to be repaid and which is required in order to settle the LLC's liabilities to creditors. Sums which cannot be demanded from a particular member shall be divided among the other members in proportion to their respective business shares. If unjustifiable payments were also made by the managers, the managers shall be liable in the same way as the member holding the largest business share. Persons obliged to make a payment under the aforementioned rules may not be exempted of their obligation to pay. The period of time-barring in respect of claims for repayment shall begin on the day when the unjustified payment was made.[38]

A member who, during the period when the members, acting as good managers, should have provided their own capital to the LLC gave a loan to the company instead, may not pursue a claim against the company for the repayment of the loan in a bankruptcy procedure or a compulsory settlement. In a bankruptcy procedure or a compulsory settlement, such a loan shall be considered to form part of the assets of the LLC. A third person who, during the period when the members, acting as good managers, should have provided their own capital to the LLC gave a loan to the company instead and were given insurance by a member for repayment of the

35 Decision of the Supereme Court of Republic of Slovenia, no. III Ips 62/2002, 14 November 2002.
36 Ivanjko, Kocbek and Prelič, 2009, p. 899.
37 Art. 495 of the ZGD-1.
38 Art. 496 of the ZGD-1.

loan or if a member undertook to stand as a guarantor, may only demand payment in a bankruptcy or compulsory settlement of the difference which that person did not receive or did not receive as a result of the insurance or guarantee. These provisions shall also apply to other legal actions by a member or third person which correspond in a business sense to the provision of a loan. It shall not be considered a loan to the LLC (instead of the contributor's own capital) if the third person did not exercise a right to demand insurance or a right to terminate the contract and have the loan repaid.[39]

If the LLC repaid a loan in the year prior to the commencement of bankruptcy or compulsory settlement, a member who granted the loan, provided insurance, or who stood as a guarantor must compensate the LLC for the repaid loan sum. The member shall only be liable up to the amount of the loan or the amount for which the member assumed the guarantee or up to the value of the insurance at the time of the repayment of the loan. The member shall be free of this obligation if he/she makes freely available to the LLC in exchange for repayment those items which were provided as insurance to a creditor. The aforementioned provisions shall also apply to other legal actions which correspond in a business sense to the provision of a loan.[40]

■ *3.3. Exclusion and withdrawal of a member*

The articles of association may determine that a member may withdraw from the LLC or be excluded from the LLC and set out the conditions, the procedure, and the consequences of a withdrawal or exclusion. Notwithstanding the preceding rule, a member may request to withdraw from the LLC in a suit if good reasons exist for doing so, and especially if the other members or a manager are causing damage to the member, if the LLC or its members are obstructing or preventing the exercise of the member's right to withdraw, if he/she is obstructed in the exercise of the rights he/she enjoys under the law or under the articles of association, or if the general meeting or the managers impose disproportionate duties upon him/her.[41] The member has to act with due care and in good faith when carrying out his/her right to withdrawal.[42]

Any member may also require in a suit that another member be excluded from the LLC if good reasons exist for doing so, and especially if the other member is causing damage to the LLC or the members, if he/she acts in violation of general meeting resolutions, if he/she fails to cooperate in the management and thereby hinders the regular functioning of the LLC or the exercise of the rights of the other members or if he/she otherwise commits a serious violation of the articles of association.[43]

When a member withdraws or is excluded, his/her business share and all the rights and obligations associated with that asset shall terminate.[44] A member who has withdrawn from the LLC shall have the right to repayment of the estimated value of his/

39 Art. 498 of the ZGD-1.
40 Art. 499 of the ZGD-1.
41 Para. 1 and 2 Art. 501 of the ZGD-1.
42 Ivanjko, Kocbek and Prelič, 2009, p. 920.
43 Para. 3 Art. 501 of the ZGD-1.
44 Para. 1 Art. 502 of the ZGD-1.

her business shares at the time of withdrawal. The value of the business share may be stipulated by the LLC and the member or evaluated by an appraiser.[45] The LLC shall pay this value to him/her within three years of the day of withdrawal at the latest, including interest at the rate at which interest is paid on bank demand deposits. A member who invested a non-cash contribution in the LLC may demand the return of the things or rights which comprise the contribution instead of such repayment provided the value of these things or rights does not exceed the estimated value of the business shares, but not within three months after the withdrawal.[46] A member who has been excluded from an LLC shall have the right to repayment of the estimated value of his/her business shares at the time of the exclusion. The LLC shall pay this value to him/her within six years of the day of exclusion at the latest, including interest at the rate at which interest is paid on bank demand deposits. If the LLC or the remaining members demand compensation from the excluded member, the LLC may withhold the repayment of the estimated value of the business share until a final ruling deciding the compensation claim or until a settlement is reached between the LLC and the excluded member.[47]

4. Managing an LLC

■ *Decision-making by the members*

4.1.1. General meeting of members

The members' rights in respect to the managing of a company and the manner in which those rights are exercised shall be set out in the articles of association unless otherwise provided by law.[48] The members shall decide on: the adoption of an annual balance sheet and a profit and loss account as well as the distribution of profit for appropriation; a demand for the payment of subscribed contributions; the repayment of subsequent payments; the division and termination of business shares; the appointment and recall of managers; measures to review and supervise the work of the managers; the appointment of a procurator and a proxy; the pursuit of the LLC's claims against the managers or members in connection with reimbursement for damage caused in the formation or managing of the LLC; the representation of the LLC in judicial processes against the managers; other matters where so determined by the ZGD-1 or by the articles of association.

Each complete 50 EUR of subscribed contribution shall secure the member one vote. The contract of members may determine that certain members have a higher number of votes for each complete 50 EUR of subscribed contribution or that the voting rights of certain members are restricted. A proxy with written authorisation

45 Zabel, 2007b, p. 153.
46 Para. 5 Art. 502 of the ZGD-1.
47 Para. 6 Art. 502 of the ZGD-1.
48 Para. 1 Art. 504 of the ZGD-1.

may authorise another person's voting on behalf of a member. Where a resolution of the general meeting relates to the exemption of a member from a certain obligation or to legal transactions or the start or end of a dispute with a member, that member may not vote in that matter, nor may he/she exercise a voting right on behalf of another person. The company may not exercise voting rights deriving from its own shares.[49]

Members shall adopt resolutions at a general meeting. The members may decide by means of a written statement not to hold a general meeting. A resolution to this effect must be adopted by all the members. In this case, the members shall send their votes to the manager in writing, by telephone, telegram or by using similar technical means.[50]

The general meeting shall be convened by registered letter to all members, which must state the agenda of the general meeting, at least 25 days prior to the day on which the general meeting is held. If a general meeting is not correctly convened it may only adopt valid decisions if all the members are present. The provision laid down in the preceding paragraph shall also apply to resolutions on matters which were not announced in the method prescribed for the convening of a general meeting at least three days prior to the session of the general meeting.[51]

The general meeting of members shall adopt valid decisions if a sufficient number of members are present to have a majority of the votes. Unless otherwise provided by law or by the articles of association, the members shall take decisions at the general meeting according to the majority of the votes cast. The articles of association may determine that in the invitation to the general meeting another date is also set for the session of the general meeting if it does not have a quorum at the original time; at that subsequent session, the general meeting shall adopt valid decisions irrespective of the number of members present. A subsequent day for holding a session of the general meeting may not be sooner than the following working day after the day originally set.[52]

4.1.2. Amending the articles of association

Members shall decide on an amendment to the articles of association at a general meeting by a three-quarters majority of the votes of all the members. The articles of association may set out other requirements for a valid decision. A resolution on an amendment to the articles of association, with the exception of the change in the registered office, registered name, or activity must be verified by a notary. If an amendment to the articles of association increases the obligations of the members towards the LLC, the resolution must be adopted by all the members, other than in the case of an

49 Art. 506 of the ZGD-1.
50 Art. 507 of the ZGD-1.
51 Art. 509 of the ZGD-1.
52 Art. 510 of the ZGD-1.

increase in the subscribed capital.[53] The amendment to the articles of association shall enter into force upon its entry into the register.[54]

4.1.3. Rights of minority members

Members whose business share accounts for less than one-tenth of the subscribed capital may require a general meeting to be convened; when they do so, they must state the matters which the general meeting should decide and the reasons for the convening of the general meeting. One-tenth of the members may require a vote on a particular matter to be included on the agenda of a general meeting that has already been convened. One-tenth of members may also convene the general meeting or include a matter on the agenda themselves if their request was not approved or if persons to whom a request should have been addressed were absent. A general meeting convened according to the aforementioned rules shall also decide whether the LLC is to bear the costs of convening the general meeting or expanding the agenda.[55]

■ *4.2. Supervisory Board*

A Supervisory Board is not compulsory for LCCs, but the members can opt for one in the articles of association.[56] If the articles of association provide that the LLC shall have a supervisory board, the provisions on the supervisory board in a public limited company shall apply mutatis mutandis to it, unless otherwise provided by the articles of association.[57]

■ *4.3. Manager*

AN LLC shall have one or more managers who shall manage the operations of the LLC at their own responsibility and represent the company. The manager is appointed for an indefinite time,[58] but the articles of association may provide that a manager be appointed for a fixed period which may not be shorter than two years. The same person may be reappointed as a manager. The general meeting of members may recall a manager at any time irrespective of whether he/she was appointed for a fixed period or indefinitely. The articles of association may determine that a manager shall only be recalled for reasons laid down therein. The rules regulating obligation relations shall be used to decide claims based on a contract to perform the function of manager. If the LLC has a supervisory board, the manager shall be appointed and recalled by that board. AN LLC may have more than one manager. The articles of association shall determine whether they shall work jointly or as individual managers.[59]

53 Para. 1-3 Art. 516 of the ZGD-1.
54 Para. 6 Art. 516 of the ZGD-1.
55 Art. 511 of the ZGD-1.
56 Ivanjko, Kocbek and Prelič, 2009, p. 936.
57 Art. 514 of the ZGD-1.
58 Ivanjko, Kocbek and Prelič, 2009, p. 938.
59 Art. 515 of the ZGD-1.

4.3.1. Management liability under the ZGD-1

For management liability in LLCs, the provisions of the public limited company shall apply mutatis mutandis. In performing their tasks on behalf of the LLC, the members of the management must act with the diligence of a conscientious and fair manager and protect the business secrets of the LLC.[60] The members of the management shall be jointly and severally liable to the LLC for damage arising as a consequence of a violation of their tasks unless they demonstrate that they fulfilled their duties fairly and conscientiously.[61] Members of the management shall not have to reimburse the LLC for damage if the act that caused damage to the LLC was based on a lawful resolution passed by the general meeting. However, the liability for damages of the members of the management board is not excluded on the basis that an act was approved by the management or supervisory board. The LLC may only refuse compensation claims or offset them three years after the claims arose provided the agreement of the general meeting is obtained and provided no written objection is made by a minority holding at least one-tenth of the subscribed capital.[62]

In recent years, the Slovenian court practice and literature have adopted the business judgment rule.[63] The meaning of "managing business" and the level of honesty and due care required from the members of the management board are both to be established on a case by case basis and interlinked. Excessively strict demands from the members of a management board could act as a deterrent to entrepreneurship that is inevitably linked also to risks.[64] Based on the business judgment rule, any business decision that proves to be harmful does not yet act contrary to the required standard of due diligence. The obligation of members of management and supervisory bodies can be defined as an obligation of endeavour and not an obligation of result.[65]

A compensation claim by the LLC against members of the management may also be pursued by creditors of the LLC if the LLC is unable to repay them.[66] After the initiation of the bankruptcy proceeding, the claim for damages due to a breach of duty according to the ZGD-1 against the members of management can be lodged also by each creditor who, in accordance with Financial Operations, Insolvency Proceedings, and the Compulsory Winding-up Act (*Slovenian Zakon o finančnem poslovanju, postopkih zaradi insolventnosti in prisilnem prenehanju; hereinafter: ZFPPIPP*)[67] is entitled to carry out procedural acts in bankruptcy proceedings or by the insolvency Trustee.[68]

60 Para. 1 Art. 263 of the ZGD-1.
61 Para. 2 Art. 263 of the ZGD-1.
62 Para. 3 Art. 263 of the ZGD-1.
63 Podgorelec, 2013, p. 98.; Podgorelec, 2015, pp. 445–460.
64 Decision of the Supereme Court of Republic of Slovenia, no. III Ips 75/2008, 21 December 2010.
65 Decision of the Supereme Court of Republic of Slovenia, no. III Ips 97/2015, 9 December 2015.
66 Para. 4 Art. 263 of the ZGD-1.
67 Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 13/14, 10/15, 27/16, 31/16, 38/16, 63/16, 54/18.
68 Para. 5 Art. 263 of the ZGD-1.

4.3.2. Liability under the insolvency law – liability claims against (former) managers

Besides insolvency proceedings against legal entities and natural persons, the ZFPPIPP also regulates the financial operations of legal entities. With provisions on the financial operations of legal entities, there are, among others, certain obligations of the company and its bodies upon occurrence of insolvency: (a) the duty of equal treatment of creditors; (b) the duty to analyse the causes for the insolvency and implement adequate measures.

After the LLC becomes insolvent, it may not execute any payments or assume any new obligations, except for those which are necessary for the regular operations of the LLC. The management and other bodies of the LLC cannot perform any actions that would contribute to the unequal treatment of creditors who are in an equal position towards the LLC.[69] The duty of equal treatment of creditors is composed of two prohibitions, namely the prohibition of the execution of payments or assumption of obligations, except for those which are necessary for the ordinary/regular business of the LLC,[70] and a prohibition of actions that would contribute to the unequal treatment of creditors who are in an equal position towards the LLC.[71] There is an assumption that creditors have been treated unequally in case the management has by-passed the business or financial currents to another legal entity or natural person or in case it has performed legal actions which were challenged at the initiation of the bankruptcy proceedings.[72]

Within a month after the start of the insolvency of the LLC, the management has to present to the supervisory board a report on measures for financial restructuring, which has to include a description of the financial position of the company, an analysis of the causes of insolvency, and the opinion of the management as to whether a minimum of 50 percent for the successful execution of financial restructuring is probable, the result of which would be regained liquidity and solvency of the company.[73] In the case of an affirmative opinion from the management that financial restructuring can be successfully performed, the report on financial restructuring measures shall contain also the description of the measures to be undertaken (e.g. an increase of the share capital with new contributions, or the sale of unnecessary assets).[74] The supervisory board has to issue an opinion on the management's report.

If the management breaches the aforementioned obligations at the entry of the insolvency, they would be liable for damages to the creditors which they suffered in the form of lower payments of their claims in the bankruptcy proceedings.[75] For the management's liability for damages, the following four conditions have to be fulfilled: (a) a bankruptcy proceeding is initiated against the LLC; (b) the management have

69 Para. 1 and 3 Art. 34 of the ZFPPIPP.
70 Para. 1 Art. 34 of the ZFPPIPP.
71 Para. 3 Art. 34 of the ZFPPIPP.
72 Para. 4 Art. 34 of the ZFPPIPP.
73 Para. 1 and 2 Art. 35 of the ZFPPIPP.
74 No. 2 Para. 3 Art. 35 of the ZFPPIPP.
75 Art. 42-44 of the ZFPPIPP.

acted unlawfully; (c) the occurrence of damages; and (d) a causal link between the unlawful acting of management and the damages.[76]

The management is said to act unlawfully in the case that it breaches the duty to treat creditors equally or fails to analyse the causes for the insolvency and does not implement adequate measures after the LLC becomes insolvent.[77]

In relation to the assumption of insolvency, the ZFPPIPP provides an irrebuttable assumption that the company has become insolvent in the moment that such a situation could be recognized by the management if the management acted with the professional due diligence of the corporate finance and corporate governance profession.[78] Insolvency shall be the situation where the debtor, within a longer period of time, is not able to settle all his/her liabilities falling due within such a period of time (so called: continuous insolvency), or becomes long-term insolvent.[79] The ZFPPIPP provides with their definition of continuous insolvency and long term insolvency several challengeable and non-challengeable assumptions, whereby the corporate finance profession underlines that the proving of such an assumption is not a condition for the existence of the insolvency of the company. The assumptions are given in order to show that in these ultimate instances the management has to start with the revision of the solvency of the company. In case it is established that the short-term solvency cannot be guaranteed without extraordinary and in-depth measures, it is clear that the company has become insolvent and that the duty to treat equally the creditors and the analysis of the causes of insolvency as well as the execution of adequate measures are necessary.

In case the management does not prove otherwise, the creditor shall be deemed to have sustained damages due to an omission or unlawful act carried out by the management, which amounts to the difference between the total amount of his/her claim and the amount up to which that claim has been settled in the bankruptcy proceedings.[80] The ZFPPIPP therefore provides for a statutory assumption, which can be challenged on the amount of damage and causal linkage between the unlawful action of management and the amount of resultant damage which has occurred to the creditor.

The individual member of management is responsible to the creditors for any damages due to the breach of the ZFPPIPP up to twice the total amount of all their remunerations for performing the function of the members of management in the year in which an act has been carried out or omitted according to the ZFPPIPP; however, for the members of management, not less than 150,000 EUR for a large company, 50,000 EUR for a medium-sized company, and 20,000 EUR for a small company or other legal entity.[81] The limitation of liability for damages shall not apply if the act has been carried out or omitted intentionally or by gross negligence.[82]

76 Plavšak, 2008, p. 65., 66.
77 Plavšak, 2017, p. 199.
78 Art. 33 of the ZFPPIPP.
79 Art. 14 of the ZFPPIPP.
80 Para. 2 Art. 42 of the ZFPPIPP.
81 Para. 1 Art. 44 of the ZFPPIPP.
82 Para. 2 Art. 44 of the ZFPPIPP.

The liability for damages according to ZFPPIPP shall not exclude the liability for damages of members of the management under other acts.[83] Namely, the liability for damages according to ZFPPIPP is not characterized by the liability for the origin of the financial position of insolvency of the company, but only for the breach of the prohibitions and duties according to ZFPPIPP after the company has become insolvent. The liability for damages according to ZFPPIPP therefore does not exclude the liability for damages of the management for becoming insolvent, that is, a situation when the company has become insolvent because the members of the management did not follow their duties with regards to managing the operations of the company with due professional care. Therefore the ZGD-1 provides that a member of the management, when performing his/her duties, has to act in the benefit of the company with the due diligence of a conscientious and fair manager and hold confidential any business secrets of the company.[84] If the members of management breach the said rule, they are jointly liable for any damages caused by the breach of their duties.[85] After the initiation of the bankruptcy proceeding, the claim for damages due to breach of duty according to the ZGD-1 against the members of management can be lodged also by each creditor who, in accordance with ZFPPIPP is entitled to carry out procedural acts in bankruptcy proceedings.[86]

5. LLCs with a single member

Slovenian legislation does allow an LLC to be formed by only one natural or legal person and stipulates some special rules regarding such an LLC. If an LLC is founded by a single person (hereinafter: the founder), that person shall adopt articles of association in the form of a notary record. Such articles of association can also be adopted on a special form in writing or electronically.[87]

If, before the LLC is reported for entry into the register, the founder has not fully paid in cash part of the subscribed contribution, he/she must provide appropriate security to the LLC for the unpaid part. The founder must submit documentary evidence of the security to the court upon application for entry into the register. If within three years of the entry of an LLC into the register all the business shares are combined in the hands of a single member, or in addition to him/her only in the hands of the LLC, that member must pay up in full all the sums of the subscribed contributions or provide appropriate collateral to the LLC within three months.[88]

Legal transactions concluded by the sole member in the name of the LLC with him/herself as the other contracting party must be drawn up in writing, whereby the

83 Para. 4 Art. 44 of the ZFPPIPP.
84 Para. 1 Art. 263 of the ZGD-1.
85 Para. 2 Art. 263 of the ZGD-1.
86 Para. 5 Art. 263 of the ZGD-1.
87 Para. 1 Art. 523 of the ZGD-1.
88 Art. 524 of the ZGD-1.

LLC shall not require a conflict representative. This provision shall not apply to legal transactions concluded as part of continuing operations.[89]

The founder shall independently decide issues that are otherwise made by members at a general meeting. The founder must enter all decisions in a resolutions book, which shall be verified by a notary no later than by the time the LLC is entered into the register. Resolutions which are not entered in the book of resolutions shall have no legal effect.[90]

6. Piercing the corporate veil

Members shall not be liable for the liabilities of an LLC.[91] However, the ZGD-1 does prescribe the liability of the members of an LLC in the following cases: (a) if they have abused the company as a legal person in order to attain an aim which is forbidden to them as an individual; (b) if they have abused the company as a legal person thereby causing damage to their creditors; (c) if, in violation of the law, they have used the assets of the company as a legal person as their own personal assets, or (d) if for their own benefit or for the benefit of some other person they reduced the assets of the company even if they knew or should have known that the company would not be capable of meeting its liabilities to third persons.[92]

Slovenian court practice is very restrictive in this matter and uses this rule in practice only in exceptional cases,[93] for example in cases when a member uses the LLCs assets for his/her personal gain.[94]

89 Art. 525 of the ZGD-1.
90 Art. 526 of the ZGD-1.
91 Art. 472 of the ZGD-1.
92 Para. 1 Art. 8 of the ZGD-1.
93 Zabel, 2006, p. 162.
94 Decision of the Supereme Court of Republic of Slovenia, no. II Ips 186/99, 1 December 1999.

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Limited Liability Companies in Croatia[3]

ABSTRACT: *This article aims to provide an overview of the main features of the limited liability company (hereinafter: LLC) in Croatia. LLCs are the most common company type in Croatian business practices. This is because of low amounts of minimum share capital, limited liability of shareholders, freedom of shareholders to regulate own internal relations and the LLC's internal organization, which is regulated by the articles of association and holds fewer formalities to function. Interestingly, most LLCs are established as a single shareholder LLC, followed by two and three shareholders LLCs. This supports the finding that Croatian LLCs are often closely held companies, whose founders also act as directors and employees of the company. Since 2012, it is possible to form a simple LLC for a minimum share capital of 10 KN (cca. 1.32 EUR), and as of 2020, LLCs can even be established online. Thus, the simplicity and cost effectiveness to establish an LLC remain its primary advantage. Mandatory provisions that shareholders must respect are inter alia capital requirements and capital maintenance, formation, and competencies of the management board and shareholders' meeting. The shareholders' meeting is superordinate to other LLC bodies, allowing directors to be appointed and dismissed at any time. Shares are alienable and inheritable, but their transfer may be limited by the LLC's articles of association. In certain cases, shareholders can be held personally liable for the LLC's obligations (e.g., in the event of abuse of limited liability, partial payment of capital contributions, and the LLC's dissolution without liquidation). Further specifics and current challenges of LLCs in Croatia will be analysed in detail.*

KEYWORDS: LLC, capital requirements, capital maintenance, bodies, membership rights, piercing the corporate veil.

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3 This paper is written under support of the University of Rijeka project (uniri-drustv-18-43) 'Legal Aspects of Companies Restructuring and Transition Towards New Corporate Governance Culture'.

https://doi.org/10.47078/2020.1.69-85

1. Introduction

In December 1993, the Croatian Parliament enacted a new Companies Act (hereinafter: CA)[4] that was modelled on the German and Austrian Company Law. The fundamental principles set forth in the CA included a uniform code that regulated both partnerships and companies. In addition, the CA regulated groups of companies, reorganization measures (mergers, divisions, conversions) and the legal status of foreign companies. It has been amended several times during the period of 1993 to 2019.

The total number of active LLCs (in Croatian: društvo s ograničenom odgovornošću) was 98 925, plus 37 015 simple LLCs in September 2019,[5] thereby accounting for 98.6% of the total number of active companies in Croatia. Dispositive provisions of the CA outweigh mandatory provisions regarding the relations between shareholders. This constitutes one of the fundamental differences between LLCs and joint-stock companies. Mandatory provisions for LLCs regulate *inter alia* formation and registration, capital requirements and capital maintenance, capital increase and reduction, bodies and their liabilities towards shareholders and creditors, and dissolution of the LLC.[6] On the other hand, shareholders are free to arrange internal relations, such as the pertinent issue of distribution of voting rights and dividends (irrelevant of the share capital paid by each member), and restrictions on transferability of shares. If the parties fail to use their party autonomy while drafting their articles of association, the CA provides for default rules to be applied.

2. Regular LLC and simple LLC

Introduced in 2012, the simple LLC became popular because of reduced formation costs and a minimum amount of share capital of only 10,00 HRK (ca. 1.32 EUR), the nominal value of each share being no less than 1,00 HRK (ca. 0.14 EUR).[7] The simple LLC was modelled on the German entrepreneurial company.[8] It should be emphasized that the simple LLC is not a different form of company but yet slightly distinct from a regular LLC. Although the same rules apply to both regular and simple LLCs, as shall be analysed, there are a few exceptions where the legislator provides a different solution for simple LLCs.

The simple LLC can only be formed under a simplified procedure if it has less than five shareholders and one director. A model protocol composed by the notary must be used for the formation of a company. This also serves as a list of shareholders and persons empowered to manage the company's business. Capital contributions must

4 Companies Act, Official Gazette, Nos. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19.
5 Croatian Bureau of Statistics, September 2019.
6 Barbić, 2010, pp. 18–19.
7 Barbić, 2010, p. 8.; Jurić, 2020, pp. 390–400.
8 Jurić, 2020, pp. 402–404.

be cash only and paid in full prior to filing the application to register the company. Contributions in kind are not allowed pursuant to Art. 390a CA.

Further, it must form statutory reserves, comprising a quarter of the annual surplus, minus losses carried forward from the previous year. Conversely, the regular LLC does not have this obligation. These reserves may only be used for the following: (a) capital increase from company funds; (b) compensation of an annual deficit, in so far as it is not covered by profits carried forward from the previous year; and (c) compensation of losses carried forward from the previous year, in so far as they are not covered by an annual surplus (Art. 390a CA). Thus, simple LLCs are encouraged, although not obliged, to transform into regular LLCs, after the business proves to be successful.

3. Capital requirements and capital maintenance of the LLC

■ *3.1. Capital requirements and payment of capital contributions*

The LLC's share capital must amount to no less than 20.000,00 HRK (cca. 2.632,00 EUR). The nominal value of each share must amount to no less than 200,00 HRK (cca. 26,32 EUR) and each shareholder may subscribe several shares in formation of the LLC.[9] The amount of the nominal values of the individual shares may be determined differently. The total of the nominal values of all shares must equal to the share capital (Arts. 389 and 390 CA). If contributions in kind are to be made, the object of the contribution in kind and the nominal value of the share to which the contribution in kind refers, must be specified in the articles of association. The value of the contributions in kind must be audited and shareholders must draft a report on company formation.[10]

Shareholders may determine the amount and date of cash pay-out contributions for shares either by means of the articles of association or shareholder decision.[11] CA sets the minimum amount and deadline for cash pay-out contributions when forming an LLC. Prior to registration, each shareholder must pay at least a quarter of the nominal value of a share (Art. 390 CA). The total amount of all cash pay-outs should not be less than a quarter of the amount of share capital. Since 2019, the CA introduced a deadline for payment, and personal liability for unpaid cash distributions, which shall be discussed later in this article.

Contributions in kind must be fully effected prior to the registration of an LLC. If, at the time of applying for registration of an LLC, the value of contribution in kind

9 Except for simple LLC or online registration of an LLC.

10 Audit is not necessary if contributions in kind are listed securities or if they were previously assessed by the certificated judicial assessor (Art. 185a CA).

11 By the articles of association, it may be stipulated that shareholders are allowed to take a decision to call in additional payments (additional contributions). If the obligation to pay an additional contribution is not limited to a specified amount, each shareholder, if he has fully paid the capital contribution, shall have the right to be exempt from payment. If they are not needed to cover a loss in share capital, any payment in additional contributions may be repaid to shareholders (Art. 391 CA).

does not equal the nominal value of the share subscribed to thereby, the shareholder must pay a cash contribution of the shortfall (Art. 390 CA). These provisions also apply to future capital increases of the LLC. Shareholders may not be exempt from the obligation to pay capital contributions, except in the case of a capital reduction in the amount of that contribution by which the share capital has been reduced (Art. 398 CA).[12]

In the event of a delayed payment of the capital share, the defaulting shareholder must pay default interest (Art. 399 CA). They may also be issued a renewed request to make the payment within a specified grace period, under penalty of their exclusion, of the share for which payment was unfulfilled. After fruitless expiry of this period, the defaulting shareholder shall be declared to have forfeited their share and any partial payments made to the company. A shareholder who has been excluded shall remain liable for any losses the company incurs on account of the defaulted amount of the original capital share, which may be called in against the share at a later point in time (Art. 400 CA). The legal predecessors of an excluded shareholder shall also be held liable for any unfulfilled obligations to pay capital contributions on the part of an excluded shareholder. The legal predecessor acquires the excluded shareholder's share against payment of the outstanding amount (Art. 401 CA). If payment of the outstanding amount cannot be collected from any of the legal predecessors, the company may sell the share by way of public auction (Art. 402 CA). Where an original capital share can neither be collected from the person obligated to pay it nor covered by the sale of the share, the remaining shareholders must raise the shortfall in proportion to their shares. Amounts that cannot be collected from individual shareholders shall be distributed proportionally amongst the remaining shareholders (Art. 403 CA).[13]

If the LLC becomes bankrupt, shareholders are jointly and severally liable for payment of unpaid capital contributions, should such payments be necessary to settle the LLC's creditors (Art. 404 CA).

■ *3.2. Distribution of profit and prohibited payments to shareholders*

Shareholders can claim the annual surplus plus any profit carried-forward and minus any losses carried-forward, in so far as the resulting amount is not excluded from the distribution amongst shareholders by law, articles of association, or by a shareholders' decision on the appropriation of earnings. Profit shall be distributed in proportion to the contributions paid for shares. Similarly, the articles of association could stipulate an alternative criterion for distribution (Art. 406 CA).[14] The LLC is not obliged to form reserves from the profit, but they may be envisaged by the articles of association (Art. 406a CA).[15]

12 Jurić, 2020, pp. 395–397.
13 Barbić, 2010, pp. 193–218.
14 Barbić, 2010, pp. 285–295.
15 Capital reserves, reserves for own shares, reserves envisaged by the articles of association and other reserves. Barbić, 2010, 279–285.

The assets the LLC requires to maintain its share capital should not be paid out to shareholders (Art. 407 CA). Prohibited payments must be reimbursed to the LLC. If the shareholder was acting in good faith, reimbursement may only be requested in so far as it is necessary to settle the LLC's creditors. If the reimbursement cannot be collected from the shareholder or directors, the remaining shareholders shall be liable, in proportion to their shares, for the amount to be reimbursed, to the extent as is necessary to settle the LLC's creditors. The LLC's claim shall become statute-barred after five years from the end of the day on which the prohibited payment was made.[16]

■ ***3.3. Purchase and pledge of own shares***

The LLC shall not purchase or take in pledge its shares for which the capital contributions have not yet been paid out fully (Art. 418 CA). It may purchase own shares for which capital contributions have been paid in full, only if at the time of the purchase it could form reserves in the amount of the expenditures for the purchase (reserves for own shares), without reducing the share capital or reserves to be formed in accordance with the articles of association, and which may not be used to make payments to shareholders. Total amount of secured claims shall not exceed the value of the shares taken in pledge. If the value of the shares taken in pledge is lower, this amount shall not exceed the value of assets above the share capital. The infringement of these provisions does not render the acquisition of or taking of the shares in pledge ineffective. However, the legal obligations in respect of a prohibited acquisition or acceptance of own shares in pledge shall be null and void.[17]

4. Transfer and pledge of shares

Shares are alienable and inheritable. If a shareholder purchases further shares in addition to their original share, these shall remain legally independent. The parties must conclude two contracts for the transfer of the shares: the contract stating the transferor's obligation to transfer the share and the transfer agreement. Both must be in the notarial form to be valid. However, if the first contract fails to meet this requirement, a validly concluded transfer agreement shall validate the entire transfer of the share (Art. 412 CA). Insofar as relations within the LLC are concerned, legal acts performed towards the transferor, as well as those performed by the transferor prior to notification of the share transfer to the LLC, shall be valid in relation to the acquirer of the share (Art. 415 CA).[18]

Amendments to the articles of association are not necessary for the transfer of shares.[19] The articles of association may impose some restrictions on the transfer of

16 Barbić, 2010, pp. 295–299.
17 Barbić, 2010, pp. 312–317.
18 Barbić, 2010, pp. 177–178.
19 Barbić, 2010, pp. 103–115.

shares, such as requiring the company's consent for transfer.[20] In that case, a shareholder who intends to transfer the share may, if they have not obtained consent from the company, request the permission of the commercial court to transfer the share. The court shall permit the transfer of the share when there are no justified reasons to deny permission, and the transfer is conducted without causing damage to the LLC, its shareholders, or creditors. Even if the court has permitted the transfer of shares, the shareholder cannot transfer shares to a person of their choice, if the LLC notifies them within one month after the court decision has become final, that it approved transfer of that particular share to another person under the same conditions (Art. 413 CA). In cases of inheritance of shares, the articles of association may stipulate that the heir shall transfer the share to another shareholder or to a person designated by the LLC, if the heir and such person have not agreed otherwise, at a price corresponding to the share value, as expressed in the LLC's latest financial statements (Art. 414 CA).[21]

A shareholder may pledge their share, that is, use it as collateral. The pledge agreement must be concluded in a notarial form. The pledge of the share must be entered into the share register and the Court Register through submission of the list of shareholders (Art. 412 CA).[22] The transferor of the share must file an application for the entry of the transfer of share into the LLC's share register (Arts. 410 and 413 CA).[23] Personal creditors of shareholders can enforce claims on their shares held in the LLC (Art. 232 of Execution Act).[24] The execution of shares of LLCs is complex in light of the fact that company law rules and articles of association can affect the process of execution.[25] For example, if the articles of association provide for restrictions of the transferability of shares, it is uncertain as to which should prevail: execution procedure or company law. According to some views of practitioners, if the articles of association provide the pre-emption right, the court should inform the shareholders of the assessed value before the sale of shares on auction, so that the shareholders can exercise their pre-emptive right.[26]

In any case, personal creditors of the shareholders are not entitled to cancel the company in order to enforce their claim towards shareholder-debtors, as they would be in the case of partnerships.[27]

20 E.g., ban on transfer of shares during LLC's existence or during certain period from LLC's formation, pre-emptive right, determination of person who may acquire shares etc. Barbić, 2010, p. 116. Share with obligation to pay an additional contribution shall be transferable only upon the LLC's consent (Art. 412/4 CA).

21 Barbić, 2010, pp. 119–128.

22 Barbić, 2010, pp. 137–141.

23 Directors shall keep the LLC's share register. Directors shall without undue delay submit to the Court Register a list of shareholders. In the event of a change in the person of a shareholder or the extent of their participation, the owner, in relation to the company, of a share shall be deemed to be only whoever has been included as such in the share register and the list of shareholders entered in the Court Register (Arts. 410 and 411 CA). Barbić, 2010, pp. 171–184.

24 Execution Act, Official Gazette, Nos.112/2012, 25/2013, 93/2014, 55/2016, 73/2017.; Mihelčić, 2012, p. 7.

25 Miladin, 2008, p. 510.

26 Marković, 2006, p. 124.

27 Art. 100 of CA.

5. Bodies of the LLC

Mandatory LLC bodies comprise the management board and the shareholders' meeting. Conversely, the supervisory board is not required. The shareholders' meeting is superordinate to other LLC bodies and may give mandatory instructions to the management board, while shareholders may bring decisions on the management of the LLC. Consequently, directors may be dismissed at any time.[28]

■ *5.1. The management board and directors' liability*

The management board consists of one or more directors. The number of directors are provided for under the articles of association. A director may be any natural person with the capacity to act.[29] The shareholders decide on appointment of directors, unless otherwise provided by the articles of association (Arts. 422 and 423 CA).[30] Appointed directors may be dismissed at any time by a shareholders' decision.[31] Likewise, a director may resign at any time by means of a written form (424a CA). An application for entry in the Court Register must be made for each change to any director and for the termination of a director's power of representation (Art. 425 CA).[32]

Director duties are as follows: (a) manage the business and represent the LLC; (b) ensure proper book-keeping and compose reports and annual financial statements of the LLC; (c) convene the shareholders' meeting, prepare proposals of its decisions, and enforce them; (d) submit applications for entry in the Court Register; and (e) initiate bankruptcy proceedings. Regarding the LLC's management and representation, when several directors have been appointed, they are all jointly entitled to manage and represent the LLC, unless otherwise provided by the articles of association. Directors manage and represent the LLC in accordance with the articles of association, decisions of shareholders, and mandatory instructions of the shareholders' meeting or the supervisory board (Arts. 422 and 427 CA).[33]

Furthermore, directors conduct company affairs with the due care of a prudent businessman, keeping business secrets of the LLC. The business judgement rule applies to their liability. Directors who breach their duties are jointly and severally liable to the

28 Barbić, 2010, pp. 319–326.

29 A director cannot be a) a member of the LLC's supervisory board and b) a person punished for certain criminal offences during five years after the finality of the judgement or a person against whom a safety measure was pronounced prohibiting them to engage in an activity which falls under the business activities of the LLC, during the period while the aforesaid prohibition remains in force.

30 This decision may be brought by the supervisory board, certain shareholders or government body which is a shareholder. Shareholders may be appointed for LLC's directors by the articles of association (Art. 424 CA).

31 They may be also dismissed by the supervisory board or a shareholder if they have appointed a director or by a court decision if there are important grounds therefor.

