

The Brief

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NEWS FLASH

Hungary

Takeover of control over private companies by the State in exceptional circumstances

Explanation and analysis of an exceptional legal measure introduced following the "red sludge" environmental disaster

Following the environmental catastrophe caused by the breached reservoir of the bauxite-aluminium factory owned by MAL Magyar Alumínium Termelő és Kereskedelmi Zrt., the Hungarian government declared a state of emergency in the affected areas and had Parliament vote new legislation authorising the State to take control of private companies in cases of declared emergency or other crises, such as a threat of war, armed aggression, industrial accident, natural or environmental disaster. The government then used this new power to assume control of MAL Zrt. In this article, we will be examining the legal basis on which this extraordinary measure was adopted, the purpose of the takeover and its exact scope and whether or not it is constitutional.



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INTRODUCTION

In the wake of the environmental disaster caused by the rupture of the reservoir at the bauxite-aluminium factory owned by MAL Magyar Alumínium Termelő és Kereskedelmi Zrt. ("MAL"), the Hungarian government issued Government Decree No. 245/2010 of 6 October 2010, declaring a state of emergency in the affected local government districts of Győr-Moson-Sopron, Veszprém and Vas by, as is generally the case when natural or environmental disasters occur. It further issued Government Decree No. 247/2010 of 12 October 2010 assuming control of MAL.

Although there is nothing surprising in the decision to declare a state of emergency in local government areas where an environmental disaster has occurred (e.g. this power was used by the government earlier this year following the serious floods affecting the country), this is not so in the case of the decision to take over a private company after the declaration of a state of emergency. Up until this incident, the ability to implement such a measure was not part of the government's arsenal of powers in crisis situations.

The takeover of MAL on 12 October was actually achieved pursuant to legislative provisions voted the day before by the by Hungarian Parliament, incorporated into Law CV of 2004 *regarding national defence* defining various exceptional measures available to the government in the case of a state of emergency or other crisis situation prevailing in the country as a whole or in specific areas of the national territory.

The government justified its decision based on a desire to act with the greatest possible efficiency in alleviating the consequences of the disaster and in safeguarding the company's assets in the face of its potential liability for the damaged caused by the catastrophe.

Although the assumption of control of private companies is now one of the measures available to the government in crisis situations, we nevertheless need to probe deeper into the legal basis for such a takeover, analyse the aim of such a measure and how far it may be taken, before considering whether or not it is constitutional.

LEGAL BASIS FOR THE TAKEOVER

The Constitution and Law XXXVII of 1996 *on civil defence* define special case scenarios (crisis situation, state of necessity or state of emergency ...) in which exceptional powers vest in the executive for the purpose of managing extraordinary situations, such as a threat of war, coup d'état, armed aggression, but also natural disasters or industrial accidents. The powers vesting in the government will depend on the gravity of the exceptional situation facing the country.

A state of emergency ("*veszélyhelyzet*") may be declared where an incident threatening the lives or physical safety of the population has occurred. The law cites examples of such incidents, such as serious pollution of the environment directly caused by toxic waste, prolonged, heavy and continuing snow storms, flooding and some ecological disasters, etc.

A state of emergency is declared *by government decree* (unlike other crisis situations that are declared by law) granting the Hungarian government the power, with the prior consent of Parliament, to take *necessary measures* that may even contravene existing legislation. A state of emergency will last 15 days. An extension of the 15 day period will require parliamentary approval.

Until now, Law CV of 2004 *regarding national defence* defines as examples of "*necessary measures*", the power to restrict the right to come and go at will, freedom of movement or to order the evacuation of certain places.

Since the passing of Law XCIII of 2010 in the wake of the MAL environmental and human disaster, amending Law CV of 2004 *regarding national defence* (published in the Official Journal on 12 October 2010), these "*necessary measures*" include a power for the government to take control of a private company by decree in the case of a state of emergency or other crisis. Such a decision by the government clearly presupposes that a crisis has already been declared.

In this instance, the government was able to order the takeover of MAL by decree dated 12 October 2010 because it had already declared a state of emergency on 6 October in the local government districts of Győr-Moson-Sopron, Veszprém and Vas (since been extended by Parliament until the end of December) because of the "red sludge" environmental disaster.



REASON FOR TAKING CONTROL AND WHAT IT INVOLVES

As stated above, the government has the power to order the assumption of control of a private company as a "*necessary measure*" in a state of emergency or other crisis.

Firstly, the Law imposes no specific procedure to be followed prior to such a "takeover". No prior notice is necessary. There are no special terms and conditions that need to be applied. Taking control of a company is not conditional on a finding by the authorities of the company's failure to comply with applicable laws and regulations, its inability to handle, or slow reaction to, an emergency situation threatening the health or safety of the population.

