

Corporate Governance Rules in Hungary and Slovakia

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Abstract

The presented thesis addresses the issue of corporate governance rules in Hungary and Slovakia. The research focuses on statutory and non-statutory regulation of public and private limited companies in both countries. It points out the fact that in both Hungary and Slovakia the basis for corporate governance is to be found in the statutory provisions of corporate law. These provisions are further refined by the non mandatory rules of the local stock exchanges in both countries, which even if accepted do not have to be kept by the company if it can provide a justifying explanation for the deviation. The comparative analysis of the legal and non statutory regulations of these two sovereign countries reveals that these regulations are fairly similar when it comes to corporate governance. However, some differences can be identified and are discussed in this paper. By examining the real life application and issues of corporate governance rules in both countries this thesis concludes that companies which desire to create a functioning and transparent business environment, in order to attract foreign investors are suggested to accept the corporate governance rules as well as the regulations of the local stock exchanges.

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Introduction

The end of the 1980s and the 1990s represent a milestone in the history of Central and Eastern Europe. The end of the socialist era, Soviet/Russian oppression and the change to market economy made it possible for the countries of this region to start their evolution into modern, welfare states. Unfortunately this procedure has taken longer than it was estimated. The last 20–25 years have not produced such a development as it was foreseen. This may be the consequence of several interlinking factors. First of all, in spite of the fact that there was a change of political orientation, the attitude and mindset of Central European and Eastern European people has not changed; although in a limited way, corruption and nepotism still play an active role in the everyday life of the Central European society. Nonetheless, selfish and bad political decisions, nontransparency and the lack of corporate governance only added to the negative tendency in the development of market. In addition to the mentioned issues the recent global economic recession caused that the struggle of transition countries to catch up to the western states seems like a never-ending story.

This thesis will focus on the corporate governance rules of two, neighboring Central European countries: Slovakia and Hungary. Before the fall of the socialist regime there was no need to discuss corporate governance in this region, because all the companies were state owned, with no shareholders at all. Nowadays, in order to be attractive for foreign investors, the need for corporate governance is becoming more and more significant in transition countries such as Slovakia and Hungary, as sound corporate governance rules support transparency and efficiency of the market. *“The importance of corporate governance has increased in connection with the accounting scandals of big American and European corporations, as well as the worldwide economic crisis that has revealed flaws in corporate*

*management and administration.*¹ Well established corporate governance rules are an important feature of every market economy and an important part of management of every private company orientated on long-term development.

This issue is one of the most discussed issues in the area of commercial law on a worldwide scale, whereby companies of post communist countries like Slovakia and Hungary have an advantage in being able to skip a historical period of development in this area and utilize the experience of the world's advanced economies.²

Corporate governance can be defined in many ways. *“Corporate governance describes all the influences affecting the institutional processes, including those for appointing the controllers and/or regulators, involved in organizing the production and sale of goods and services...”*³

The homepage of Bratislava Stock Exchange defines corporate governance as follows. *“Corporate governance is a complex of processes, laws, regulations and practices that guide the relations between the executive management, statutory bodies, shareholders and other concerned parties of a company.”*⁴

According to the experts of the Budapest Stock Exchange:

the corporate governance primarily includes:

- careful management of the company (drafting and implementation of strategy);
- financial planning and execution of it;
- controlling of the company's internal processes;
- issues of business ethics;
- transparent operation of the company;

¹ Bratislava Stock Exchange, What is corporate governance? (March 17, 2013), available at <http://www.bsse.sk/bcpben/IssuersGuide/CorporateGovernance/tabid/965/language/en-US/Default.aspx>

² Central European Corporate Governance Association, Corporate Governance Code for Slovakia 4 (January 2008)

³ Shann Turnbull, Corporate Governance: Its scope, concerns & theories, Graduate School of Management Macquarie University, Sydney, (March 17, 2013), <http://cog.kent.edu/lib/turnbull4.html>

⁴ Bratislava Stock Exchange, What is corporate governance? (March 17, 2013), available at <http://www.bsse.sk/bcpben/IssuersGuide/CorporateGovernance/tabid/965/language/en-US/Default.aspx>

- principles and procedures regarding the disclosure and corporate social responsibilities.⁵

In general, the corporate governance rules of any country should provide for a transparent and healthy business environment that makes the economic market of the given country attractive for foreign investors. Thus companies should be established and lead according to these rules, which make it desirable to do business and invest in the chosen country. Corporate governance rules are new phenomena in transition countries. For that reason not much research on this topic has been conducted so far. Thus articles, ratings, legal and non-legal rules provide the basis for this thesis.