32 Barbić, 2010, pp. 328–348.

33 Barbić, 2010, pp. 357–366.

LLC for any incurred damage. In case of dispute, directors bear the burden of proof to demonstrate that they employed the due care of a prudent businessman.[34] Directors are liable for damage if, in violation of the CA, they undertake the following: (a) return capital contributions to shareholders, (b) pay interests or dividends to shareholders; (c) purchase or take in pledge own shares of the LLC; (d) distribute the LLC's assets; (e) make payments after the occurrence of insolvency or over indebtedness; and (f) pay remuneration to members of the supervisory board or grant loans from the LLC's assets. In the latter cases, the claim for damages may also be asserted by creditors if they are unable to settle their claims from the LLC. Where compensation must be paid to settle the LLC's creditors, the directors' liability cannot be abrogated because they acted in compliance with a decision brought by the shareholders, whether through a mandatory instruction of the shareholders' meeting or the supervisory board. The claims for damages prescribe after five years (Art. 430 CA).[35]

The claim for damages against directors may be made only with previous approval of the shareholders' meeting (Art. 441 CA). The LLC is represented in the litigation by the supervisory board or a special representative appointed by the shareholders' meeting. Shareholders whose combined shares make up at least one-tenth of the share capital may claim for damage against the directors if the shareholders' meeting refused to approve such a claim. The claim must be made within three months after the date of which the shareholders' meeting refused approval.[36] If the claim is dismissed as unfounded, and if it is established that it was malicious, the plaintiff shall indemnify damages incurred to the defendant (Art. 453 CA). Minority shareholders make the claim on their behalf, but they can only demand that defendants compensate damages incurred to the LLC.[37]

■ *5.2. The supervisory board*

The supervisory board is not a mandatory body of the LLC. Its formation may be envisaged by the articles of association.[38] However, the formation of a supervisory board is prescribed by the CA for large LLCs (Art. 434 CA).[39]

The supervisory board consists of three members. Although the articles of association may foresee that the supervisory board has more than three members, the number must always be uneven (Art. 435 CA). Any natural person with the capacity to act may be appointed into the supervisory board, whereas the CA prescribes who

34 They are also liable for damages incurred in the LLC's formation or by undue influence of third persons and shareholders on the LLC's directors and the supervisory board members.

35 Barbić, 2010, pp. 391–399.

36 Identical case is when shareholders put a proposal to make such a claim to the management board but omitted to put the proposal on the agenda of the shareholders' meeting.

37 Barbić, 2010, pp. 399–402.

38 The simple LLC cannot have a supervisory board.

39 E.g., for an LLC with more than 200 employees the supervisory board is mandatory under a special law; for an LLC with share capital above 600.000,00 HRK and with more than 50 shareholders; for an LLC who is a controlling company of other companies within a group of companies. Barbić, 2010, pp. 403–407.

cannot be a member (Art. 437 CA).[40] The shareholders' meeting elect's members of the supervisory board. One-third of its members may be appointed by certain shareholders who are determined by the articles of association (Art. 437 CA).[41] The supervisory board members are elected and appointed for a maximum of four years, with the possibility of re-election and re-appointment. Elected members of the supervisory board may be dismissed at any time through a shareholder's decision.[42] Similarly, a member of the supervisory board may resign at any time through written form. An application for entry in the Court Register must be made for each change of person of any supervisory board members (Art. 439 CA).[43]

The powers of the supervisory board are determined by the articles of association. The duties of the supervisory board are as follows: (a) supervise directors; (b) represent the LLC in relation to directors; (c) compose a report on the supervision of directors and submit it to shareholders; (d) convene the shareholders' meeting; (e) give mandatory instructions to directors with regard to the LLC's management; and (f) provide consent for particular operations of directors regulated by the articles of association, or by a decision of the supervisory board in individual cases (Art. 439 CA).[44] Further, it provides consent for agreements concluded between directors and the LLC, for loans granted to directors from the LLC's assets and on the repeal of the prohibition of competition.[45] The CA provisions on the liability of directors apply to the liability of supervisory board members, respectively.[46]

■ *5.3. The shareholder's meeting*

Shareholders may exercise their rights in the LLC through the shareholder's meeting or outside of it. Directors and the supervisory board members may participate in the work of the shareholders' meeting. The shareholder's meeting decides upon issues pursuant to the CA and the articles of association of the LLC. The CA differentiates between matters over which the shareholders' meeting has exclusive jurisdiction and those that can be transferred to other LLC bodies (Art. 441 CA).[47]

40 A member of the supervisory board cannot be: a) the LLC's director, b) a member of the supervisory boards in ten other companies, c) a director in a company controlled by the LLC, d) a director of another company in whose supervisory board there is one of the LLC's directors and e) a person punished for certain criminal offences in the specified period or a person against whom a safety measure was pronounced, prohibiting them to engage in an activity which falls under the LLC's business activities.

41 A member of the supervisory board may be appointed by the commercial court in case of emergency (Art. 439 CA).

42 Appointed member may be dismissed by the shareholder who appointed them. All members of the supervisory board may be dismissed by a court decision if there are important grounds therefor.

43 Barbić, 2010, pp. 412–421.

44 Should the supervisory board refuse to give such consent, directors are authorized to request consent from the shareholders' meeting. The shareholders' meeting decides on consent by at least three-fourths of all votes.

45 If an LLC does not have a supervisory board, these consents are given by shareholders.

46 Barbić, 2010, pp. 407–411.

47 Barbić, 2010, pp. 437–445.

Matters falling under the scope of its exclusive jurisdiction are as follows: (a) the approval of the annual financial statements, the appropriation of earnings, and the approval of the work of directors and the supervisory board members within the previous financial year; (b) the repayment of additional contributions; (c) the election and dismissal of the supervisory board members; (d) the assertion of claims for compensation of damage to which the LLC is entitled in relation to directors and the supervisory board members and the appointment of a special attorney if the LLC cannot be represented by directors or by the supervisory board; (e) the approval of agreements by which the LLC acquires objects or rights for which the paid price exceeds the amount of one-fifth of the share capital, if concluded two years after the LLC's registration; (f) the amendments of the articles of association; (g) the increase or reduction of share capital; (h) approval of the LLC's reorganization measures and entrepreneurial agreements; and (i) the LLC's dissolution.

The shareholders' meeting need not be held if all shareholders agree in writing about a decision, or if they declare acceptance through submitting their votes in writing regarding a decision (Art. 440 CA).[48]

The shareholder's meeting can be convened by directors, the supervisory board, liquidators, minority shareholders and persons or LLC's internal bodies which are determined by the articles of association. They meet at least once a year[49] and whenever the company's interests so require. Furthermore, a meeting is convened without delay if it is evident that the LLC has lost one-half of its share capital (Art. 442 CA). Notice of the shareholder's meeting must be given no less than seven days prior to the day of the meeting,[50] in a way provided for under the articles of association.[51]

The decisions of a shareholder's meeting is valid if the meeting is attended by shareholders or their representatives whose shares represent at least one-tenth of the LLC's share capital. The quorum may be abolished or increased by the articles of association. If there is no quorum, and the articles of association do not provide otherwise, a new shareholders' meeting must be convened with an identical agenda. Nevertheless, irrespective of the quorum, valid decisions may be adopted at such a meeting (Art. 444 CA).[52]

The shareholder's meeting makes decisions with a majority of the votes cast, unless otherwise provided for by the CA or the LLC's articles of association.[53] Each 200,00 HRK of the nominal value of a share grants one vote,[54] unless otherwise provided

48 There are a few exceptions to this rule. Barbić, 2010, pp. 427–431.

49 The annual shareholder's meeting must be held in the first eight months of the current financial year for the previous financial year.

50 Barbić, 2010, pp. 446–455.

51 The default rule is via registered mail to all shareholders (Art. 443 CA).

52 Barbić, 2010, pp. 455–458.

53 E.g., decisions on amendments to the articles of association, the increase or reduction of share capital, the approval of LLC's reorganization measures and entrepreneurial agreements, and on the LLC's dissolution, are made by a majority of at least three-fourths of all votes cast. These decisions must be in notarial form. Barbić, 2010, pp. 462–464.

54 In a simple LLC, each 1,00 HRK of share capital grants one vote.

for by the articles of association.[55] A shareholder may vote in person or by a representative with the power of attorney in written form. A shareholder who is to be discharged or exempt from an obligation by a decision, has neither a voting right in this connection, nor can he exercise that voting right for another (Art. 445 CA).[56]

The directors must, on request and without undue delay, provide each shareholder with information on the LLC's affairs and allow them to inspect the LLC's books and documents. They may refuse to provide information or permit inspection when there is a concern that the shareholder could use the latter for non-company purposes, thereby putting the LLC or an associated company at a significant disadvantage. Such a refusal requires a decision of shareholders, or directors in cases where the LLC has a supervisory board. Each shareholder who has been denied access to information can make a request to the commercial court to be granted this information or inspection of files within fifteen days from the shareholder's decision (Art. 447 CA).[57]

■ *5.4. Two-shareholder LLCs comprising of equal shares*

On 1 June 2017, the central Court Register counted 18393 registered LLCs as a two-shareholder LLC, which represents ca. 15% of LLCs in Croatia.[58] The most common practice is that these shareholders hold equal shares. In the case of a deadlock, where shareholders cannot reach an agreement and neither side prevails, shareholders are left with few options. Ideally, shareholders should provide for internal dispute resolution mechanisms to help them resolve their disagreements. However, to the best knowledge of the author, there is no such practice to date.

Shareholders in a deadlock and unable to reach an agreement, can request that the court withdraw the LLC (Art. 420/2 CA), for the expulsion of the other shareholder (Art. 420/3 CA) or dissolution of the LLC (Art. 468 CA).[59] In the first two cases, one of the shareholders exits the LLC, while in the last, the company ceases to exist. For withdrawal from the LLC, if not otherwise provided for in the articles of the association,[60] the shareholder must prove the existence of a justified reason. Pursuant to the CA, withdrawal is practicable when other shareholders or LLC bodies cause damage to the shareholder, if they prevent the shareholder from exercising its rights in the LLC, and if the LLC body imposes disproportionate commitments onto the shareholder.[61] For the expulsion of the shareholder, if not otherwise provided for in the articles of the association, the LLC or the shareholders must prove the existence of the important reasons,

55 E.g., limiting or expanding voting rights (regardless of the nominal value of shares), giving the right to veto to a shareholder for certain or all decisions, block of shares with voting rights.

56 Barbić, 2010, pp. 256–271.

57 Barbić, 2010, pp. 241–252.

58 For comparison, during the same duration there were 80644 one-member LLCs.

59 Čulinović-Herc, Marinac Rumora and Braut Filipović, 2018, p. 64.

60 In this case, the requirements, procedure and consequences of such withdrawal or exclusion of a shareholder from the LLC must also be determined.

61 By withdrawal of a shareholder, their membership in the LLC ceases, and he is entitled to reimbursement of the market value of their share as at the time of the withdrawal (Art. 421 CA). Barbić, 2010, pp. 156–171.

such as the behaviour of the shareholder undermining the achievement of the LLC's goal, and therefore, their membership becoming burdensome for the LLC.[62] However, there is only a handful of withdrawal and expulsion cases found in case law.[63]

For the dissolution of the LLC, the shareholders (holding at least 10% of share capital) must also prove the existence of an important reason before the court, where the inability to reach an agreement due to the deadlock in the shareholder's meeting is considered to be one of those reasons.[64] In the authors' opinion, shareholders should be continuously encouraged to use their autonomy while drafting the articles of association, in order to provide for viable solutions in the event of the shareholders' disagreement.

6. Minority right shareholders

The CA recognizes the minority shareholders as a group of shareholders in need of additional rights to boost their position towards majority shareholders. The threshold is often 10% of share capital, which provides them with the necessary standing to undertake various actions – both within the LLC and before court.

Shareholders whose combined shares make up at least one tenth of share capital[65] shall be entitled to request that a meeting be convened, stating the purpose and the grounds therefor. They shall also have the right to request amendments to the agenda, at least three days after the notification of the shareholders' meeting is published or received. If the request is not complied with, or there is no person to whom the request can be directed, the minority shareholders may themselves convene the meeting, or make the announcement by giving notification of the matter to be addressed (Arts. 442 and 443).[66]

Each shareholder may propose an audit of the LLC's annual financial statements. If shareholders refuse such a proposal, the commercial court may appoint one or more auditors, on request of shareholders whose shares together make up at least one tenth of share capital. The court shall grant such a request only if major violations of the CA or articles of association are likely to have been committed (Art. 450 CA).[67] Shareholders are also entitled to request a judicial appointment of the LLC's liquidators for important reasons (Art. 471 CA).

Shareholders with at least 10% of share capital can file a lawsuit for compensation of damages caused by the breach of duties of directors or supervisory board members, in cases where other shareholders or the management board refused to

62 The court shall pronounce exclusion of the shareholder, on condition that the LLC pays them compensation for the market value of the share within the specified period.

63 Čulinović-Herc, Marinac Rumora and Braut Filipović, 2018, p. 68.

64 Barbić, 2010, p. 576.

65 This threshold may be lowered by the articles of association.

66 Barbić, 2010, pp. 449–450; Slakoper, 2009, pp. 421–424.

67 Barbić, 2010, pp. 465–468; Slakoper, 2009, pp. 424–431.

take such an action (Art. 453 CA). However, minority shareholders are responsible for damages caused by such proceedings if it is established that these proceedings were commenced *mala fide* or due to gross negligence.

In the situation where the director of the LLC is also its shareholder, other shareholders have an additional right: the right to request revocation of the director-shareholder before the court, if there exists an important reason for the revocation (Art. 424 (2) CA). A shortcoming of this solution is that after the revocation, the shareholders must appoint another director, while the minority shareholders again cannot prevail in terms of their choice. A small number of these disputes in case law is thus unsurprising.[68]

7. The single shareholder LLC

The single shareholder LLC is the most common form of LLC in Croatia. It can be established by the statement on its formation in notarial form (Art. 387 CA). Prior to the LLC's registration, the shareholder may pay capital contributions partially, in which case he must provide appropriate guarantees (unlike the regular LLC) for payment of the remaining capital contributions (Art. 394 CA). The single shareholder LLC may form another single shareholder LLC, without any additional requirements, in comparison to the other founder of the LLCs.[69]

If the LLC was formed by more shareholders with partial payment of capital contributions, and subsequently (within three years after the LLC's registration) becomes a company with a single shareholder, within three months following the consolidation, the shareholder must a) make full payment of capital contributions, b) provide guarantee to the LLC for the payment of the remaining capital contributions, or c) transfer part of the shares to a third party.[70] If he fails to do so within an additional period determined by the court, the court shall issue a decision on the LLC's dissolution (Art. 398 CA).

On the other hand, it is not necessary to convene the shareholder's meeting to adopt decisions within its jurisdiction. If all the LLC's shares are held by one shareholder, or in addition by the LLC, he must document the decision in written form, and sign the document without undue delay upon adoption of the decision (Art. 440 CA).

If the sole shareholder is simultaneously the sole director or one of the directors of the LLC, their legal transactions with the LLC may be performed only with the LLC's special approval.[71] These legal transactions shall be documented without undue delay following their performance, in the written form. These documents are not required

68 Čulinović-Herc and Braut Filipović, 2017, p. 417.
69 Barbić, 2010, pp. 56–61, Slakoper, 2009, pp. 590–592.
70 Slakoper, 2009, pp. 592–594.
71 The approval may be given by articles of association or by a decision of the supervisory board or the shareholder's meeting.

when it comes to transactions concluded under the usual conditions, being the LLC's ordinary course of business (Art. 426 CA).[72]

8. Piercing the corporate veil

Due to the LLC being a separate legal entity with its own assets, shareholders are not liable for the LLC's obligations. Their duty is to pay capital and additional contributions that exist until the LLC's dissolution. Nevertheless, the CA imposes personal liability of shareholders for LLC's obligations under certain conditions.[73]

If a shareholder abuses their limited liability in the LLC, they may not rely on exemption from personal liability for the LLC's obligations under the CA (Art. 10 (3) CA). Furthermore, the shareholder shall be liable for the LLC's obligations if they (Art. 10 (4) CA) a) abuse the LLC as a legal person to attain their personal interest, b) abuse the LLC as a legal person, thereby causing damage to the LLC's creditors, c) use the LLC's assets as their personal assets, contrary to the CA, and d) reduce the LLC's assets for their benefit or for that of another person, although he knew or should have known that the LLC would not be capable of performing its obligations to third parties. Usually, the burden of proof lies on the plaintiff, who must prove such abuse of the shareholder. Conversely, in cases described under Art. 10 (4) of the CA, the burden of proof lies with the shareholder who must prove non-existence of such an abuse.[74]

Piercing the corporate veil usually arises in cases when the company is undercapitalised,[75] in relations between parent companies and subsidiaries[76] and in mixing of the company's assets with personal assets of shareholders.[77] As to the number of these disputes in case law, there are more than 100 final judgements pertaining to piercing of the corporate veil in joint-stock companies and LLCs. Thus, this matter is moderately represented in court disputes.

9. Novelties and current challenges faced by LLCs in Croatia

In April 2019, a new amendment to the CA was introduced, bringing about several important novelties for Croatian LLCs. The most important component is the introduction of the simplified termination of the LLC, that is, dissolution of the LLC without liquidation, which is less costly and less time consuming for all LCC parties. The decision must be reached unanimously by all shareholders. The condition to be met

72 Barbić, 2010, p. 364.
73 Barbić, 2008, pp. 296–298.
74 High Commercial Court of Croatia, 2003, Pž-1522/03.
75 E.g. High Commercial Court of Croatia, 2003, Pž-636/03.
76 E.g. High Commercial Court of Croatia, 2003, Pž-1760/02.
77 E.g. High Commercial Court of Croatia, 2004, Pž-6369/03.

is that the LLC does not have any obligations towards creditors and employees.[78] In order to protect creditors, CA provides that shareholders shall be jointly and severally liable with their personal assets for the remaining LLC's obligations if they appear within two years from date of publication of entry of the LLC's dissolution in the Court Register (Art. 472a-472f CA).[79] This system proved to be extremely popular in practice. Thus, since April 2019 there have been over 1000 LLC terminations under this simplified procedure.

Furthermore, the 2019 amendments introduced additional rules for shareholders who have not paid the full amount of cash contributions. Under Art. 390 (2) of CA, the remaining cash contributions must be paid in full within one year from registration of an LLC. Shareholders who have not paid the full amount of cash contributions shall be jointly and severally liable, with their personal assets, for all company obligations up to the amount of all unpaid cash contributions. They may evade this liability if they pay capital contributions in full before the entry of formation or capital increase of the LLC in the Court Register.[80] In the authors' opinion, this newly introduced personal liability is contrary to the principle of limited liability of shareholders for a company's obligations.

Since 2020, LLC and simple LLC may be registered online via websites of the Court Register, without a proxy and a notary in the process of formation (Art. 397 (a-e) CA). Online registration may be used only for forming LLCs where share capital is entirely paid in cash. LCC's shareholders and directors may access websites only in person with authentication certificates (eID or FinaCertRDC). The model protocol and application to register the company are available in the electronic form and are generated in the Court Register system.[81] It is yet to be seen how online registration will function, although there are serious concerns regarding its practice, primarily due to possible identity abuse and money laundering issues.

10. Conclusion

LLCs are the most popular company type in Croatian business practice. This is not surprising, as its formation and functioning is simpler and less costly in comparison to joint-stock companies. Furthermore, shareholders enjoy the limitations of their

78 The decision must be in notarial form and published on the Court Register website. All shareholders must give the statement on non-existence of LLC's obligations and on acceptance of the personal liability for remaining LLC's obligations, if they appear after entry of the LLC's dissolution, in the Court Register. LLC's assets shall be distributed between shareholders, in accordance with the plan on distribution of LLC's assets. Such dissolution shall be approved by a decision issued by commercial court. Shareholders, creditors, and public bodies may challenge the court decision.

79 Jurić, 2020, pp. 534–536.

80 Jurić, 2020, p. 396.

81 Jurić, 2020, pp. 404–407.

liability towards the LLC's creditors, as well as freedom to regulate their internal relations. The simple LLC, with a minimum share capital of 10,00 HRK (ca. 1.32 EUR), additionally promotes its popularity. Since 2020, it is possible to register the LLC from home, utilizing the online registration on the Court Register website, which has been introduced as another measure to simplify LLC formation.

However, Croatian LLCs face similar challenges that those in comparative jurisdictions face. Two shareholders LLCs remain a conundrum if shareholders ever enter into a 'deadlock' at the shareholders' meeting. The problem of relations between minority and majority shareholders are barely tackled, by means such as possibility of withdrawal by the shareholders from the company or through expulsion of an unwanted member.

In the authors' opinion, shareholders should be enticed to use party autonomy when drafting the articles of association, which could most effectively enhance their position during disagreements with other shareholders. The Croatian legislature has demonstrated a willingness to shape LLCs in line with the needs of business practice. However, this proves to be a continuous challenge. Only time and practice will show which measures were successful, and which should be revised in further amendments to the CA.

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KOVÁCS BÁLINT[1]

Non-territorial Autonomy in East-Central Europe: What About Romania?

ABSTRACT: *The paper attempts to provide an understanding of the reasons Romania has not sought non-territorial autonomy as a solution for minority claims by analysing a 15-year-old legislative proposal elaborated by a minority rights organisation. Although the analysis of this antiquated proposal seems long overdue, it holds answers relating to the attitude of the State and of minority organisations regarding autonomy, in which—ultimately—the issue seems to be a lack of serious intention by either of the two to change the minority legal status quo.*

KEYWORDS: non-territorial autonomy, statute of minorities, Romania, Hungarian minority.

1. Introduction

The term autonomy is hard to define because a unitary institutional description of it is lacking, as noted in the professional legal literature. This has led to confusion regarding what constitutes autonomy in practice and the way it should be defined theoretically.[2] The term derives from ancient Greece and translates to self-legislation. The term is not to be confused with the right to self-determination, which is usually associated with the right to form a sovereign state when certain conditions are met.[3] However, autonomy is a form of self-determination, and some interpret the concept as implying *internal self-determination*, meaning a form of democratic participation in the sense of the right to decide on the internal and local matters of a community.[4]

In general, autonomy is associated with claims of territorial self-administration (territorial autonomy [TA]). However, non-territorial autonomy (NTA) has also become

1 Researcher, Ferenc Mádl Institute of Comparative Law, Hungary; PhD Candidate, University of Debrecen, Géza Marton Doctoral School of Legal Studies, Hungary, balint.kovacs@mfi.gov.hu.

2 Malloy, 2015, p. 5.

3 Fisch, 2015, p. 53.

4 Vizi, 2014, p. 31.

https://doi.org/10.47078/2020.1.87-109

a popular subject not only among social science scholars, but also within minority organisations and more importantly, in the internal organisation of states as a solution for national minorities' claims regarding questions of identity preservation. As such, NTA has come to signify more generally the granting to a specific community (ethnic, religious, or linguistic) the right to self-government by its own institutions and rules regarding its cultural or social matters,[5] or more generally, matters regarding their identity. Thus, the difference between TA and NTA is that the transfer of authority is accomplished at the community level, not territorial level, and thus, theoretically, it does not make a difference where members of the respective community reside territorially. The scholarship notes three general differences between TA and NTA: (1) the right to self-regulate is granted to a group of people defined culturally and not territorially, (2) self-government is limited to questions of culture, and (3) the given powers can only be exercised with regard to individuals who have voluntarily chosen to be members of the cultural group.[6] In further delimiting the notion of NTA, from a general minority rights law perspective, the difference is mainly an institutional one, meaning NTA does not exist without self-regulating institutions.[7]

The concept of NTA has entered the mainstream through the political leadership of the late 19th and early 20th centuries during the search for an answer to questions regarding the cohabitation of nationalities. Similar ideas also emerged earlier, but without using the modern terminology. Lajos Kossuth, leader of the Hungarian revolution of 1848, described a principal feature of NTA, stating that the issue of nationality like that of religion, is a subject of social interest, and the state should not have anything to do with either of them.[8] However, a much more complex development of the idea of cultural autonomy is found in the work of Karl Renner entitled *Staat und Nation* (State and Nation), published in Vienna in 1899.[9] This is considered the primordial work on the subject, containing and constituting the foundation thereof and with it, of the debates it started.

Karl Renner and his contemporary Otto Bauer, both social-democratic politicians in the Austro-Hungarian Empire—also called Austro-Marxists—were working on a political program that aimed to maintain the territorial unity of the Empire by focusing on economic matters to unite the working class. The Empire was deeply divided along ethnic lines, and as secessionist nationalism was taking over, its territorial integrity was threatened. The two politicians proposed a solution that extended beyond territorial division. In their project, all national groups could freely enjoy their own cultural identity on the territory of a *denationalised* state, leaving common matters such as that of the economy or foreign affairs to the central government.[10] Such a system would allow all national groups to determine their own destiny regarding matters of culture

5 Benedikter, 2011, p. 11.
6 Donders, 2008, p. 100 *cited by* Yupsanis, 2014, p. 12.
7 Malloy, 2015, p. 5.
8 Jászi, 1918, p. 17.
9 The English translation of the text can be found in Nimni (ed.), 2005, pp. 13–42.
10 Yupsanis, 2016, p. 111.

and identity. It was suggested that by introducing this type of institution, competition among ethnic groups would subside and the potential conflict between their interests and those of the State would likely disappear.[11]

This system, called cultural autonomy or NTA, is based on two principles: the personality principle and principle of non-territoriality. The personality principle states that all citizens are allowed to freely determine their own ethnic identity, which usually implies voluntarily registering on special lists for minorities with the purpose of voting for their own cultural self-government institutions. The principle of non-territoriality establishes that the rights of registered persons belonging to national minorities will be granted regardless of their place of residence within the State. Of course, both principles have practical limitations; however, cultural autonomy remains an extremely relevant institution for the integration of persons belonging to national minorities.

The purpose of this paper is to present the main features of the concept of NTA, its relevance to minority accommodation, its place in international legal (or quasi-legal) instruments, and its potential place in the Romanian legal regime through the lens of the claims of national minorities. Their proposal is compared with existing systems implemented in the East-Central European region.

2. The purpose of non-territorial autonomy

At the end of WWI, the dismantling of East European Empires with the promise of the right to self-determination of peoples bore an expectation that each nation would have its own State. However, economic and strategic interests were concealed behind the right to self-determination, as the newly drawn borders could not assure the impossible *one country one nation* scenario. A solution was needed for the minorities remaining in newly formed or enlarged countries. The structural disadvantages minorities faced in these unitary nation States had to be countered with supplementary rights tailored to their needs, which could only be exercised collectively, such as the right to education or to their own culture.[12] Furthermore, to avoid internal conflicts, minorities also had to be integrated in the political structures of these States. Although representatives of the winning States had protested more or less loudly to Britain's imposition, France and the United States created a Committee on New States to draft a Minority Treaty, which was ultimately signed in a similar form by Poland, then Czechoslovakia, Romania, Yugoslavia, Greece, Austria, Hungary, Bulgaria, Latvia, Lithuania, and Estonia.[13] Some of these treaties contained the obligation to provide for some form of cultural autonomy for minorities.

11 Wong, 2013, p. 59.
12 Smith, 2014, pp. 15–16.
13 Fink, 1996, p. 280.

It is believed that the main advantage of cultural autonomy is that the debates around identity issues do not take place between the majority and minority, but are debated in the minority group itself.[14]

The rights of national minorities are still primarily approached from a national security perspective, especially in East-Central Europe. Generally, the fear associated with granting TA has to do with maintaining the territorial integrity of the State, which is why rational debate around such solutions cannot be had. TA seems to be an organisational policy reserved for Western democracies, where implementing such arrangements reflects trust from the part of the majority population. This translates into a higher degree of confidence that it is the right policy choice regarding the specifics of a particular State. It has been noted that Western countries have granted TA to all national minority communities with more than 250.000 members who have manifested claims for such accommodation, but it has also been granted to smaller communities.[15] NTA has been implemented in many countries in the Central and Eastern European region as well. NTA is viewed as a means of granting national minorities the right to internal self-determination and self-government in identity matters (mainly culture and education) without compromising the sovereignty and territorial integrity of the State in the eyes of the majority. Thus, NTA appears as an institution that grants minorities the right to self-government in matters of identity, leaving matters not related to identity (such as economy, infrastructure, etc.) to be decided within the main institutions of the State, as they would normally be.[16] NTA separates minority rights issues from territory through the personality principle, while addressing two major issues of national minorities in general: cultural self-government appears as a measure against assimilation, and the issue of minority representation and participation in public matters of the State.[17] Political representation and participation in public life are considered fundamental rights of minorities, also constituting an important measurement in the State monitoring system of the Framework Convention for the Protection of National Minorities (FCNM) of the Council of Europe. Ensuring the right to self-government is considered one of the most efficient ways of representation and participation.[18] Thus, by getting minorities involved in structures that ensure collaboration with the State—in this case the NTA institutions—the level of minorities' integration in public life is improved. In the present context of the European Union, where the limits of State sovereignty have become somewhat fluid, minority claims for autonomy should not be viewed as a security issue or challenge to State sovereignty. This is because these claims have mainly to do with establishing better institutions for representation and control over cultural, social, and economic development.[19]

14 Stroschein, 2015, p. 27.
15 Kymlicka, 2008, p. 19.
16 Stroschein, 2015, p. 28.
17 Smith, 2014, p. 17.
18 Art. 15 Framework Convention on the Protection of National Minorities; Para. 35 OSCE Copenhagen Document, Lund Recommendations.
19 Vizi, 2015, p. 38.

Seeking to better manage the situation of national minorities, countries in East-Central Europe have implemented different forms of NTA. This model is becoming quite popular, particularly with States where national minorities live spread out on their territory and as a complementary institution for TA arrangements, which is usually ideal for minorities living in compact communities.[20]

3. Non-territorial autonomy in international law

The minority rights regime of the League of Nations, based on collective rights, has not been continued within the human rights regime of the United Nations, which is based on individual rights. However, the discussion around autonomy found its place in the existing regime, as more soft law instruments hint at collective rights for minorities and recommend the implementation of autonomy as a minority rights solution.

The International Covenant on Civil and Political Rights states in Article 27 that persons belonging to minorities should be granted the right to enjoy their own culture in community with other members of their group. In addition, the UN Declaration on the Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities provides in Article 3 the right of minorities to exercise their rights in a community. Although not expressly mentioning autonomy, these documents do open the floor to collective solutions for granting minority rights.

Article 3 of the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) provides for the right to self-determination of indigenous peoples by virtue of which they can freely determine their political status and pursue their economic, social, and cultural development. In exercising these rights, Article 4 of UNDRIP provides that indigenous peoples have the right to autonomy or self-governance in matters relating to their internal and local affairs. The legal literature notes that an increasing number of minority groups redefine themselves as indigenous peoples to obtain more rights, going beyond claims of cultural autonomy.[21]

Numerous international documents recommend NTA as a particularly good solution for ensuring the effective participation of national minorities in public life. Although these are just a set of recommendations, the implementation of any type of autonomy arrangement being an exclusive State right, the soft law instruments of international law should be considered in a modern and democratic State. Some of these documents are presented below.

The Advisory Committee on the FCNM Commentary on the effective participation of persons belonging to national minorities in cultural, social, and economic life and in public affairs states that beyond the representation and participation of persons belonging to national minorities in elected bodies, public administration, judiciary,

20 Smith, 2014, pp. 19–20.
21 Marinkás, 2018, p. 31.

and law-enforcement agencies, attention should be given to cultural autonomy arrangements that can reinforce minority participation in public affairs.[22]

Several other documents are also tied to the Council of Europe, such as Recommendation no. 1609/2003, the draft European Charter of Regional Self-Government, and Thematic commentaries no. 3 and 4 of the Advisory Committee on the Framework Convention for the Protection of National Minorities. These contain recommendations regarding the implementation of cultural autonomy.

Furthermore, several documents of the Organization for Security and Co-operation in Europe (OSCE) and recommendations of the High Commissioner on National Minorities deal with the protection of minority and identity rights. Among these, the Lund Recommendations must be mentioned because of its recommendation concerning the use of TA and NTA, or a combination of the two to ensure minority participation and regulate minority education, culture, language rights, religion, and other factors important in the identity of national minorities.

In the European Union, minorities are mentioned in the Copenhagen accession criteria of 1993, where their protection seems tied to the abovementioned OSCE recommendations, FCNM, and European Charter for Regional or Minority Languages, even though the European Union itself does not have a mandate regarding minority rights. However, the Treaty of Lisbon has introduced the respect of the rights of persons belonging to minorities as a fundamental value of the European Union.

4. Autonomy in Romania

The word autonomy is not foreign to Romanian legislation. After the 1989 toppling of the communist regime, the concept was used in all laws concerned with the country's administrative organisation. However, this concept of autonomy does not embody a minority rights arrangement, but is a principle establishing the right and effective ability of local public administration authorities to manage and solve public matters in the name and interest of a local community.[23] This definition is based on the provisions of Article 3 of the European Charter of Local Self-Government.

Noteworthy is that during the communist regime in Romania, the so-called Autonomous Hungarian Region (later called the Mureș-Autonomous Hungarian Region) had existed for almost two decades. Of course, this TA cannot be deemed a genuine arrangement for the participation of minorities in public life, as it was a structure within a communist State with soviet roots and hardly accepted by the Romanian communist leadership.[24]

22 Paragraph 72 of Document ACFC/31DOC(2008)001, available at: https://rm.coe.int/16800bc7e8 (Accessed 06.07.2020).

23 As per the provisions of Art. 1 para. (3) of Law no. 69/1991 regarding local public administration, Art. 3 para. (1) of Law no. 215/2001 on local public administration, Art. 5 letter j) of the Administrative Code (Emergency Government Ordinance no. 57/2019).

24 Andreescu, 2001, p. 206.

Even though the concept of *autonomy* is not strange to the Romanian legal system, the claims of the Hungarian minority in Romania (numbering approximately 1,2 million individuals, constituting about 6% of the total population) are treated as a national security issue and refused immediately. The legal literature notes that the feelings of aversion towards such claims in this area of Europe have to do with the concept of the *nation state,* which even though conceived and developed in Western Europe in the 17–19th centuries but mostly relinquished after World War II through regionalisation and decentralisation, remains a defining factor in East-Central Europe.[25] Public discussions around autonomy rehash old stereotypes of the interwar period that autonomy translates to *state within a state*, the loss of sovereignty, loss of control, and ultimately the unravelling of the State itself. Thus, most public discussions, media reports, and majority opinions concerning autonomy claims paint the picture of a Hungarian community lead by enemies of the State. Neither the concept of autonomy nor the sources of the claims seeking such arrangements are understood by the public, even though in the last three decades there have been multiple attempts at generating genuine public debate around the subject. Regarding the sources of these claims, the legal situation in the interwar period is worthy of examination, a time in which international treaties resulted in extensive legal and political debate around the subject of cultural autonomy.

■ *4.1. The interwar period*

At the end of World War I, in an attempt to avoid conflicts generated by the treatment of national minorities, special legal regimes were imposed on newly formed or enlarged countries through international treaties regarding the rights of minorities, as briefly mentioned above.

The Treaty concerning the protection of minorities in Romania was signed on 9 December 1919.[26] It provided for the recognition of some of its provisions as fundamental law so that no other legal instruments would contradict or oppose it and no other legal instruments or administrative actions would have priority over it (Art. 1 of the Treaty). Regarding the subject herein discussed, Article 11 of the Treaty is important because through this, Romania assumed an obligation to grant the Szekler and Saxon communities in Transylvania local autonomy in matters of religion and education. The legal literature at that time observed that this provision constitutes an undertaking through which the State obliged itself to grant at least cultural autonomy,[27] while other opinions suggested it was a foundation for the granting of collective rights.[28]

Politicians, as representatives of minority communities, made multiple attempts at the time to introduce collective rights and cultural autonomy into Romanian legislation, but without success.[29] Even though Romania signed and ratified the Treaty, its

25 Kovács, 2012, pp. 1–4.
26 Published in the Romanian Official Gazette no. 140 of 26 September 1920.
27 Mikó, 1934, p. 5.
28 Gaftoescu, 1939, p. 116.
29 For details regarding these attempts see: Ciobanu, 2010, pp. 179–190; Zahorán, 2010, pp. 191–211.

application was not considered and structures establishing cultural autonomy were never actually founded. The non-application of the Treaty was also enforced by the legal system and given doctrinal support by legal professionals. The Constitution of 1923 did not even mention the Treaty or provide for a status of national minorities, and neither did the 1938 Constitution. Furthermore, regarding the application of the Treaty, by acquiring the right to analyse the constitutionality of laws, the Court of Cassation and Justice continuously noted that international treaties have the power of ordinary laws, meaning they can be modified by other ordinary laws.[30] Article 1 of both Constitutions provided that the Romanian Kingdom was a nation-State, unitary and indivisible. The proponent of the 1923 Constitution interpreted the term *unitary* as excluding any possibility for local autonomies, condemning any sense of regionalism, stating that it might constitute a 'State crime'.[31] Even though representatives of the Hungarian and other minorities tried to petition the League of Nations regarding these issues, their attempts were ultimately unsuccessful.[32]

■ *4.2. The communist period*

The communists came to power in Romania after World War II. Although the soviet-style reorganisation of the country resulted in the establishment of the aforementioned Hungarian Autonomous Region, cultural autonomy did not seem compatible with the soviet system. The name of this Autonomous Region, containing the word Hungarian, is certainly misleading at first glance, seemingly establishing TA on ethnic foundations even though it was moot. Nevertheless, this did not sit well with Romania's communist leadership, which began to manifest its nationalism as it was gradually increasing the intensity of the façade of independence from the Soviet Union.

This national communist regime ended the Autonomous Region and began a cultural revolution with disastrous consequences for minorities. The regime became increasingly oppressive towards minorities, automatically considered enemies of a highly paranoid State, violating every aspect of their identity and fundamental rights such as the restriction of education rights (e.g. the merger of the Hungarian language Bolyai University with the Romanian language Babeș University, which negatively affected Hungarian language higher education), and massively curtailing cultural and religious expression.

■ *4.3. Post-communist Romania*

While autonomy has remained one of the political desires of the biggest national minority group in Europe—the Hungarians living in Romania—legislative projects never passed through the Romanian legislative, even after the national communist regime

30 As per Decision no. 84 of 13 October 1938, and other similar earlier decisions, *cited by* Nagy, 1944, pp. 52–53.

31 Dissescu, G. Speech at the National Constituent Gathering (*Adunările Naționale Constituante*), *Proiectul Constituțiunii*, p. 41 *as cited by* Nagy, 1944, p. 64, note 14.