The Law does not define which companies can be taken over. We may suppose (although this is open to interpretation) that taking control of a company may only be ordered where necessary to avert a situation or mitigate its consequences.

In any event, a State "takeover" of a company in a state of emergency does not mean that the company is to be nationalised: the State cannot become a shareholder in the company under its assumed management.

Such a company takeover is defined solely in terms of the powers devolving on the government commissioner placed in charge of the company's and specifically appointed for the purpose by the government or the prime minister *or* on the Minister of Finance, depending on the circumstances. Essentially, the company takeover involves:

- analysing the company's financial situation;
- approving and endorsing the company's financial commitments;
- taking decisions on issues that generally fall within the jurisdiction of the company's main decision-making body in an attempt to alleviate the situation that prompted the state of emergency or to mitigate its consequences;
- asking the authorities to order the company to utilise certain economic or financial services or to prohibit it from engaging in certain activities.

The commissioner's powers are limited or at least have certain boundaries:

- the takeover is intended to be temporary, although the Law does not stipulate a specific duration;
- in circumstances where the government commissioner is making decisions generally taken by the company's main decision-making body, he is required to give written notice of those decisions to the company's directors and members of its supervisory board.

If the decree ordering the State takeover should later be held unconstitutional by the Constitutional Court, the Law also provides that the company and its shareholders will be entitled to compensation for any damage caused by the government commissioner.

IS THE "TAKEOVER" CONSTITUTIONAL?

There are two constitutional principles or rights that may undermine the constitutionality of the legislation empowering the State to take control of a company in a declared state of emergency in the country: the principle of legal certainty and property ownership rights.



Principle of legal certainty

The principle of legal certainty is defined by the Constitutional Court as requiring legislation and regulations to be comprehensible, predictable and transparent.

The predictability, comprehensibility and transparency of the provisions of Law XCIII of 2010, amending Law CV of 2004 *regarding national defence* could be called into question because:

- the Law does not specify in what circumstances the government is empowered to take control of a private company in a state of emergency;
- the Law contains no indication on how the duration of the takeover is to be defined and in what circumstances the assumption of control may be extended;
- the powers of the government commissioner have been given an extremely wide definition.

Any vagueness on these issues in the legislation may be explained by the fact that it was only intended to provide a general legal framework to which the government will add in each special case in which it wishes to exercise this power, depending on the prevailing circumstances.

However, Government Decree No. 247/2010 ordering the takeover of MAL is not specific in its stipulations. It may be held not to provide the necessary legal certainty and therefore be held unconstitutional because:

- it is not certain that the particulars it provides concerning the government commissioner's powers renders them any more comprehensible, predictable and transparent (the decree merely supplements the list of the government commissioner's powers defined by the Law, stipulating, for example, that in analysing the company's financial situation, the government commissioner may consult its balance sheets or asset statements, its bank statements and any contracts binding it legally or that his power to approve or endorse the company's financial commitments also includes the right to take part in negotiations between the company and its creditors);
- the decree is silent on the issue of how long the takeover should last.

Property rights

The Hungarian Constitution raises property ownership to the level of an entrenched constitutional right. However, this right does have its limits. The Constitutional Court applies a proportionality test to the right of ownership to ensure that laws or regulations limiting the right are justified by reason of the public interest or the defence of other constitutional rights or values, and that they are proportional to it. Where such a limitation is intended, the Court must satisfy itself that:

- the limitation imposed on the right of ownership serves a public interest objective;
- it is necessary to achieve this objective; and
- the violation of property ownership is proportional to the objective to be achieved.

The application of these criteria is extremely subjective. We may wonder whether the takeover of a private company by the State in a declared state of emergency does serve a public interest objective, whether it is necessary to achieve that objective and, above all, whether it is proportional to that objective. This begs the question: would it not be possible to envisage measures that are less "invasive" of property ownership than those contemplated by the Law to achieve the same goal.

It is difficult to anticipate how the Constitutional Court might rule if these issues were indeed submitted to it for consideration.

The Constitutional Court may hold that the Law is not in itself in at odds with property ownership although, in the long run, this may well depend on how the government applies it when issuing each decree ordering a company takeover.

The government's stated goals in issuing Decree No. 247/2010 for the takeover of MAL are to stabilise and re-launch production at the factory as soon as possible, to ensure that all relevant claims are duly indemnified, to make a rapid assessment of the liability of all those involved and to prevent an aggravation of the damage caused.



Should a referral be made to the Constitutional Court challenging the constitutionality of this government decree, the Court will have to decide whether the takeover of MAL satisfies a public interest objective and, in the affirmative, whether assuming control of the company is necessary to achieving this objective. It will also have to decide whether the violation of property ownership that it implies is in proportion to the goal the decree is designed to achieve. The extent of the government commissioner's powers and the failure to specify any time limit for the assumed management of the company may well raise doubt as to the need for, and the proportionality of, the adopted measure.



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