The presented thesis will examine the corporate governance rules of Hungary and Slovakia, with focus on the primary sources of corporate governance, namely the legal rules and other non legislative regulations. The first chapter will concentrate on the corporate governance rules of Hungary. It will mainly analyze provisions regulating the structure and internal relationships in the companies. In addition, in order to provide the reader with a basic theoretical background, definitions and theoretical reasoning will be given to each elaborated legal topic. The second chapter will focus on the Slovak regulation of the issue of corporate governance. When necessary, the Slovak solution will be compared to the Hungarian one, in order to point out the differences. Finally, the third chapter will provide an insight into the real life application of corporate governance rules. In the first part of this chapter the functioning of one of the biggest Central European public limited company MOL plc. will be presented. The thesis concludes with the summary of application of corporate governance rules in Slovakia.

⁵ Budapest Stock Exchange, Corporate Governance Recommendations of the BSE – History, (March 17, 2013), available at <http://bse.hu/topmenu/issuers/corporategovernance>

1 Corporate Governance Rules in Hungary

Introductory thoughts

The past twenty five years have seen increasingly rapid advances in the field of corporate governance in the Central European region. Hungary is no exception in this regard. Corporate governance rules are gaining on importance in order to lure foreign investors to come and do business in Hungary. The economic development of this Central European country has been very specific. It used to be the leader of the region in the first decade after the fall of the Berlin wall in 1989. It represented a prosperous country full of economic potential, whose market was rapidly evolving. This beneficial development was caused first of all by the fact that Hungary chose a different privatization method (gradual privatization) as for example Slovakia, and so “*equity market capitalization increased slowly, while in countries with rapid mass privatization (e.g. Slovakia), market capitalization jumped to very high levels and then decreased due to de-listing of illiquid companies.*”⁶ Furthermore, some strict regulatory mechanisms were introduced, that protected investors from fraud, in contrast to at that time less developed countries like Slovakia, where fraud, tunneling and other illegal activities happened on an everyday basis.

However, all this changed in the new millennium. Slovakia has taken over and is now one of the leading economies of the region, while Hungary is struggling to make its economy functional and attractive for foreigners again. This situation was caused by several reasons, among which bad political maneuvering should be mentioned in the first place. The solution of this problem is a complex issue in the era of the economic recession. The introduction of

⁶ Anete Pajuste, Corporate Governance and Stock Market Performance in Central and Eastern Europe, A study of nine countries 1994-2001 5 (15 April 2002)

effective corporate governance rules plays a significant role in the process of market revitalization, as they provide transparency and create a healthy corporate environment.

I shall now elaborate the main elements and the main rules connected with corporate governance in Hungary. The first part of this chapter will focus on the statutory and non-statutory regulations of the presented issue. The second part will deal with the structure and inner relationships in the Hungarian public and private limited company.

1.1 Sources of Corporate Governance in Hungary

The issue of Corporate Governance is mainly concerned with the regulation of private limited companies and publicly held limited companies, because of their size and complex structure of inner relationships. The main difference between these two types of legal entities is that the public limited companies issue shares which are traded on the secondary market. *“The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.”*⁷ The primary sources relating to corporate governance in Hungary can be divided into two large groups: 1) the Corporate Governance Recommendations of the Budapest Stock Exchange and 2) statutory regulations.

1.1.1 The Corporate Governance Recommendations of the Budapest Stock Exchange

The local stock exchanges are those institutions which have contributed the most to the development of corporate governance rules in transition countries. They set internal rules for companies, in order to be permitted to trade their shares on the stock exchange. Furthermore,

⁷ OECD Principles of Corporate Governance 17, (2004)

by this way they support transparency and efficiency of the market. These rules are not of a legal character, thus they are not mandatory. Despite this fact they are applied by the companies not only to be able to trade their shares on the stock exchange but also to be attractive for foreign investors to invest into their companies by buying their shares.

The Budapest Stock Exchange created a set of rules called The Corporate Governance Recommendations (hereinafter referred to as the “Recommendations”). *“The Recommendation are considered to be an addition to relevant Hungarian legislation, primarily for listed, public limited companies registered in Hungary.”*⁸ These rules were first published in 2004, but shortly after that they had to be replaced by a newer version in 2008, in order to comply with EU provisions. *“When compiling the recommendations, the suggestions were formulated taking account of the most commonly used international principles, of experiences gathered in Hungary, and of the characteristics of the domestic market.”*⁹ The provisions of the Recommendations are divided into 3 types:

- Recommendations (“R”): these are the main rules of the Recommendations;
- Suggestion (“S”): in addition to the recommendations they suggest the proper way of application of these rules;
- Explanation (“E”): provide further interpretation and reasoning.