32 For a short enumeration of these petitions, see Gaftoescu, 1939, pp. 108–109.

was toppled. The 'new' political class was made up of many former *apparatchik*, who used the nationalist card to strengthen their position. This resulted in an anti-minority and anti-Hungarian sentiment, which still constitutes the basis for refusing the claims for autonomy of the Hungarian minority. A result of these political views is a highly restrictive interpretation of the post-communist Romanian Constitution, which is not compatible with autonomy (in whichever form). Symbolism and stereotypes of the interwar period emerged, viewing autonomy as an assault on the territorial integrity of the Romanian State to its essence as a nation State and unitary State.[33]

Although it seemed like international pressure was not fruitful, much hope was placed on external pressures. However, during the talks for Romania's accession to the Council of Europe and OSCE at a conference in 1992, the Romanian Minister of Foreign Affairs stated that OSCE was focusing too much on the rights of minorities and not enough on minorities' obligations to respect the territorial unity of and loyalty towards the State.[34] This was a turning back to the interwar period when minorities had to demonstrate their loyalty towards the State. Still, the Parliamentary Assembly of the Council of Europe in its Opinion 176 (1993) took notice of the written declaration of the Romanian authorities in which they commit themselves to basing their policies regarding the protection of minorities on the principles laid down in Recommendation 1201 (1993), and prescribes monitoring the honouring of these commitments. The question of monitoring Romania's commitments regarding the minority regime prescribed by the Recommendation was reiterated in Order 508 (1995) of the Parliamentary Assembly. Recommendation 1201 contains provisions regarding collective rights and alludes to autonomy as a solution for ensuring minority rights: 'In the regions where they are in a majority the persons belonging to a national minority shall have the right to have at their disposal appropriate local or autonomous authorities or to have a special status, matching the specific historical and territorial situation and in accordance with the domestic legislation of the state'.

Hungary also stepped in as it attempted to broker a deal between Romania and the Hungarian community living on its territory with the occasion of the accession of Romania to the North Atlantic Treaty Organization (NATO) and the European Union. However, these negotiations were also unfruitful. Hungary was not even able to negotiate the inclusion of autonomy among the obligations to Romania through the bilateral treaty between Romania and Hungary, a precondition of NATO membership. The Treaty of understanding, cooperation, and good neighbourliness, signed in 1996, also refers to Recommendation 1201, but with the clarification—at the request of Romania—that it does not refer to collective rights and does not impose on the parties the obligation of granting TA on an ethnic basis.[35]

It was observed that because no international treaties impose an obligation on sovereign States to grant autonomy, whether territorial or non-territorial, such

33 Turda, 2001, pp. 199–200.
34 Decker, 2007, p. 440.
35 Salat, 2014, p. 133.

international intervention is usually exceptional and as such, appears as solutions imposed by the powerful on situations of prolonged conflict and violence (e.g. the Dayton Accords in Bosnia and Herzegovina, Good Friday Agreement in Northern Ireland, 2005 Iraqi Constitution granting limited autonomy to Kurdistan). Luckily, there have been no violent conflicts of such magnitude between the Romanians and Hungarians; however, this also means that international intervention seeking to impose autonomy is not considered possible.[36]

With opportunities for internationally negotiating autonomy excluded, the representation of these claims now seems to be exclusively in the hands of the political representation of the Hungarian community in Romania, resulting in at least 16 legislative projects, some of which include NTA in some form.[37] However, these proposals could hardly have found place in a legal regime and State policy that completely exclude collective rights, as shown above. The exclusion of admitting collective rights has recently been reiterated in the Comments of the Government of Romania on the Fourth Opinion of the Advisory Committee on the implementation of the Framework Convention for the Protection of National Minorities by Romania [GVT/COM/IV(2018)001] paragraph 3, where the Government re-emphasised that its minority protection regime 'revolves around the *right of the individual*' and that '[t]he Romanian Government rejects any inference or recommendation that would oblige it to grant collective rights to national minorities…'. Emphasising the degree to which collective rights are unacceptable, the Comments also state '[a]s a disclaimer, the Government of Romania emphasizes that references in these Comments to "national minorities/ minorities" cannot in any circumstance be considered as an implied recognition by the Romanian authorities of the collective dimension of the rights pertaining to persons belonging to national minorities'.

This policy is also reflected in the Constitutional regime of the State. Regarding the right to identity contained in Art. 6 of the 1991 Romanian Constitution (revised in 2003), the State recognises and guarantees the right of *persons* belonging to national minorities to the preservation, development, and expression of their ethnic, cultural, linguistic, and religious identity. This provision limits cultural rights to the individual without providing for the possibility of collectively exercising these rights. The collective exercise of these rights, in case they comprise essential forms of self-determination (political, cultural, etc.), could result in autonomy.[38] Paragraph 2 of Article 6 provides that protection measures taken by the Romanian State for the preservation, development, and expression of identity of persons belonging to national minorities shall conform to the principles of equality and non-discrimination in relation to other Romanian citizens. This provision would allow for a restrictive interpretation in the sense that the supplementary rights necessary for the adequate protection of minorities could be deemed unconstitutional. In this context, granting supplementary rights to

36 Salat, 2014, p. 132.

37 For details concerning these proposals and the controversies surrounding them, see Salat, 2014.

38 Brunner, Küpper, 2002, p. 19 *cited by* Vizi, 2014, p. 28.

accomplish adequate minority protection is widely acknowledged in the legal doctrine, and it is the essence of minority protection to grant something more than 'equality'.[39]

The Romanian Constitution also contains provisions regarding religious autonomy (Art. 29), which provides that the State supports religious cults and for the organisation of denominational (religious) schools (Art. 32). Furthermore, the Constitution establishes the right of minorities to study and be educated in their mother tongue. There is also legislation regarding the use of mother tongue in public administration, and several other legal instruments that contain special provisions for minorities. Even though there is legislation in place with provisions that seem to afford special attention to the needs of minorities, the application of these legal provisions is inconsistent. Inconsistencies are due to the unwillingness of authorities to apply the law, which lands some cases in court, resulting in inconsistent jurisprudence. Such is the example of Cluj-Napoca/Kolozsvár, where civil society actors successfully sued the administration of the city in 2016 to ensure the application of the law on public administration (Law no. 215/2001) enacted in 2001. This Law provided extensive language rights for minorities constituting more than 20% of the local population. (This was the case of the Hungarian minority in Cluj-Napoca according to the 1992 census, which constituted the official headcount in accordance with the law.) However, as the complete application of this law did not occur even after the lawsuit had been won, in 2019 when the law was replaced, it resulted in a loss of rights for the local Hungarian community numbering around 50.000 members. Note that this all happened under the watch of the political representation of the local Hungarian community, which did not address the issue in any way.

The principles in accordance with which minority rights provisions should be interpreted are not always clear to authorities or the courts. A mix of international conventions, constitutional principles, and legal provisions containing minority rights, between which the hierarchy is not clear enough, usually leads to the ad-hoc establishment of a hierarchy of leading principles on a case-by-case basis. However, the fact that the legislation concerning minorities is spread out in many different legal instruments constitutes a major issue because of the difficulties in accessing them by persons belonging to minorities. The complications caused by the legal provisions being spread out in many legal instruments is sometimes also a problem for researchers and professionals. This constitutes an issue of access to law and results in a lack of awareness of rights by the average citizen belonging to a minority. Furthermore, the exact content of minority rights on which these citizens can rely becomes hazy.

The minority rights policies of the post-communist period have been described as 'two steps forward, one step back',[40] although in the last decade hardly any steps have been taken forward. One could easily argue that the steps forward in the last decade have been formal with inapplicable legal provisions. Such is the case of legal provisions adopted in 2017 requiring healthcare and social care institutions to employ persons speaking minority languages when the number of persons belonging to a

39 Humphrey, 1973, p. 81.
40 Decker, 2007, p. 438.

minority in a municipality totalled more than 20% or more than 5,000 individuals to ensure their language use rights.[41] However, this legal provision has not been applied because the government has not implemented rules, which have yet to be adopted. Thus, it appears a step forward only because it adds to a multitude of legal provisions on which minorities cannot really rely.[42] The adoption of the Administrative Code[43] in 2019 constituted a major step back for the second-largest Hungarian community living in Romania in Cluj-Napoca/Kolozsvár. These examples were briefly described to ensure the reader understands that the discontent is not without cause. A detailed analysis of the abovementioned issues might constitute the topic of a future paper. For the purposes of the present paper, the main draft proposal containing NTA is examined in slightly more detail in the next sections.

5. Legislative proposals

In the last three decades, a number of legislative proposals have been drafted promoting TA and NTA, some of which have also been submitted to the Romanian Parliament.[44] During the negotiations between the political representatives of the Hungarian minority (the only one to my knowledge that systematically manifested claims for self-organisation through autonomy) and those of the majority regarding any form of autonomy, representatives of the Hungarian community were systematically accused of intending to create a *state within a state*.[45]

In recent political communication, the emphasis still seems to be on TA;[46] however, the attempts of these political organisations or clandestine attempts of individuals do not seem serious enough. Political representatives' insistence on the Hungarian minority for TA and mostly nothing more seems counter-productive, as the representatives of the majority do not seem to accept any type of territorial re-organisation based on ethnic criteria. This has been made clear by the political representation of the majority and all political parties. There is as yet no political

41 Law no. 95/2006 regarding reform in healthcare, republished in Official Gazette of Romania no. 652/2015.

42 Kiss, Toró, Székely, 2018, p. 117.

43 Published in Official Gazette of Romania no. 555 of 5 July.

44 Some of the legislative proposals have been analysed in Bognár, 2006, pp. 85–117 and Bakk, 2004, pp. 39–60.

45 This also happened at the Atlanta negotiations in the USA in 1995, which took place at the invitation of the Project for Ethnic Relations. Telling eyewitness accounts of these talks are contained in Andreescu, 2001, p. 159.

46 The latest attempt in this sense was in 2020, when the Statute of the Szekler Autonomy accidentally passed the Chamber of Deputies of the Romanian Parliament, but was subsequently swiftly repealed by the Senate. The occasion to publicly engage in anti-Hungarian rhetoric had not been missed by politicians. Even the President of Romania, whose office is apolitical and who has the constitutional duty to mediate, chose to engage in partisan political discourse, alienating the Hungarian community, a part of Romanian society.

party in Romania—except the parties of the Hungarian minority—that supports TA for minorities.

The situation seems different for NTA, which unlike TA, has thus far not been emphatically refused. In addition, while TA understandably touches a nerve with the majority mainly because of its territorial nature, NTA should be an easier sell because of its lack of pronounced territorialism. However, this has not been the case. There are two noteworthy legislative projects containing NTA: one is the project drafted in 2005 by the Democratic Alliance of Hungarians in Romania (DAHR) regarding the statute of national minorities, which contains provisions aimed at guaranteeing NTA. The other was drafted in 2004 by the Hungarian People's Party of Transylvania and is called the Legal framework for personal autonomy of national minorities. We briefly consider the 2005 draft proposal of the DAHR in the following section, however belated it seems, because it is the only project close to being adopted by the Romanian Parliament. We also compare its provisions to the NTAs in the region.

The draft legislative proposal[47] was submitted to Parliament in 2005 based on the provisions of Article 73 paragraph (3) letter r) of the Romanian Constitution, which states that the law on the statute of national minorities shall be regulated by *organic law*. All other organic laws regulating the fields prescribed by the mentioned article in the Constitution have already been adopted, except for the statute of national minorities. For the purposes of the current research, only the provisions regarding NTA are explored.

The section on NTA of the draft law begins with the statement that the State recognises and guarantees the cultural autonomy of national minorities (Art. 56). The draft proposal of the DAHR wishes to establish cultural autonomy on the Estonian model, because the DAHR wanted to avoid conflict and refusal, which would have resulted from submitting a proposal consisting of autonomy with territorial elements.[48] However, this does not seem to be an issue nowadays when discussion surrounding NTA has simply vanished. Chapter V of the proposal contains a definition of cultural autonomy, stating that the concept signifies the capacity of a national minority community to gain decision-making competences regarding issues relating to cultural, linguistic, and religious identity through national councils elected by its members.

Although there are similarities between the provisions contained in the draft proposal and the legislation in other States with NTA arrangements, there are also large differences, as shown below. Certainly, political disagreements concerning the project doomed it from the start; however, analysing some of its provisions may provide insight into the intentions of those who proposed the law. Regarding the politics behind it, the opposition party at the time (in 2005), the Social Democrats, did not support the proposal and neither did the governing coalition in its entirety. Criticism also stemmed from other national minority organisations, who feared that the provisions ensuring that every person may freely declare one's own identity might lead to the emergence of

47 For details regarding the drafting of the project, see: Varga, 2010, pp. 395–410.
48 Decker, 2007, p. 443.

'new minorities' and that the functioning of the special registries would be thwarted by the phenomenon of ethno-business.[49] Issues of constitutionality also arose, with some authors arguing that the election of the leadership of national councils was incompatible with the Constitution.[50] Interestingly, issues of constitutionality did not arise in the opinion of the Legislative Council (the specialised advisory body of the Romanian Parliament charged with approving legislative proposals).[51] Political hype had been created around the project several times after it was first submitted to Parliament, although the lack of understanding of the institutions contained in it did not enable serious discussion and the implementation of NTA.[52]

All legislative projects concerning autonomy have been rejected in Parliament, while serious public debate around this issue is non-existent. The content and meaning of the notion of autonomy appear to be unclear both in minority communities and to the majority, mostly because of the political interests the term has served.[53] It has been observed that autonomy in Romania has become present as a goal in itself and not as a means for the political parties of the Hungarian community to improve its situation. This is demonstrated by the discourse attached to it, which is lacking in coherence and detail, and omits the essentials.[54] Social scientists contend that the lack of results in the 'fight for autonomy' in the last three decades has brought about a degradation of this subject to the level of electoral propaganda.[55] The struggle for TA is ceaseless, but without results, while NTA is not even on the agenda of minority representatives even though it would have a greater chance of acceptance by the majority. Comparative legal research of some provisions of the draft proposal has been included in this paper to assess its functionality and better grasp the intentions of the DAHR regarding this proposal.

■ *5.1. Comparative analysis of the 2005 draft proposal*

NTA is not interpreted in the same manner in all countries and its implementation does not produce the same results in each State. The Romanian draft law, although seemingly a 'classic' NTA regulation similar to what we see in other countries in the region, is actually specifically tailored to the existing political powers. As mentioned, the draft law is modelled on Estonian law, which might not be the best model in the region.[56]

The analysis shows that much is lacking in the draft law in comparison to the legal regimes adopted in other States in the region.

49 Decker, 2007, p. 445.
50 Decker, 2007, pp. 446–447.
51 Approval (aviz, in Romanian) no. 575/23.05.2005. http://www.cdep.ro/proiecte/2005/500/00/2/cl502.pdf (Accessed 06.07.2020).
52 Pepine, 2010.
53 Salat, 2014, pp. 124–125.
54 Bognár, 2006, pp. 110–111.
55 Kiss, Toró, Székely, 2018, p. 138.
56 The reports of the Advisory Council on the Framework Convention for the protection of national minorities even suggested drafting a new law. The Third Opinion on Estonia, ACFC/OP/III(2011)004, para. 61.

Many factors can influence the outcome when applying legal provisions establishing NTA. An important factor in the implementation of cultural autonomy is that it favours communities with a high level of socio-political cohesion.[57] Another important factor is the rules prescribed for financing NTA structures, which lacking consistent provisions for mandatory State financing, exposes these institutions to ad-hoc financing and the 'good will' of governments. More generally, when a law establishing NTA does not contain enough details regarding the extent of the power-sharing arrangement between State and NTA institutions, its functions can easily be restricted to a minimum, leaving NTA at the behest of State institutions. It is easy to observe that the Romanian draft law is poorly worded, in that it does not attempt a genuine reform of the minority rights regime. Rather, it seeks to introduce a new institution into an existing framework of minority representation without much actual change. The intention of the DAHR to maintain its status within the Hungarian community appears obvious, as in accordance with the law, the national council is formed by the organisations of national minorities and some of the provisions seem to consolidate the position of existing organisations.

■ *5.2. Establishing institutions*

The draft proposal defines cultural autonomy as the capacity of national minority communities to have decision-making powers regarding cultural, linguistic, and religious matters through the councils elected by its members [Art. 57 para. (1)]. The establishment of the councils of national minorities is provided in the regulation of other States as well, constituting the basis of exercising the right to cultural autonomy. In accordance with the personality principle, legal provisions on NTA provide that persons who wish to adhere formally to a national minority group can do so by registering in an electoral registry. The number of persons registered must ensure the representativeness of the particular minority in correlation with the number of individuals belonging to that minority. Sometimes, this number is settled as a percentage of the number of those who identified with a particular minority during the census. However, this is not the rule. In Serbia, the proportion for representativeness is 40% (Art. 29 of the Serbian law), while the Estonian law from the interwar period mandated that at least half of the people belonging to the same ethnic group should be on the registry to be able to vote for their own cultural council. The new law in Estonia adopted in 1993 does not provide such a threshold, and neither does the law in Hungary. The draft law provides that the national council is to be established by the organisations of national minorities, the members of which must constitute at least 10% of citizens who declared themselves as belonging to a particular national minority in the latest census, and that a person may only be a member of one minority organisation at a time. The minority organisations thusly formed shall have the right to establish a National Council of Cultural Autonomy through internal elections. However, important is that in case the minority

57 Smith and Hiden, 2012, p. 82.

organisation decides not to constitute such a council, the law allows it to exercise most of the prerogatives reserved for national councils.

Regarding representativeness, Article 73 of the draft law sets an advantage for organisations of national minorities that have obtained a parliamentary mandate (which in Romania means crossing the 5% electoral threshold), prescribing that such parties shall be considered representative. According to the law, in case a minority group does not cross the electoral threshold to obtain parliamentary representation, the organisation that obtained the most votes shall be considered representative of the particular national minority group. Thus, minority organisations running in an election usually get one seat in the Chamber of Deputies (the lower house of the Romanian Parliament) to ensure parliamentary representation for minorities. However, according to Article 62 paragraph (2) of the Romanian Constitution, only one minority organisation may represent a particular minority. The draft law obviously puts its initiators at a great advantage, the DAHR being the only national minority organisation that ever passed the 5% electoral threshold in the last 3 decades. Although this is a merit of the DAHR, it is also a situation of a lack of choice and is perceptibly maintained by the initiator of the draft law.

The draft law establishes that after the formation of the national council, internal elections shall be held. No other details are specified in the law, and it is left up to the minority organisations how these are to be organised. Regarding the rules governing the national council, the draft proposal leaves it to the organisation itself to establish its own internal rules and regulations. The proposal only provides for the number of representatives in the national council, which is correlated with the number of persons belonging to a particular national minority and determined in accordance with the census and not with the number of those registered in a special registry. In this regard, a more detailed regulation is found in Serbia and Hungary, where the support needed for proposing candidates and the number of representatives who can be elected is clearly provided for by law. The Serbian law provides that candidates can come from organisations of national minorities (political parties or NGOs) and groups of citizens belonging to a specific national minority with the condition that 1% of those in the special electoral registry supports such a candidate. The Serbian system also provides for a special system of electors in case 40% of the members of a minority do not register for elections but the minority group still wishes to form a council. In Hungary, persons with the general right to vote who are registered in a particular registry have the right to vote for representatives in the minority council, and candidates must be proposed by 5% (or at least five persons) of the persons on the registry.

It seems that the Romanian draft law proposes the formation of one central representative organ for minorities, a unitary system, as in Serbia and Estonia, without any mention of smaller organisational forms. For example, the Russian system provides for three levels of organisation: local, regional, and federal. The Hungarian system also has more levels of organisation: the municipality level (townships, cities, the Capital), county level, and national level.

According to the draft proposal, only persons who are citizens are able to register with the organisations of national minorities to form national councils. This is similar to the situation in Estonia, Serbia, and Russia. There are also examples such as the law in Hungary (or interwar Latvia) where non-citizen permanent residents also have the right to vote on national councils.

Another important aspect relates to the fact that exhaustive lists are introduced of minorities recognised by the State as those having a right to establish NTA institutions. Article 74 of the draft law in Romania enumerates 20 such minorities, while the Hungarian law contains 12. The Serbian and Russian laws do not provide these exhaustive lists. Estonian law leaves the system open to all minority groups numbering more than 3,000 individuals to establish their own institutions for cultural self-governance, and enumerates some of the minorities with this right.

■ *5.3. The powers of the national council*

The Romanian draft law limits the powers of national councils to issues concerning culture, language, and religion. Nevertheless, these fields are generally provided for in the regulation of other countries as well with local specifics that can be considered.

The draft proposal states that national councils will have the right to organise, manage, and control educational, cultural, and media institutions; to draft strategies and priorities for education and the protection of cultural heritage; the right to be consulted regarding questions of representativeness among the staff managing institutions that serve national minorities; to establish scholarships, as well as cultural and scientific awards; and to impose special taxes on its members. In the next part, these powers are examined through a comparative law lens.

The draft law provides the power to organise, manage, and inspect educational and cultural institutions, or to participate in such activities with other public authorities. Interesting is that the drafters of this proposal did not provide for the right to *establish* such institutions, as it appears in Serbian, Hungarian, Russian, or Estonian law. Oddly, the right to establish educational institutions is provided to the organisations of national minorities and religious cults, but not to the national council as per Article 16 paragraph (2) and (3) of the draft proposal.

Councils have the right to establish and manage public media institutions or take part in such activities with other public authorities. The draft law upholds the right to participate in the drafting of strategies concerning the protection of cultural heritage. Regarding private educational and cultural institutions belonging to minorities, the council shall be the one to appoint their leaders, while in appointing leaders of similar but public institutions, the State authority shall seek the approval of the minority council.

Note that legislation in many other States provides even more powers to national councils. For example, the Romanian draft law lacks provisions regarding the right of councils to legislative initiatives in questions concerning minorities or establishment of further institutions such as companies and foundations meant to serve minorities.

These are all provided for by the law in Serbia or Hungary. Even the Russian law contains provisions regarding the representation of the interests of national minorities through NTA institutions in relation with legislative and executive powers, and with local authorities. This shows that the institution of national councils has not been thought over thoroughly regarding the potential powers such an institution should be given.

The Hungarian law provides for the obligation of authorities to hand over institutions if NTA structures ask it whenever the institution serves a particular minority at a rate of 75%. There is also a provision in the Serbian law related to the transfer of so-called founders' rights over some cultural, educational, or media institutions towards national councils of minorities. No such provisions exist in the draft proposal.

Regarding internal powers, the Romanian draft law only specifies that national councils shall establish their own internal rules and regulations, without any mandatory provisions. It would be important to establish what the law allows regarding issues such as the use of symbols of minorities and other details that might conflict with other laws. Lacking clarity in the sharing of prerogatives might lead to issues in the application of the law and to conflicts with other laws.

The execution of the decisions of national minority councils would be ensured by the institutional structures of the council itself or by the competent public authorities, as per Article 57 paragraph (2). However, as shown above, if the sharing of prerogatives is not clearly provided for, national councils may find themselves isolated by unwilling public authorities, having to go to court every time the execution of council decisions is refused. The lack of precise provisions would lead to difficulty in the application of the law.

The Romanian draft law does not provide for the right to use minorities' languages as an official language, and does not contain the right to propose such a thing. However, Serbian law expressly provides for this.

In addition, regarding the issue of access to law, which was mentioned earlier regarding the mosaic of minority rights and legal provisions in Romania, the publication of important pieces of legislation in the language of minorities with assistance from the minority institutions should be included, similar to Serbian law. This will enhance legal awareness among minorities, and contribute to developing the minority language, especially regarding legal and technical terms.

As shown above, the draft law seems to need more work, as the cultural autonomy institutions formed under such a law by the organisations of national minorities would be established only formally because their establishment does not actually widen representativeness and does not offer a genuine chance for participation by persons belonging to national minorities. Rather, it extends to a certain extent the *hegemony* of the existing organisations of national minorities. Most important, from a functionality viewpoint, more specific rights, prerogatives, and obligations should be established regarding the minority council and State institutions that will be in contact with such bodies.

■ *5.4. Financing*

Similar to the previous section, the regulation concerning the financing of national councils and their activities is poorly detailed. It is essential for the NTA to work and receive sufficient material support from the State to improve the situation of national minorities. A lack of accurately drafted legal provisions in this sense may result in weak institutions.

The Romanian draft law provides that minority educational institutions may be established by the organisations of national minorities, and that such institutions *may* receive State aid from the state or local budget. This financing situation is similar in Russia, where the law does not provide for mandatory financing, resulting in many minority councils not receiving financing. In some systems, the lack of clear financial backing from the State combined with the organisational specifics of cultural autonomy institutions (limited activities, broad government oversight, bureaucracy) has resulted in simple non-governmental organisations being considered more advantageous for minority self-organisation than the NTA institutions allegedly designed to benefit minorities.[58] Financing is also an issue in Estonia, where similarly, the law does not provide for mandatory government financing. Thus, it is up to the government to decide how much financing should be granted, if any. Some believe this hampers the functional existence of cultural autonomy. [59] In effect, in Estonia, only the Swedish and Ingrian Finnish minority have formed cultural autonomy institutions, while the Russian minority did not manage to organise itself and now have to organise their education through NGOs.[60] Furthermore, not even established cultural autonomy institutions seem functional (like in the case of the Ingrian Finns) because cultural autonomy institutions do not differ much from NGOs, especially from a financing viewpoint.[61] In Serbia, not only is State financing mandatory, but the national councils can make suggestions on the allocation thereof to ensure the funds are put to better use. The same law provides that not more than 50% of the budget of national councils can be spent on current expenses such as rent, utilities, equipment, and staff.

Thus, financing seems to be one of the main and most important parts of NTA legislation, determining the functionality of the institution.

6. Conclusions

The Romanian draft law remained a draft and was never put in practice. The causes of this are manifold, but mainly political. After exploring the contents of the draft proposal, it can be said that an updated proposal would establish a genuine NTA and better suit the minorities living in Romania.

58 Barbieri, 2014, pp. 218–219.
59 Yupsanis, 2016, p. 123.
60 Smith and Hiden, 2012, p. 112.
61 Smith, 2014, p. 312.

The experience of other legal systems is noteworthy and should be considered in more detail when drafting a new proposal. The complexity of NTA brings with it new questions regarding minority rights. While this constitutes a step forward, it is by no means a panacea for the issues of minorities. Even though the Romanian Constitution and current political establishment do not favour granting collective rights, consistent and genuine communication from minority representatives could change that. Collective rights may be part of a well-drafted statute of national minorities prescribed by the Romanian Constitution as a legal instrument to be adopted by organic law. The purpose of such a law should be to establish self-regulating institutional structures suitable for the conservation of the identity of minorities and to ensure their political participation. Such participation should nevertheless be diverse and not reserved for a single organisation.

The understanding of NTA is essential to obtaining it. The term should be clarified both to minorities and the majority without unnecessary political discourse attached to it. Because this type of arrangement grants rights to individuals belonging to national minorities, it seems best suited for a system based on individual rights. While the idea of regulating NTA through the statute of national minorities seems good, it is puzzling that a modern law in this sense is lacking and the old law treated as if it did not exist. The political representatives of minorities seem lost in the labyrinth of legal provisions. 'Details' such as which legal provisions are in force must be carefully observed so that they can be fully used for the benefit of minority communities. It is not outlandish to state that minority organisations should be more focused on understanding the legal regime they are working in. Either way, the old statute on national minorities, Law no. 86/1945, seems applicable and should be employed lacking a more modern legal regime.

As no serious legislative proposals have been submitted to public debate and the term *autonomy* is still misunderstood and viewed negatively by the majority, the first step towards improving the situation and obtaining NTA should be taken by minority representatives, especially those of the Hungarian minority as the most numerous and vociferous in this regard currently. Nevertheless, such political clairvoyance seems lacking within the political representation of the Hungarian community.

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HERBERT KÜPPER[1]

Expert Opinions on Foreign Law in Court: Applied Comparative Law in the Munich Institute for East European Law

ABSTRACT: *Comparative law has many facets. It often consists of basic research for academic purposes, but it may have a practical side as well. A genuine combination of basic and applied comparative legal research are expert opinions on foreign law for a domestic court. The expert researcher has to fully comprehend the foreign law on the books as well as in action, and has to be able to translate this foreign law into the legal background of the domestic court and into the procedural setting of the law-suit at hand. Taking the 'Munich Institute for East European Law' as an example, this essay describes the continuous basic research as a prerequisite for expertise on foreign law, as well as the practice of writing expert opinions for courts of law and authorities with regard to the law of the formerly socialist countries in Europe.*

KEYWORDS: basic comparative research, applied comparative research, expert opinions on foreign law, country expert system vs. field of law expert system, Ostrecht, Munich Institute for East European law, Max Planck Institutes on foreign and comparative law.

A lawyer specialising in comparative law is often challenged by the more domestic colleagues about the justification of this work or at least of its public funding. Naturally, there are ample reasons to compare laws. First, there is of course the fact that science in its pure form is free of any instrumental sense: to increase human knowledge is justification in itself. More mundane reasons for comparative law include that the study of foreign law deepens the understanding for one's own law, that the study of foreign legal solutions may yield inspiration for the development of one's own law, that political and economic decision-makers as well as the domestic legal profession may wish to have knowledge on the law of a partner (or, as the case may be, competitor or enemy)

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https://doi.org/10.47078/2020.1.111-130

country.[2] However, a hard-boiled domestic lawyer will hardly be convinced by these reasons because they remain in the realm of academic studies.

However, comparative law may serve very practical purposes, sufficiently practical to convince even our hard-boiled domestic lawyer. Every country in the world has political, economic and other relations with the outside world. As a consequence, the domestic legal system comes into contact with foreign law, and questions arise which can only be answered with a precision sufficient for practical needs if both parties possess knowledge about the other legal system. This is especially true in the continent of Europe where countries are small, the next state border is nearby, and national economies have never been autarkic but have always complemented each other, where the European Union integrates economies on a supranational level and where one of the centres of the globalisation lies. Today, it is not unusual that the London branch of a German company buys goods in Papua New Guinea and has them shipped to a factory in Spain or China, or that a Serbian company with Hungarian owners sells services to a Singapore-based branch of the Norwegian state fund. A French national residing in Monaco may hire a car in the Czech Republic and suffer an accident in Poland from a car insured in Denmark. And not to forget the human factor: A child of a Liechtenstein and a Luxemburg nationals may find himself in trouble in Moldova and addresses the local Hungarian embassy because neither Liechtenstein nor Luxemburg maintain a diplomatic representation in Chişinău; at the same time, his parents file a divorce in Jersey. What appears like text-book constellations is real life in Europe's integrating legal space. If and when disputes arise in such human or business contacts, they usually concern more than one legal system. Here, comparative law finds a practical application.

In this paper I describe the structure and the work of the Munich Institute for East European Law[3] as a German research institution for comparative law specialising in the legal systems of the formerly socialist countries in Eastern Europe.

1. From the interwar period through the Cold War to the present day: What is, and why do we have, 'Ostrecht'?[4]

Research on the legal systems in the Eastern half of our continent has always been a forte of the German science of comparative law. The first comprehensive description of Russian law in German language, including a translation of the central corpus of law, dates back to 1722. Until WWI, research on Eastern Europe's legal systems was not systematic but incidental. This changed after 1918. The demise of the Ottoman, the Tsarist and the Habsburg empires had created a wide variety of new states east of the lands of Swedish, German and Italian language, and the Soviet Union was building a very new political, social, economic and legal system. Research on this region required

2 On the raison d'être of comparative law cf. Kischel, 2015, pp. 47–91.

3 Institut für Ostrecht München; for more information see www.ostrecht.eu.

special knowledge of 'exotic' languages, of history, culture etc, in the case of the Soviet Union of its official ideology as well. If was felt in Germany that such knowledge was necessary because of the proximity of that region. At the same time, it was obvious that such a specialised knowledge needs to be concentrated and nursed in a specialised institution. For this reason, 1920 the 'Osteuropa Institut' (Institute on Eastern Europe) was founded in Breslau as an extra-universitarian, interdisciplinary research institution on the region from Finland in the north to Greece in the South and from Yugoslavia and Czechoslovakia in the West to the Soviet Union in the East. In 1922, this institute founded a department for legal studies.

Quite from the beginning, the research on Eastern Europe's legal systems was called 'Ostrecht'. Literally, this means 'Eastern law' but in German it is quite clear that this does not mean the entire East but Eastern Europe. When the term 'Ostrecht' was coined in the early 1920s it did not intend to insinuate that so diverse legal systems as Estonia, Bulgaria, Hungary, the Free City of Danzig, or the Soviet Union had anything in common. It was merely a pragmatic term to denote legal studies on countries east of the German (and Swedish and Italian) speaking lands. In this sense, the journal 'Ostrecht' (founded in 1925, closed in 1934 because the publishers were not considered 'Aryans') used this term, too. During the nazi time, the Institute on Eastern Europe, including its legal studies department, continued its work on a reduced scale and without any intellectual ambitions, and it stopped functioning towards the end of the war.

In 1957, the last director of the legal studies department of the Institute on Eastern Europe, Reinhard Maurach, managed to re-found studies on East European law as a separate extra-universitarian research institute: the 'Institut für Ostrecht München' was born. Naturally, in those days it was a child of the Cold War and contributed to the research on the ideological enemy through the lens of the law. In the light of the Cold War, the meaning of 'Eastern Europe' narrowed down to the socialist countries, the 'Eastern Bloc'. This was reflected in the meaning of 'Ostrecht': non-socialist countries such as Finland and Greece stopped being an object of 'Ostrecht' research. Instead, 'Eastern European studies' in general and 'Ostrecht' in particular dealt with the entirety of the socialist world, including East and South East Asia and, eventually, Cuba, which is, seen from Germany, unequivocally in the West. Therefore, 'Ostrecht' ceased to be a pragmatic term based on geography, and became a political term instead. Studying the law of the socialist countries no more meant comparative research with the traditional methodology but meant, inter alia due to the ideological character of the socialist law, 'system studies'. 'Ostrecht' abandoned its academic roots in comparative law and became a part of the overarching '[anti-]communist' studies. One effect of this change was that it became customary to analyse all (or at least a larger number of) socialist countries. Where 'Ostrecht' had been, in the period during the wars, a collection of various country studies, it adopted a more overarching regional perspective during the Cold War.

During the Cold War, the work of the 'Institut für Ostrecht' in Munich was not limited to theoretical, academic studies. The institute gave its expertise to

decision-makers in politics and the economy. Whenever a West German court had to apply the law of a socialist state, the institute wrote the expert opinion. Due to the limited and highly politicised economic contacts between East and West the cases where socialist law had to be applied were not too frequent. In numerically highest demand was Yugoslav law because of the large number of Yugoslav citizens living and working in Germany: They usually did not adopt German citizenship, and as a consequence their family and succession cases were to be handled according to Yugoslav law including the laws of the various federal states and provinces of Yugoslavia.

The end of the socialist world and thus of the Cold War put a question mark to the entire Western research infrastructure on Eastern Europe. Suddenly, Eastern Europe was no longer the enemy, and public funding could no longer be justified with the competition between the systems in East and West. As a result, a considerable amount of the research infrastructure on Eastern Europe was closed down, including several university institutes on East European law.

The Munich Institute for East European law, not belonging to a university but to the Federal Ministry of Justice, could prove the justification of its existence partly with the excellence of its research and partly with the practical significance of its work. In this institute there were specialists who knew the languages and the countries, who had the time and the capacity to follow all the quick changes in the politics and the law of the post-socialist transition, and who quite often had personal contacts in the formerly socialist countries. This was a valuable asset to political and economic decision-makers as well as for the courts where the number of cases with an East European element grew.

As a result, the Munich Institute for East European Law survived the reorganisation of the research infrastructure on Eastern Europe. Nowadays its raison d'être as well as its work resemble more the interwar period than the era of the Cold War. The de-ideologization of the law in the Eastern European countries opened the avenue for the 'Ostrecht' to return to the classical comparative law and its methods. The formerly socialist countries are no longer forced into one bloc but have become sovereign states that decide freely about their respective legal development. As a result, less and less common factors unite the legal systems of, e.g., Latvia, Slovenia, Romania, Armenia, and Mongolia. The universal bloc perspective of the Cold War 'Ostrecht' has atomized again into the study of Russian, Ukrainian, Belarusian, Hungarian, Polish, Montenegrin, Albanian, Turkmen, or Tajik law.

This gives rise to the question whether we need today an 'Ostrecht' with its separate institutions. The answer is the same as during the interwar period: a pragmatic 'yes'. The languages of Eastern Europe – even Russian – are not commonly known in Germany. German pupils, when they leave school, know more about the history of France than of Bohemia, despite the fact that the Czech lands were an integral part of the German Empire for many centuries. Therefore, research on Eastern Europe requires specialist knowledge, and specialist knowledge can flourish grow if fostered in specialised institutions. Furthermore, in Germany there is the political will to have

knowledge on Eastern Europe, due to the geographic vicinity, political and economic interests, as well as historical and cultural links. This is why a certain research infrastructure on Eastern Europe is maintained, and this is why the Federal Ministry of Justice decided to continue to fund the Munich Institute for East European Law.

The term 'Ostrecht' has changed as well. It has turned from the political-systemic expression it was during the Cold War back into a pragmatic, geography-based word. It no longer denotes the idea that the various countries of research have much in common. The common factor is the geographic position east of Germany, not more. Therefore, in German it is not a contradiction in terms to accept countries like Hungary, the Czech Republic, Slovakia, Poland or Slovenia as part of Central Europe and, at the same time, naming the legal research on these countries 'Ostrecht'.

2. The Munich Institute for East European Law

■ *2.1. Institutional and structural aspects*

As was mentioned before, the Munich Institute of East European Law is an extra-universitarian research institution funded by the Federal Ministry of Justice. According to German tradition, the federal state of its seat, Bavaria, stands a certain portion of its budget.[5] Its legal form is an association in private law which for federal reasons is the common legal frame for German research institutions in the public sphere. In order to guarantee an interdisciplinary framework, the Institute for East European Law, together with other research institutions on Eastern Europe, maintains as a forum for co-operation the Research Centre for Eastern and South Eastern Europe in Regensburg.[6]

The Institute for East European Law is organised in country departments.[7] Since law exists by the state and in states, organising comparative legal research in country departments makes sense. The advantage of the country department is that every researcher can concentrate on one or two language(s) and culture(s), can concentrate on one or two legal systems and therefore has the chance to oversee the foreign legal system in its entirety. This specialisation allows them to establish extensive

5 Since the re-unification it has become common in Germany that federal scientific institutions in the Western states are co-financed by up to 50% by the state of its seat, whereas federal scientific institutions in the Eastern states often haven an exclusive federal financing. The Munich Institute for East European Law receives, for historical reasons, a quota of 25% from Bavaria, and the federal financing amounts to 75%.