It has to be pointed out, that *“alignment and compliance with the recommendations are recommended but not mandatory for companies listed on the stock exchange.”*¹⁰ However, according to the Act IV of 2006 of the Republic of Hungary on Business Associations as amended companies are required to submit an annual report on corporate governance as well.

⁸Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 4(November 12, 2012)

⁹ Budapest Stock Exchange, Corporate Governance Recommendations of the BSE – History, (March 17, 2013), available at <http://bse.hu/topmenu/issuers/corporategovernance/cgr.html?query=recommendation>

¹⁰ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 4, (November 12, 2012)

In addition, companies listed on the stock exchange have to make a declaration on their application of the Recommendations. This has to be in accordance with the “comply and explain” principle.

In accordance with the "comply or explain" principle, they have to indicate their compliance with those recommendations included in specified sections of the Recommendations ("R" - recommendation) and whether they apply the different suggestions formulated in the Recommendations ("S" - suggestion). In some cases, the Recommendations also contain explanations ("E" - explanation) which give directions regarding the relevant recommendation or suggestion or the manner of compliance with those contained therein.¹¹

However, the companies either neglect to apply them or apply them in a different way. In this case they have to clarify and explain the divergence. It can happen (and mostly happens) that even if applied, the companies do not comply with all of the recommendations.

The structure of the Recommendations consists of four main points, which are equally important in order to establish a prosperous company:

1. **The Shareholders’ Rights and Treatment of Shareholders** – this part mostly focuses on the General Meeting, where the shareholders can exercise the vast majority of their rights.
2. **Responsibilities of the Managing Body and the Supervisory Board** – This is the most extensive part of the Recommendations and deals with the roles and obligations of these bodies, their mutual relationship and effective and proper functioning. This part also concentrates on the problems of extensive remunerations, conflict of interests, monitoring and control inside the company and risk management.

¹¹ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 5, (November 12, 2012)

3. **Committees** – the third section is dedicated to committees, whose primary role is to make the inside operations of the company more effective.
4. **Transparency and disclosure** – finally the Recommendations deal with transparency and disclosure, although the requirement of disclosure appears in every chapter of the Recommendations. Disclosure and transparency serve as basis for all the above mentioned regulations, because in order to provide for effective outside monitoring disclosure is inevitable. *“Transparency and a proper level of openness about the activities of the different boards and committees are important parts of corporate governance policy, so the company’s disclosure practices may be crucial to the perception of the company.”*¹²

1.1.2 Statutes as the basis of the Corporate Governance Rules in Hungary

The legal origin of Hungarian civil law is German, just as in the case of Slovakia. *“German law is typical ‘lawyers’ law’, using a very specific technical language and definitions, striving for absolute preciseness. It makes also a very extensive use of codes.”*¹³ Statutory regulation is crucial when it comes to corporate governance, as the other non-statutory regulations (e.g., the Corporate Governance Recommendation, internal regulations) have to be in compliance with the legal rules. The main statutory sources are the following:

- Act IV of 2006 of the Republic of Hungary on Business Associations as amended (hereinafter referred to as “the Companies Act”).

¹² Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 21, (November 12, 2012)

¹³ István Czajlik, János Vincze, CORPORATE LAW AND CORPORATE GOVERNANCE THE HUNGARIAN EXPERIENCE 6, Institute of Economics Hungarian Academy of Sciences KTK/IE Discussion Papers 2004/11

- Act XL of 1991 of the Republic of Hungary on Bankruptcy and Liquidation Proceedings as amended (hereinafter referred to as “Bankruptcy Act”)
- Act V of 2006 of the Republic of Hungary on the Registration of Businesses as amended (hereinafter referred to as “the Companies Registration Act”).
- Act CXX of 2001 of the Republic of Hungary on Capital Markets as amended (hereinafter referred to as “the Capital Markets Act”).
- Act C of 2000 of the Republic of Hungary on Accounting as amended (hereinafter referred to as “the Accounting Act”).

In general, under the Companies Act shareholder rights and obligation are regulated, so as the decision making process and the structure and functioning of the Supervisory Board and the Board of Directors. Together with the Civil Code it establishes the concept of fiduciary duty and duty of care for directors and executives. The Companies Registration Act deals primary with the procedures for registering and winding-up companies. The Capital Markets Act is important when it comes to corporate governance-related matters, as it regulates disclosure requirements. Further regulation of disclosure and transparency is provided by the Accounting Act.

All in all, the primary issues that have to be regulated are the rights and obligation shareholders and other stakeholders, the structure of the corporations, transparency, disclosure, the question of control and ownership, liability and enforcement. I shall discuss now the most important issues regarding corporate governance, starting with shareholder rights, followed by the rights of the other stakeholders and the duties of the company’s bodies.