6 More information on this research centre is available on its web site: http://www.wios-regensburg.de.

7 The country departments are: Belarusian law; Bosnian law; Bulgarian law; Croatian law; Czech law; Hungarian law; Kosovar law; Moldovan law; Montenegrinian law; North Macedonian law; Polish law; Romanian law; Serbian law; Slovakian law; Slovenian law; Russian law; Ukrainian law; law of the other CIS countries. From among the East European countries this leaves only Albania, Estonia, Latvia, and Lithuania without a country department; for the research on the law of these states the Institute fosters co-operations with external researchers.

professional networks in their area of research. Since the researchers of the Institute for East European Law are country experts, they do not specialise in one or two fields of law but deal with all fields of law of "their" country/countries. The only exception is tax law: this field of law follows its own, very special rules and therefore requires specialised legal and methodological expertise, and tax legislation practically everywhere in Eastern Europe is extremely volatile so that reliable research is only possible on the spot, but not from abroad. For these reasons tax law is not an object of regular comparative research in the Institute for East European Law.

This country expert system has, next to the advantages mentioned before, some disadvantages, too. The researchers risk being isolated in the research of "their" individual country/countries and work parallelly, but not together with the other country experts. This isolation has the danger that common traits of several or all East European countries are easily ignored. This danger is minimised by the academic director who oversees global trends in the legal developments of Eastern Europe, and by regular work meetings where the entire research staff assembles to discuss actual as well as structural questions, problems and observations.

With its country expert system, the Institute for East European Law follows an organisational pattern opposed to that of the Max Planck institutes that conduct comparative research only for one field of law each. There are different Max Planck institutes for foreign civil, public, criminal, labour, social and intellectual property law as well as for legal history. The Max Planck institutes have specialists for the various fields of law who are not, in turn, specialists for one or two countries. On the other hand, the country specialists of Institute for East European Law may lack their Max Planck colleagues' in-depth structural knowledge in the chosen field of law, instead they are in the position to adopt a holistic perspective of the entire legal system of the country or countries they specialise on. Both systems have their advantages and disadvantages, and in their combination the Max Planck institutes and the Munich Institute for East European Law neutralise each other's weak spots.

The academic staff of the Institute for East European Law comprises six lawyers. These six researchers serve all country departments with the exception of Bulgaria which is dealt with by an external researcher. Most researchers specialise on more than one country, usually kin countries: Russia, Ukraine, Belarus and CIS are in the hands of one colleague, so are the Czech Republic and Slovakia, Romania and Moldova, and the Yugoslav successor states minus Kosovo. All full-time researchers are fully trained German lawyers. This is important especially when writing expert opinions for German courts or authorities: A German lawyer knows the professional background of German judges and administrative staff and can therefore explain the foreign law in a way they understand. Apart from their German legal training, the researchers have profound knowledge of the language(s) and the culture(s) of "their" country or countries, and of course they get to know the law of that country/countries very well.

■ *2.2. The work of the Munich Institute for East European Law: a combination of basic and of applied research*

What does the research work in the Institute for East European Law look like? How do the researchers fulfil their duties? Comparative law studies in the Institute for East European law are a unique combination of basic research and applied research.

The first step of all research is to monitor the legal development. For this purpose, the researchers study the official gazettes of the East European countries – nowadays in electronical form – in order to ascertain new laws and changes in the normative acts. They also study the court practice and the legal literature from and about their countries. Apart from the German and international journals on East European and on comparative law, the institute holds a wide variety of legal journals from Eastern Europe. Just to give an impression: from Hungary, there are in paper (in alphabetical order)[8]: Aarms, Acta Humana, Acta Juridica Hungarica, Állam- és Jogtudomány, Annales Universitatis Scientiarum Budapestinensis de Rolando Eötvös Nominatæ. Sectio Iuridica, ELTE Law Journal, Gazdaság és Jog, Jogesetek Magyarázata, Jogtudományi Közlöny, Jura, Közbeszerzési Szemle, Közjogi Szemle, Magyar Jog, Magyar Kereskedelmi Jogi Évkönyv, Parlamenti Szemle, Polgári Jogi Kodifikáció, Pro Futuro, Pro Publico Bono, Új Magyar Közigazgatás and, from now on, Central European Journal of Comparative Law; more journals are accessible online. The study of Magyar Közlöny, Kúriai Döntések and these journals provide a fairly comprehensive overview of the situation of Hungarian law. In the other country departments, the situation is similar.

The next step is to document the most important aspects of the legal development. The researchers of the Institute for East European Law write monthly chronicles, ordered according to the fields of law, about the most important normative acts and court decisions. These chronicles are published in a monthly journal edited in the institute: 'Wirtschaft und Recht in Osteuropa'. These two steps – monitoring the legal development and documenting it – guarantee that each researcher has an up-to-date overview over the legal system of the researched country or countries.

Apart from the monthly 'Wirtschaft und Recht in Osteuropa' (WiRO), the institute edits the annual journal 'Jahrbuch für Ostrecht' (JOR) as well as a book series titled 'Studien des Instituts für Ostrecht München'. Further research activities encompass the translation of East European normative acts, individual or all-institute research projects, the publication of research results in journals, books and other media, contributions to the German loose-leaf collections on foreign law, advice to decision-makers in the political[9] and economic sphere, fostering international contacts and exchange

8 Some of these journals have ceased to exist. The institute possesses the old volumes.

9 Just one small example: During the time when Hungary did not have a Ministry of the Interior, Germany hosted an EU meeting of the ministers of the interior. From Hungary, the invitation was confirmed by the Minister for Justice and Public Order. The German Federal Ministry of the Interior called the Munich Institute for East European Law inquiring why Hungary did not send the 'proper' minister to that meeting.

and, last but not least, writing expert opinions for courts and authorities as well as for law firms, companies and other private clients.[10]

Most of the translations of East European laws and other normative acts are published in a four-volume loose-leaf collection edited by the institute: 'Handbuch Wirtschaft und Recht in Osteuropa'.[11] This handbook contains both descriptions of the central fields of civil and economic law and translations of the most important economy-related normative acts. The form of a loose-leaf edition was chosen because it makes it easy to update translated normative texts. The handbook is designed to help the German legal and business practice, but serves as a tool for academic studies as well.

The Institute of East European Law as well as its individual researchers participate in research projects sometimes of a purely legal and sometimes of an interdisciplinary nature. Two examples: In 2016/17, the Hungarian Constitutional Court and the Hungarian Kúria jointly invited research on the relationship between supreme courts and constitutional courts. The author of this paper, who is the managing director as well as the institute's country expert on Hungarian law, together with a Hungarian colleague, successfully applied with an interdisciplinary project: the comparison of that relationship in selected Central European countries.[12] Every year, the Deutsche Akademische Austauschdienst (German Academic Exchange Service) sponsors a German-Ukrainian-Kazakh seminar organised by the Institute of East European Law and the University of Regensburg together with the Centre for German Law of the Taras Shevchenko University Kyiv, the National University of Kazakhstan and more Ukrainian universities. The subjects alternate annually between direct democracy and administrative judicial protection, subject-matters of high actuality in all three countries. Advanced students and doctoral students from Germany, Ukraine and Kazakhstan meet in spring and in autumn, present their papers on selected aspects of the subject-matter of the seminar, hear presentations by professors and practitioners – in 2019, e.g., the President of the Hungarian Kúria described the first experiences with Hungary's new Administrative Litigation Code – and, finally, draft a model law for direct democracy resp. administrative litigation.

In Germany there are extensive loose-leaf editions, covering all countries of the world, on the fields of law where foreign law is generally often applied or where the knowledge of foreign law is important: citizenship law, family law, law of succession, civic status and registration. These collections are written for practical use in courts, public authorities and law firms and usually contain both the translations of

10 The expert opinions for the legal practice are dealt with in detail infra, chapter 3.

11 More information is available at: https://www.ostrecht.de/publikationen/wiro-handbuch.html and https://www.beck-shop.de/handbuch-wirtschaft-recht-osteuropa-wiro/product/381.

12 Attila Vincze, Herbert Küpper (with the participation of Lukas Diem and Claudia Fuchs): *Az Alkotmánybíróság és a felsőbíróságok kapcsolata. Konfliktusok és kooperáció jogösszehasonlító szempontból*, handed in in 2017. Later, an extended version was published in German language: see Küpper and Vincze, 2018.

the pertinent foreign laws and explanatory texts. The researchers of the Institute for East European Law update "their" countries in these collections.

Teaching is not the primary focus of the Institute for East European Law because it is not a university institute. However, most researchers assume teaching obligations either at German universities where they teach the law of "their" respective country or countries, or at universities in "their" countries. The author of this paper, e.g., regularly teaches at the Andrássy University Budapest, as well as at the doctoral school of the Law Faculty in Pécs and the training of Hungarian-German / German-Hungarian legal translators in Szeged. Here again, the country expert system shows an advantage. In academic contacts with the hyper-centralised countries of Eastern Europe, the first addressees usually are the institutions based in the respective capital city. A specialised country expert, however, has the chance to establish contacts with institutions beyond the capital. In my case, I teach in Pécs and Szeged, and I keep close contact with the faculties in Miskolc and Debrecen as well as with judges, attorneys etc based all over the country. This is of particular importance because Hungary consists of more than Budapest.

Apart from university teaching, the institute operates as a training institution in the practical legal education, accepting trainees who are interested in comparative law. And the institute serves as a receiving organisation for foreign guest researchers. The institute's extensive library on Eastern European laws attracts researchers even from Eastern Europe itself who want to conduct comparative research on more than one Eastern European state.

3. Expert opinions on foreign law as applied comparative law[13]

One of the institute's core activities, apart from the basic research and its documentation in monthly chronicles, are expert opinions for German courts and authorities. This task is the reason why the institute belongs to the Federal Ministry of Justice and not to the Federal Ministry of Science. Quite often, courts and authorities from other countries than Germany seek the institute's legal expertise because their countries do not possess a similar research institution. Most foreign requests come from Austria, followed by Switzerland, the Netherlands, and the Scandinavian states. International clients for the institute's expertise were i.a. the International Criminal Tribunal for the former Yugoslavia and the international military troops in Bosnia-Herzegovina.

■ *3.1. The legal basis of an expert opinion on foreign law*

Germany does not have the centralised court expert system that Hungary has. On the contrary, the German court expert system is just as decentralised as most aspects of

13 Küpper, 2004, p. 32.

public life in this country.[14] If a German court needs external expertise – be it on foreign law, on medical causation, on the psychological situation of an accused, on the market value of a property, or on the interpretation of accident traces on a car wreck, just to name some examples – it will search for such an expert. For certain fields of expertise, including foreign law, there are unofficial lists. No court is compelled to choose an expert from that list, but is free to choose whoever it wants. In private and economic cases, the court will seek the consent of the parties first, whereas the parties' approval of the prospective expert is less important in criminal and administrative cases.

In general, courts that need an expert opinion on foreign law will address the university institutes for the collision of laws and comparative law.[15] Most law faculties have such an institute. These institutes, however, usually employ experts on Western European and North American legal systems. Furthermore, there are one or two chairs for Turkish, Islamic, or Japanese law. For East European law, there are two university institutes left (in Cologne and Kiel; and there is a chair for law at the interdisciplinary Institute for East European Studies at the Free University of Berlin), but they have little staff and cannot provide legal expertise on all East European countries. Therefore, in cases involving e.g. Russian, Polish, Hungarian, Croatian, or Bulgarian law, the court or authority will request an expert opinion from the Munich Institute for East European Law. For reasons of procedural law, the request for an opinion is not addressed to the institute as such but to the concrete researcher. The nomination of the expert for a case needs to address a natural person who is then obliged to give the opinion in persona.

The legal basis for the introduction of external expertise in a court procedure is decentralised again. There is no law on court experts or on expert opinions for all courts, but each branch of the judicial system has its own procedural act[16] with more or less explicit rules on the nomination of an external expert and their rights and duties. If an expert is employed in an administrative procedure, the legal basis is the specific law applied in that procedure or, if that law does not contain any pertinent rules, the general administrative procedure act. The most detailed rules on external expertise can be found in the Civil Procedure Code and the Criminal Procedure Code.

In a German court (or administrative) procedure, foreign law is an object of evidence, i.e. the expert and the expert opinion are 'means of proof', like witnesses, a confession or objects of evidence. There is no established rule whether foreign law

14 On centralisation and decentralisation as the typical traits of the Hungarian resp. the German legal culture see Küpper, 2016, pp. 131–141. On the centralised Hungarian system of court experts see most recently Kúria, Joggyakorlat-elemző csoport: A szakértői bizonyítás a bírósági eljárásban: Összefoglaló vélemény, 12.2.2015, http://www.kuria-birosag.hu/sites/default/files/joggyak/osszefoglalo_velemeny_2.pdf; Bányai, 2020, pp. 120–122.; Bartal, 2018, pp. 321–326.; Cséffai, 2019, pp. 80–87.; Nogel, 2018, pp. 162–168.

15 The charters of the Max Planck institutes for foreign laws expressly state that expert opinions on foreign law (except on request of the government) are not a task of these institutes.

16 There are separate codes of procedure for civil, criminal, administrative, labour, social, and financial courts, for the Federal Court of Patents, for the Federal Constitutional Court, one each for the constitutional courts of the 16 federal states, as well as for the various disciplinary and similar courts.

and the evidence concerning it are a question of law or a question of fact. The German courts seem to adopt a pragmatic stance and treat it sometimes as fact and sometimes as law.[17] The wrong interpretation or application of foreign law may be a reason for appeal, but legal practice is not uniform and takes a rather pragmatic approach.[18]

■ *3.2. Statistical overview of the practice of the Institute for East European Law*

Expert opinions on foreign law are most frequent in civil (including economic) cases. This is true for expert opinions on East European law as well. Every year the Munich Institute for East European law delivers between 80 and 120 formal expert opinions. This number does not include the frequent informal inquiries which, by virtue of their size or their role in the procedure, do not require a formal opinion but are answered through informal information. Some 70–80 percent of the formal expert opinions concern civil and economic cases. The exact content differs from country to country.

With respect to the EU member states, the most frequent constellation are traffic accidents. EU law allows EU residents to sue the insurance of the other party of a traffic accident at their place of residence even if the accident happened in another EU state. This plaintiff-centred forum does not alter the applicable law: In these cases, the law of the place of the accident is to be applied. So, if a German resident suffers a traffic accident in Hungary, (s)he may sue in Germany, but the German court will have to apply Hungarian law. In about a third of the Hungarian road accident cases, the plaintiff is a German resident but a Kosovar or a Turkish citizen, usually on their way to or from visits to family in the former homeland. And in quite a few cases the defendant is not Hungarian, but the insurer of a Polish, Slovakian or Czech lorry. In the practice of the Institute for East European law there are court cases where a plaintiff German resident of Kosovar citizenship – or, if we do not accept Kosovo as an independent country, of Serbian citizenship – suffered on Hungarian territory a road accident caused by the Slovakian driver of a lorry insured in Poland – a classical text-book case for the collisions of law.

In this context we must not forget, however, that the inclusion of an external expert on foreign law does not question the principle of 'iura novit curia'. This means that the expert will only describe the foreign law, whereas the domestic German law – including the German law of collisions and the pertinent EU law – remains within the realm of the German court. In practice, however, a sizeable proportion of judges try to "smuggle" questions on the German law of collisions into the questions to the expert, hoping that the expert on foreign law knows the German law of collisions better than the German court does. There are two possible ways to react to this. First, the expert on foreign law may formally protest and refute the parts of the questions relating to German (including EU) law. Second, the expert on foreign law may ignore the inadmissible questions on German law and concentrate on the foreign law. The Institute for East European Law usually chooses the second way in order not to undermine the

17 Baumbach, Lauterbach, Albers and Hartmann, 2016, p. 1337.
18 Baumbach, Lauterbach, Albers and Hartmann, 2016, p. 1929.

court's authority with a formal protest. Only when the attorney of one of the parties keeps insisting that the expert should include into the answer the questions on the law of collisions, the researchers of the institute protest formally.

Another large group of cases concern family law. Most family law cases are related to the law of the Yugoslav successor states or to Polish law. Many ex-Yugoslav and Polish citizens live in Germany. When they file a divorce or argue about maintenance or the right to see their children, the law of their citizenship is applicable. Germany is home to many emigrants from Hungary as well, but usually at least one of the Hungarian spouses holds German citizenship, too, and this opens the avenue to the applicability of the German autonomous law. For this reason, there is no need to apply Hungarian law in most 'Hungarian' family law cases.

In Hungarian law, a large group of cases relates to dentist liability; about half of these cases are heard by German and the other half by Austrian courts. In the department for Czech law, a large group is liability cases for plastic surgery. In both cases, the reason is obvious. Other frequent fields of law are real property, contracts, and company law. In the latter group, there is a certain 'standard case' of an Eastern European company active on the German market; when a law-suit arises and the East European company fears to lose it, it often protests that it does not exist at all as a legal person because allegedly there has been a major mistake in its foundation process: as a non-entity, it purports that it cannot participate in the court procedure. The question whether a company founded and registered in, e.g., the Czech Republic, Hungary, or Poland, naturally is a question of Czech, Hungarian, or Polish law, and this is where the expertise of the Institute for East European Law comes in.

A large number of business-related cases with respect to Russian law encompasses questions of customs law and customs criminal law, legal regulations very popular among Russian authorities for blackmailing foreign investors, and of the non-enforceability of Russian court decisions against the Russian state within Russia. Trade mark disputes, too, are typical for Russian law. The background is that the Russian state wishes to re-nationalise the old Soviet trademarks that were privatised in the 1990s, often to Western investors. Within Russia itself the Russian state can capture these trademarks without having to observe Russian (or any other) law, but on the world markets Russia can assert its claim only if non-Russian courts accept that. For this purpose, Russia usually argues that the privatisation process violated the Soviet or Russian law of the time. This gives rise to court orders for expert opinions on Soviet and Russian privatisation law of the late 1980s and early 1990s. The cases where the Munich Institute for East European Law gave expert opinions include the trademarks for vodka brands 'Stolichnaya' and 'Moskovskaya' as well as the cartoon figure 'Cheburashka'.[19] Most of the law suits on ex-Soviet trade marks are conducted before Austrian courts.

Expert opinions on foreign criminal law are ordered comparatively rarely because the law of collisions does not envisage the application of foreign law by criminal

19 In a similar case concerning Polish law, the Institute for East European Law delivered an opinion in a trade mark dispute about 'Lolek and Bolek' pending before a German court.

courts. Yet, in some criminal cases questions of foreign law may play an auxiliary role. If the criminal act was committed outside Germany, the question of punishableness under German law may depend from whether that act is a criminal offense also in the country where is was committed. In 2019 a criminal court requested an expert opinion on Ukrainian sexual criminal law: on a bus from Kyiv to Germany, one passenger had sexually molested the young woman sitting next to him while the bus was still on Ukrainian territory; he was arrested and charged when the bus reached its destination in Germany. In this constellation, the German court has power to punish the act only if it is punishable under Ukrainian law as well, and also for the sentence the provisions of the Ukrainian law are of relevance. Another typical question in criminal law is the exact meaning of a foreign previous conviction and of the pertinent criminal records. For no known or obvious reason, the majority of these questions concern Czech law.

Probably the second largest group after road traffic accidents are pension cases. These usually start before the pension authority and involve the subsequent procedure before the social court as well. Under German law, ethnic Germans who move into Germany from certain East European countries (former Soviet Union, Poland, Czech Republic, Slovakia, Romania and, in certain constellations, the former Yugoslavia) may have their East European pension biography acknowledged for a pension under German rules. This requires the translation of an East European, usually socialist working biography into the categories of the German pension law. It is obvious that this difficult task is prone to give rise to innumerable debates: What was the exact status of a tractor driver in the 1970s in the Kyrgyz SSR – and does it make a difference if (s)he worked on a sovkhoz or a kolkhoz? Was the village secretary in a small settlement in the Carpathian mountains in the early 1980s 'close to the regime', which would disqualify him/her from the pension privileges under German law? Do or do not count as pensionable income the fees for the trade union which in socialist Czechoslovakia were deducted directly from the worker's income and transferred to the trade union? Another aspect of immigration from the former Soviet Union is the question whether certain Russian pensions or property in the former Soviet Union may be, has to be or must not be deducted from the German social aid. In the case of a Hungarian receiving German social aid the institute had to describe the legal nature of the Hungarian 'indemnification pension'.[20] Pension-related questions form the bulk of expert opinions in administrative procedures.

A more recent field for administrative bodies to request expert opinions on East European law about is immigration. Under EU law, asylum seekers can only be sent back to another EU country if the asylum procedure there meets European standards. Quite often, asylum seekers in Germany claim that they cannot be sent back to Hungary, Croatia, Bulgaria or Romania (or, outside the scope of the Institute for East European Law, to Greece). In such a situation, the asylum authority or, more often, the administrative court seeks confirmation about the EU-conformity of the asylum

20 The expert opinion is published in *Jahrbuch für Ostrecht* 2013/2, pp. 435–438.

law of the given country and requests an expert opinion. Here again, the principle of 'curia novit iura' prevails which means that the expert opinion will describe the foreign law. Whether it complies with EU law is a question for the court (or the authority) to answer because EU law is part of the domestic law and as such can be neither an object nor a yardstick in expert opinions on foreign law. In 2015 the German administrative courts started to select test cases in which they asked for an expert opinion, published the expert opinions in the data bases on asylum law, and have used the opinions and their assessments in the numerous subsequent cases. This way, they save the tax payer many costly expert opinions. The expert opinion on Hungarian law was requested by the Administrative Court of Düsseldorf in 2015. In its judgement the court came to the conclusion that in certain – though rather exotic – constellations the Hungarian law did not award the asylum seeker a hearing to the extent required by EU law. In recent years, the pertinent case-law of the European Court of Human Rights on the post-2015 asylum law of many states has become an important source of information for asylum authorities and administrative courts in Germany. This and the results of the test cases have led to a situation where the requests for expert opinions on asylum law have dropped to zero.

■ *3.3. How is an expert opinion on foreign law written?*

In the usual course of things, a court (or an authority), when noticing that foreign law is relevant to their case, formulates an order that an expert opinion on the pertinent foreign law is to be requested. This order nominates the prospective expert and formulates the questions to be answered in the opinion. As mentioned before, the court will seek agreement with the parties on the person of the expert in civil and economic, but not necessarily in other cases. An expert who has delivered a private expert opinion to one of the parties is usually barred from being appointed court expert, but if all parties agree such an expert may be appointed.

The appointment needs to be accepted, but acceptance may only be refused on sufficient grounds. With the appointment a contract arises between the court and the expert, and at the same time the expert obtains the status of a participant in the procedure. Consequently, the expert incurs certain duties such as confidentiality and, most important of all, neutrality. The violation of these duties may be sanctioned.

In very rare cases a party may try to obtain a favourable opinion with inadmissible means. During the last three decades, there has been one attempt of bribery in the practice of the Munich Institute of East European Law. One of the parties called the expert on the phone insinuating that they would consider a reward if the expert advocated a certain interpretation of the law in their favour. In such a case, the proper procedure is that the expert notifies the director of the institute; both notify the judge in charge of the case. Since the telephone call was not recorded, there was no proof, and consequently the court could not sanction the party in question. The judge asked the researcher of the institute whether he still felt sufficiently neutral even after the

attempted bribery, and when the expert gave a positive answer the court continued his appointment – happy that it did not have to look for a new expert.

Before making the order to request an expert opinion, the court may inquire with the institute whether the problem in question falls within the scope of the institute's expertise. Such a preliminary information procedure is infrequent, but does happen, usually if the country in question does not "belong" unequivocally to the Institute for East European law[21] of if the required field of law is exotic.

When the court decides to request an expert opinion in a civil case, the order will oblige either the plaintiff or both parties to advance the foreseeable costs as fixed by the court. In a civil case the experts' costs are part of the costs of the procedure which are to be borne by the defeated party. The state does not want to advance the experts' costs in order to avoid having to try and recover them after the end of the procedure. In cases where the state bears the costs of the procedure anyway such as certain criminal, administrative, social, financial, or labour procedures, advancing the costs of the opinion is less important. If the court requests advance payment from one or both parties, it will go to the next step only after the full amount will have been paid.

The usual nest step is that the court sends, together with the order, the entire case file – German courts[22] usually in paper, Austrian courts, which are much more advanced with electronic case files, often in electronic form. The expert first reads the order, and then the file.

The question(s) by the court, as set out in the order, are the core of the entire expert opinion. The adequate wording of the questions may cause problems, the source of which lies in the fact that in Germany, Austria and the other countries that request expert opinions, a foreign element does not constitute a separate competence within the court. For this reason, there are no specialised chambers or judges for cases with an element of foreign law. A case with a foreign element may hit every judge, and most expert opinions are requested by judges who face this problem for the first time in their life. Moreover, neither the university nor the subsequent practical education prepare a judge or an administrative official to formulate a request for an expert opinion on foreign law properly. A reform of court competencies might help. If a foreign element constituted a criterion for competence, every court could form one (or more, as the case may be) specialised chambers, and the judges active in these chambers can specialise

21 Recently a court seeking an expert on Latvian law started such a preliminary inquiry, being aware that the institute did not have a country expert on Latvian law, and being unable to find anybody else in Germany. In this special case the institute could accept the request because the question could be answered on the basis of the Latvian Civil Code of 1937, re-enacted in 1992, which exists in an official German version.

22 Administrative bodies have a somewhat different standard procedure. They keep the files and only send the order and, as the case may be, copies of the most relevant documents. The reason for this different practice is that a court procedure usually is suspended during the work of the expert so that the court can dispense with the file. An administrative authority, on the other hand, often continues its procedure so that it needs the full case file.

in the German law of collisions, the technique of formulating questions and of choosing appropriate experts.

The wording of the question may bear several sources for problems. First, a question may not be exact enough. The task of the expert on foreign law is to describe the applicable law, not to apply it to the case in question, nor to solve the case on the basis of the foreign law. The expert opinion is to provide the knowledge necessary to put the German judge into the position where (s)he can apply the foreign law and solve the case. The more exact a question is, the more exact the answer can be. A very wide question such as "Is the plaintiff's claim justified under the law of ...?" requires a very extensive opinion – the cost of which may be out of proportion with the value of the dispute. On the other hand, the court is often not in the position to formulate a precise question. The facts may be unclear, or a precise question may be possible only in knowledge of the foreign law – a knowledge which the court does not have but wishes to obtain. If a question is too vague or if it, with view to the pertinent foreign law, does not hit the spot, it often helps to clarify open aspects in a direct communication between expert and judge. In most such cases, the judge will give the expert carte blanche. Sometimes, however, the differences between the question in the court order and the question useful to solve the case are so blatant that the court order has to be reworded formally.

The second trap when formulating the question is the domestic law of the court. Many judges solve the case in their head on the basis of their own law. Accordingly, they formulate questions that make sense according to German or Austrian dogmatics. This does not mean, however, that these questions advance the solution of the case in Russian, Bosnian, Moldovan or Slovakian law. In road accident cases many plaintiffs demand immaterial damages. In German law, these claims are based in the law of tort. The new Hungarian Civil Code of 2013, just to name one example, has shifted the legal basis of these claims from tort to personality rights. As a result, a thinking in the categories of tort may not be adequate for formulating the questions proper to solve the case in Hungarian law. More examples: there are strong differences in the details of land registers and company registers between all European states, and these differences may have an impact on the material law. In some countries, statutory prescription is an instrument of material civil law, in other countries of civil procedure law. The German or Austrian judge needs to abstract from the peculiarities of the German or Austrian rules when drafting a question with view to Polish, Lithuanian or Serbian law.

The third source of problems are the facts. It helps enormously when the court gives the facts which are to be the basis of the expert opinion on foreign law. Extracting the relevant facts from the statements of the parties in the case files is not only a cumbersome business but is fraught with ambiguities and the necessity to interpret. If this task is left to the expert on foreign law the risk is high that the expert describes the law for a set of facts different from the facts that the court bases the case upon. Such an opinion is useless. On the other hand, if the court defines the facts that the expert is to take as a basis, one of the parties may easily interpret this as a hostile bias by the

court, and the court risks being rejected. In such a situation, a compromise between the necessary unequivocalness of the facts and the neutrality of the court may be that the courts asks what the applicable foreign law is if one takes for granted the statements of the plaintiff (as summarised by the court) and, separately, the statements of the defendant (again as summarised by the court). This question technique does not work in all cases but in many. It is costly, however, because separate sets of facts need to be analysed, which makes the opinion lengthy and expensive. Especially in cases with strongly disputed facts, however, this double analysis of the plaintiff's statements and the defendant's statements is necessary because only the comparison between the two analyses indicates to the court which facts require proof and which do not.

If the question at hand is sufficiently clear or has been clarified in the communication between the expert and the court, the expert can begin writing the opinion. If the court order does not set the facts that are to be taken as a basis, the first step of the expert is to ascertain the facts by studying the statements of the parties. In this case, the opinion's text will have to describe the facts that the expert took as a basis.

The core activity is to answer the court's questions about the foreign law. Sometimes the questions have to be re-grouped or modified to adapt them to the foreign legal system. In extreme cases, a question has no connection to the solution of the case in the light of the foreign law. In this case it is legitimate for the expert not to answer it because an expert opinion does not describe foreign law as *l'art pour l'art*, or to alter the question to the extent that it contributes to answering all relevant questions of foreign law pertinent to the case at hand.

When describing the foreign law, the expert has a role similar to, but not identical with the judge. It is not the task of the expert opinion to solve the case, but to describe the applicable foreign law to the extent that the German sitting judge is able to apply it to the case. The expert on foreign law must not subsume the facts of the case under the rules of the foreign law but must describe the foreign law in sufficient detail so that the judge can do so. If, for example, the interpretation of a given norm is under debate in its country, the expert must not decide that debate but must describe the pros and cons stipulated in the debate and leave the decision to the judge. This sometimes makes it necessary to describe the foreign law in a somewhat wider scope than only the norms that decide the case. Often, norms form a network of legal institutions or value decisions by the law-maker, and if the sitting judge needs to know about this in order to decide the case correctly, these questions of law adjacent, but not in a strict sense pertinent to the case need to be described as well. A question on a detail of the Hungarian form of the trust ('fiduciary asset management') is hardly answerable without describing the general construction of this legal institution, and this may require even some basic description of the interaction of contract and property in Hungarian law.

The wider scope of description necessary in an expert opinion may include legal facts and a glance at the legal culture of the country. A German or Austrian judge can better develop a proper understanding of Hungarian company law when knowing that

in Hungary a limited liability company or even a joint-stock company is not an unusual form for small businesses.

The expert on foreign law is required to concentrate not so much on the law on the books but on the law in action. The goal is to describe the foreign law under the perspective of how a foreign court would decide the pending case. The ideal of the German law is that the German judge decides the case exactly as a foreign judge would. However, there is a second ideal, too. The German court is to apply the foreign law 'correctly'. This means that the German court is not expected to, and in fact must not imitate foreign corrupt court practices or other 'incorrect' distortions of the applicable law in foreign practice. The German court must apply the foreign law the way a foreign court would if acting 'correctly'.[23] In expert opinions on Hungarian law, this gap between 'real' and 'correct' court practice is not wider than in any other Western European jurisdiction and therefore does not pose a problem. In opinions on Russian law, however, there have been cases where there was reason to give a hint that the pertinent Russian court practice was corrupted by political influence, greed, or other illicit factors.

All this shows that an expert opinion on foreign law is a demanding task. The expert needs to know the law on the books as well as the law in action, needs to spot corrupt practices, and needs to be able to explain the embeddedness of the question at hand in wider legal structures and legal facts. All this has to be described and explained in a way that a German (or Austrian) court with its German (or Austrian) legal thinking can understand it. Last but not least, the opinion must present the foreign law in a way that fits into the precise procedural situation.

The researchers of the Institute for East European Law can do that because they specialise on one or two countries. The continuous basic research which covers the entire legal system (except tax law) provides the researchers with a holistic perspective. This holistic view enables the expert to spot and handle connections between various fields of law. Two examples: in the tort law of many East European countries (and beyond), statutory prescription of claims based on tort is often linked to the statutory prescription in criminal law.[24] The procedures and especially the procedural remedies in business-related administration such as register procedures (land register, company register, lien register etc) or procedures of the competition authorities cannot be properly understood without at least some idea of the general administrative procedure law of the country, despite the fact that all these procedures usually have legal bases separate from the general administrative procedure codes. An expert on civil or business law only may miss these links but the holistic perspective of the country expert can place the rules of foreign law into the context of the overall legal system.

Finally, the institute publishes its expert opinions on questions of general interest in its 'Jahrbuch für Ostrecht'. The average number of opinions thus published is 3 to 4 every year.

23 Baumbach, Lauterbach, Albers and Hartmann, 2016, p. 1337.

24 The pertinent Hungarian rule is § 6:533(1) of the Civil Code.

4. Final remarks

As could be seen, the work of the Institute for East European Law combines basic research and applied research ideally. In fact, the basic research of monitoring the foreign legal system to its full extent is the prerequisite of high standards in the applied research. One of the most demanding forms of applied research certainly is an expert opinion on foreign law for a domestic court. This requires an in-depth understanding of the foreign law on the books and in action, the latter purified from corrupt practices, if necessary, and this understanding of foreign law needs to be translated into the dogmatic categories of the domestic legal thinking of the sitting judge as well as into the procedural situation at hand. Still, it is highly satisfying to be able to contribute to resolve a real-life dispute. Let me finish my paper with a one-liner that the researchers of the Institute for East European Law have coined for their work: "An expert opinion on foreign law has three guaranteed readers: the judge as well as the two parties – which is two more than the average academic paper has."

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Some Current Problems with the Regulation of Limited Liability Companies in Serbia[3]

ABSTRACT: *In Serbia, the legal status of limited liability companies (LLCs; društvo sa ograničenom odgovornošću, d.o.o.) is for the most part regulated by the Companies Act (Zakon o privrednim društvima). All four basic legal forms of company are regulated by this Act. Unlike in Austria and Germany, there are no special laws on LLCs and joint stock companies (JSCs). Regulating all legal forms of a company with the same act, including procedures for their liquidation, status changes (acquisition, merger, division, and spin-off), and changes of legal form, may be considered a conceptual shortcoming of the regulation relating to LLCs and of company law in Serbia in general. A specific law would enable legislators to tailor detailed rules pertaining only to LLCs, in which all peculiarities of this legal form of companies might be better addressed. Furthermore, there are relatively numerous legal norms applicable to JSCs, the appropriate application of which is can be legally extended to LLCs. However, most of them are not conceptually applicable due to the different nature of JSCs and LLCs. In addition, company law will have to undergo significant changes in upcoming years due to the process of accession of Serbia to the European Union and the fulfilment of the conditions contained in chapter 6 of the accession negotiations pertaining to company law.*

KEYWORDS: limited liability company, LLC regulation in Serbia, participation in LLC, share in LLC, liability of members, protection of minority members and company's creditors

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3 This article has been written as the result of the authors' researches within the research project Biomedicine, Protection of Environment and Law (Biomedicina, zaštita životne sredine i pravo) within the Faculty of Law of the University of Novi Sad, supported by the Serbian Ministry of Education and Science (Ministarstvo prosvete i nauke Republike Srbije) under grant number 179079.

https://doi.org/10.47078/2020.1.131-145

1. Introduction

The legal status of limited liability companies (LLCs; *društvo sa ograničenom odgovornošću,* d.o.o.) in Serbia is for the most part regulated by the Companies Act (*Zakon o privrednim društvima*). This Act was enacted in 2011 and has been amended several times since then (the latest amendments are in force as of 1 October 2018).

The Act contains both general and special rules. The general rules pertain to all four basic forms of company (general partnership, limited partnership, limited liability company -hereinafter: LLC, and joint stock company – hereinafter: JSC), while special rules set out legal regimes particular to each form of company, including LLCs.[4] Unlike in Austria and Germany, there are no special statutes pertaining only to LLCs and JSCs, however. Regulation of all legal forms of company is done under the same statutory Act, including procedures for their liquidation, status changes (acquisition, merger, division, and spin-off), and changes of legal form. This appears to be a conceptual shortcoming of company law in Serbia, in particular and simultaneously, of statutory regulation relating to LLCs.

According to the Companies Act, an LLC is a company in which one or more members own shares in the company's share capital without being personally liable for the company's debts except in cases provided in Article 18 of the Act.[5]

An LLC under Serbian law essentially bears the features of a capital company: a minimal mandatory share and minimal mandatory capital are prescribed;[6] the company must have specific bodies; members are not responsible for the obligations of the company except in the case of 'piercing the corporate veil'; it can be established as a unipersonal company;[7] etc. However, it bears certain characteristics of a partnership as well: although the shares are transferable in principle and subject to few restrictions, the membership structure rarely changes over time, the number of members is usually small, etc. According to the Companies Act, an LLC may have one or more members—there is no restriction concerning their number. The members own shares in the share capital of the company; each member may have only one share, expressed as a percentage of the share capital.[8] Consequently, in the case of acquisition of a share by another member, the acquired share is attributed to the member's existing share. A share represents a membership relationship in the company. The members have membership rights (proprietary and management rights), as a rule, in proportion to the percentage value of the shares they own, but also membership obligations correlating to the same percentage value.[9]

4 Special rules on limited liability companies are contained in Arts. 139-244.
5 Companies Act, Art. 139.
6 Companies Act, Art. 114.
7 Companies Act, Art. 139.
8 Companies Act, Art. 151, s. 2.
9 Companies Act, Art. 152, s. 2.

An LLC may, as a rule, conduct any economic activities. However, the performance of certain exceptional activities through an LLC may be excluded by special laws. Such is the case with financial activities—the activities of banks, insurance companies, certain types of investment funds, and certain other financial organizations can be conducted only through a JSC.

2. Mandatory and default rules in the regulation of LLCs

The special rules of the Companies Act pertaining to LLCs are predominantly *default norms,* as members may divert from them in the company's incorporation document. For example, the incorporation document may provide for special rules regarding the exercise of certain management and property rights. It is (e.g.) possible to derogate from the statutory rules setting out that members exercise their voting rights and the right to participate in the distribution of profits and liquidation of surplus in proportion to the percentage value of the shares they own. Instead, in the incorporation document, members may stipulate a different scaling of voting rights or ratio in the distribution of profits or liquidation surplus.[10] In this sense, it is clear that the incorporation document, in addition to the Companies Act, is an important source of company law rules.

Some of these rules are so-called *semi-imperative* norms. In these cases the Companies Act enables members to deviate from statutory rules in the incorporation document, but they can do so only by complying with certain restrictions. For instance, a decision at a members' meeting on share capital reduction, increase of share capital, and profit distribution to members, according to the Act, requires a qualified majority of 2/3 of the total votes of all members of the company,[11] but the Act also allows members to adopt a lesser majority required for a decision on such issues, although not less than a simple majority (50% + 1 vote) of the total votes of all members.[12]

Only a few norms are of a purely *imperative* character. These pertain to the following: members' obligation to pay a pecuniary contribution or to transfer a non-pecuniary contribution into company's assets; to the means of proving that the contribution has been refunded to a member or that he or she has been released from the obligation to pay or transfer the contribution (except in the case of share capital reduction);[13] to protection of creditors in the case of share capital reduction;[14] to the scope of competencies of the company's collective organs/bodies; and to a range of norms applicable to JSCs, the appropriate application of which is extended to LLCs. The purpose of these imperative rules is to strengthen the protection of the company's interests, the interests of company's creditors, and the interests of the minority members.

10 Companies Act, Art. 152, s. 2.
11 Companies Act, Art. 211, s. 2.
12 Companies Act, Art. 211, s. 3.
13 Companies Act, Art. 60, s. 1. and Art. 46, s 3.
14 Companies Act, Art. 147a.

3. Members' shares in LLC as collateral

Members' shares in the LLC may be used as collateral: a share may be an object of a non-possessory pledge according to the Companies Act[15] and the Law on Registered Pledge on Movables. The latter prescribes that the subject of the pledge may be shares and other property rights that their holder can dispose of freely.[16]

A member may, therefore, pledge his share or a part of it, unless it is stipulated otherwise by the incorporation document.[17] If the incorporation document prescribes that the transfer of shares to third parties is subject to the prior consent of the company, such consent is also required for pledging the share or a part of it, but not for a subsequent sale in the process of enforcing the claim from the value of the pledged share.[18]

There is only one restriction in this regard: it is prohibited to pledge a share in an LLC on behalf of the LLC itself.[19] The so-called own share (treasury share), that is, a share in the LLC that the LLC acquired from a member,[20] can also be used as collateral.

4. Transfer of a share between members and to third parties

Two types of transfer of a share are distinguished in the Companies Act: transfer between members and that to a third party. The transfer of a share between members is, in general, subject to no restrictions. Restrictions may be imposed by the incorporation document, but there are none envisaged by the Companies Act.

However, the Companies Act does establish a right of pre-emption on behalf of other members, applicable in the case when a member expresses intention to transfer his share to a third party.[21] The priority of members' pre-emptive rights is proportionate to the ratio between their share and the value of the total capital of the company. This pre-emptive right is judicially enforceable.[22] In exceptional situations when there is a clear interest of the company that a certain member, considering his personal traits and capabilities, remain a member of the company, it is possible to establish in the incorporation document that the transfer of that member's share to a third party is subject to the company's prior approval. The Companies Act contains detailed rules pertaining to this situation.[23]

15 Companies Act, Art. 177.
16 Law on Registered Pledge on Movables, Art. 10, s. 3.
17 Companies Act, Art. 177, s. 1.
18 Companies Act, Art. 177, s. 2.
19 Companies Act, Art. 156.
20 Companies Act, Art. 157.
21 Companies Act, Art. 161.
22 Companies Act, Art. 163.
23 Companies Act, Arts. 167-169.

5. Enforcement of claims of members' personal creditors against shares in the LLC

The personal creditors of members are not also thereby the creditors of the LLC, and hence, the LLC is not liable for any personal debt of the members. However, the members' shares in the LLC may be an object of enforcement of the claims of the members' creditors. In the case of sale of a share in such an enforcement procedure or in a procedure of a court/out-of-court settlement pursuant to the law governing registered pledges on movable assets, (a) members having a pre-emptive right retain it in the enforcement procedure and (b) if the incorporation document requires the consent of the company for any transfer of shares, the company's consent is legally not required, but the company is entitled to designate the purchaser of the share pursuant to Article 168 of the Companies Act.[24]

6. Rules and practice of management responsibility (claims for damages caused to members)

The managing directors of the LLC, members of the supervisory board (in the case of two-tier management systems), appointed agents of the company, authorised signatory/procurator (Ger. *Prokurist*), members with significant (at least 25%) share in the capital, any member in controlling position, and persons linked to the above-mentioned ones, have special duties towards the company—the duty to act with due diligence, avoid conflict of interest, report legal transactions and actions involving personal interest, observe the prohibition of competition, and keep business secrets.[25] Generally, directors and members of the board of directors are obliged to act in accordance with the Act, incorporation document, and decisions taken at members' meetings,

In case of infringement of any of the said duties, the infringing persons may be held liable for damages caused to other members or to the company itself, if the relevant causation between the breach of duties and the occurrence of damage is proved. In such a case, there are two actions at other members' disposal: the so-called *individual or direct action* and the so-called *derivative action*. In addition, breach of special duties in individual cases may be a justifiable reason for the exclusion of a member by a court decision[26] or a ground for termination of the employment contract if the person owing special duties is also employed by the company.

In the case of individual (direct) action, the person entitled to sue (Ger. *Aktivlegitimation*) in the litigation (the plaintiff) may be a member to whom persons owing

24 Companies Act, Art. 171.
25 Companies Act, Arts. 61-76.
26 Companies Act, Art. 196, s. 1.

special duties towards the company have caused damage by their active action or by omission, that is, failing to act. The person capable of being sued (Ger. *Passivlegitimation*), that is, the defendant, is the person in breach of these duties.[27] However, according to the general tort law rules, set out by the Law on Obligations, the defendant may also be the company itself because it bears responsibility for the acts and omissions of its employees, managing directors, or members of company bodies.[28] In case law, individual lawsuits are usually filed on grounds of non-payment or evasion of payment of profits, inaccurate presentation of results of business operations, violation of the pre-emptive right to enter a new contribution in the case of increase of share capital, preventing exercise of voting rights, etc.[29] There are no collective lawsuits in Serbian procedural law; however, in cases when members are directly or indirectly harmed by actions or omissions of persons owing special duties, it is possible to merge proceedings initiated on the basis of multiple individual lawsuits.

If a member cannot prove that he or she has personally suffered damage as a result of acts or omissions of persons owing special duties towards the company, and if the damage is instead caused to the company per se, any member or members owning at least 5% of the total share capital may file a derivative action.[30] Such an action (Lat. *actio pro socio*) is filed in the plaintiff's own name but on behalf of the company. All economic benefits of the action (compensation for damages), if the plaintiff succeeds in his or her claim, are to be transferred/paid directly to the company and not to the plaintiff; this way, the member protects his or her own economic interests, too, although indirectly. On the other hand, a significant limitation is that if a dispute is unsuccessful, that is, the claim is not granted, the costs of the proceedings will be borne by the claimant him- or herself and not by the company, as he or she filed the action in his or her own name.[31]

This legal transplant from the common law legal tradition is contrary to the general rules of Serbian civil procedure. The basic rule of litigation is that the right to sue belongs to the person asserting a claim against the defendant (here, the tortfeasor). The company has been directly damaged by the breach of special duties, while the members have only indirectly suffered damage, in the form of a decrease in the value of their shares due to the damage to the company itself. Considering that the derivative claim, as a legal transplant, is not fully in line with the principles of Serbian civil procedural law, it is not surprising that these types of lawsuits are especially rare in case law. Thus, although derivative claims are a seemingly important instrument against directors or controlling members acting in bad faith, their use by minority members in Serbia has not been widely accepted.[32]

27 Companies Act, Art. 78.
28 Law on Obligations, Art. 172.
29 Arsić and Marjanski, 2018, p. 76.
30 Companies Act, Arts. 79-80.
31 Arsić and Marjanski, 2018, p. 77.
32 Radović, 2019, p. 39.

7. Piercing the corporate veil

The general rule is that the members may not be held liable for the LLC's debts. The exception is envisaged by Art. 18 of the Companies Act, regulating the institution of piercing the corporate veil. Establishing members' liability for company's debts is possible only upon action of the creditor, filed at a competent court. The liability of the members must be declared by a court decision and owed to a named creditor. The Companies Act determines for what reasons a member's liability for the debts of the company may be established. The list of reasons is not exclusive, but liability may be established especially if the member (a) uses the company to achieve forbidden purposes; (b) uses the property of the company or disposes thereof, as if it were his or her own property; (c) uses the company or its property for a purpose detrimental to the company's creditors; (d) decreases the value of the company's property to acquire benefits for him-/herself or for third parties if he or she knows or should know that the company will not be able to meet its debts.[33]

The company's creditor files an action in the court of the place where the seat of the company is located, within six months from the day when the creditor gained information on the abuse of the corporate personality of the company and within five years from the day of the abuse, at the latest.[34] If the claim of the creditor is not yet due at the time when he or she gains knowledge of the abuse, the deadline of six months starts from the day when the claim becomes due.[35]

We may, therefore, conclude that the liability of a member, based on the principle of piercing the corporate veil, may be established only by the decision of a competent court. The rules of the Companies Act are then only some sort of guiding rules, naming the most important types of cases in which a member undoubtedly abuses the corporate personality of the company. However, this liability does not arise directly from the Act; instead, the court must determine the existence of abuse in the concrete case at hand, regardless of which form it manifests itself. Consequently, the case law has a profound importance in establishing whether the corporate personality of a company has been abused or not. In practice, the rules on piercing the corporate veil have most often been applied to unipersonal LLCs, where the abuses mentioned above are the most common.[36]

Given that companies with a single controlling member (shareholder) predominate in Serbia, due to the concentration of ownership in JSCs and numerous single-member and family LLCs, there is a particular interest in the development and implementation of the concept of breaking through a company's corporate personality. Although Serbian law has long regulated the legal institution of piercing of the

33 Companies Act, Art. 18, s. 2.
34 Companies Act, Art. 18, s. 3.
35 Companies Act, Art. 18, s. 4.
36 See in detail: Milenović 2009, pp. 116–128.; Arsić 2010, pp. 504–512.

corporate veil, it has rarely been applied in practice. In addition, the diversity of legal interpretations has contributed to an improper understanding of this mechanism for the protection of creditors, and hence, the courts often apply it incorrectly. That is, since the introduction of this institution, courts have demonstrated a wide scope of differing interpretation of cases of piercing the corporate veil, ranging from too wide[37] to too narrow. In the case law, courts have considered that there is a basis for piercing corporate personality even when a member gives a personal guarantee that the company will meet its contractual obligations. Conversely, courts today avoid breaking through the company's corporate personality even in situations when a member is clearly abusing the corporate personality, considering this sanction overly severe. Moreover, proving the fulfilment of the prescribed conditions for the existence of the abuse of corporate personality is generally difficult, as the burden of proof is on the claimant, who as a rule will not be able to prove all the relevant facts for establishing abuse. It seems, therefore, that simply transplanting a legal institution from the common law tradition cannot be sufficient without achieving an adequate level of development of legal thought to substantially understand the legal institution the courts are meant to apply.[38]

8. What is the responsibility of de facto administrator towards the company's creditors in the case of insolvency?

There are no specific rules in the Companies Act pertaining directly to the liability of a single or majority member acting as de facto administrator in insolvency. The only form of liability of a member towards the creditors of the company is in the case of piercing the corporate veil, already explained above.

Furthermore, the interests of creditors may enjoy protection by the institution of annulment of juridical acts and transactions concluded with the purpose of causing prejudice to creditors (Lat. *actio Pauliana*). Serbian law differentiates the annulment of legal acts in bankruptcy proceedings from the procedure of annulment outside bankruptcy. The annulment of a debtor's transaction hindering the creditor's possibility of collecting the debt is, as a general legal institution, regulated by the Law on Obligations. It enables creditors to request that the court declare a specific transaction of the debtor to be without legal effect towards the creditor. This is the out-of-bankruptcy annulment.[39] The in-bankruptcy annulment is regulated by the Bankruptcy Act.[40] The major difference between the two types of annulment is as follows. The out-of-bankruptcy annulment has legal effect only towards the one creditor who requested the annulment. However, the annulment in bankruptcy affects all creditors of the debtor company,

37 See for example the judgment of the Supreme Court, Prev. 133/99 of 6.7.1999.
38 Radović, 2019, p. 41–42.
39 Law on Obligations, Arts. 280-285.
40 Bankruptcy Act, Arts. 119-123.

regardless of whether they have been parties in the litigation initiated to have the transaction annulled. In the case of annulment in bankruptcy, the transaction whose annulment has been declared by a conclusive court decision has no legal effect against the bankruptcy estate.

By the same token, if the request for annulment is granted in respect of juridical acts, transactions, or dispositions of the debtor in a litigation based on which a decree for an in enforcement procedure has been issued, the decree loses its legal effect in relation to the bankruptcy estate. The consequence of a successful annulment in bankruptcy is that the third party (with whom the debtor entered into the transaction) will be obliged to transfer all benefits acquired based on the transaction or juridical act that has been annulled. As all bankruptcy creditors are entitled to receive a share of the bankruptcy estate, under equal conditions and in proportion to the value of their claims respectively, the conclusion is clear that annulment in bankruptcy aims to increase the extent of the collection of claims of all bankruptcy creditors.

Another difference between the two types of annulment manifests in respect of the scope of restitution. In the case of out-of-bankruptcy annulment, the property and rights acquired based on the annulled transaction are subject to restitution only to the extent necessary to satisfy the claim of the one creditor who initiated the litigation. However, in the case of in-bankruptcy annulment, the restitution is complete. Furthermore, in the case of in-bankruptcy annulment, it is not required that the plaintiff creditor prove that the transaction hinders the collection of his or her claim. This is presumed based on the fact that the debtor is already in bankruptcy, while the creditors gain capacity to sue because their claims have been confirmed in the bankruptcy procedure. In the case of out-of-bankruptcy annulment, the deadlines are computed to the upcoming period, while in the case of in-bankruptcy annulment they are computed 'backwards'. The transaction is subject to annulment if it was entered into within a specific period before the debtor has been declared bankrupt.

Finally, the Criminal Code incriminates three criminal acts in relation to bankruptcy and hindering creditors from collecting their claims: causing bankruptcy,[41] causing false bankruptcy,[42] and causing damage to creditors.[43] Consequently, if the liability of the single or majority member is established for any of the aforementioned criminal acts, creditors who have sustained damage may request compensation according to the general tort law rules of the Law on Obligations.

9. Decisions in members' meetings

The exclusive competencies of LLC members' meeting are manifold. They can be divided into several categories according to their nature (content): 1. decisions on

41 Criminal Code, Art. 232.
42 Criminal Code, Art. 232a.
43 Criminal Code, Art. 233.

normative content: the most important are the decisions on amendment of the incorporation document and on approval of annual financial reports; 2. decisions relating to the *property* of the company: the most important are the decisions on the distribution of profits, capital reduction, and capital increase; 3. decisions relating to the *appointment of the officers and members of different bodies* of the company—the most important decisions in this category are those on the appointment of the managing director, members of the supervisory board in the case of two-tier management, and the liquidator/liquidation administrator; and 4. *status-related decisions*, of which the most important are the decision on a member's request for withdrawal, member's exclusion from the company, change of company status (acquisition, merger, division, spin-off), and change of legal form of the company (for example: from LLC to JSC).

The Companies Act does not provide solutions for the situation where the decision making process in the LLC is blocked. This may happen when there is a disagreement between members whose shares are equal or who have the same voting power at the members' meeting. Unlike in the regulation of JSCs, where in case of a blockade in decision-making the possibility is provided of filing a lawsuit for dissolution of the company at the discretion of the court, no such rules are provided for in LLC regulation. We find it prudent to foresee a similar application of these rules to LLCs, however.

Members may, however, devise by a separate contract—a so-called shareholders' agreement—any means for dissolving the situation when the members' meeting is unable to adopt a decision. In addition to the incorporation document, members of an LLC may, in accordance with Article 15 of the Companies Act, conclude a shareholders' agreement the purpose of which is to regulate their legal relations with the company. It must be concluded in writing. In such a shareholders' agreement, members can regulate their special obligations towards the company, their rights and obligations in connection with the transfer of shares, how they will vote at meetings on specific or all issues, the way of distribution of profits, the way of solving blockade in decision-making, and any other issues they consider relevant to their relationships. Stalemate in the decision-making process is in practice usually resolved by establishing a put or call option regarding the transfer of shares. In case of discrepancy between the incorporation document and the shareholders agreement, the provisions of the latter prevails; these contracts, however, produce a binding effect only between those members who have concluded them.[44]

10. Minimal capital requirements and capital protection rules

According to the Companies Act, the minimal share capital requirement in an LLC is only 100 RSD (less than one euro), unless a larger amount is prescribed by a special law for performing certain business activities (e.g. leasing companies, insurance

44 Arsić and Marjanski, 2018, p. 50.

intermediaries, factoring companies, etc.).[45] Therefore, it is evident that under Serbian law the notion of a minimal capital requirement has lost its function as a meaningful means of protection of creditors.

The Companies Act contains some rules that aim to protect the company's share capital: prohibition of registration of share capital in an amount smaller than the minimal share capital requirement, prohibition of restoring to a member the amount or contribution in kind that has been paid or transferred to the company as the member's capital share,[46] prohibition of releasing members from the obligation to pay or transfer their contribution except in the case of a decrease in share capital,[47] rules on the deadlines for payment or transfer of members' contribution,[48] rules on the legal consequences of members' failure to pay or transfer the contribution,[49] rules on joint and several liability of the seller and buyer of a capital share for the fulfilment of the obligation to pay or transfer the contribution to the capital,[50] rules on the appraisal of contribution in kind,[51] prohibition of the provision by the company loan, credit, or collateral for the member's obligation to acquire a share, restrictions on acquiring own shares by the company and related rules,[52] restriction of payments to members and related rules, etc.[53]

11. Protection of minority members

The Companies Act does not devote a special section to the protection of members who constitute the minority at the members' meeting but does have some special rules aimed at their protection: rules on the right of members who jointly have at least 20% of the capital to convene a members' meeting; rules on the right to suggest items for the agenda of the members' meeting;[54] right of the disagreeing members to have their share bought by the company at appraised or book value, depending which is higher, if they have voted against a change of legal form, change of legal status, disposition of property of greater value, or change to the incorporating document affecting their rights disadvantageously.[55]

The special rights of dissenting shareholders are stipulated in the part of the Companies Act relating to JSCs, but in accordance with section 477, they also apply to LLCs. These rights enjoy judicial protection. In addition to the rights of minority

45 Companies Act, Art. 145.
46 Companies Act, Art. 60, s. 1.
47 Companies Act, Art. 46, s. 3.
48 Companies Act, Art. 46, s. 2.
49 Companies Act, Art. 48.
50 Companies Act, Art. 175, s. 2.
51 Companies Act. Art. 50-58.
52 Companies Act, Art. 157.
53 Companies Act, Arts. 182-185 and 275.
54 Companies Act, Arts. 204-205.
55 Companies Act. Arts. 474-477.

members prescribed by law, it is possible to extend the special rights of minority members in the incorporation document or the shareholders' agreement.

12. Unipersonal LLCs as members of another unipersonal LLC

According to the Serbian Companies Act, members of an LLC may be natural and legal persons in all possible combinations.[56] This means that there are no restrictions on the right to form another unipersonal LLC whatsoever. A unipersonal LLC the member of which is a natural or legal person can form another unipersonal LLC, the sole member of which would be the already established LLC, as a legal entity.

13. Perspective reform in the legal regulation of LLCs?

A profound reform of company law in Serbia has been going on since the adoption of the previous Companies Act, in 2004. At present, as indicated earlier, the legal regime for LLCs is predominantly regulated by the Companies Act of 2011, which sustained amendments in 2015, 2018, and 2019. However, these amendments do not concern the key institutions of the legal regime for LLCs. It is clear that Serbian company law will have to undergo significant changes in upcoming years due to the process of harmonization of domestic law with the law of the European Union in light of the conditions contained in chapter 6 of the accession negotiations, related to company law.

14. Conclusions

In our view, one of the reasons for some of the shortcomings in the legal regulation of LLCs in Serbia is that there is no special statute pertaining only to LLCs; instead, the same statute regulates all four legal forms of companies, including their liquidation and status changes (acquisition, merger, division, spin-off). This contrasts the model that prevails in Austria and Germany, in which special statutes cover LLCs only, which we consider a proper legislative model. Regulation of all legal forms of companies in the same act is a basic conceptual flaw of Serbian company law. A law specific to LLCs would enable the legislator to tailor detailed rules pertaining only to LLCs, in which all peculiarities of this legal form of company might be addressed.

Furthermore, there are relatively numerous legal norms applicable to JSCs, the appropriate application of which has been extended to LLCs. However, most of them are not fully applicable due to the different nature of JSCs and LLCs.

56 Companies Act, Art. 9. s 3.

Most notably, difficulties arise regarding the application of the rules on capital increase, which are not fully developed in relation to LLC, which is why the legislator prescribed the appropriate application of JSC capital increase. Consequently, the content of the decision to increase the share capital was adjusted primarily to JSCs. This is not the best legal technique for regulating such an important procedure, which in practice requires the proper selection of provisions that can be applied to the increase of LLCs share capital as well.[57] In domestic practice, the Agency for Commercial Registries (*Agencija za privredne registre*, APR) plays an important role in the application of the rules of the Companies Act. In order to assist business entities, the Registry publishes templates which can be used by companies to draft and submit documents to register any change in the Registry. Analysing the template for drafting a decision on the increase of share capital, it seems that the Registry does not treat the decision merely as an initial, preparatory action before commencement of the procedure for increasing share capital. Rather, it treats it as an action based on which the change in data regarding the amount of share capital is fully implemented in the Registry.[58] This interpretation of the nature of members' decision to increase share capital is not only theoretically incorrect but may also have serious implications for the application of law. At the time of adoption of such a decision in the members' meeting, many things are yet uncertain. First, for example, it is uncertain whether and to what extent there will be an increase in share capital; the only thing certain at the time is that the increase cannot go beyond the total increase set out in the decision adopted at the members' meeting. Second, the value of the shares and their proportion after increase also remains uncertain. The decision adopted at the members' meeting solely represents the will of the company, and not the personal will of the members, and if the decision is taken as the sole document based on which the increase of capital is registered, it implies that an obligation is imposed on members who voted against the decision. That would be contrary to the principle of party autonomy, a fundamental principle of contract law, and to the spirit of the Companies Act as well.[59] This practice of the Registry is a consequence of the lack of regulation of contribution subscription statements and subscription agreements (Ger. *Zeichnungsvetrag*) in Serbian law. In comparative law, a subscription agreement between member and company is made on the basis of the member's subscription statement and the corresponding statement of the will of the company. The proper practice of the Registry would then be to register the share capital increase only when both the decision at the members' meeting and the subscription statement or agreement on the other, are submitted. However, a clear legal basis for that is missing in the Companies Act.

Similarly, in the amendments of the Companies Act from 2018 the rule prescribing the appropriate application of the section governing capital reduction from JSCs over to LLCs was repealed, and a new set of rules were introduced pertaining to the

57 Marjanski, 2017, p. 758.
58 Marjanski, 2017, p. 762.
59 Marjanski, 2017, pp. 763–764.

capital reduction of LLCs. However, the new regulations are less detailed than the ones pertaining to capital reduction of JSCs. This has led to numerous difficulties in relation to concrete requests for capital reduction filed by companies at the APR.[60]

Furthermore, the Serbian Companies Act does not devote a special section to the protection of members who constitute a minority at the members' meeting; instead, the special rights of dissenting shareholders are stipulated in the part of the law relating to JSCs, which in accordance with section 477 of the Companies Act applies to LLCs as well.

Finally, the protection of the interests of the creditors of the LLC essentially comes down to the application of the institution of piercing of the corporate veil only, and it is not applied in the case law appropriately, inter alia because of the slow pace of resolution of disputes by the courts.[61] Furthermore, Serbian courts have recently proved reluctant to apply the institution of piercing the corporate veil even in situations where a member is clearly abusing the corporate personality of the company, as the courts consider it to be an overly severe sanction and as proving the fulfilment of the prescribed conditions for the abuse of corporate personality in Serbian case law is connected with great difficulties, since the burden of proof of all conditions is on the plaintiff, and more often than not, he or she will not be able to prove all the relevant facts for establishing the abuse of corporate personality.

60 Marjanski, 2018, p. 1044.

61 See details at Marković, 2001, pp. 853–863.

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PAPP TEKLA[1]

The Status of the Limited Liability Company since the New Hungarian Civil Code Came into Effect

ABSTRACT: *Historically, the form of the limited liability company was first introduced in Hungary by Act V of 1930. This type of company, which is equipped with all the advantages of members in a limited liability, was born out of the relevant necessity in the economy. However, it is quite flexible in its nature, could be established easily and demonstrates a simpler organizational structure than a company limited by shares. Therefore, the limited liability company fits within the general frame of small and medium enterprises, and is the main and most popular form of a company in Hungary. This paper gives an overview of the characteristics, regulations, foundation, organization, minority rights, business share, members and managing directors' liabilities in Hungarian limited liability companies from a regulatory and practical perspective.*

KEYWORDS: characteristics, regulation, foundation, organization, minority rights, business share, member's and managing director's liabilities of the Hungarian limited liability company.

1. Introduction

1.1. The regulation

Before the new Hungarian Civil Code – which came into effect on the 15th of March, 2014 – a two (duplex)-law model was applied in Hungary, and included the Company Act alongside the Civil Code. The separate regulation on economic companies began with Act VI of 1988 and lasted until Act IV of 2006. Today, it is Act V of 2013 – the new Hungarian Civil Code – that implies company law (in Book 3) on the basis of the monistic principle of codification.

The new Hungarian Civil Code is comprised of three levels in Book 3: general and common provisions of legal persons related to business associations, cooperatives,

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https://doi.org/10.47078/2020.1.147-178

groupings, funds and society; general and common rules of business associations (dealing with general partnerships, limited partnerships, limited liability companies and stock companies); and the special rules of each company. Furthermore, company law is affected by the Firm Act, the Accounting Act, the Bankruptcy Act, the Act on Capital Market, the Competition Act (Act LVII of 1996), the Act on Civil Procedural Law, the Act on the Investment of Foreigners in Hungary (Act XXIV of 1988), the Act on the Branches and the Commercial Representation of Foreign Undertakings (Act CXXXII of 1997), the Act on Private Entrepreneurs and Private Enterprise (Act CXV of 2009), the Act on the European Economic Interest Grouping (Act XLIX of 2003), the Act on the Societas Europaea (Act XLV of 2004) and the Act on the European Cooperative Society (Act LXIX of 2006).

On this basis, regulations in Hungary appear both complicated and complex. For example, the regulation of company law is divided into norms of private and public law (whereas only the private law rules can be found in the Hungarian Civil Code), and there are three levels of regulations in the Civil Code, ranging from general to special rules for each business association. Furthermore, the regulation of company law in Hungary is not an independent branch of law, but an independent field of law within civil law. As such, Hungary has a peculiar, rather imperfect type of single-law model (system). For example,

■ *1.2. Business association forms*

There are two basic principles in Hungarian private law: (a) the cogency of the forms of legal persons,[2] and (b) the formula of the prescribed forms in company law;[3] the latter principle means that the establishers of a company can only choose these forms, and not any other (new) forms like a silent company (stille Gesellschaft). Furthermore, they can neither mix these forms into partnerships limited by shares (Kommanditgesellschaft auf Aktien), nor can they combine these forms with any other forms of legal persons, like a cooperative limited by shares (Genossenschaft auf Aktien).

'Gazdasági társaság' means an economic company like in German company law (Handelsgesellschaft); similarly, partnerships in Hungary are also referred to as companies.

■ *1.3. The default rule of business associations*

In the articles of incorporation, members may diverge from the prescriptions of the Hungarian Civil Code on legal persons when regulating their relations with one another and the legal person, as well as when regulating the organisational structure and

2 Section 3:1 HCC [Legal capacity of legal persons] (4) Such types of legal persons may be established as defined by law, including the association, the business association, the cooperative society, the grouping and the foundation (as well as the state).

3 Section 3:89 HCC [The constraint of form] (1) A business association may operate in the form of a general partnership, limited partnership, limited-liability company or joint stock company. The last one has two sub-types: a private company limited by shares or a public company limited by shares.

operation of the legal person. The first exception to this is in the case where divergence is prohibited by the Civil Code, whereby the members of a legal person shall not diverge from the prescriptions; the second exception is if it manifestly violates the rights of the creditors, the employees or a minority of the members of the legal person, or in the case where it undermines the efficient supervision of the lawful operation of legal persons.[4]

This particular Hungarian regulation is extremely complicated, as the starting point is the freedom of the formation of legal persons and the general principle of default regulation, which can only prevail based on the following steps (whereby meeting the criteria of one step means passing to the next step). The first step is to examine the nature of the legal relationship: does this legal relation exist among the members of the legal person or between the legal person and the member; the second step is to determine whether this legal relation concerns the organizational structure or the operation of the legal person; the third step is to explore whether there is any respective prohibition in the Civil Code in terms of the legal relation. If there isn't any prohibiting rule, the fourth step will be to examine the violation of the rights of the creditors', the employees' and the minority members' to the legal person; following this, the final step is to determine if this legal relation hinders the efficient supervision on the lawful operation of the legal person; if the answer to this last question is "no", then we may derogate from the prescriptions of the Civil Code. This conditional default rule is conspicuously controversial in Hungarian legal literature, as well as in the related court decisions that have been delivered based on it.[5]

2. The characteristics of the Hungarian limited liability company[6]

Historically, the form of a limited liability company was first introduced in Hungary by Act V of 1930. This type of a company, which is equipped with all the advantages of members in a limited liability company, was born out of relevant necessity in the economy; however, it is quite flexible in its nature, can be established easily and demonstrates a simpler organizational structure than a company limited by shares. Therefore, the limited liability company fits within the general frame of small and medium enterprises,[7] and is the main and most popular form of a company in Hungary.

This form of a business association has a mixed character. The legal act to create a limited liability company is based on the legal entities agreeing on what is necessary. The legal relationship, which results from the incorporation, has not lost its contractual relationship entirely. For example, the business shares of the

4 Section 3:4 (1) – (3) HCC.
5 See also: Veress, 2019a, pp. 96–97.; Veress, 2018, pp. 22–23.
6 Papp, 2015, pp. 189–190.
7 Auer et al., 2011, p. 20.

members can only be transferred to third persons provided that this is not precluded or restricted by the memorandum of association; additionally, the administration of the affairs of the company and the representation of the company can be exercised by one or more managing directors elected by the members. The limited liability company is both a capital and a personal association that is suitable for a family business or a large enterprise. The basic characteristic of a limited liability company is that its members are bound by trust,[8] and it can either be founded by a single member or multiple members. The limited liability company may also be established by both non-resident and resident natural and legal persons to jointly engage in business operations or for objectives other than making profit (non-profit LLCs). Although the limited liability company may be incorporated under the general registration proceedings, as well as the simplified registration proceedings (by utilizing a standard form of a contract), it can only be done through the designated electronic registration platform.[9]

The limited liability company is a complete legal person, meaning that it is a separate legal entity that possesses its own property, liability, organization and corporate name.[10] The limited liability company shall bear its legal capacity under its corporate name, and may gain rights or undertake commitments such as acquiring property, concluding contracts, and suing or being sued.

From this it follows that the term 'limited liability company' (korlátolt felelősségű társaság) is misleading, as it is not the liability of the company that is limited, but the liability of its member.

3. The impact of the default rule on the legal practice of the limited liability company

■ *3.1. General bans on the prevalence of the default rules in company law*

The cogency of the forms of legal persons, the formula of the prescribed forms in company law[11] and the definitions on the characteristics of the companies[12] shall block the prevailing default rules related to business associations. The cogent and imperative nature of the Firm Act,[13] the standard form of the memorandum of asso-

8 Veress, 2019b, p. 121.
9 Papp, 2015. pp. 46–48, pp. 348–349.
10 Section 3:1 (1) HCC.
11 2977 general partnerships, 116629 limited partnerships, 343948 limited liability companies and 6433 joint stock companies existed in the Firm Registry (Registrar of Companies), effective on the 1st of July 2018 (Cleghorne 2018/8., pp. 8–9).
12 ÍH 2018. 116.: The limits of derogating from the Civil Code are such rules that constitute the definitive essence of creating norms in terms of the characteristics of business associations, and also such provisions that affect third persons.
13 Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings

ciation[14] and the simplified e-registration process[15] exclude the possibility of applying the default rules to company law.

■ *3.2. The judicial decisions*

A decision of the High Court of Appeal[16] declared that, according to the default rule, the founders/members of a business association may only derogate from the rules on business associations in the memorandum of association.

The civil divisional court session, held between the 21st and the 23rd of May, 2014, concluded that the judges of the registry court were unable to evaluate the situation at the time of forming the business association, particularly in terms of any derogations clearly violating the interests of the creditors, employees and minority members to the legal person, or to judge the likelihood of this hindering the efficient supervision of legal persons.

We can find contradicting court decisions drawn, as follows; (a) in connection with the initial capital, the core deposit and the business shares of a limited liability company[17] (i.e. how many core deposits and business shares is a member of a limited liability company entitled to own: one[18] or more?[19]). Before the new Hungarian Civil Code, the judicial decisions declared that each member was only entitled to one core deposit and one business share.[20] Nowadays, such court decisions and opinions[21] are encountered, according to which one member of the limited liability company may

14 General partnerships, limited partnerships, private limited liability companies and private companies limited by shares may utilize this standard form (a model is provided by the Appendix to Firm Act in order to establish their memorandum of association). In this case, the memorandum of association may only contain what is set by given standard form. The forms of the documents are also applicable to any memorandum of association to be established in the given standard form.

15 Aside from redress procedures, company registration proceedings are non-judicial proceedings carried out electronically, to which the provisions of Act III of 1952 on the Code of Civil Procedure shall be duly applicable, unless otherwise provided for in the Firm Act. If the partnerships, the limited liability companies and the private company limited by shares will be based on a model of contract (i.e. a memorandum of association determined by the Civil Code and the Firm Act), then these business associations shall become registered in a simplified, electronic way.

16 ÍH 2017. 65.

17 Section 3:161 [Definition and scaling of the initial capital and the core deposit] (1) The core deposit is the capital contribution of the member. The core deposits of members may be of different degrees, whilst the degree of each contribution may not be less than one hundred thousand Forints. (2) Each member may have one single core deposit. (3) If several persons have jointly undertaken the provision of one single core deposit, their liability for providing the core deposit shall be joint and several. (4) The amounts of all core deposits provided added up shall constitute the initial capital, which may not be less than three million Forints.
Section 3:165 [Common property over business shares] (1) One business share may form the rights of several legal entities.

18 Civil divisional court session on 21-23 May 2014.

19 ÍH 2017. 30.

20 BDT 2004. 939.; 3/2009. (VI. 24.) PK vélemény; Veress, 2019a, p. 119.

21 Vékás, 2018, p. 391.; Dzsula, 2014, p. 5.; Veress, 2019a, p. 120.

own more core deposits and more business shares. In accordance with the view of Veress Emőd,[22] the principle of 'one member – one core deposit – one business share' is a determining and substantive attribute of a limited liability company. (b) Regarding the rule on the amount of the initial capital and the core deposit allowed to be held by one member of a limited liability company, is this provision cogent or not?[23]

The following rules are considered as default rules in the interpretation of the courts: (a) the executive officer(s)[24] may also be a member(s) of the board of directors in the case of a limited liability company;[25] (b) the regulation on the fulfilment of the contribution in cash[26] in the case of the limited liability company;[27] (c) the auxiliary service may only be performed personally,[28] however, this auxiliary service can be a contribution fulfilled in cash (over the core deposit), and the term for the fulfilment of this obligation may be limited,[29] or the auxiliary service may be performed not only on the grounds of a membership relation, but also within the framework of an employment relation.[30] (d) The Hungarian Civil Code also provides the definition of the business share,[31] yet it fails to specify the special-right business share: the creation of a special-right business share is only possible if there is no respective legal norm prohibiting it.[32]

22 Veress, 2019a, p. 120.

23 Section 3:161.

24 Section 3:196 [The management of the company] (1) The management of the company shall be exercised by one or more managing directors.

25 BDT 2015. 30.

26 Section 3:162 [Provision of capital contribution in cash] (1) Where according to the memorandum of association a member is required to provide less than half of the respective cash contribution before the application for registration is submitted, or if the memorandum of association provides a time limit of over one year from the time of registration of the company to make available the part of the cash contribution that was not paid before the application for registration was submitted, the company shall not be allowed to pay any dividend insofar as the unpaid profit calculated with respect to the members' core deposits (according to the provisions on the payment of dividends) reaches the initial capital together with the cash contributions that the members have already paid. (2) As in the case provided in Subsection (1), members shall bear liability for the company's debts up to the unpaid part of their cash contribution.

27 FÍT 10. Cgf. 47 021/2015/2.

28 Section 3:182 [Auxiliary services] (1) In the absence of a particular legal relationship that covers this, if the member performs any action of personal involvement in the company's activities, any compensation in return for such action may be requested in accordance with the respective provisions of the company's memorandum of association. The company may be entitled to enforce demands against its member for failing to perform such actions of personal involvement, on the condition that it is ensured by the memorandum of association.

29 BDT 2019. 4057.

30 Kúria Mfv. 10.362/2017/3.; EBH2018. M.22.

31 Section 3:164 [Concept of business share] (1) A business share shall be the entirety of all rights and obligations relating to capital contributions. Business shares shall come into existence upon the registration of the company. (2) The rates of business shares shall align with the capital contributions of the members. The business shares of identical rates shall grant identical membership rights.

32 PÍT Gf. 40.015/2016/6.; PJD 2017. 8.

The rule of selling the business share[33] is considered cogent by the judicial practice[34] from the perspective of protecting the creditors.