1.2 Shares and Shareholders

The shareholder is a person or artificial person that legally owns a share in the company. Different types of shares can be issued by a Hungarian public or private limited company. The main types of shares are as follows: ordinary shares, preference shares, employee shares, interest-bearing shares and redeemable shares. The ordinary share is the basic type of shares without any special right attached to it. The preference shares include some kind of privilege when it comes to the distribution of dividends; or assets in case of liquidation; or preference related to voting rights. Employees can get shares on a discount rate or for free, but the issuance of the so called employee shares is limited up to 15% of the registered capital of the company. Finally, interest-bearing shares provide their owner with a right to interest and the redeemable shares are connected with the right of the owner to sell them or the right of the company to buy them.

A different category of shares is represented by the own shares of the company. These are regulated by Articles 223 – 230 of the Companies Act. Own shares are shares issued and owned by the same company. *“Unless otherwise prescribed in this Act, limited companies may acquire their own shares only if able to finance it from its assets other than of the share capital.”*¹⁴ Even this is limited as the combined limited value of the own shares may not exceed 10% of the registered capital of the company. Furthermore the company will not be furnished with voting rights or rights to dividends by acquiring its own shares.

Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.¹⁵

¹⁴ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 223 sec. 1

¹⁵ OECD Principles of Corporate Governance 18, (2004)

These basic rights, connected with the ownership of shares, belong to all of the shareholders, although some restrictions may appear.

The restrictions of acquisition of shares can be set by law or by the articles of association as well (Article 204 of the Companies Act). Further restriction is the pre-emptive right of the shareholders. This is crucial when it comes to the issuance of new shares. The articles can define the pre-emptive right of the existing shareholders, in order to prevent other persons to join and so dilute control. This restriction can be, and usually is, also set by the articles of association for already existing shares. When such a restriction is applicable, the existing shareholder has to offer the shares he is willing to sell first to the other shareholders or company. The articles can define other restrictions for the acquisition of shares, as well as they can render the transfer of shares subject to the consent of the private limited company. In this case the management is the body to approve such acquisition. This „*consent may be refused on substantial grounds, in particular, if:*

- a) the shares in question are to be acquired by a competitor of the company; or*
- b) in consideration of the purpose of the company and the sphere of its shareholders, refusal is justified by some other reason set forth in the articles of association.“¹⁶*

According to Article 182 of the Companies Act:

The voting rights attached to shares depends on their face value, with the exception if the articles of association of the public or private limited company contains provisions to preclude or restrict voting rights for certain specific classes of shares under this Act or another act. Shares with the same face value shall carry identical voting rights.¹⁷

¹⁶ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 203 sec. 3

¹⁷ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 182 sec. 1

This means that the voting right is determined by the face value of the share. The Recommendations also support the “one share – one vote” principle. *“In accordance with the ‘one share – one vote’ principle, in public limited companies all shares must have the same voting rights, and each share has to have one vote, which in practice represents a voting right proportionate to the face value of the share.”*¹⁸ However, there several exceptions exist to this principle, such as shares without voting rights, voting caps, golden shares.

Generally, the voting right of the shareholders cannot be limited, unless their capital contribution is not fully paid. Nevertheless, *“preference related to voting rights in the case of preferential shares may be restricted or prohibited by the articles of association.”*¹⁹ Furthermore, when a hearing for the expulsion of a shareholder takes place at the court, this shareholder is according Art. 48 sec. 4 of the Companies Act upon request suspended from its shareholder rights, including voting rights, until the end of such hearing.

1.3 The General Meeting

Shareholders can exercise their voting rights during the General Meetings (hereinafter referred to as “GM”) of the company. This can be done by attending the GM personally, or by proxy. To achieve an effective and informed voting, the shareholders must be sent an invitation at least fifteen days prior to the first day of the GM. This invitation has to contain among others the agenda of the GM, so in that way the shareholders are informed about the issues being discussed at the GM. The GM is not able to reach a decision unless the quorum requirements are met. *“The general meeting has quorum if shareholders representing at least half of the votes embodied by shares with voting rights are present.”*²⁰ However, there are

¹⁸ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 6, (November 12, 2012)

¹⁹ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 186 sec. 4

²⁰ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 234 sec. 1

cases when a qualified majority is requested for some decisions to be passed. This majority represent a threshold of three quarters of the votes embodied by shares with voting rights. Those matters, which require the qualified majority can be prescribed by the companies charter, although there are resolution that can be adopted only by a qualified majority. These are listed in the Companies act and include: the voluntary dissolution of the company; decisions to approve and amend the articles of association; decisions on changing the operating form of the private limited company; decisions on transformation or termination of the company without succession, alteration of the rights attached to the various series of shares, and the conversion of categories or classes of shares; decisions to reduce the share capital.

As we live in an era of technological development, where the new means of communication are recognized by law, the shareholder can also vote by electronic means or mail. The importance of electronic voting is reflected in the Companies Act, as it is mentioned in several provisions – Art. 20 deals with general provisions applicable to all legal entities; Art. 241 regulates the GM convened via conference call; and Art. 242, which enables to vote and reach decisions in writing, without physically attending the GM. In addition the meetings of the Board of Directors can be attended electronically as well.

The Recommendations also stress out the importance of technological means. They point out the necessity of using the internet and suggest uploading the basic documents on the company's website. The invitation for each general meeting and any information connected with the GM should be uploaded as well. This enables the shareholders to be well informed at any time on the forthcoming GM, its agenda, time and place and other matters. The GM itself should be organized in a way that no one should be prevented from attending it – *“The company should not issue requirements for participation with the intention of preventing the*

*participation of particular shareholders.*²¹ The invitation should define the agenda clearly and without room for differing interpretation. The GM should be led and organized in a way, that all of the shareholders could have an opportunity to present their opinion, even I writing prior to the GM. *“It is suggested that the Managing Body and the Supervisory Board are represented at the general meeting in order that they can answer any questions that may arise.”*²² Thus, shareholders can face these organs directly. This should support the position of the shareholders and provide them with an opportunity of a more diligent scrutiny. When it comes to the election of members of the Supervisory Board (and the Management, unless it is the right of the Supervisory Board) the Recommendations are against a combined vote. *“In the case of voting for executive officers or members of the Supervisory Board, the general meeting should vote on each candidate separately.”*²³ This ensures that eventually the most suitable candidates who enjoy the support of the majority of shareholders will be picked.

1.3.1 Extraordinary General Meeting

The possibility to call an Extraordinary GM is available as well. This can be initiated by the supervisory board of the company in cases when the management acts wrongfully. This is why the monitoring function of the supervisory board has to be taken into account by the Board of Directors, because it can easily be replaced by unsatisfied shareholders on the Extraordinary GM. Furthermore, an auditor can initiate the calling of the Extraordinary GM as well. This happens usually in the case when *“a considerable decrease in assets of the business association is probable, or perceives any other issue which entails the liability of the executive officers or the supervisory board members as set forth in this Act (the Companies*

²¹ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 7, (November 12, 2012)

²² Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations, 7, (November 12, 2012)

²³ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations, 8, (November 12, 2012)

act)²⁴ The Board of Directors has also a duty to call a GM within the period of 8 days, whenever it comes to its notice that:

- a) the company's equity capital has dropped to two-thirds of the share capital due to losses; or
- b) the equity of the company has dropped below the amount limit specified in Article 207 (1); or
- c) the company is on the brink of insolvency or has stopped making payments and its assets do not cover its debts.²⁵

Article 303 section 3 of the Companies Act orders to convene an Extraordinary GM “*in consequence of the shareholders' opinion relating to a public take-over offer for the shares of a public limited company or at the request of the person having obtained a qualifying holding upon the successful conclusion of the public take-over offer*”²⁶

Finally, minority shareholders are given the option to request the calling of an Extraordinary GM as well.

1.4 Protection of minority shareholders

„The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.”²⁷ The minority shareholder is an equity holder who does not enjoy the voting control in a company. Therefore, the existence of some protective rules is essential in order to give the minority shareholders the ability and possibility to exercise their rights as shareholders. These protective rules are scattered in the Companies Act. The most general provisions can be found

²⁴ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 44 sec. 2

²⁵ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 245 sec. 1

²⁶ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 303 sec. 3

²⁷ OECD Principles of Corporate Governance 20, (2004)

under Title 2, in Article 49. According to this, the threshold for minority protection is set at controlling of 5% of the voting rights; however, this can be even reduced to a smaller percentage by the charter. Shareholders “*controlling at least five per cent of the voting rights may, at any time, request that the business association’s supreme body be convened, indicating the reason and the purpose thereof.*”²⁸ This means, that the management has to call a GM upon such request in 30 days. If it fails to do so, the court of registry will convene the GM. In this way the minority shareholders are protected even from the bad faith acting of the management. The group of shareholders controlling at least 5% of voting rights can also ask the management to add an issue of their choice to the agenda of the GM, in the case of public limited companies this threshold is lowered to 1%.

The mentioned threshold of 5% is needed to start examination ordered by the court of registry in case that:

business association’s supreme body has refused a proposal that the last annual report prepared pursuant to the Accounting Act, or any event which has occurred in the management during the last two years be examined by an auditor, or, if the decision on a regularly announced proposal to this effect has been ignored by the supreme body.²⁹

This provision provides the minority shareholders with the opportunity to act and protect their interest in case of sabotaging the GM by the majority shareholders. The same is true for the possibility to enforce a claim by the minority shareholders controlling at least five per cent of the votes on behalf of the company in court proceedings. Without this protection it could easily happen that the executive officers, Supervisory Board members, the auditor or other shareholders could act to the detriment of the company without being punished.