33 Section 3:177 [The selling of business shares] (1) If a member is excluded from the company by order of the court, or if his/her membership is terminated due to the member's failure to provide the capital contribution or supplementary payment, the business share of this member must be disposed of. (2) The former member and the company shall agree the conditions and the mode of selling within fifteen days from the date of termination of his/her membership. The agreement shall fix the time limit within which the business share must be disposed of – which may not exceed three months -, and the minimum selling price, which may not be less than the total of the capital contribution and supplementary payment that the former member had failed to provide. If no agreement is reached within the prescribed time, or if the business share is not disposed of within the time limit fixed in the agreement, the company shall dispose of the share in question by way of public auction within forty-five days following the deadline prescribed for the agreement or for the sale. (3) In the interest of carrying out the selling procedure, the company shall be entitled to introduce measures and make statements as deemed necessary.
Section 3:178 [Auction notice] (1) If the business share is sold by way of an auction, the company shall publish an auction notice at least eight days before the scheduled date of the auction. (2) The auction notice shall contain: a) the company's name and its registered office; b) the place and time of the auction; c) important particular details of the business share offered; d) the reserve price; and e) the terms and conditions of the payment of the purchasing price. (3) The reserve price may not be lower than the sum the former member still owes the company due to his/her failure to provide the capital contribution and supplementary payment.
Section 3:179 [Implementation of the auction] (1) Auctions shall be held in the presence of a notary public. The notary shall record the auction report minutes in the form of an authentic public instrument. (2) Apart from the former member, any person may bid to purchase the business share. The price offered may not be lower than the reserve price. The binding period of the highest bidder shall cover the time period, during which the acceptance could normally be expected, also considering any right for pre-emption that may exist for the business share in question. (3) Based on the highest bid, a member of the company, the company itself and a third person designated by the company may exercise the right to acquire the business share with priority over others in accordance with the provisions on the transfer of business shares to third persons. If the entitled persons did not exercise such right, the highest bid made in the auction shall be accepted. (4) In the event where a business share is sold in an auction, the buyer shall pay the purchasing price to the company, and the company shall conduct the final settlement with the former member.
Section 3:180 [Allocation of the purchasing price received] (1) From the purchasing price, the company is entitled to lay claim to the capital contribution and supplementary payment that the former member had failed to provide. If the purchasing price exceeds that amount, the company is entitled to cover the costs of the selling procedure, and the remaining sum is due to the former member. (2) If the purchasing price received is insufficient in terms of covering the costs of the selling in accordance with Subsection (1), the former member shall reimburse the company of the sum that the company was unable to recover from the purchasing price.
Section 3:181 [Unsuccessful auction] (1) If no bid is received in the auction covering at least the reserve price, the auction shall be declared unsuccessful. (2) Within the period of six months from the date of exclusion of a member or from the termination of his/her membership, the business share may be offered in a public auction anytime and without any limitation. (3) If either of the auctions fail, the company shall be entitled to withdraw the business share within thirty days. (4) If the business share of a former member is not sold within the period of six months from the date of exclusion of the member or from the termination of his/her membership, the company shall withdraw the business share. If the business share is withdrawn, the former member shall be entitled to lay claim for his/her portion out of the company's capital, according to the provisions on the allocation of the purchasing price received from the selling of the business share.

34 BDT 2016. 3568.

■ *3.3. Conclusions*

We can draw the following conclusions: (a) some questions do not have clearly defined answers, for example, the amount of the initial capital and the quantity of the core deposits and the business shares; (b) there is a great deal of legal uncertainty due partly to the formulation of the norms of company law (many semi-mandatory rules and default phrases apply the expressions of "must", "not allowed", "prohibited", "obliged"),[35] and partly to the controversial court decisions and opinions disclosed in the legal literature; (c) the syndicate contract comes into the spotlight, as its increased role can be grasped in the background of the operation of the business associations, which is the opposite to the legislator's intention;[36] (d) the form of the limited liability company becomes transformed into a private company limited by shares, whereby the Hungarian company law shall become deprived of a particular, and widely popular, type of company; (e) the application of the statutory instruments of company law shall become even more challenging.

4. The formation of a limited liability company[37]

■ *4.1. General intrinsic validity requirements*

The limit of the freedom of enterprise and association is prescribed in the Fundamental Law of Hungary,[38] which recognizes and supports the right of establishing business enterprises, and also declares that everybody has the right to form any organization with others or to join any organization for the purpose of protecting their economic and social interests. Yet, this constitutional principle shall not prevail without any limitations, as not everybody is allowed to establish a company for any purpose in any way.

With the exception of the limited liability company (and the public or the private company limited by shares), at least two members are required for the foundation of a business association. The Hungarian branch of a foreign company does not have the right to found a company or participate in its operation.[39] As the direct commercial representation office of foreigners shall bear no legal capacity, it may not pursue any business activities. The civil association and the condominium – legal capability/ legal subject status restricted to a specific purpose – may not form a company. The pre-company may neither establish an economic company nor function as a member,[40] because only a registered company with a full legal subject status can meet the

35 Miskolczi-Bodnár, 2019, p. 9.
36 Kommentár, 2014, p. 214.
37 Using of Auer et al., 2011, pp. 27–29.; Papp, 2015, pp. 141–142.; Lexikon, 2019, pp. 307–308.
38 Hungary shall recognize the fundamental human rights exercised individually, and also as part of a community. Everyone shall have the right to establish or join organizations (Articles I. and VIII. to the Fundamental Law of Hungary).
39 EBH 2003. 887; BH 2003. 420.
40 Section 3:101 (2) c) HCC.

requirements of the foundation of a company.[41] The cooperative, the budgetary agency or the local government can only become a member in a company with limited liability. If the registry court interdicts a person, then the person is prohibited from becoming a member of any business association.[42]

The limited liability company must have a defined objective that is lawfully permitted, and can either be established to engage in joint business operations with the objective of making profit or with a non-profit character. Certain specific economic activities shall be restricted by law, in order to only be pursued by specific company forms; for example, the activity of a patent agent may only be carried out by a limited liability company in the form of a joint business enterprise. Similarly, certain economic activities may only be exercised in the possession of a respective permit (activity-specific permit), for example in the case of telecommunications. A business association may engage in the pursuit of an activity that is ordered by law to be conditional on a specific qualification, so long as a member of the company who has personal involvement in that activity, or at least one person who is contracted to work for the company by means of employment or any other civil law relationship, shall meet said qualification requirements.[43]

The limited liability company may only be implemented by firm registration proceedings according to Act V of 2006 (on Public Company Information, Company Registration and Winding-up Proceedings).

If the legal conditions (legal subject status, defined objective and method of establishment) shall fail to be realized by the founders of the limited liability company, the company will not come into existence.

■ *4.2. Particular intrinsic validity requirements*

In addition to the general provisions,[44] the amount of the capital contribution provided by each member in the form of the core deposit[45] shall also be defined in the memorandum of association. Furthermore, the name 'korlátolt felelősségű társaság', or its equivalent abbreviation 'KFT', must be applied in the corporate name of the limited liability company.

41 EBH 2003. 883; BH 2003. 471.

42 Section 3:90 (3) HCC; Section 9/B Firm Act.

43 Section 3:97 (2) HCC.

44 Section 3:5 [Content of the instrument of incorporation] Beyond the founders' intention to establish a legal person, the instrument of incorporation of a legal person shall specify a) the name of the legal person; b) the position of the legal person; c) the objective or main activity pursued by the legal person; d) the names of the founders of the legal person, including their residence or seat; e) the monetary or asset contributions to be made to the legal person and the value of the contributions, as well as the method and the time of their completion; and f) the first executive officer of the legal person.

45 Section 3:161 (1) HCC.

■ *4.3. The initial capital of the limited liability company*[46]

The limited liability company is founded with an initial capital, consisting of the capital contributions adding up to a pre-determined amount. The initial capital of the company consists of individual members' capital contributions. Monetary and asset contributions are the contributions of financial value provided by the members of a company. Although the capital contributions may be of various amounts, the amount of each capital contribution provided must not be less than one hundred thousand Forints.[47]

As a result of this, the liability of the members is generally limited to their individual contributions, whilst the claims of the creditors towards the limited liability company will be made against the company's property. The fixed minimum value of the assets must be raised initially, and it must also be consciously retained from the business. Firstly, this condition serves to protect the creditors, and secondly, for the protection of the members against any such actions of the managing directors, which could reduce the value of their business shares as long-term investments. The entirety of all capital contributions shall be the initial capital of the company, which shall not be less than three million Forints.[48]

Following the registration of the company, the rights and obligations of the members, and their shares from the assets of the limited liability company, become embodied by their business shares; a business share refers to the entirety of the rights and obligations related to the core deposit.[49] A member's business share also manifests his/her interests in the company, and is thereby qualified as a valuable and transferable right, including a group of rights on membership and capital shares. The business shares of the members shall be consistent with their respective capital contributions.[50]

5. The organization of the limited liability company[51]

■ *5.1. The corporate hierarchy of the companies under the effect of the general and common rules on legal persons and the companies decreed in the Hungarian Civil Code*

5.1.1. The supreme body of the company[52]

The supreme body of the company is the decision-making body. The members and the founders shall exercise their decision-making capacity under the effect of the Civil

46 Using of Auer et al., 2011, p. 398.; Papp, 2015, p. 119.; Lexikon, 2019, p. 166.
47 Section 3:161 (1) HCC.
48 Section 3:161 (4) HCC.
49 Section 3:164 HCC.
50 ÍH 2009. 174.; PJD 2017. 8. I.
51 Using of Auer et al., 2011, pp. 431–439.; Papp, 2015, pp. 81–95., 173–177.; Lexikon, 2019, pp. 168., 183–185., 122–124., 291–292.
52 Section 3:16 (1) HCC.

Code or the instrument of constitution, in the form of a body comprised of its members (as selected by all of the members). The company's supreme body in general and limited partnerships is the assembly of members, whereas in limited liability companies and groupings it is the meeting of the members (or the members' meeting), and in stock companies it is the general assembly.

The supreme body's main duty to a company is to adopt decisions on fundamental and strategic issues; the matters rendered under the exclusive competence of the supreme body are defined by the provisions pertaining to the company's specific form.

Supreme body meetings may be attended by the members of a company, as well as any person invited according to the rule of law or the memorandum of association, albeit without voting rights; therefore, all members of the company shall have the right to partake in the supreme body's activities.

The competence of the supreme body are the following: (a) Resolutions on personal matters; after the foundation of the company, the executive officers, the members of the supervisory board and the auditor shall be elected by the supreme body. However, additional competencies can be granted; for example, the articles of association of the companies limited by shares, or the memorandum of association of the limited liability companies, may contain provisions to assign the right for the appointment and removal of the members to the management board and the managing directors, as well as the right to establish their remuneration with the supervisory board;[53] (b) Resolutions on economic policy matters: the annual report of the company, as prescribed by the decrees of the Accounting Act, and the allocation of taxed profits pertain to the competence of the supreme body to the company;[54] (c) The amendments to the memorandum of association;[55] (d) Resolutions on the termination of the company with or without succession.[56]

The supreme body shall draw its decisions in held sessions or without held sessions.[57] The supreme body shall be summoned by invitation,[58] usually by an executive officer, and this invitation must include the name of the company, the registered seat address, the date and the place of the meeting, as well as the agenda. The supreme body shall hold its meeting session at the venue of the registered seat. In case the session of the supreme body was not summoned in accordance with these rules, it can only be held on the condition that all of the persons entitled to partake are present, and with that they also unanimously agree to hold the meeting. Decisions in the meeting may only be drawn upon the points of the agenda, on the condition that it was announced in congruence with the respective rules, unless all of the entitled participants are present and they unanimously agree to deal with the issues that are not on the agenda.

53 Sections 3:21 (3), 3:109 (3) HCC.
54 Auer et al, 2011, p. 135., 3:109 (2) HCC.
55 Section 3:102 (1) HCC.
56 Sections 3:39, 3:48 HCC.
57 Sections 3:16 (2), 3:17 (1), 3:18-3:20, 3:111 HCC.
58 Zala Megyei Bíróság I. Gf. 20-99-040006/5.

The session of the supreme body is not public. The executive officers and the members of the supervisory board to the company can partake in the sessions of the supreme body only in the function of advisors.

A member may exercise his/her membership rights in the meeting of the supreme body through an application on electronic telecommunication devices instead of personal participation, on the condition that such devices, along with the requirements of and instructions for their utilization have been specified by the instrument of constitution, so that both the identification of each member, as well as the interactive and unrestricted communication between members is ensured. Any resolution adopted at a meeting that was not summoned or held as per the rules shall for this reason be declared invalid, but it can become made valid retroactively from the date of the meeting, on the condition that all of the members unanimously approve it accordingly within thirty days from the date of the meeting. In the meeting of the supreme body, the quorum exists when more than half of the members possessing the voting right are present; the quorum must be verified for each decision-making event.

In the meetings of the supreme body, the members make decisions on the matters by voting. In the process of adopting a resolution, the following persons are prohibited from voting: (a) those for whom the resolution contains any exemption from any obligation or responsibility; (b) those who shall be advantaged otherwise, by the encumbrance of the company; (c) those with a family member that has a vested interest in the decision, and who is neither a member nor a founder of the company; (d) those who maintain any relation based on majority control with another organization to have a vested interest in the decision; (e) those who have a vested interest in the decision. The member of a limited liability company is excluded from the passing of a resolution if the supreme body has decided that the member is to be elected as the managing director.[59]

The members pass the resolutions with the majority of the votes verified for the keeping of the quorum. When a simple or a qualified majority of the votes is prescribed under the decrees of the Civil Code to pass a resolution, any clauses in the instrument of constitution enabling a lower voting rate is declared null and void. When unanimity is prescribed under the effect of the Civil Code to pass a resolution, any different clause in the instrument of constitution shall be null and void.

In a case where the instrument of constitution allows resolutions to be adopted without holding a session, management shall initiate the respective process by sending the draft of the resolution to its members. Members shall be given the period of at least eight days from the date of the draft's delivery to hand, in order to send their votes to management. In the process of adopting a resolution without a held session, the respective provisions of the Civil Code on the quorum and the voting shall apply unless the decision-making process may be declared sufficient (i.e. when the number of votes sent to management equals at least the number of the members possessing the voting

59 BDT 2019. 3980.

right, who would be required to attend in order to reach the quorum if the meeting was conducted in a held session). When it is requested by a member, the management shall summon a meeting of the supreme body. Management shall determine the result of the vote within three days from the deadline of the vote, or if all the members' votes are received earlier, then the result will be determined within three days of the date when the last vote was received; furthermore, management shall provide the result to the members in a written format, within an additional three days. The date of the resolution must be the last day of the deadline for voting, unless the votes of all of the members were received earlier, in which case it will be the day when the last vote was received.

5.1.2. The operative organ (management) of the company[60]

The executive officers or the board of the executive officers shall exercise the management of the company in accordance with the respective provisions governing the specific forms of companies. The executive officers must perform their management duties by representing the interests of the company. The 'management' activity means passing the decisions other than those conferred by the memorandum of association onto the competence of the supreme body, or another organ of the company, and which are required to be passed in relation to the operation of the company.

The management of general and limited partnerships shall be exercised by one or more managing directors that are appointed or elected by the members; if no managing director has been appointed or elected, each member shall function as that. The management of limited liability companies shall be exercised by at least one managing director, whereas the management of stock companies shall be exercised by the management board, unless the competence of the management board has been conferred to a single executive officer (general director) by the articles of association of the private limited companies.[61] The articles of association of public companies that are limited by shares may also contain provisions to designate management and supervisory functions upon the board of directors (the one-tier system); in the case of a public company limited by shares, there is no supervisory board and the executive officers shall be recognized as the members of the board of directors.

The legal status of the executive officer:[62] the executive officer is entitled to manage the operations of the business association under the effect of a personal services agreement, or a contract of employment, as agreed with the company. The executive officers are elected for a term of five years, yet for business associations that have been established for a shorter period, they are only elected for that particular period. The mandate of the executive officer takes effect from the time when the entitled person has accepted it; the executive officer may be re-elected, and may also be recalled by the supreme body of the company at their will at any time.

60 Sections 3:21 (2),3:112 (2) HCC.
61 Sections 3:282 81), 3:283 HCC.
62 Sections 3:112, 3:114, 3:115 (1) HCC.

The executive officer is entitled to independently managing the operation of the business association, based on the priority of the interests of the business association. In this capacity, the executive officer must exert his/her duties in due compliance with the respective statutes of law, the instrument of constitution and the resolutions drawn by the supreme body of the company. The executive officer may not be instructed by the members of the business association, and his/her competence may not be denied by the supreme body. In regards to a single-member company, the single member may instruct management, and the executive officer will thus be required to act accordingly.

The general duties of the executive officer:[63] the executive officer is responsible for the representation of the company[64] and for reporting to the registry court – through electronic channels – on the foundation of the company, any amendments to the memorandum of association, the rights, facts, and data included therein, and also on the changes of these, as well as any other data required by law. The executive officers must treat all business secrets of the company as strictly confidential. Upon the request of the members, the executive officers shall provide information on the situation of the company, and the access to any such information within the documents, records and the registers of the company. The executive officer is entitled to demand a written declaration of confidentiality before providing information or granting access to information. The executive officers exercise the employer's rights over the employees of the company. The executive officer shall manage the operation of the business association independently, based on the priority of the interests of the business association.

5.1.3. Supervision of the operation of the companies by the owners: the supervisory board

For the purpose of inspecting the management of the company, and in order to protect the interests of the business association, the members can effectively prescribe the establishment of the supervisory board (comprised of three persons) in the memorandum of association.[65] The establishment of the supervisory board is mandatory, (a) if the number of full-time employees of the business association shall exceed two hundred on an annual average, and the working council did not waive the participation of employees in the supervisory board, either; (b) in public companies limited by shares, even if the company does not apply the one-tier system; (c) in private companies limited by shares, if it is requested by a group of shareholders that together possess at least 5% of the total voting rights.

In case the annual average number of the full-time employees employed by the business association exceeds two hundred, one-third of the supervisory board must be created with the representatives of the employees. Within the supervisory board, the representatives of the employees must have the same rights and obligations as all the other members. In case the opinion of the representatives of the employees shall unanimously differ from the majority opinion of the supervisory board, the minority

63 Sections 3:22, 3:23 HCC.

64 Auer et al., 2011, pp. 152–153.; EBH 2002. 780.

65 Sections 3:26 (1), 3:119, 3:290 (1), (3), 3:124-3:128 HCC.

opinion of the employees must be exposed at the next meeting of the supreme body. The representatives of the employees that are members of the supervisory board shall inform the employees of the activities of the supervisory board.

The members of the supervisory board are independent from the management of the business association; thus they shall not be bound by any instructions when pursuing their duties. In this capacity, the member of the supervisory board may not be instructed by either the members of the company or the employer.

As previously mentioned, the members of the supervisory board are elected for a term of five years, except in the case of a business association that is established for a shorter period, in which case they are elected for that particular period.[66] The mandate of a member to the supervisory board shall take effect from the time when the entitled person accepts it; the members of the supervisory board may be re-elected and recalled by the supreme body of the company at their will at any time. The regulations governing the personal services agreement relation are also applicable to the members of the supervisory board.

The supervisory board shall assess all propositions brought before the supreme body, and present its opinion thereof at the meeting of the supreme body. The supervisory board shall have access to the documents, accounting records and books of the business association; furthermore, they shall also be entitled to demand information from the executive officers and the employees of the company, and to inspect the company's finance accounts, petty cash, securities portfolio, inventories and contracts, or to have them inspected by a competent expert.

If the company has a supervisory board, then the supreme body of the company may adopt a decision on the financial report, having previously obtained the written report of the supervisory board thereof.[67] If the supervisory board declares that the activity of management is against the law, the memorandum of association or the resolutions of the supreme body of the company, or that it hinders the interests of the company or its members, the supervisory board has the right to convoke the meeting of the supreme body of the company to deal with that issue and to take the necessary decision.[68]

The peremptory supervisory board: in case the instrument of constitution transfers the responsibility onto the supervisory board for taking and approving such decisions, which should otherwise fall under the competence of the supreme body or the management, the members of the supervisory board are held liable for the damages that they have caused to the business association while acting in that capacity, in accordance with the provisions on the liability for damages caused by breaching a contractual obligation.

66 Sections 3:26 (4), 3:27 (1), (2), 3:121 (2), (3), 3:120 (2), (3), 3:123 HCC.
67 Section 3:120 (2) HCC.
68 Section 3.120 (3) HCC.

The operation of the supervisory board:[69] the supervisory board shall act as an independent body that consists of its members. The supervisory board shall elect a chairman from among its members. The members of the supervisory board shall act in person, in that any representation of the supervisory board is prohibited. The supervisory board shall establish its own rules of operation, which are subject to the approval of the supreme body of the company. The supervisory board shall reach the quorum if at least two-thirds of its members, or at least three members, are present. The supervisory board shall pass its resolutions with a simple majority of votes.

The members of the supervisory board are liable for the damages caused to the company by failing to meet their responsibilities, in accordance with the provisions on the liability for damages caused by the breaching a contractual obligation.[70]

5.1.4. The supervision of the operation of the companies from the public interest: the statutory auditor[71]

On the condition that a company is obliged by the Civil Code, as well as by the Accounting Act, to employ a statutory auditor, or in case it is thus prescribed in the memorandum of association of the company, the supreme body of the company shall elect the statutory auditor for the company and shall determine the essential details of the contract to be made and implemented with the auditor.

The supreme body of the company shall appoint the statutory auditor for a fixed term, with a maximum of five years. The term of appointment of the statutory auditor may not be less than the period between the time of the (general) meeting held by the members when the appointment was made, and the time of the (general) meeting held by the members for the passing of the actual annual report.

The statutory auditor must have access to the documents, accounting records and books of the business association in order to be able to complete his/her duties, and is also entitled to request information from the executive officers, the members of the supervisory board and the employees; furthermore, he/she is entitled to inspect the finance accounts, the cash accounts, the securities portfolio, the inventories and the contracts of the company, as well. Moreover, the auditor is also entitled to attend the supervisory board's meetings as an advisor (whenever it is applicable), and he/she must attend the relevant meetings upon the supervisory board's request. The supervisory board shall include the points proposed by the auditor in the agenda.

The statutory auditor is prohibited from providing any services to a business association, and is also prohibited from collaborating with management in a manner that would, in any way, hinder his/her ability to carry out his/her professional duties objectively and independently.

The statutory auditor appointed by the supreme body of the company shall be responsible for conducting the audits of the accounting documents of the company

69 Sections 3:121 (1), 3:122 HCC.
70 Section 3:28 HCC.
71 Sections 3:38, 3:129-3:131 HCC.

according to the relevant regulations, as well as for providing an independent audit report to determine if the annual accounting of the business association is congruent with the legal requirements, and if it reflects a true and fair assessment of the assets and liabilities of the company, its financial position and the loss of its profits. The statutory auditor must treat all of the business secrets relating to the operation of the company as strictly confidential. The statutory auditor is to be invited to the sessions of the supreme body of the company when they shall deal with the financial report of the company. The auditor must attend these meetings, although if he/she should fail to appear, the meeting will still be held. Should the statutory auditor detect any changes regarding the assets of the company that are likely to hinder its capability to suffice any claims against the company, or if he/she should encounter any circumstance that shall affect the liability of the executive officers or the members of the supervisory board with respect to the activities exercised in those capacities, he/she must promptly call upon the management to take immediate action, in order to enable the members to make the necessary decisions. In the case of any compliance issues regarding this notification, the auditor shall proceed to inform the registry court, as this is the organ exercising judicial control over the company involved in such an incident.

5.1.5. Other bodies of the companies[72]

On the basis of the instrument of constitution or its equivalent authorization, the supreme body shall prescribe the operation of any further organs in addition to the organs and the officials defined by the Civil Code; such prescriptions must not affect the competence and the responsibilities of the organs and the officials defined by the Civil Code.

■ *5.2. The organizational structure of a limited liability company*

5.2.1. The meeting of the members

The supreme body of the limited liability company is the meeting of its members. The meeting of the members shall bear the exclusive right for the approval to make and enter contracts by and between the company and its members, its managing director, its supervisory board member, its auditor or their close relatives.[73] The following cases fall under the competence of the meeting of members: (a) regarding the form of the company's organization: both the election and the recalling of the managing director, the supervisory board members, the auditor and the allocation of their remuneration; (b) in connection with the fundamental decisions on the permanent operation of the limited liability company, the approval of the annual report prepared in congruence with the Accounting Act, as well as the decision upon the payment of the interim dividends; (c) in membership-related cases like the order and the returning of the supplementary capital contributions, exercising pre-emption rights on behalf of the company,

72 Section 3:132 HCC.
73 Section 3:188 (2) HCC.

granting consent to transfer any business shares to a third person, granting consent for the division of business shares, the order on the withdrawal of the business shares, the resolution on initiating the exclusion of a member; (d) with regards to the strategic resolutions, it is the decision on the termination of the company without either succession or transformation, the adoption of a decision on the increasing or the decreasing of the initial capital, the adoption of a decision on the creation of a recognized group of companies and also on the contents of the draft controlling agreement and the approval of the draft controlling agreement; (e) ordering the examination of the annual report, the management and the financial operations of the company by an auditor; (f) the enforcement of claims towards the members, managing directors, supervisory board members and/ or the auditor; (g) any amendment of the memorandum of association; (h) all the issues assigned exclusively to the competence of the meeting of the members by force of law or by the memorandum of association.

The meeting of the members shall be convoked by the managing director. These meetings shall be convoked to take place at the seat of the company. In addition to the cases defined in the Civil Code or in the memorandum of association, the meeting of the members shall be summoned if it is deemed necessary in the interest of the limited liability company. The managing director must either summon the meeting of the members with no delay, or initiate its decision-making process without holding a meeting, in order to ensure that the necessary measures are taken if it should come into his/her knowledge that (a) the equity of the company has decreased down to half of the initial capital due to losses; (b) the equity of the company has decreased below the limit that is prescribed by the law; (c) the limited liability company is about to undergo insolvency or if it has already stopped making any payments; or (d) if its assets can no longer cover its debts.[74]

The invitation of the members to the meeting must include the agenda of the meeting, and must be sent at least fifteen days in advance. The memorandum of association must not specify a deadline of less than three days. When the member shall propose certain additions to the agenda in accordance with the provisions on setting the items of the agenda, the matter proposed shall be considered to have been placed on the agenda, on the condition that such a proposal gets delivered to the members and the managing director at least three days before the meeting.[75]

If the meeting of the members should fail to reach the quorum, the reconvened meeting shall reach the quorum for the issues of the original agenda, irrespective of the voting rights represented by the present members, on the condition that it has been reconvened by between three and fifteen days from the original date. Any provisions in the memorandum of association on setting the reconvening date as by less than within three days is null and void. The meeting of the members reconvened due to the

74 Section 3:189 HCC.
75 Section 3:190 HCC.

missed quorum may be reconvened, and are subjected to the same conditions (i.e. in accordance with the rules in the invitation for the original meeting).[76]

The discussion of the meeting of the members held by electronic means of communication, and also the resolutions adopted thereby, shall be recorded, so that they can be retrieved at any time in the future. In case a resolution that was adopted by the meeting of the members shall have to be submitted to the registry court, the minutes of the meeting must be prepared, and signed by the managing director.[77]

The managing director must always ensure that the minutes of the members' meeting is duly recorded, except for meetings held electronically. This recording must also include the place and the time of the members' meeting, the people present, the percentage of the voting rights represented by these people, the significant events, the statements and resolutions discussed during the meeting, the number of votes for and against the resolutions and the those refraining from, or those non-partaking in, the vote. The minutes must then be signed by the managing director and a member that is present at the meeting who is elected as the witness of the meeting's minutes.[78]

Following this, the managing director must enter all the resolutions adopted by the members into the book of resolutions with no delay.[79]

All of the members shall have access to the minutes of the members' meetings, and the recordings of the members' meetings will be held in electronic means of communication, as well as in the book of resolutions; members may also request copies of the contents thereof. Aside from these, any provisions in the memorandum of association are declared null and void.[80]

5.2.2. The managing director

The administration of the company's business and the representation of the limited liability company are to be exercised by one or more managing directors elected by the members or third persons. The memorandum of association may determine that all of the members are entitled to exercise management and the representation of the company, whereby the members are considered to have recognized all of the general provisions on the executive officers as applicable to them.

The duties of the managing director are as follows: representing the company; administrative tasks (e.g., to convoke a members' meeting); exercising the employer's rights; informing the members; keeping the business secrets; preparing minutes; taking care of the book of resolutions; keeping the register of members; organizing the sale of members' business shares.[81]

The managing director maintains a register of the members of the limited liability company (register of members). The following shall be included in the register of

76 Section 3:191 HCC.
77 Section 3:192 HCC.
78 Section 3:193 HCC.
79 Section 3:194 HCC.
80 Section 3:195 (1) HCC.
81 Auer et al., 2011, pp. 385–386.

the members: (a) the name (corporate or business name), the address (registered office) and the capital contributions of each member; (b) in connection with the jointly owned business shares, the name (corporate or business name) and the address (registered office) of the owners and their joint representative, and the amount of capital contributions; (c) the amount of the initial capital; (d) the provisions of the memorandum of association on any supplementary capital contribution or auxiliary service, as well as the restrictions or prohibitions on the transfer of the business shares.

Any changes to the person or the business share of the members (more precisely, the transfer or the division, the acquisition or the withdrawal of business shares or the acquisition of the business shares by the limited liability company) must be entered into the register of the members by the managing director. The managing director shall submit the register of the members or, if any of the data included therein has changed, the updated version of the register of the members to the registry court.[82]

The duty of the managing director is to organize the sale of a member's business shares in the following cases: if the member failed to complete his/her capital contribution in spite of receiving the relevant request; if the member did not fulfil his/her obligation on the supplementary capital contribution as ordered by the members' meeting, in spite of the relevant warning received; if the member was excluded from the company by virtue of a court decision with binding force.[83]

5.2.3. The supervisory board and the auditor

With respect to the election, the competence, the liability and the termination of the legal relationship of the supervisory board (and its members), as well as the auditor, the general provisions on the legal persons, as well as the common rules of the business association, are applicable where appropriate.

6. The rights of the minority of members[84]

■ *6.1. The general rules of minority rights*[85]

The members that together possess at least 5% of the total voting right may request to either convoke the supreme body of the company at any time (they are also required to cite the reason and the purpose thereof) or the passing of a decision without a held session. In case the management should fail to complete such a request within eight days from the date of its receival to convoke a meeting of the supreme body at the earliest date possible, or to pass a decision without a held session, the registry court shall convoke the meeting of the company's supreme body upon the request of the

82 Section 3:197 HCC.

83 Auer et al., 2011, p. 387.

84 Using of Auer et al., 2011, pp. 243–249.; Papp, 2015, pp. 103–104., 173–177.; Lexikon, 2019, pp. 161–162.

85 Section 3:103 HCC.

relevant members, or it shall entitle such members to either convoke the meeting or carry out the procedure for the passing of a decision without a held session. The costs that are thereby incurred shall be borne by the requesting members. The decision on whether the costs incurred are to be borne by the company or by the persons that convoked such meeting will be taken by the business association's supreme body in the meeting convoked upon the request of the minority stakeholders or by force of a decision adopted without a held session.

■ ***6.2. The special rules of minority rights***[86]

In case the company's supreme body rejects or does not present a decision on the proposal of the latest financial report, any economic event that has occurred in connection with the activities of the management during the last two years or any undertaken contractual obligation to be examined by an auditor engaged specifically for this particular purpose, such examination must be ordered, and the auditor shall be appointed at the expense of the company by the registry court upon the request of any member or members possessing at least 5% of the total votes, submitted within a thirty-day period calculated from the date of the meeting of the supreme body. The costs of the audit shall be both advanced and borne by the company; the company shall be able to charge the costs to the involved members in case the request for the audit that they placed proved to be groundless.

If the company's supreme body rejected – or did not present a decision on – the request to enforce a claim against the members, the executive officers, the supervisory board members or the auditor of the company, any member or members possessing at least 5% of the total votes may proceed with the enforcement of the claim themselves, in representation of the company and for its benefit, within thirty days starting from the date of the supreme body's meeting on the matter.

Further minority rights are provided at the stock company, as per the relevant decrees of the Hungarian Civil Code.[87]

7. The business share[88]

The business share refers to the entirety of the rights and obligations that originate from a connection with the core deposit.[89] The business shares shall come into existence upon the registration of the company, and they cease to exist at the termination of the company.[90] The business shares of the members shall be consistent with their respective capital contributions. Identical membership rights shall be assigned to equivalent

86 Sections 3:104, 3:105 HCC; Balásházy, 2007.
87 Sections 3:259 (1), (2), 3:261 (4), 3:266, 3:290 (3) HCC.
88 Using of Auer et al., 2011, pp. 404–419.; Papp, 2015, pp. 199–204.; Lexikon, 2019, pp. 293–299.
89 About the lawsuits relating to the business share see more in: Mika, 2018, p. 3., 7.
90 BDT 2019. 4029.

business shares.[91] One business share may be owned by several persons, in which case these persons shall be treated as a single member from the aspect of the company; their rights may only be exercised by their joint representative, and each member shall bear joint and several liability for the obligations of all the members.[92]

■ *7.1. The transfer of business shares*[93]

The business share is transferable,[94] and can be subject to the related transactions. The business share may be freely transferred among the members of the limited liability company, except for the company's own business share. The members may grant each other pre-emption rights in the memorandum of association, and they may also define restrictions on, or conditions to, the transfer of business shares to third persons through other instruments.

An independent business share or a property rate may also be transferred. The transfer of an independent business share increases the value of the business share of the new owner (merger of business shares), and the transfer of an ownership interest in a business share creates joint ownership of the affected business share (non-merger) of the business share owned by the acquirer.[95]

The members may conclude the transfer of business shares to non-members, although this is subject to the consent of the limited liability company (the members' meeting decides on this). The conditions for the consent being granted or rejected shall be provided for in the memorandum of association.

The transfer of business shares based on legal grounds other than a contract of sale (e.g., donation, exchange, contribution in kind, contract of inheritance, life-annuity contract, maintenance support agreement, etc.)[96] may, however, be excluded from, or restricted by, the memorandum of association.

The business shares may be transferred to third persons only if the member concerned has paid up his/her capital contribution in full. The member concerned, the limited liability company or the person designated by the members' meeting shall have, in this fixed order, the pre-emption right to the business shares being transferred by means of a sales contract, provided that this is not excluded from, or restricted by, the memorandum of association. If the member concerned, the company or the person appointed by the company fails to take his/her pre-emption position within fifteen days from the date that the purchasing offer was announced, he/she is to be declared as not having executed his/her pre-emption right; any transfer of the pre-emption right will thus be declared null and void.

In the event of transferring the business shares, the rights and obligations of the transferrer linked with his/her membership, all of the transferred entitlements shall

91 Section 3:164 HCC.
92 Section 3:165 (1) HCC.
93 Sections 3:166-3:169 HCC; Gál, 2013, pp. 5–8.
94 See more in: Veress, 2019b, pp. 121–126.
95 BDT 2019. 3995.
96 ÍH 2004. 71.

become passed on to the party acquiring the business shares. The business shares may only be transferred under the effect of a written agreement. The memorandum of association is not required to be amended as a result of any transfer of business shares. In regards to any changes made to the ownership and date thereof in the register of members, the party acquiring the business share must notify the limited liability company within eight days of when the relevant details of such a change were shared. The notification must be issued in the form of an authentic public or private document, and the sales agreement on the business share must also be attached. In addition to the fact of acquiring the business share, the notification shall also include a statement on the fact that the party acquiring the business share has acknowledged all of the provisions in the memorandum of association as binding.[97]

■ *7.2. The devolution of business shares*[98]

The devolution of business shares is the change in the member, but not in the legal title of the transaction.[99] In case a member has deceased or terminated membership, his/her business share shall be passed on to his/her legal successor. The memorandum of association may prohibit the transfer in the case where the memorandum of association allows for the redemption of the business share by the members or the company.

If a member is deceased, then his/her heirs (or if the member is a legal person, then upon the transformation), the merger or the division of such legal person, or in the event of a succession of its business shares based on acts of law, then its successor may request that the managing director enter him/her into the register of the members upon providing valid proof of the inheritance or succession.

The managing director may decline to register the heir or the successor on the basis that the persons authorized accordingly under the memorandum of association should provide a statement on the acquisition of the business shares in congruence with the relevant prescriptions detailed in the memorandum of association, within a term of preclusion of thirty days starting from the date on which the heir or the successor submitted the request for his/her registration effectively, and provided that the market value of the business share has also been paid up to the heir or the successor by authorized persons.

In case the member shall be terminated without any succession, and his/her business share was not transferred before its removal from the registry, or in the course of the property distribution proceedings to involve the business share, the company shall either withdraw the business share in question, or it shall distribute the business share among the members in accordance with the percentages of their capital contributions.

The devolution of the business share shall set in ipso iure; thus this is not required to be regulated in the memorandum of association, yet the successor must notify the

97 ÍH 2018. 74.
98 Sections 3:170, 3.171 CC.
99 Auer et al., 2011, p. 417.

limited liability company owning an interest in such business shares upon the facts of the inheritance or the termination with succession thereof, and the managing director must have the register of the members adjusted accordingly, and therefore initiate the registration at the competent registry court.[100]

■ *7.3. The division of business shares*[101]

The division of the business share is the procedure of forming more business shares from one business share.[102] The division of the business share does not affect the initial capital of the limited liability company, it only changes the number of the members and the business shares.

The business shares may only be divided by the method of transfer, in the event of succession upon the division of a member being a legal person (regarding its business share), inheritance, the division of common marital property or dissolution without succession (i.e. lack of a new entitled owner of the right). The memorandum of association may prohibit the division of business shares if the business share is the object of a joint property relationship (that of contracting parties, successors, heirs, spouses) or is withdrawn by the company.

The decision on the division of the business share shall be subject to the consent of the members' meeting. The consent of the members' meeting is not required for the division of the common marital property. The provisions related to the minimum value (HUF 100,000) of the capital contribution are also applicable to the division of the business share.

■ *7.4. The withdrawal of the business share*

The withdrawal is a specific ipso iure method of acquisition of the business share by the limited liability company, whereby the limited liability company shall eventually get hold of the business share when it is abandoned by the reduction of the initial capital.[103] The subject of the withdrawal may be a singular independent business share, and it is not possible to withdraw any fraction of a jointly owned business share.[104] The withdrawal of the business share may be prescribed by the Civil Code or by the memorandum of association.

The withdrawal of the business share is mandatory as per the Civil Code in the following three cases: (a) if a member is terminated without succession, and its business shares were not transferred either before it was removed from the registry, or under property distribution proceedings to involve the business share, the company shall either withdraw the business shares in question or it shall distribute the business share among the members in accordance with the percentages of their capital

100 Kisfaludi, 2007, p. 389.
101 Section 3:173 HCC.
102 Kisfaludi, 2007, p. 394.
103 Auer et al, 2011, p. 365.
104 ÍH 2008. 75.

contributions;[105] (b) the limited liability company shall withdraw its own business share (pursuant to the rules of the reduction of the capital) in case the company was unable to alienate its own business share or deliver it to the members in accordance with the proportions of their capital contributions without compensation within one year from the date of the purchase;[106] (c) in case the business share of a former member is not sold in the six month period after the date of the member's exclusion, or the termination of his/her membership, the company must withdraw the business share (alongside the claim submitted by the former member regarding the obtaining of his/her own due portion from the company's capital).[107]

The Civil Code provides for the possibilities of the withdrawal of the business share: in case the member shall fail to complete his/her capital contribution as undertaken in the memorandum of association, and thus his/her membership terminates; in case the member shall become expelled by the order of the court; in both cases the business shares must be sold by means of a public auction in the first place. If the public auction is unsuccessful, the business share may be withdrawn.

The decision on the withdrawal of the business share forms the competence of the supreme body, as a result of which the rights and obligations originating from, or in connection with, the business share shall be terminated, as well as the membership of the owner of such business share.[108] Upon the withdrawal of the business share, the initial capital shall be reduced by the amount of the core deposit behind the affected business shares.[109]

■ *7.5. The limited liability company's acquisition of its own business share*[110]

The limited liability company can acquire its own business share through its operation: this is a special situation, whereby the company disposes of the business share constituting membership rights; the own business share is a transitional distinction drawn by the demarcation between the assets of the company and the property of the member.[111]

Limited liability companies may acquire their own business shares by the method of transfer, based on the decision of the members' meeting. The limited liability company may purchase its own business share from its assets to the extent of the initial capital. Only those business shares may be acquired, with regard to which the capital contributions have been paid in full. The own business share may not be acquired if the company is not authorized to pay out any dividends. The annual report and the interim balance certificate shall be considered for the allocation of funds covering the acquisition of the own business share within a six month period from the date when the balance certificate was issued.

105 Section 3:177 (1) HCC.
106 Section 3:175 (3) HCC.
107 Section 3:181 (4) HCC.
108 Section 3:176 (1) HCC.
109 Section 3:176 (2) HCC.
110 Sections 3:174, 3:175 HCC.
111 Sárközy, 2001, p. 245.

The amount of the capital contributions behind the company's own business shares may not surpass 50% of the initial capital.

The limited liability company may not exercise its membership rights in connection with its own business shares; such business shares shall be disregarded in respect to the rules on the quorum. The company is not entitled to receive dividends for its own business shares. Any dividends payable for the company's own business shares shall thus be distributed among the members entitled to receive dividends according to the percentages of their capital contributions.

Within a one year period from the date of the purchase of the business share, the limited liability company shall alienate the business shares acquired in return for a compensation, or by delivering those to the members according to the percentages of their capital contributions without any compensation, or it shall withdraw such business shares pursuant to the rules of the reduction of the capital. The company shall dispose of the business shares upon the termination of membership as they are considered to have failed to complete the capital contribution, or the exclusion of the member to be ordered by the court, if the membership was terminated due to the member having failed to provide the supplementary payment.

■ *7.6. Lien on the business share*[112]

A lien on the business share must be registered in or cancelled from the Registrar Of Companies upon the request from the member (obligor) or the lien holder (according to the Appendix to the Firm Act, the documents must be enclosed with the request). The registry court shall examine the contract of lien with respect to the data and the details of the limited liability company, as well as its member (in terms of their compliance with the actual records in the Firm Registry).[113]

The business share may also become sequestered or seized. To sequester means that the business share is restrained from alienation and encumbering, and a seizure means that the right to dispose of the business share has been suspended.[114]

8. The questions of liability[115]

■ *8.1. The liability of the member*

With the exceptions set out in the Hungarian Civil Code,[116] the members of a limited liability company shall not be liable for the liabilities of the company. As per the rule, the liability of the members towards the company shall only extend to the submission

112 See more in: Veress, 2019b, p. 125.; Török, 2008, pp. 8–15.

113 Section 61/A FA (Firm Act: Act V of 2006 on public company information, company registration and winding-up proceedings).

114 BDT 2019. 4029.

115 Using of Auer et al., 2011, pp. 354–361.; Papp, 2015, pp. 137–138., 190–191.; Lexikon, 2019, pp. 117–119., 236–237., 315–319.

116 Pázmándi, 2014, pp. 18-23.

of their capital contributions and any other contributions, as set forth in the memorandum of association.[117]

As an exception to the rule, the member of the limited liability company may bear limited liability against the creditors of the company, and an unlimited liability against his/her company or against the creditors of the limited liability company.

The liability of the member of the company is limited in the following cases: (a) when the members of the pre-company (the form of existence from the date on which the memorandum of association was countersigned or issued as an authentic document, until the decision of the registry court) shall be deemed limited (according to the rates of the assets distributed) in their liability for any debts originating from the commitments entered therein, until the date of the termination of the operation as a pre-company;[118] (b) when any members that provide contribution in kind accept the responsibility towards the limited liability company to the extent that the value marked in the memorandum of association doesn't over exceed the value of the contribution that is effective at the time of submission; if the value of the contribution in kind does not reach the value marked in the instrument of constitution, the company may demand to settle the difference with the person that provided the contribution in kind, within five years from the date of its submission;[119] (c) if the memorandum of the association decrees that the member must submit less than half of his/her monetary contribution before the request for the registration of the company has been filed, or it enables a deadline for the submission of the still unpaid monetary contribution more than one year after the date of the registration of the company, then the company is not allowed to pay any dividends to its members until the unpaid profit (calculated according to the rules on the payment of dividends) has been split equalling in rates the monetary, or asset contributions of each member, and the amount of the monetary contributions already settled by the members shall not reach the amount of the initial capital; in those cases, the members shall bear the responsibility for the debts of the company to the extent of the unsettled parts of their monetary contributions;[120] (d) if the liability of the member was limited to the obligations of the business association during the existence of the limited liability company, the liability of the member for the obligations of the terminated company shall be limited to the rate of the assets having been distributed upon the termination of the business association, which is due to said member.[121]

The member of the limited liability company has unlimited liability against his/her company when the members who were aware of, and consented to, the contribution in kind being valued higher than its actual worth at the time; in this case, they shall bear a joint and several liability towards the company, together with the providing

117 Section 3:159 HCC.
118 Section 3.101 (1), (5) HCC.
119 Section 3:10 (3) HCC.
120 Section 3:162 HCC.
121 Section 3:48 (3) HCC.

person, in accordance with the provisions on the liability for damages caused by the breaching of a contractual obligation.[122]

The member of the limited liability company shall bear unlimited liability towards the creditors of the company in the following cases: (a) if a member or a founder to a legal person should abuse his/her limited liability, as a consequence of which they act upon the dissolution of the legal person without succession, there shall be any unsettled claims of the creditors remaining; in this case, the member and the founder in question are obliged to bear unlimited liability for such debts;[123] (b) if the controlled member of the group is under liquidation, then the dominant member must be held liable for the debts of the controlled member; the dominant member shall be acquitted from this liability on the condition that it is capable to prove that the insolvency of the controlled member was not the consequence of the unified business strategy of the group;[124] the rules of the qualified majority control[125] are appropriately applicable to the liability of the singular member of a one-man limited liability company;[126] (c) if the member of the legal person shall cause damages to a third party in a manner that is related to his/her membership capacity, then the legal person shall bear liability for that towards the injured party, but the member and the legal person together share a joint and several liability in case the damage was caused deliberately;[127] (d) in case the registry court removed a limited liability company from the Registrar of Companies by an act of compelled cancellation,[128] the former member of the company – who was registered at the time of the de-registration – shall bear unlimited liability for the remaining unsettled claims of the creditors of the company, if he/she is proved to have abused his/her own limited liability[129] (if there are more members, their liability is joint and several);[130] (e) if the debtor has accumulated debts up to 50% of its equity, it is upon the request from the creditor or the liquidator when the court shall declare the former member with majority control (having transferred his/her share within three years before the start date of the liquidation procedure), to bear unlimited liability for

122 Section 3:99 (2) HCC.
123 Section 3:2 (2) HCC.
124 Section 3:59 HCC; Section 63 (2) BA (Bankruptcy Act: Act XLIX of 1991 on bankruptcy proceedings and liquidation proceedings).
125 ÍH 2018. 79.; BH 2019. 22.
126 Section 3:208 (3) HCC; ÍH 2019. 31.
127 Section 6:540 (2), (3) HCC.
128 ÍH 2018. 113.: This is a pre-condition of the member's liability.
129 BDT 2018. 3936.: The membership relation has created the possibility of causing damage as well as gaining property to the debit of the creditor.
130 Section 118/A (1) FA; Section 118/A (2), (3) FA: A member is considered to have abused his/her limited liability if they have a history of making unfavourable business decisions, treating the company's assets as their own, or supporting a resolution without taking reasonable care (that he/she knew or should have known), such that the resolution was clearly opposing the significant interests of the company; any former member who transferred his/her share within a period of three years before the opening of the involuntary de-registration shall bear unlimited liability for the thereby unsettled claims of the company's creditors, if found to have abused his/her limited liability or acted in bad faith when transferring his/her share.

the remaining unsettled obligations of the debtor, unless he/she is capable of proving that the debtor was insolvent at the time of the transfer of said share, and that the accumulation of debts only happened thereafter, or that he/she acted in good faith when transferring his/her share despite the fact that the debtor had already been in a situation of potential danger with insolvency (or was already insolvent).[131]

■ *8.2. The liability of the managing director*[132]

The executive officer must be held liable for the damages caused to the business association by his/her management activities, in accordance with the provisions on the liability for damages caused by the breaching of a contractual obligation.[133]

The person appointed to represent the legal person shall be responsible for submitting the request for the registration of the legal person to be established, such that the representative shall be liable to the founders according to the provisions on the liability for damages caused by the breaching of a contractual obligation for the damages caused by his/her failure to either submit the request (or the submission) in due time, or if he/she did it in a deficient or erroneous manner.[134]

If the registration of the business association is rejected by virtue of a decision with binding force, the business association under registration must terminate its operation without delay, once it has gained knowledge about the decision. For the damages caused by the breaching of this obligation, the executive officers of the business association under registration are liable, according to the provisions on the liability for damages caused by the breaching of a contractual obligation.[135] If the operation of the business association under registration is terminated, the obligations undertaken until that time shall be settled from the assets made available to the would-be business association; if the liability of the members of the would-be business association for the obligations of the business association was limited, and if certain claims have still remained unsettled despite the proper fulfilment of the members, then the executive officers of the would-be business association shall bear joint and several unlimited liability against third parties.[136] These provisions are also applicable if the business association withdraws its request for registration.[137]

If the supreme body of the business association grants the managing director a certificate of discharge from the compliance of his/her management activities realized in the previous financial year, at the same time as their approving of the financial report upon the request from the managing director, the business association may only enforce its claim against the executive officer for the damages he/she caused by violating his/her management obligations, if the facts and data that served the basis for

131 Section 63/A BA.
132 See more in: Nochta, 2019, pp. 15–18.; Török, 2015.
133 Section 3:24 HCC; BDT 2019. 3994.; BDT 2019. 4011.
134 Section 3:12 HCC.
135 Section 3:101 (4) HCC.
136 Section 3:101 (5) HCC.
137 Section 3:101 (6) HCC.

the discharge were false or defective. After the termination of the business association without succession, those who were members at the date of the deletion of the business association may enforce their claim for the damages against the executive officers within a term of preclusion of one year from the date of the deletion of the business association; the members are entitled to lay such claims for such damages to the extent of their rightful share in the assets distributed.[138]

If the business association is terminated without succession, the creditors may enforce their claims for the damages up to the amount of their unsettled claims against the executive officers of the business association, based on the rules on the liability to be borne for the damages caused under extra-contractual obligations, if the executive officer involved failed to take into account the interests of the creditors when the circumstance endangering the business association with insolvency did set in; this provision is non-applicable in the event of termination by winding-up.[139]

In the case where the registry court removed a company from the Registrar of Companies by an act of compelled cancellation, the executive officer of the company is to bear liability for the unsettled demands of the creditors to the company to the extent of the detriment thus created,[140] if he/she pursued his/her duties without considering the interests of the creditors after the occurrence of the situation endangering with insolvency, due to which the property of the company decreased, and the fulfilment of the demands of the creditors became thwarted (if this involves more executive officers their liability is joint and several).[141] The executive officer shall be exempt from the liability if he/she makes it evident that the situation endangering with insolvency did not occur during the effectivity of his/her legal relationship as an executive officer; or in the case that it did not occur due to the practice of his/her management role, and that after the occurrence of the situation endangering with insolvency he/she did execute all of the possible measures generally expected from a person in such a position, to ensure avoiding or decreasing the losses of the creditors, and also that the actions of the supreme body of the company were initiated.[142]

The creditor of the liquidator[143] may file a complaint at the competent court throughout the liquidation procedure for the judicial declaration that[144] those personnel, who were in the company's leadership in the three years preceding the start date of the liquidation, pursued their duties without considering the interests of the creditors after the occurrence of the situation of insolvency,[145] and in a cause and effect relation to this, the property of the company decreased, or the overall fulfilment of the demands

138 Section 3:117 (1), (3) HCC.
139 Section 3:118 HCC.
140 ÍH 2018. 76.
141 Section 118/B (1) HCC.
142 Section 118/B (4) FA.
143 ÍH 2019. 67.
144 BH 2018. 231.
145 See in: Mika, 2018, p. 7.

of the creditors were thwarted by another cause.[146] This also qualifies as an activity of ignoring the interests of the creditors if the leader failed on his/her obligations (as defined by acts of law to prevent, stop or justify damaging the environment), and as a result of this, the overall fulfilment of the demands of the creditors were thwarted. If several persons caused the injury together, then their liability is declared joint and several.[147] The leader is also exempt from the liability if he/she makes it evident that he/she did not undertake any unreasonable business risks in the state of the debtor after the occurrence of the situation of insolvency, and also that he/she did execute all of the possible measures generally expected from a person in such a position, to ensure avoiding or decreasing the losses of the creditors, and also that the actions of the supreme body (decision-making body) of the debtor company were initiated.[148]

146 ÍH 2018. 78.; ÍH 2018. 121.

147 Section 33/A (1) BA; ÍH 2018. 139.: This rule shall be applied and interpreted together with Section 3.118 HCC.

148 Section 33/A (4) BA; See more: Mohai, 2018, pp. 32–41.

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Limited Liability Company in Slovakia: Current Problems Faced

ABSTRACT: *This article is focused on the Limited Liability Company (LLC), the most popular form of company in Slovakia, as a legal form for small and medium enterprises. The article analyses selected topics that are important for comparison and for establishing a better understanding of the Slovak regulation; these are mainly capital requirements and capital protection, bans on the return of investment contributions, management responsibility, the responsibility of the single or majority member, and rules on minority protection. The article also describes the current problems regarding the LLC regulation in Slovakia (restrictions on the company formation, transfer of business shares, piercing the corporate veil, de facto statutory body/ director.*

KEYWORDS: LLC in Slovakia, management responsibility, responsibility of LLC members, LLC capital requirements, capital protection, minority protection, business share/ participation, piercing the corporate veil.

1. Introduction to the Slovak regulation of Limited Liability Companies

The Limited Liability Company (LLC) is the most popular form of company in Slovakia. LLCs may be formed by one person (a natural or legal person) and may have a maximum of 50 members under the Slovak Commercial Code. LLCs may also be established for purposes other than business.[3]

To a large extent, the LLC is established for the purpose of business activity, and the expansion of this form of business is directly related to the safety of business in relation to the LLC members. Any business failure will not be reflected in the personal

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3 Patakyová, 2019, p. 69.

https://doi.org/10.47078/2020.1.179-194

property of the LLC member.[4] LLC is an entity whose registered capital is made up of its members' contributions and whose members are liable as guarantors for the company's obligations until their paid-up investment contributions are entered in the Commercial Register. Upon payment of the shareholder's contribution in full and registration of the payment of the contribution in the Commercial Register, the shareholder is not liable as a guarantor for the company's obligations. The LLC is liable for breaches of its obligation with its entire property.

The LLC is obliged to create registered capital, which must amount to at least 5 000 euros. The value of the shareholder's contribution must be at least 750 euros. Each member may participate in the registered capital of an LLC with only one investment contribution. The amount of individual member's investment contributions may be determined differently, but the sum of all individual contributions must correspond to the total amount of the company's registered capital.

Of all company types, LLCs make up the highest number of established companies per year in Slovakia. Figure 1 shows the proportion of the number of LLCs established in relation to other forms of legal entities. LLCs are marked in dark green.[5]

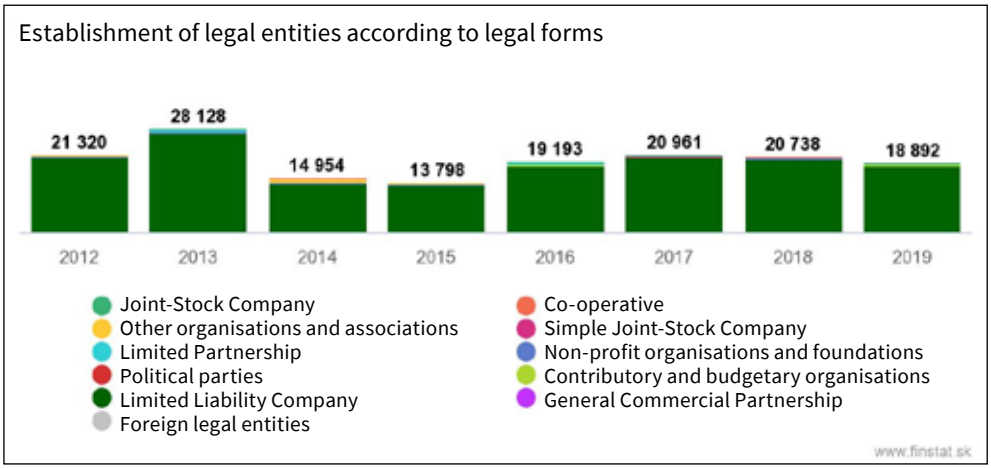

Figure 1. The proportion of the number of LLCs established in relation to other forms of legal entities. LLCs are marked in dark green.

According to legal theory, the LLC is classified as a capital company.[6] However, it also has some properties typical of a personal company (e.g. the option of excluding the

4 Patakyová, 2016, p. 459.

5 The graph is available at: https://finstat.sk/analyzy/statistika-poctu-vzniknutych-a-zaniknutych-firiem (Accessed: 7 February 2020).

6 Kraakman, 2017, p. 5. identifies these five characteristic features of the modern capital company: (i) separate legal personality, (ii) limited liability or non-limited liability of partners / shareholders, (iii) transferability of business shares and shares, (iv) centralised management governed by directors/members of the board of directors, and (v) (residual) ownership of the company based on legal capital contributions.

inheritance of a shareholding, limiting or excluding the transfer of business shares, and limitation on the number of LLC members).[7]

The question that arises is 'To what extent does the LLC legislation open up space for members to deviate from the LLC legal regulation?' The Commercial Code does not address the question of mandatory and default legal provisions and does not set any general rule in this regard. Regarding the question of the mandatory or default character of provisions regarding LLCs, it is necessary to do so with respect to the limits of the associated contractual freedom, since corporate documents are contracts *sui generis*.[8] Legal provisions of company law in the Commercial Code are considered primarily as mandatory. Patakyová (partially) agrees with this conclusion, but in this context declares that provisions regarding company law in the Commercial Code are under the rule set by Section 2(3) of the Civil Code considered as imperative, and therefore mandatory, considering the character of these provisions containing individual rules. Therefore, Patakyová partially corrects the above-mentioned approach and asserts that

> *"in the sphere of private law it is also adequate in this context to require a restriction and not to search for permission for autonomous regulation, whereby in case of an absence of restriction, the permission is implicitly given by law and participants of legal relationships may express relevant will praeter legem. I consider it necessary to highlight that the prohibition of certain autonomous regulation may arise from all 'sources' of the legal regulations of relationships which are subject to the Commercial Code and also from the principles which undergird the Commercial Code."*[9]

In particular, the provisions related to the formation of LLCs and the legal restrictions around their formation, the essential elements of the memorandum of association, the repayment of contributions and capital formation (minimal capital requirements), capital protection and profit distribution rules, and the provisions related to the protection of creditors all have a mandatory character. The provisions governing the liability of the statutory body and the statutory powers of the General Meeting, which cannot be delegated to another body, are also mandatory. Those mandatory provisions are mainly intended to preserve the essential characteristics of this type of company and to safeguard the balance within the company and the protection of third parties.

7 Patakyová, 2016, p. 459.
8 Patakyova, 2019, p. 46.
9 Patakyová, 2016 cited in Patakyová, 2019, p. 47.

2. Restrictions *ex lege* on the formation of LLCs

A person who wants to form an LLC must comply with several legal restrictions. The person may not be listed as a tax debtor or social insurance debtor (the application for registration of the company shall be accompanied by the consent of the competent authority involved in the formation of the company). This restriction was introduced for the declared purpose of combating tax fraud.[10] This limit shall not apply if the tax administrator concerned has given his consent[11] to the formation of the company. An LLC cannot be established by any person registered as liable with regard to valid commenced enforcement proceedings either. These limits mentioned above do not apply to the founder, the foreign person.

The Slovak legislator transposed the Twelfth Company Law Council Directive[12] by adopting specific restrictions on situations in which a natural person is the sole member of several companies or the single-member company is the sole shareholder of an LLC.[13] One individual may be a sole member of no more than three LLCs. The Unipersonal LLC cannot form or be a single member of another LLC. These limits apply only to LLCs and not to joint-stock companies or simple joint-stock companies. The Commercial Register examines the fulfilment of the limits above when an LLC is entered in the Commercial Register. Compliance with these limits is demonstrated by a written declaration provided by the founder. However, compliance with these limits is not examined in the case of the transfer of business shares during the existence of the company. In the case that these restrictions are breached upon entering the LLC in the Commercial Register, the court maintaining the Register shall refuse to enter the company in the Commercial register. If the restrictions are violated after the transfer of business shares during the existence of the company, the court may decide on winding up the company. Such a decision would not be automatic; the court would provide the company with a time period to withdraw the reason for cancellation before deciding to wind up the company.[14] During this period, the company may adjust its structure to comply with the legal requirement that bans chaining.

10 Mamojka, 2016, p. 424.

11 The possibility of granting the consent to the tax administrator was introduced by an amendment Nr. 390/2019 Z. z. to the Commercial Code; this legislation will be effective from 20.10.2020.

12 Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies.

13 Ovečková, 2017, p. 750.

14 Section 68 (6) Commercial Code pursuant to the amendment to the Commercial Code effective from 1.10.2020 pursuant to 68b (1) Commercial Code; The new wording of Section 68b of the Commercial Code, which will be effective from 1.10.2020, does not, in contrast to the current version of Section 68 of the Commercial Code, contain an explicit obligation for the court to set a period for removal the reason for cancellation. However, according to the explanatory memorandum to the new wording of Section 68b of the Commercial Code, such court's calls will be automated. In our opinion, the automatic winding up of companies without a court call would be a disproportionate sanction and interference with the company's existence.

The open question is whether this ban on the chaining of unipersonal LLCs also applies to foreign persons. Most commentators tend to think in the affirmative; otherwise, there would be an unjustified difference between a Slovak and a foreign person, and the possibility of waiving the application of the chain ban on foreign persons would be contrary to the objective of the Directive.[15]

3. Minimal capital requirements and capital protection rules

The amount of capital registered by an LLC must be at least 5000 euros. The Commercial Code includes several capital protection rules.[16] Such rules are, in particular, those relating to the creation of capital, which lay down the procedure for the repayment of contributions by LLC members (a monetary investment contribution or a nonmonetary contribution). A nonmonetary contribution may only be an asset with an economic value that can be ascertained. The value of a nonmonetary contribution shall be, in principle, based on expert testimony, unless the Commercial Code states otherwise.[17] The Commercial Code does not require that the property be used in coherence with the company's main entrepreneurial focus. It is prohibited to make investment contributions in the form of an undertaking to perform some work or supply a service. A receivable against the company may be considered a non-monetary contribution. The member who transfers the receivable to the company is liable as a guarantor for its enforceability up to the value of its contribution. A nonmonetary contribution must be provided before the amount of the registered capital is recorded in the Commercial Register. Should the company not acquire the ownership title to a particular object of a nonmonetary investment contribution, even though such nonmonetary contribution is regarded as paid up, the member who undertook to provide such a contribution must pay its value in money and the company must return the nonmonetary contribution to this member unless the company is under obligation to surrender it to the entitled person. If the value of a nonmonetary contribution does not reach the originally agreed-upon amount by the time of the company's incorporation, the member who made the nonmonetary contribution must pay the difference in monetary instruments.

The tools for protecting capital also include the rules for the payment of profits and the prohibition of hidden profit payments.[18] The LLC may pay a profit share or

15 Ovečková, 2017, p. 463.
16 Patakyová, Grambličková and Kisely, 2017, pp. 885–902.
17 E.g. Section 59b Commercial Code.
18 Section 123 (2), (3) in conjunction with Section 179 of Commercial Code.

distribute other own funds only if the conditions set out in Section 179 (3)[19] and Section 179 (4)[20] of the Commercial Code are met, and if, in any circumstances, this does not cause it bankruptcy.

These are the provisions of a joint-stock company which apply to an LLC as well and which are significantly affected by the objectives set out in the capital directive.[21] An important condition for the distribution of net profit, together with the replenishment of the reserve and other funds, is the coverage of losses from previous periods. Section 179 (3) of the Commercial Code provides *a net surpluses test (a nimble dividend test, a running account profit test)* based on Article 17 (3) of the Consolidated Capital Directive.[22] Section 179 (4) of the Commercial Code provides *an equity test (a solidity test, a net asset test)* based on Article 17 (1) of the Consolidated Capital Directive, and this test was supplemented by *a bankruptcy test*.[23]

The ban on the return of investment contributions[24] serves as the effective protection of creditors and prevents shareholders from obtaining any benefits to the detriment of the company's assets, with the exception of the payment of profits.[25] The goal is to avoid any performance in favour of the company member without adequate consideration of the company. The factual definition of the term 'investment contributions' is very broad and the approach is one of substance over form. The legal definition of investment contributions approximates the concept of distribution used in English law. In most cases, in practice, it will not be an investment contribution at all, nor will

19 Section 179 (3) of the Commercial Code reads as follows: "Until the LLC is wound up, LLC members are only entitled to the distribution among between them of net profit that has been reduced by contributions to the reserve fund, or any other fund applicable, created by the company under the law, and by the accumulated loss of previous years, increased by the retained profit of previous years and other of its own resources created from profits whose utilization is not stipulated by law."

20 Section 179 (3) of the Commercial Code reads as follows: „The company may not distribute net profit or other of its own resources among/ between shareholders, if, in all circumstances, this does not cause it to bankruptcy and if the equity ascertained from the approved annual financial statements is, or would be in consequences of the profit distribution, lower than value of the registered capital increased by the reserve fund, or any others funds if applicable, created by the company which must not be, under the law or articles of association, used for payments to shareholders, reduced by the value of unpaid registered capital, provided this value has not yet been included in the assets reported in the balance sheet under a special Act."

21 Second Council Directive (Capital Directive) on the company law of 13.12.1976, 77/91 / EEC on the regulations governing the formation of public limited liability companies and the maintenance and alteration of their capital, as amended by Directive 92/101 / EEC, OJ 1992 L 247 / 64.

22 Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.

23 Patakyová and Gambličková, 2016, p. 459.

24 Section 67j of the Commercial Code.

25 Ovečková, 2017, p. 530.

there be funds generated from it.[26] The ban on the return of investment contributions is defined very broadly; examples of some of the definitions of 'investment contributions' in regard to this ban are as follows: (a) performance without adequate consideration based on a contract between a member of the company and the company, and (b) performance of the company provided due to the guarantee, lien or other security provided by the company to secure the member's obligations or for their benefit. 'Their benefit' means not only the member's benefit but also the benefit of the person who is the person close to member or a person acting on behalf of a member etc.

The Commercial Code includes not only the capital protection rules but also rules supporting capital increases in cases of impending bankruptcy through the provisions of the company in crisis. Slovak legislation on this matter was inspired by the German and Austrian legislation of the company in crisis. The essence of the company in crisis is the definition of the substitute equity financing resources, which in principle means loans provided by related creditors (these could also be members of the company) during the company's crisis (bankruptcy or threat of bankruptcy). While the company is in crisis, it is not allowed to repay these loans to the related creditors; the time limits set for repayment do not run, and thus the company will not default.

4. Trading possibilities of a business share

In principle, the Commercial Code allows LLC members to regulate the transferability of business shares in an agreement of association. The regulation of the transferability of business shares is primarily not mandatory and opens the space for LLC members to edit the regulation of the Commercial Code otherwise. The Commercial Code distinguishes between the transfer of a business share to another LLC member and transfer to a third party. Unless the agreement of association stipulates otherwise, an LLC member may transfer their business share to another LLC member with the consent of the general meeting. If the agreement of association permits, an LLC member may transfer their business share to another person.

The Commercial Code prohibits the transfer of business shares to another LLC member or third party if a company is in the process of winding up, if the company is wound up by a court or by a court decision, or if the company is subject to bankruptcy or restructuring. Since 1.10.2020 the Commercial Code also prohibits the transfer of business shares to another LLC member or third person if the debtor is registered as liable in the register of valid commenced enforcement proceedings.

The provisions of the Commercial Code relating to the formal requirements for a contract on the transfer of a business share (written form of a contract and signatures must be verified) and the conditions for the transfer of a majority interest[27] are manda-

26 Patakyová, 2016, p. 326.

27 In principle, at least 50% is considered to be the majority, see Section 115 (8) of the Commercial Code.

tory. The transfer of the majority interest requires the consent of the tax administrator if the LLC member or the acquirer is on the list of tax debtors. This consent is not necessary in the case of a foreign person, regardless of whether he/she is an LLC member or an acquirer. In the case of a transfer of a majority interest, the effects of the transfer do not take effect until the entry in the Commercial Register.

The possibility of establishing a lien on a business share depends on its transferability under the agreement of association. A business share may not be subject to a lien if the agreement of association does not permit the transfer of a business share. If a business share may only be transferred with the general meeting's approval, its approval shall also be required for establishing a lien on a business share; unless such approval is granted, no lien shall be established; the meeting's approval is not required for the transfer of a pledged business share by an existing lien. If under the agreement of association, the fulfilment of another condition is required for the transfer of a business share, the fulfilment of such a condition is also required for the establishment of a lien.[28]

Claims of personal creditors of the LLC member may be enforced against the business share.[29] The effects of the distraint of the business share depend on the possibility of transferring it. A free transferable business share without any limits is enforceable by selling at auction by analogy with the provisions on the sale of movable assets. In the case of the limited transferability of shares, the legal effect of the distraint shall have the same effects as the cancellation of an LLC member's participation in the company by the court. The distraint is then conducted to the debtor's right to a settlement share.

5. The rules and practice of the executive officer's responsibility

Executive officers are the managing authorities of LLCs. Executive officers are obliged to perform their activities with professional care (*duty of care*) and in accordance with the interests of the company and all its members (*duty of loyalty*). Executive officers do not have to be experts but they must act professionally[30]; they have to obtain and take into account in their decision-making all available information related to the subject of their decision, ensure confidentiality of information and facts whose disclosure to third parties could cause harm to the company or endanger the interests of the company's members, and while exercising their powers, must not give priority to their own interests, the interest of only certain members, or the interest of third parties over the company's interests. The fulfilment of the duty of care is evaluated from an objective point of view; the personal abilities and experience of the executive officers are not decisive. Executive officers are obliged to select an appropriate expert advisor *(culpa in*

28 Section 117a (3) of the Commercial Code.
29 Section 113b of the Enforcement order.
30 Csach, 2019, p. 183.

eligendo); however, if the executive officer possesses the necessary expertise, he must use it. A part of the executive officer's duty of loyalty is the prohibition of competitive conduct, as well as an obligation to confidentiality.

Executive officers who have breached their duties while executing their powers shall be responsible for damages suffered by the company. Executive officers are not obliged to remunerate the company for the damages suffered, (a) if they prove that they proceeded with professional care and in good faith and were acting in the interests of the company. The burden of proof lies with the executive officer who must prove compliance with his obligations (the reverse burden of proof). From the doctrinal point of view, this approach is called *business judgment rule*.[31] For example, the Delaware (US) approach is different. The decision-making activity of the Delaware courts has shaped this rule.[32]

> *"In Delaware, the business judgement rule provides a presumption that, in making a decision, directors were informed, acted in good faith and honestly believed that the decision was in the best interest of the company. The business judgment rule is both a procedural guide and a substantive rule of law."*[33]

Procedurally, it places the initial burden of proof on the plaintiff to prove why the rule is inapplicable.[34] However, the objectives of the above approaches to the business judgement rule are identical. The rule brings safe harbour for executive officers/directors' business decisions and allows for honest mistakes in decision-making. Executive officers are also not obliged to remunerate the company for the damages suffered, (b) if they are executing the resolution of the General Meeting that is not contrary to legal regulation or the agreement of association.

The question of whether the executive officers are responsible in the case that they implement a resolution of the general meeting that is in compliance with the law/statutes but not in the interest of the company is a theoretical one. We have not had many court decisions on the liability of the executive officers. However, such claims have been more common in recent years, including creditors' claims towards executive officers. Following a creditor's claim, the district court has already ruled on the liability of the executive officer, who has executed some decision of the general meeting that was in accordance with the law but was not in the interest of the company.[35]

Agreements between the company and its executive officer that exclude or limit the executive officer's liability are prohibited. Neither the agreement of association nor articles of association may limit or exclude an executive officer's liability. A company may waive claims for damages it has against its executive officers or may conclude a

31 Csach, 2019, p. 184.
32 Petrek and Katkovčin, 2018, p. 227.
33 Pinto and Branson, 2018, p. 224.
34 Pinto and Branson, 2018, p. 224.
35 District court in Zvolen 13C202/2011 from 20.3.2017.

settlement agreement with them only three years after such a claim first arose, provided that the general meeting consents to such a waiver and that no shareholder or shareholders whose investment contributions amount to 10% of the registered capital object to such a decision at the general meeting in the minutes.[36]

■ *5.1. Claims for damages caused by executive officers*

LLC members are entitled to claim the damages caused to the company by executive officers on behalf of the company. LLC members are not entitled to claim reflex damages: that is, damage resulting from damage to the company's assets.

Company creditors may claim damages caused to the company by executive officers on their behalf or their own account if they cannot satisfy their claim through the company's assets. The creditor must prove, inter alia, that he cannot satisfy his claim through the company's assets. The inability to satisfy a claim from the company's assets must be objective because of a lack of assets of the company, it cannot be a subjective unwillingness of the company to fulfil a creditor's claim.[37] The basic requirement for bringing such a claim is the damages suffered by the company as a result of a breach of the executive director's duty. The filing of such a claim by the creditor is limited quantitatively to the amount of the creditor's claim. The creditor's claim shall not be limited if a waiver agreement or a settlement agreement between the company and the executive officer has been concluded. In the event of bankruptcy, the creditor's claim is exercised by the bankruptcy trustee. This legal option for creditors to submit a claim broadens the liability of executive officers to the extent that they are liable up to the amount of the damages caused, with all their assets.

■ *5.2. Special duties of the executive officers*

In addition to general responsibilities (duty of care, duty of loyalty, duty of good faith), executive officers also have a number of special duties, some of which are mentioned in this paper. They are obliged to take measures to overcome the crisis.[38] The executive officer who finds, or, considering all circumstances, could have found, that the company is in crisis, must do everything possible, as may be required in line with the principle of reasonable professional skill and due care, from a reasonable and prudent person to overcome such crisis.

These special duties that arise in a crisis situation are intended to avert the crisis and ensure that the measures taken are effective. However, this particular obligation to overcome the crisis can also be inferred from the general duty of care.[39]

The executive officers have the obligation to duly submit a proposal for a bankruptcy proceeding to be initiated. Executive officers have a specific responsibility for not duly submitting a bankruptcy proposal under the Slovak bankruptcy act: an

36 Section 135a (4) of the Commercial Code.
37 Mamojka, 2016, p. 543.
38 Section 67b of the Commercial Code, See: Kalesná and Patakyová, 2019, pp. 215–217.
39 Duračinská, 2017, pp. 268–272.

obligation to pay a legal contractual penalty to the company of 12,500 euro, and liability for any damage caused to creditors by not duly submitting a bankruptcy proposal. Unless otherwise proven, the Bankruptcy and Restructuring Act[40] assume that the creditor has suffered damage to the extent that the creditor's claim was not settled after the insolvency proceedings were closed due to the debtor's lack of assets, the cancellation of bankruptcy declared for the debtors' property due to lack of assets or the enforcement proceeding was closed due to lack of the debtor's assets. This is a rebuttable presumption of the amount of damage and the burden of proving the amount of damage caused was thus transferred to an obliged person.[41]

The court's decision on a legal contractual penalty is the decision on exclusion (disqualification).[42] The court may decide on the exclusion of a representative from the statutory body for a specified period of time; the excluded representative may not perform as a member of the statutory body for the set time period. Violation of the ban on performance is sanctioned by a legal guarantee by the excluded manager for the benefit of the creditors.[43]

6. Responsibility of LLC members

■ *6.1. De facto statutory body (director)*

LLC members, in principle, are not obliged to care (they do not have a duty of care as executive officers) and are not liable for the debts of the company towards its creditors. However, LLC members may be the holder of the duty of care as a de facto statutory body (de facto director) under the Commercial Code.[44] De facto director under the Slovak Commercial Code refers to a person who effectively exercises the powers of a statutory body without being appointed to the office. Legal regulation of the de facto director is focused on facticity, on the basis of which the fact of management is the most important factor, not the legal status of the 'director'. Therefore, the facto director can be anyone, not just a company member or shareholder.[45] The facto director may be, for example, a senior employee, legal person, or state.[46] The de facto director has the same responsibility as a real member of the statutory body/real executive officer.