²⁸ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 49 sec. 1

²⁹ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 49 sec. 3

An interesting, new feature of the Hungarian public or private limited companies is the option to choose between the one-tier and two-tier model. In short, the main difference is that the one-tier model lacks the establishment of the supervisory board. Interestingly, the establishment of the supervisory board is mandatory „*for private limited companies if requested by the founders or members (shareholders) controlling at least five per cent of the total number of votes*“³⁰ This enables the minority shareholders to have an impact on the establishment of the company, regardless of their not so favorable position.

The minority shareholders are also protected when it comes to distribution of the own funds of the private limited company. Again, the shareholders controlling at least 5% of the voting rights may request, the court of registry to appoint an independent expert to examine whether these distributions were made in a legal manner. This is also applicable in the case of public limited companies, yet again the threshold represents only 1%.

Although minority shareholder protection is an important corporate governance issue, at times all of the shareholders have a need for protection against the elected organs of the company. This is caused the conflict of interests, which can appear between the shareholders of the company and the elected members of the boards.

1.5 The Supervisory Board and the Management Board

Generally, the Supervisory Boards main role in the company is the monitoring of the decisions and acts of the Management Board. Originally in Hungary every public or private limited company had to establish a Supervisory Board and a Management Board. However, this has changed and today “*public limited companies have the opportunity to establish a one-tier (Anglo-Saxon) board structure, where there is no Supervisory Board operating, and the*

³⁰ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 33 sec. 3 b)

*board called the Board of Directors executes the management and monitoring functions at the same time (unitary board structure)... .”³¹ If created, this organ acts as an independent body and consists of three to fifteen members, who act in person – “*representation on the supervisory board is not allowed.*”³² The Supervisory Board has extensive rights when it comes to gathering information, as these serve as the basis for its monitoring function.*

The Management Board handles the administrative duties of the company as an independent body. In the two-tier company model the rights and duties of the Board of Directors are realized by the Supervisory Board and the Management Board. The Management Board of a private limited company can be substituted by a single general director. However, this is not possible in a public limited company, where the board shall consist of five to eleven members according to Article 308 and 309 of the Companies Act. The members are appointed and removed by the GM, unless the articles of association of private limited companies contain provisions that empower the supervisory board with this right. The chairman is elected by the management board among its members or by the GM if the articles of association prescribe so.

In order to work properly, the majority of the members of the Management Board should be independent. Conflict of interest could appear if the member of the Management Board was holding office in the management boards of different companies. This is prohibited, as in that case the board member is not considered independent by the law. Other reasons causing lack of independence are listed in Article 309, section 3, and are the followings: being an employee or auditor of the company – this puts another obstacle to workers representation at the management board; providing services to the company – this provision should in a way make the functioning of the company more transparent, and the

³¹ Corporate Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations, 4, (November 12, 2012)

³² Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 34, sec 3

reducing the agency costs; shareholder controlling at least 30% of the votes or his close relative or spouse – this prevents allocation of ownership and control by a single, or a group of shareholders; entitlement to receive financial benefits based on board membership if the limited company operates profitably; engagement in a partnership with a non-independent member of the limited company in another business association and being an executive officer or executive employee of a business association, whose independent board member also holds an executive office in the public limited company.

The longest section of the Recommendations covers the responsibilities of the Managing Body and the Supervisory Board. It sets out the basic responsibilities of both of these organs, among which defining the strategy of the company and setting the corporate objectives are the most important for the Management board. It also points out the importance of the independence of these bodies and its members, and the duty of loyalty and care “*by keeping in view at all times the best interests of the company, the rights of shareholders and other parties concerned, and, preferably, the interests of other parties concerned, the Managing Body should act with due diligence and care.*”³³ These provisions are trying to solve the agency cost problem. This problem roots in the split of ownership and control in the company. According to this theory, the shareholders hire agents to act on the behalf of the company, but the interests of the agents and owners differ and this could be costly for the company. In order to cut the agency cost the managers should act in the best interest of the company as recommended above. This problem is closely connected with the conflict of interest problem. The problem occurs when a Member of the Managing Body has some personal connection to a transaction or by taking decision he is also influenced by personal factors. This problem is also covered by the Recommendations.

³³ Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 10, (November 12, 2012)

Members of the Managing Body should inform the Managing Body and (if there is one operating) the Supervisory Board (in case of a unitary board structure the Audit Committee) if he (or any other person in a close relationship to him) has a significant, personal interest in a transaction of the company (or of any of the company's subsidiaries).³⁴

These transactions can be also to the benefit of the company, thus they are not forbidden. However, stricter transparency rules should apply to keep on the safe side.

In case the members of the Managing Body perform well, they are usually entitled to some kind of remuneration. As this is a delicate issue, and has been abused ever since, the Recommendations make an effort to bring the foolish and expensive remuneration costs to a halt. All of this happens by imposing strict and well established guidelines on evaluation and remuneration, which make the whole process more transparent.

1.6 Representation of other stakeholders in the company

For almost a century the law of corporations has largely concerned itself with the interests of shareholders. (...) Most of the doctrine of corporate law, and indeed much of the work of corporate law scholars, focuses on the problem of making sure that management honestly and conscientiously serves the interest of the shareholders.³⁵

These views are tightly connected with the theory that the company is owned by the shareholders. However, looking at shareholders as the owners of the company is outdated, since now we look at the company as a nexus of contracts. Thus the position every stakeholder should be equal, regardless of the fact whether it is a shareholder, employee, creditor or investor. It follows that each of the stakeholders should be adequately represented in the bodies of the company. *“The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active*

³⁴ Governance Committee of the Budapest Stock Exchange Company Limited by Shares, Corporate Governance Recommendations 12, (November 12, 2012)

³⁵ Greenfield Kent: The Failure of Corporate Law 41, University of Chicago Press, (2007)

co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. “³⁶

The Companies Act deals only with employee representation. According to Articles 38 and 39 if the annual average of the number of full-time employees employed by company exceeds two hundred, the employees shall have the right to be represented in the supervisory board of the company. The employees should comprise one-third of the members of the supervisory board and the same rights as the other members of the supervisory board. In case when there is no Supervisory Board established in the company – the one-tier model – the supervision procedure should be agreed upon between the Board of Directors and the workers council. The workers council plays a significant role in the nominating of the employees’ representatives. The representatives are then selected and appointed at the GM of the company. Other stakeholders are not represented at any level in the company’s bodies.

1.7 The Protection of Creditors

Creditors are concerned to be stakeholders of the company. As shareholders contribute to the company with their capital, employees with their work, so do creditors supply the company with credit. Significant difference among creditors and other stakeholders is that creditors are outsiders to the company. They have no voting right and no legal influence. This situation was abused ever since, so the introduction of a protective device was needed. Title 3 of the Companies Act regulates the personal liability of the member of a company, introducing the doctrine of piercing the corporate veil.

This doctrine was created to fight against injustice, to fight cases where strict application of the limited liability constituted a breach of principal values of the legal system. This doctrine is an exception to the general rule and provides, under certain factual circumstances, that the shareholders of the company are not

³⁶ OECD Principles of Corporate Governance 21, (2004)

protected by the veil of this legal fiction and become directly liable for the company's obligations to third parties.³⁷

All of this is reflected in Articles 50 and 51 of the Companies Act and is mainly connected with the event of termination of a private or public limited company. In that case *“any members (shareholders) of private limited-liability companies and public or private limited companies, who has abused their limited liability or the company’s legal personality to the detriment of creditors, shall bear unlimited and joint and several liability for the unsatisfied obligations of the defunct business association.”*³⁸ It should be noted here that this provision is applied mainly in cases of liquidation. However, this provision favors creditors, and puts pressure on the managers, members of the supervisory board or other influential shareholders to act in a professional manner and in the best interest of the company.

Another act where we can find provisions aimed to protect creditors and their money is the Bankruptcy Act. *“Bankruptcy laws protect troubled businesses and provide for orderly distributions to business creditors through reorganization or liquidation.”*³⁹ The goal of reorganization is to provide the insolvent company with time and space to reorganize its assets and business strategy according to a plan, in order to survive and provide future payments to its creditors. Keeping the company alive should be beneficial for everyone. Liquidation is a procedure where the company ceases to exist, while its assets are sold, in order to refund its creditors. However, liquidation is a widely abused procedure where in the end the creditors are often left with nothing, or only with the refund of a slight portion of their originally given credit.