The facto director has the same responsibility as a member of the statutory body/executive director. They are obliged to perform their activities with professional care (*duty of care*) and in accordance with the interests of the company and all its members (*duty of loyalty*). However, there is some disagreement on the possibility of delegating some specific duties of the statutory body/executive director (e.g., the obligation to duly

40 Section 11a Bankruptcy and Restructuring Act.
41 Mašurová, 2018, p. 173.
42 Section 74a Bankruptcy and Restructuring Act.
43 Section 13 of the Commercial Code.
44 Section 66 (7) of the Commercial Code.
45 Csach, 2018, p. 15.
46 Csach, 2018, p. 15.

submit a proposal for a bankruptcy proceeding to be commenced, or disqualification) to the de facto director. According to some, the de facto director will not carry all the duties of the executive directors;[47] according to some others, these special obligations are also transferred to the de facto director.[48]

■ *6.2. The Slovak 'piercing of the corporate veil'*

The possibility to pierce the corporate veil under Slovak law represents the responsibility of the controlling entity for the bankruptcy of the controlled entity.[49] Through this, responsibility has been explicitly incorporated a special tort: direct responsibility of the controlling entity towards the creditors of the controlled entity, in our legal order.[50] The controlled entity is, in principle, a company in which an entity has a majority on voting rights based on the share's ownership or an agreement. It is irrelevant whether the agreement is valid or invalid; factual control is sufficient.

The controlling entity is liable to the creditors of the controlled entity for damages caused by the bankruptcy of the controlled entity if it has contributed to this bankruptcy. The estimated amount of damages is the amount of the creditor's unsatisfied claim after the suspension of bankruptcy proceedings. The controlling entity may be liberated of its liability if it proves that it has acted with knowledge and in good faith in accordance with the interests of the controlled entity.

Before the adoption of the legal regulation of the controlling entity's responsibility for the bankruptcy of the controlled entity in our legal system, such liability could previously have been derived primarily from Section 424 of the Civil Code, which, however, imposes stricter conditions for the exercise of liability, especially contradiction with *boni mores* and at least indirect intent (*dolus eventualis*) on the pest side.[51] However, we are not aware of any case of the application of this provision in connection with the liability of the controlled entity or the statutory body towards creditors in practice.

7. Decisional rules in the general meeting

The general meeting takes decisions through voting by the LLC members. The number of votes of each LLC member shall be determined by the proportion of the value of their investment contribution to the amount of the company's registered capital, unless the agreement of association determines a different number of votes.[52] Thus, the agreement of association may regulate the number of votes attributable to every LLC member in a different manner. For example, each LLC member will have an equal number of votes,

47 Mašurová, 2018, p. 177.
48 Csach, 2018, p. 18.
49 Section 66a of the Commercial Code.
50 Mašurová, 2018, p. 172.
51 Mašurová, 2018, p. 172.
52 Section 127 (2) of the Commercial Code.

although the quantity of investment contributions will vary. The agreement of association may further stipulate that the number of votes of each LLC member will depend on the extent of repayment of his investment contribution and not on the amount of the investment contribution taken over.[53]

A simple majority is required for a decision at the general meeting. However, the Commercial Code or an agreement of association may require a higher number of votes.[54] The Commercial Code determines the necessary (minimum) quorum for taking decisions at the General Meeting. The Commercial Code does not allow a lower limit to be set in the agreement of association.

The Commercial Code does not explicitly contain solutions regarding the case of two LLC members with equal participation (investment) in disagreement. However, the Commercial Code allows for the conclusion of an agreement between the LLC members in which they can agree to resolve such a situation, should it occur.[55] In some conflict situations, the Commercial Code contains a solution for voting at the general meeting. An LLC member may not exercise their voting right if the general meeting is deciding on their (a) non-monetary contribution, or (b) expulsion or the submission of a proposal for their expulsion from the company. These provisions are mandatory.

The minority of LLC members are protected through the general provision under Section 56a of the Commercial Code. This provision contains a general prohibition on the abuse of a shareholder/member's rights and majority and minority votes in a company, and also prohibits any conduct which is intended to place any of the company's shareholders/members at a disadvantage by means of malpractice.

However, the protection of the minority is also based on their ability to bring about a derivative claim on behalf of the company against the executive officer and another LLC member.[56] Also, each LLC member is entitled to file a petition with the

53 Patakyová, 2016, p. 552.

54 For example, the following decisions under Section 125 Subsection 1 always require approval by at least two-thirds of all votes of LLC members: paragraphs a) the approval of the conduct of persons acting in the name of the company before its incorporation; c) the approval of the articles of association and changes thereto, unless the law stipulates otherwise; and d) decisions on changing the agreement of association (Section 141), provided that such decisions are entrusted to the powers of the general meeting by the law or agreement of association; e) decisions on increasing or reducing the registered capital, and decisions on non-monetary contributions; and i) decisions on winding up the company or changing the legal form, if permitted by the agreement of association. The agreement of association may determine a higher number of votes required for the adoption of such decisions.

55 Section 66c of the Commercial Code.

56 Under Section 122 (3) of the Commercial Code, 'Acting in the company's name, each shareholder (LLC member) is entitled to exercise claims for damages or other claims that the company has towards an executive office, or to exercise claims for paying up an investment contribution by a shareholder (LLC member) that defaults in paying up the investment contribution or to exercise claims for the return of any benefit paid to a shareholder contrary to law. This shall not apply if the company has already begun exercising such claims. A person other than the shareholder (LLC member) who filed such action or a person entitled by such shareholder (LLC member) may not act in the name of the company in court proceedings.'

court to pronounce the decision of the general meeting invalid under the terms and conditions set by the Commercial Code.[57]

8. Changes regarding the traditional concept of the LLC

In the context of the regulation of LLCs, there is a debate on the need for a ban on chaining and the restrictions of transfer of a majority interest concerning the need to present the tax administrator's consent. However, the last amendment to the Commercial Code[58] has made the legislation even more stringent, and the restriction does not only apply to tax debtors but also to persons who are listed as liable in the register of valid commenced enforcement proceedings. In addition, the last amendment to the Commercial Code, which will be effective from October 2020, introduces a restriction on the executive officer, who may be only a regular person not on the list mentioned above at the time of entry in the Commercial Register. The explanatory memorandum justifies this restriction by the need to ensure that the executive officer is able to perform his position economically and effectively. If such persons are included as liable in the register of valid commenced enforcement proceedings, they are not able to act economically and effectively for the company and to bind it to third parties. However, such a requirement does not apply to members of the board of directors of joint-stock companies or to statutory bodies of other forms of company.

Also discussed is the amount of the registered capital and which form of trading company is more suitable than the start-up. Since 2017, it has been possible to establish a new form of the capital company: a simple joint-stock company with a minimal capital requirement of 1 EUR. This form of company, inspired by French legislation, was incorporated as a form suitable for start-ups. Despite the option of creating a simple joint-stock company with 1 EUR, practice has not yet responded to this opportunity; as can be seen in Figure 2 (below), the LLC is still the most popular form of company with 5000 euros. A possible reason for this is that the simple joint-stock company format opens up the possibility of shareholder agreements to regulate relations between them,

57 Under Section 131 (1) of the Commercial Code 'Each shareholder, executive officer, liquidator, bankruptcy trustee, settlement administrator or member of the supervisory board may file a petition with the court to pronounce the decision of the general meeting invalid, if it is contrary to the law, agreement of association or articles of association. A former shareholder or executive officer shall also have such right if the decision of the general meeting relates to them. However, such right shall expire if the entitled person fails to exercise the right within three months from the adoption of the general meeting's decision, or if the general meeting was not duly convened, then from the date when such person could have learned of the decision.
(2) Upon the petition of a shareholder, the court may rule a general meeting's decision invalid only if such violation of the law, agreement of association or articles of association could limit the rights of the shareholder petitioning for such a ruling.'

58 An Amendment Nr. 390/2019 Z. z. to the Commercial Code.

which, however, can be rather discouraging because of its flexibility, unlike the pre-set legal rules of the LLC.

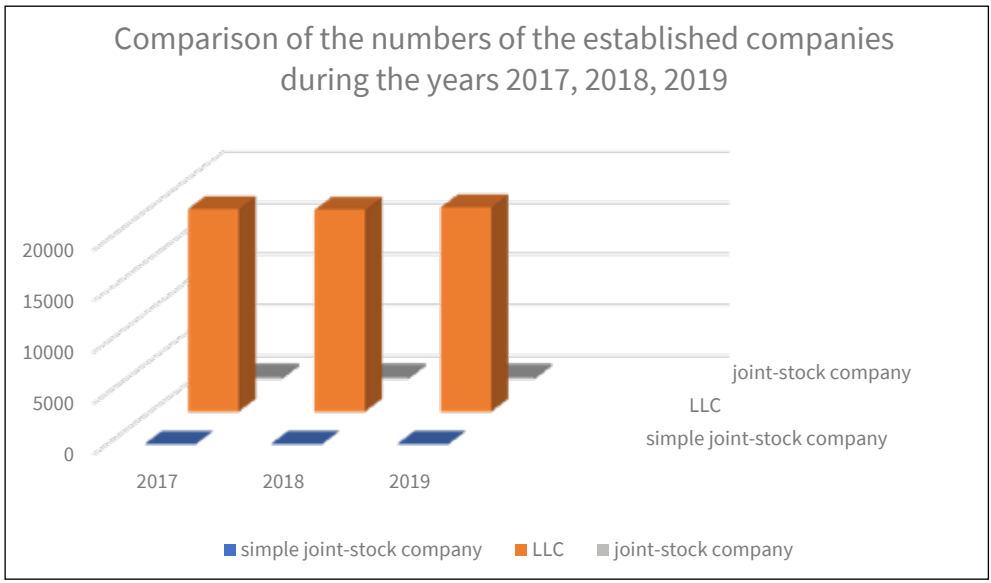

Figure 2. A comparison of the numbers of different types of companies established from 2017 to 2019 according to company type. LLCs are marked in red.[59]

59 The comparison was made on the basis of the data available at: https://finstat.sk/analyzy/statistika-poctu-vzniknutych-a-zaniknutych-firiem (Accessed: 24 February 2020).

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EMŐD VERESS[1]

Limited Liability Companies in Romania: *De Lege Lata* Clarifications and *De Lege Ferenda* Proposals in Regard to the Forced Execution of 'Social Parts' for the Personal Debts of an Associate

ABSTRACT: *The limited liability company is the most prevalent form of company in Romania. It is similar to the French S.A.R.L. (société à responsabilité limitée) or the German GmbH (Gesellschaft mit beschränkter Haftung), but important differences can be identified in the context of this type as it exists in Romania. This article focuses on a single but very important problem: Can the creditors of associates of limited liability companies enforce their claims by selling or acquiring participation in the limited liability companies of their debtors? And, if so, under what conditions? The problem of de lege lata is controversial, and the author seeks to offer a plausible interpretation of the existing norms, which make the rule effective but, at the same time, preserve the essential and traditional features of the limited liability company. In addition, several alternatives to de lege ferenda proposals are suggested, making this study a valuable contribution to the future development of Romanian company law and offering insights for further comparative research.*

KEYWORDS: Romanian company law, Law no. 31/1990 on companies, Romanian limited liability companies, debts of company associates, execution of social parts

Introduction

In this study, we discuss what is currently one of the most complicated problems of the Romanian regulation of limited liability companies. During the reconstruction of the market economy after the collapse of the Soviet dictatorship in 1989, it was stated that 'the Romanian limited liability company follows the form used throughout continental Europe, for example, that of the French S.A.R.L. (*société à responsabilité limitée*) or the

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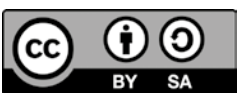

https://doi.org/10.47078/2020.1.195-207

German GmbH (*Gesellschaft mit beschränkter Haftung*). It combines some of the benefits of the joint-stock company with the relatively simpler procedural requirements of general partnership and is particularly well suited to small- and medium-sized firms with only a few owners. This form has been the most used to date and will probably continue to be the favoured form for most domestic and foreign investments'.[2] This is still true today: the limited liability company is the most prevalent form of company in Romania.

1. The social parts of limited liability companies

To understand a legal system, it is always necessary to investigate the legal concepts used in that country because, in many cases, there is no terminological correspondence compared to known notions or, more problematically, the words used are similar only at first sight. In reality, their legal contents differ. Using English legal terminology, it is difficult to discuss in-depth issues of company law in continental legal systems. Thus, first of all, an attempt at terminological clarification is needed. The participation titles in company capital in the case of limited liability companies [societăți cu răspundere limitată] are called 'social parts' [părți sociale], as opposed to shares, in the case of joint-stock companies and limited joint-stock partnerships, and 'interest parts' (partnership shares), in the case of general partnerships [societăți în nume colectiv] and limited partnerships [societăți în comandită simplă], all of which have legal personality under Romanian law. Consequently, there are three types of participation titles in companies: shares, social parts (sometimes imprecisely and misleadingly translated as shares of a limited liability company), and 'interest parts', each category having a distinctive and well-defined legal regime.[3]

All the formalised rights (incorporated into shares or social parts) recognised by the company, are issued in exchange for a contribution to the company's capital, and confer the benefit of becoming an associate of the respective company, with all the rights and duties, with or without the patrimonial character, that have their source in this investment.[4]

In Romania, the legal regime of social parts, as incorporeal assets, is outlined by the regulations contained in Companies Law no. 31/1990.[5]

In terms of their circulation, the social parts can be transferred between associates,[6] without the need to meet special conditions. Each associate of a limited

2 Gray, Janson, Janachov, 1992, p. 16.

3 The French legal terminology is identical: The Code de commerce uses the term 'parts sociales'. For example, see article L223-2 Code de commerce.

4 In this sense, Cărpenaru, 2012, p. 376.

5 Republished in Official Gazette of Romania no. 1066 of November 17, 2004, but with subsequent modifications.

6 Art. 202 para. (1) Law no. 31/1990. However, the association articles may introduce certain limitations, for example, preferential rights or other rules on such transmission. See Cucu, Gavriș, Bădoiu, Haraga, 2007, p. 453.

liability company may transfer to another associate all or a part of the social parts he holds in that company, freely. No approval by the company or the other associates is required by the law, unless the articles of association contain derogating rules: for example, preemption rights in favour of other members.

The problem is more complicated in the case of the transfer of social parts by an associate to persons outside the company (i.e. persons who do not hold the status of associate). This operation is allowed by law only if it has been approved by associates representing at least three-quarters of the company's capital.[7] The explanation of this approach is simple: the limited liability company is a corporate form in which *affectio societatis*, the special relationship of trust between the associates, plays a particularly important role. As has been shown, the associates of a limited liability company 'want to remain in their intimate and lasting circle'.[8] The existence of this relationship of trust is presumed between the existing associates of the company, which justifies the fact that between the associates the social parts can be transferred freely because the *affectio societatis* principle is not violated ('the company does not have to be afraid of its own members'[9]). On the other hand, if the social parts are transferred to a third party, who does not have the status of associate, the existence of *affectio societatis* must be verified. For this reason, the associates representing the qualified majority of the capital must approve the transfer. A free assignment of social parts would lead to a situation where the place of an associate agreed by the other members would be taken over by an unapproved, unwanted third party, a person with whom the other associates may not want to work, which would affect *affectio societatis*, the ideological basis of the limited liability company, until its eventual destruction

This is why, as we have shown, art. 202 para. (2) of Law no. 31/1990 stipulates that 'the transmission to persons outside the company is allowed only if it has been approved by the associates representing at least three-quarters of the company's capital'.

Here, the question arises whether the legal norm is mandatory or applied as default, as the answer to this question determines whether a derogate from this norm by the provisions of the statute of the limited liability company, is legal or not.

One opinion is that 'It is possible to mitigate the *intuitu personae* character of the association, by providing in the articles of incorporation the possibility of free transfer of social parts'.[10] In this conception, the rule would have a default character because, by the statute, the legal regime of the transmission of social parts could be modified, and, for example, have attributed to them, a freely transferable character.

We cannot agree with this approach. This rule is mandatory, on the basis of several arguments.

7 Art. 202 para. (2) Law no. 31/1990 on companies.
8 Georgescu, 1927, p. 323.
9 Georgescu, 1927, p. 323.
10 Piperea, Piperea, 2014, p. 649.

In general, Law No. 31/1990 operates with mandatory norms. Whenever it is necessary to change a mandatory regime, to allow a derogation, the law expressly indicates this (generally, using the expression 'unless the articles of association provide otherwise'). These mandatory norms form what we call corporate public order, the violation of which entails the sanction of nullity.

If we accept the opposing view, then the legal regime of the social parts (conditional on their assignment), which is at the heart of the limited liability company, would be essentially be changed, the social parts being transformed in practice into freely transferable shares by the will of the associates, which is unacceptable without changing the legal form of the company. The most important distinguishing feature of the limited liability company, in contrast to the joint-stock company, is established by the differentiated legal regime of the social parts, compared to the shares of the joint-stock company. Thus, a 'joint-stock company' (a limited liability company with freely transferable social parts), created with a capital of 200 lei (approximately 50 euros), would also contravene European norms, which impose a minimum share capital of 25,000 euros for joint-stock companies.

The wording of the legal text, '... is allowed only if...', also suggests that this rule is mandatory.

Last but not the least, art. 11 of Law no. 31/1990 expressly provides that 'social parts may not be represented by negotiable securities' (i.e. 'may not be incorporated in securities that circulate freely on the market...').[11] Art. 277 para. Part (1) lit. d) of the same law sanctions as a criminal offence the act of issuing negotiable securities representing social parts of a limited liability company.

Consequently, considering the normative framework outlined above, we consider the norm contained in art. 202 of Law no. 31/1990 to be a mandatory rule, which does not allow derogation, neither in the sense of introducing the possibility of free transfer of social parts, nor in the sense of imposing the unanimity requirement for the same, which would bring the legal regime of the associates in a limited liability company much closer to the regime of partners in general and limited partnerships.[12]

11 Piperea, 2014, p. 127. The solution is identical in France (see art. 1841 of the French Code Civil and currently – after 2019 – the art. L. 221-13 of the Code de Commerce).

12 However, the method by which the imperative legal restrictions imposed by the provisions of art. 202 para. (2) of Law no. 31/1990 can be, to some extent, relativised is simple. If, in the future, we want to alienate the social parts and expect that we could not obtain a qualified majority from the other associates, the best solution is to acquire the status of associate through another limited liability company with a sole associate set up for this purpose. In this situation, we can indirectly alienate the social parts of the limited liability company associate in the first company, as there is no need for the approval of its associates. Basically, the associates in the first limited liability company do not change, because only the social parts of the associate limited liability company are alienated.
Law no. 102/2020 (Official Gazette of Romania no. 583 of July 2, 2020) eliminated the restriction from the Law no. 31/1990 that a person can establish only one unipersonal (one-man) limited liability company. Therefore, from July 5, 2020, an unlimited number of unipersonal limited liability companies can be founded by the same person in Romania.

2. Forced execution of social parts

The question now arises whether social parts can be enforced by the associates' personal creditors.

The problem of the forced execution of the social parts can be raised in two hypostases. First, if the associate holding such social parts has debts and an enforceable title is obtained against him (the simplest, a judgement, but the issue also arises if he has contracted in its own name, or as a guarantor, a bank contract, in itself an enforceable title).[13] Second, if the associate has assumed a guaranty with the social parts held, for the execution of its own debts or for those of third parties, by signing a hypothecation agreement on the social parts, which also constitutes an enforceable title. In the first situation, the social parts are not burdened by a hypothec; in the second situation, social parts are encumbered by a movable hypothec.[14]

Thus, under the conditions of art. 2389 of the Romanian Civil Code in force from 2011, the shares issued by joint-stock companies and the social parts held by the associates of limited liability companies may be hypothecated (may form the object of a movable hypothec).[15] According to art. 2431 of the Civil Code, validly concluded hypothec contracts are enforceable titles (there is no need to obtain a judgement to enforce the debt again the debtor).

The classic approach was that, because of the limited liability company's *intuitu personae* character, the social parts could not be enforced.[16] However, if these social parts – according to the express provisions contained in the current Civil Code – can be hypothecated, their foreclosure should be possible; otherwise, such a hypothec would be of no practical use.

Currently, Law no. 31/1990 on companies, as amended by Law no. 152/2015,[17] establishes even more vigorously that the creditors of an associate may still seize, during the company's existence, the assets due to the associates by liquidation or seize and sell the shares or the social parts of their debtor.[18]

It seems that, because of legislative changes, the possibility of forced execution of social parts was realised, for the first time indirectly, by recognising the possibility of them being hypothecated, and most recently, by the provision of Law no. 31/1990,

13 We must mention that social parts cannot be enforced for the debts of the limited liability company itself, because they are part of the associates' patrimony, and not of the patrimony of the respective limited liability company.

14 A hypothec is a real right on the movable or immovable property made liable for the performance of an obligation. It confers on the creditor the right to follow the property into whatever hands it may come, to take possession of it, to take it in payment under certain conditions, sell it, or to cause it to be sold and thus to have a preference upon the proceeds of the sale.

15 Veress, 2015, p. 316-317.

16 In this sense, Săuleanu, 2012, p. 71.

17 Official Gazette of Romania no. 519 of July 13, 2015.

18 Art. 66 para. (2) Law no. 31/1990.

wherein the possibility of the forced execution of social parts in favour of an associate's creditor is directly and expressly recognised.

In the matter of moveable hypothec, the hypothec on the shares or social parts of a company regulated by Law no. 31/1990 of companies, republished with subsequent modifications and completions, is constituted according to the rules established by a special law. In this sense, art. 99.1 of Law no. 31/1990 establishes the following, regarding (just for) shares issued by joint-stock companies:

'(1) The constitution of a moveable hypothec on shares is made by a document under private signature, in which will be shown the amount of the debt, the value and the category of the shares with which it is guaranteed, and, in the case of registered shares issued in material form by mentioning the security on the title, signed by the creditor and the shareholder debtor, or by their proxies.

(2) The hypothec is recorded in the register of shareholders, kept by the board of directors, respectively by the directorate, or, as the case may be, by the independent company that keeps the shareholders' register. Proof of record shall be issued to the creditor in whose favour the security on the shares has been provided.

(3) The hypothec becomes opposable to third parties and acquires the rank in the order of preference of creditors from the date of registration in the Electronic Archive of Real Movable Guarantees'.[19]

Also, art. 124 para. (2) of Law no. 31/1990 stipulates that, 'if real securities are constituted on the shares, the voting right belongs to the owner'.

Most recently, In Law No. 152/2015 (for the amendment and completion of some normative acts in the field of registration in the trade register, at art. 66 of Law no. 31/1990), a new paragraph was introduced, which reads: 'The hypothec legally constituted on the shares or social parts can be executed according to the law. The administrators/members of the management bodies are obliged to make available to the secured creditor or the enforcement body, at their request, the financial statements and any other documents or information necessary for the evaluation of the shares or social parts as well as to facilitate their taking over'. Law no. 152/2015 also amended the previous paragraph of art. 66 of Law no. 31/1990, and, according to the legal text in force, the creditors of an associate 'may seize and sell the shares or social parts of their debtor'.

At first sight, these legislative changes created a legal framework for the forced execution of social parts. But the issue is not so simple. If we recognise the absolutely enforceable nature of social parts, then, as we have shown, limited liability companies are transformed into an atypical form of joint-stock company, which changes the legal regime of the limited liability company itself.

The jurisprudence has not yet made a decisive contribution to solving the serious problems of interpretation that is revealed in the following example. In this case, the creditor filed an enforcement plea against the bailiff's refusal to put up for

19 It is currently operated under the name National Register of Movable Publicity [Registrul Național de Publicitate Mobiliară].

public auction the social parts held by the debtor in several limited liability companies. The court of the first instance rejected the enforcement plea, establishing that art. 202 of Law no. 31/1990 establishes a special assignment procedure for social parts. However, the court of the second instance upheld the creditor's application. It allowed the enforcement plea, stating that 'only in the case of an enforcement plea in which the debtor is also a party can it be established with certainty whether the creditor is indeed entitled to sell at auction the social parts held by the debtor in various limited liability companies...'.[20] In other similar cases, it was established that the sale of social parts could be enforced, but the arguments used by courts are simplistic, and do not reflect the complexity of the legal problem created by the improvised amendment of Law no. 31/1990 of companies through Law no. 152/2015. The changes imposed by the legislator were insufficiently prepared and deficient.

3. Limits of forced execution of social parts deriving from the legal nature of limited liability companies

From the legal texts analysed above, it appears that the bailiff will be able to enforce the social parts: will be able to seize them and will be able to put them up for sale, as the legislator is aiming at facilitating the forced execution of these social parts to protect the personal creditor of the associate.

However, the interpretation that the social parts have become freely transferable in the event of enforcement is contrary to the essence of a limited liability company, which is a closed-type company. The problem arises both in the case where a creditor pursues the social parts free of encumbrances held by his debtor, who is an associate in a limited liability company, and also in the event that an associate has constituted a movable hypothec on the social parts he holds in a limited liability company. We have to examine both cases separately.

First, under the conditions of art. 202 para. (2) of Law no. 31/1990, the transmission of the social parts to persons outside the company is allowed only if it has been approved by the associates representing at least three-quarters of the capital.[21] As we have shown, this rule is mandatory. It is essential to the limited liability company, and it is categorically opposed to a third party (for example, a successful bidder in the event of a forced sale) acquiring social parts' and, consequently, becoming an associate in the limited liability company, against the will of the qualified majority provided by law.

Between art. 66 para. (2) – (3) and art. 202 para. (2) of Law no. 31/1990, both texts in force, there is a clear conflict, which can, and must be, reconciled.

20 Prahova Tribunal, decision no. 1009 of 11 July, 2016 (*www.lege5.ro*).

21 For details, see Veress, 2010, p. 96-105. In the Romanian legal doctrine, it has been shown that it is important to create a statutory clause by which, if the associates do not approve the assignment of social parts, they or the company to be obliged to purchase the social parts of the assignor (forced redemption clause). See Catană, 2013, p. 145.

Basically, the social parts can be enforced only when the rule from art. 202 para. (2) is not violated, as follows: (a) if the general meeting approves with the required majority of three quarters, the forced sale (the successful bidder is accepted as a new associate); (b) in the case of a limited liability company with a sole associate, when it is not necessary to have approval from the general meeting the social parts may simply be executed to recover the debts of the sole associate. However, this is possible only if all the social parts can be forcibly sold. If only a part of the social parts were enforced, together with the initial associate, a third party would also acquire the same status, and the company would be transformed into a company with two associates (the debtor as a former sole associate and the buyer as a new one), which again violates the *affectio societatis* principle; (c) if the forced cession of the social parts is done in favour of another associate (because the social parts can be transmitted freely between the associates, without the need for approval from the general meeting).

Any other interpretation defeats the essence of the limited liability company's identity, being *contra naturam societatis*. The free enforceability of social parts is contrary to the partnership (*intuitu personae*) characteristics of the limited liability company, and the other associates would be obliged to work with a 'foreign' person, with the buyer of the social parts, in the absence of *affectio societatis*, which would not be in accordance with legal provisions. The administrator may facilitate the forced sale of the social parts only by convening a general meeting of associates and by submitting to vote the alienation of the social parts in compliance with the provisions of art. 202 para. (2) of Law no. 31/1990.

Second, in the case of hypothec, Law no. 152/2015 creates more problems.[22] Conciliation was sought between the right to hypothecate social parts, on the one hand, and the rule contained in art. 202 para. (2) of Law no. 31/1990, which requires the agreement of a qualified majority of associates representing three-quarters of the capital for the acceptance of a third party in the company, on the other. Thus, art. 202 of Law no. 31/1990 was supplemented with a fifth paragraph, which establishes the following: 'The provisions of para. (2) are also applicable in the case of the hypothec on social parts, but only in terms of its constitution'. Consequently, the creation of the moveable hypothec must be approved in advance by the associates who represent the qualified majority of three-quarters of the company's capital.

Unfortunately, the proposed solution is deficient, because (a) a prior agreement on the hypothec does not really protect the *intuitu personae* character of the limited liability company, because the agreement must exist *in personam*; that is, the associates must agree on the person of the successful bidder, and not issue a blank agreement; (b) even worse, if we accept the interpretation proposed by some doctrinaires regarding the free enforceability of social parts by the associate's unsecured creditors, based on art. 66 para. (2) of Law no. 31/1990 (disputed above), we will be in the realm of serious discrimination between the unsecured and secured creditors of the associate

22 Official Gazette of Romania no. 519 of July 13, 2015.

and between the associates themselves in the first or the second case. The hypothec needs a *priori* approval of a qualified majority for the guaranty's constitution, which is a necessary renunciation of the *intuitu personae* character of the limited liability company for hypothecation. However, a simple unsecured creditor does not need any approval to enforce the social parts of its debtor; so must the other associates passively tolerate this enforcement?

4. The rules of civil procedure applicable to the forced execution of social parts

The Romanian Code of Civil Procedure contains important regulations on the forced execution of social parts. Art. 757 Code of Civil Procedure bears the marginal title sale of securities and goods with a special circulation regime.[23] Indirectly, therefore, the law recognises the character of (incorporeal) 'goods' with a special circulation regime for social parts.

In practice, the rules on forced selling of social parts are included in para. (3) – (5) of art. 757 Code of Civil Procedure.

According to these texts, the sale of shares of closed companies and social parts is amicably done according to art. 754 Code of Civil Procedure.[24] If the amicable sale is not possible, the executor makes the sale by public auction, 'unless the law provides a special system for their circulation'. In the case of social parts', however, there is a special system regarding their circulation, which derives from the provisions of Law no. 31/1990 of companies.

If the sale of the incorporeal goods is made by the executor, or by a specialised agent, he 'shall draw up a specification which, in addition to other provisions provided by law, shall include, under penalty of nullity of sale, the articles of incorporation of the company, the number and the nature of the shares or social parts subject to sale, the guarantees established on them, the special clauses regarding their sale or assignment and the preferential rights granted to the associates, the annual financial statement for the last two financial years, and any documents necessary to assess the consistency and value of related company rights attached to the shares or social parts put up for sale'.

We can note that the enforcement regime of the Code of Civil Procedure does not change in any way, the specific legal regime imposed by Law no. 31/1990.

23 For details, see Oprina, Gârbuleț, 2013, p. 683-685.

24 Art. 754 Code of Civil Procedure provides as follows: '(1) The bailiff, with the creditor's consent, may approve the debtor to proceed to sell the seized goods. In this case, the debtor is obliged to inform the bailiff in writing about the offers received, indicating, as the case may be, the name or address of the potential buyer, as well as the terms by which the latter undertakes to provide the proposed price. (2) If until the fulfilment of the term stated in para. (1) the third-party buyer does not provide the price offered at the disposal of the bailiff, a term will be set for sale at public auction, according to art. 759'.

Moreover, according to art. 757 para. (5) Code of Civil Procedure, 'the specifications will be communicated to the debtor, the creditor, the issuing company, and the other associates to formulate possible objections within five days from the communication, under the sanction of forfeiture. The bailiff will resolve the objections, by an executory warrant, given with the parties' summoning. If no objections are raised, or they are rejected, and the decision is not challenged by those concerned, the enforcement will continue, according to the law'. Consequently, to preserve *affectio societatis* and to defend the special circulation regime of social parts, the associates have the opportunity to defend themselves by objecting, and if the warrant issued by the bailiff is not favourable to them, they can challenge it by contesting the enforcement itself, within fifteen days from the communication of the warrant.[25]

The provisions contained in the Code of Civil Procedure have been the subject of an exception of unconstitutionality.[26] In the reasoning of the exception, it was argued that limited liability companies are established by each associate, in consideration of the personal qualities of the other associates, so that the indirect exclusion of a member from the company, by forced execution of social parts held by him, for a debt contracted in his personal name, is likely to contravene the constitutional and conventional provisions regarding the right of association. In this context, the exclusion of an associate from a limited liability company as a result of the forced sale of his social parts in the company was perceived as contrary to the fundamental right of association, as this infringes the most important characteristic of limited liability companies, which is mutual trust between associates. It was also pointed out that the obligation imposed indirectly by the criticised text of the law, namely that of continuing the company's activity with another associate, infringes the law of freedom of association of persons.

The Constitutional Court rejected this exception of constitutionality, holding that the invocation of the violation of the provisions of art. 40 of the Constitution regarding the right to association is not incidental in the case, given that, according to this constitutional text, the right of association refers to non-profit, public law associations, which do not seek to obtain or share benefits, but to express freedom of thought for political, religious, or cultural purposes. Therefore, the basis for establishing public law associations is not a private law contract, but freedom of association is enshrined at a constitutional level. This reasoning is correct.

The Court also analysed the provisions of the Code of Civil Procedure by referencing art. 45 of the Constitution, which regulates economic freedom. In this context, the Court noted that the criticised legal provisions establish a creditors' right to file a claim against a debtor, who is an associate in a limited liability company, for a debt

25 Article 715 para. (2) Code of Civil Procedure, in the form modified by art. I point 36 of Law 138/2014 for amending and supplementing Law no. 134/2010 on the Code of Civil Procedure, as well as for amending and supplementing related normative acts (Official Gazette of Romania no. 753 of October 16, 2014). Prior to this change, the deadline was five days from the communication of the warrant.

26 Constitutional Court Decision no. 218/2015 (Official Gazette of Romania no. 405 of June 9, 2015).

contracted in his personal name. Therefore, given that the patrimony of the associated debtor within a limited liability company is distinct from that of the company itself, and the personal creditors of the associate cannot pursue the property of the company, the criticised text of the law is not likely to prevent, by itself, the pursuit of economic activity. This reasoning is also accurate.

The constitutionality of this text of the Code of Civil Procedure has been established. However, these norms are of a procedural nature; they must be applied in all cases, in close correlation with the material law, with the provisions of Law No. 31/1990 companies. The problem, in its essence, is not one of constitutionality.

The legal regime of the social parts' cannot result from the Code of Civil Procedure, but from the special law of companies, an crucial clarification because the court before which the exception of unconstitutionality was raised, expressed an incorrectly reasoned opinion on the exception. The tribunal considered that the provisions of Law no. 31/1990 of companies would no longer be applicable after the entry into force of the new Code of Civil Procedure. This code implicitly repealed the restrictive rules regarding the cessation of social parts. We cannot accept such an interpretation: the fundamental characteristics of the limited liability company, established by special company law, cannot, and are not, implicitly reshaped, through procedural rules, which have a different purpose.

5. *De lege ferenda*

The free forced execution of social parts defeats the *affectio societatis* principle, leads to an alteration of the social type,[27] and modifies the essence of the legal form of the limited liability company. The current regulation must be rethought based on correct principles. In this context, we can agree with the Constitutional Court's contention that 'the protection of the interests of the associates of a limited liability company, based on mutual trust between the associates, cannot be invoked as a priority argument to the detriment of the interests of creditors equally protected by law'. However, these interests must be reconciled, and the interests of an associate's personal creditors cannot defeat the interests of the other associates in the limited liability company.

Many procedures reconcile the protection of *affectio societatis*, but at the same time, they also consider the interests of creditors. We mention only by way of example that the Romanian Civil Code, in the matter of simple companies,[28] contains a regulation that deserves to be analysed for application and transposition to the case of limited liability companies. Thus, art. 1901 para. (2) of the Civil Code establishes that, 'any

27 Georgescu, 1927, p. 323.

28 The term simple company [societate simplă] in Romanian law practically refers to a contract of partnership by which the parties, in a spirit of cooperation, agree to carry on an activity, to contribute thereto by combining property, knowledge or activities and to share among themselves any resulting pecuniary profits. The simple company has no legal personality.

partner may redeem, substituting in the acquirer's rights, the participations acquired for consideration by a third party without the consent of all partners, within 60 days from the date on which he knew or should have known the assignment. If several associates exercise this right simultaneously, the participants are allocated profits in proportion to the share of the associate'. Through these provisions, the law protects *affectio societatis* by creating the legal possibility in favour of the partners to substitute themselves in the rights of the acquirer (adjudicator) of the participations.[29]

However, many other procedures can be devised that, on the one hand, protect the limited liability company, but on the other hand provide protection even to creditors. For example, (a) in the event of a forced sale, the company should be able to repurchase its social parts at a price determined by an evaluation expert, for the sole purpose of cancelling them, which is equivalent to the corresponding reduction of the capital (with the sum of the nominal value of the social parts held by the foreclosed associate), so that the associate's creditor will be satisfied with the price paid by the company for the social parts (b) in case of forced execution of the social parts of an associate, a reasonable time (for example a period of 90 days) must be granted for the other associates to buy the social parts themselves or to arrange their purchase from the pursued associate by an approved third party, at a price determined by an evaluation expert, so that the pursuing creditor will be satisfied with the price paid. (c) although the legal obligation has been created for the hypothec on social parts to be approved in advance by the associates, with the majority required for their transfer, approval which is valid as an *a priori* agreement can be combined with the mechanism in art. 1901 Civil Code for the case of simple companies in order for better protection of a limited liability company; (d) it is possible to legally ensure the associates' ability to take the decision, in the case of forced execution on the social parts of an associate, of dissolving the company, in which case the creditors will follow the rights of the associate resulting from the liquidation.

It is clear that the current regulations must be rethought, because they are contradictory, debateable, and even controversial. In the spirit of the ideas expressed here, precise regulation would also be for the benefit of creditors, who could then be more aware of the extent of the risks assumed in relation to their debtors. For these reasons, we support a rethinking of the norms contained in Law no. 31/1990, through which a true balance between affectio societatis and the interests of creditors could be achieved. A clear regime would be beneficial and provide legal certainty.

29 This legal text could be invoked even today in the matter of the limited liability company, considering art. 1887 para. (1) of the Romanian Civil Code, which establishes that the rules regarding the simple company constitute companies' general law. In the absence of special derogatory norms, art. 1901 para. (2) Civil Code could also be applicable to the limited liability company. But at this moment, there is no jurisprudential confirmation of this interpretation.

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