³⁷ JUDr. Alexandra Horváthová, LL.M, C., Piercing the Corporate Veil” Doctrine and Liability of Parent Corporations. Comparison of World Legal Systems and Possible Application in Slovakia 41, Bulletin Slovenskej Advokácie 11/2012

³⁸ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 50 sec. 1

³⁹ United States Courts, Bankruptcy, available at <http://www.uscourts.gov/FederalCourts/Bankruptcy.aspx>

The initiation of bankruptcy proceedings, in principle, does not require the approval of creditors. In practice it is usually the debtor, who initiates bankruptcy proceedings against himself. However, the liquidation proceedings can be triggered by one or more creditors, or by the authority if they detect that either the bankruptcy or the reorganization will not lead to the desired results. Furthermore there is a statutory trigger that sets off the liquidation proceedings that we can find in the Companies Act:

If, according to the annual report prepared pursuant to the Accounting Act, a business association does not have sufficient own funds to cover the subscribed capital prescribed for its form of business association over two consecutive financial years, and the members (shareholders) of the business association fail to provide for the necessary own funds within a period of three months after approval of the annual report prepared pursuant to the Accounting Act for the second year, the business association shall be required to adopt a decision within sixty days of this deadline for transformation into a different business association, or for its termination without succession.⁴⁰

All the mentioned legal devices are primarily aimed to help the creditors to recollect their investment. This can happen by the distribution of the collateral, at the final stage of the bankruptcy proceeding. The crucial point at this stage is the order of groups of the creditors – the higher the rank of the group the higher the refund. The order is regulated by the Bankruptcy Act. The position of the lien holder is privileged, as he is among the first who are refunded. However, he cannot repossess the pledged property after the bankruptcy proceedings have started.

Another important legal device is the *Actio Paulina*, which is rarely used in real life, for it is too time-consuming and demanding to bear the burden of proof. According to Article 33/A section 1 of the Bankruptcy Act, the creditor, or the liquidator on behalf of the debtor, can during the bankruptcy proceedings file a claim with the court to check whether the actions and decisions of the managers were made in good faith, in the best interest of the company

⁴⁰ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 51 sec. 1

and its creditors. If the contrary is proven, the managers are held personally liable for the detriment caused to the creditors.

As mentioned earlier, the main goals of bankruptcy law is on the one hand to help the debtor to survive, and on the other hand to protect the creditors as well. Unfortunately, these provisions are abused on a daily basis in Hungary and in Slovakia as well, having the companies wiped out and leaving the creditors without any chance to get their loans back. This could be changed by making the initiation of bankruptcy proceedings subject to the approval of the creditors. However, this would most probably lead to cancelling every attempt of bankruptcy and so undermining the whole idea of this legal instrument.

1.8 Judicial Review

The opportunity to seek justice via judicial review is a great tool in the hands of the shareholders and other stakeholders. It forces each member of the company – shareholders, representatives, managers – and the bodies of the company to avoid wrongful acts and supports transparency. Under Article 45 of the Companies Act: *“Any member (shareholder) of a business association may request the judicial review of resolutions adopted by the organs of the business association on the grounds that such resolution violates the provisions of this Act, other legal regulations, or the memorandum of association.”*⁴¹ This important provision is a tool of shareholder protection. First of all, it tips the scales in favor of the shareholders and to the detriment of the managers. In this way, the management is not only monitored by the Supervisory Board, but it can be supervised by each shareholder as well. Secondly, as the GM is considered to be an organ as well, minority shareholders are protected as well, as any single shareholder can initiate such judicial review against the resolution of the GM which is run by the majority shareholders. However, judicial review can be initiated also by the

⁴¹ Act IV of 2006 of the Republic of Hungary on Business Associations as amended Article 45 sec. 1 of

Supervisory Board and any executive officer. Regardless of the fact who lodges the suit, it is directed against the company itself. Nevertheless, personal liability of the shareholder is also an option, which is connected with the doctrine of piercing the corporate veil and creditors' protection.

Concluding Remarks

To sum up, although corporate governance rules do not represent the top issue in the world of business in Hungary, they are getting more and more important. The lack of interest when it comes to corporate governance rules is caused by the fact that the vast majority of the companies are small or one-man-owned limited liability companies, where such regulations are not necessary. On the other hand, to make the market work and to attract investors, large firms, international groups, a well established stock market and effective corporate governance rules are of essence. As pointed out, corporate law provides the basis for the corporate governance rules. It deals with such crucial issues of corporate governance as the structure and inner relationships in the company, shareholder rights and duties. However, the protection of other stakeholders is neglected as the company is still looked at as the property of the shareholders and not as the nexus of contractual relationships among different stakeholders.

2 Corporate Governance Rules in Slovakia

Introductory thoughts

The Slovak Republic is a young country, sharing its south border with Hungary. The last twenty-five years represent a milestone in the history of this country. Alongside with Hungary and other countries of the region, the breeze of democracy came to Czechoslovakia at the end of the 1980s. Typically for the post-communist countries, this was the beginning of the era towards establishing a democratic society, and the transition from the planned economy into market economy. However, this did not happen as smoothly as in Hungary or Poland. First of all, the split of Czechoslovakia into Czech Republic and Slovakia had its impact on the economic development. On the other side, this fresh start provided a good opportunity to build the basis of the economy of the new countries on a solid ground. Unfortunately, in case of Slovakia just the opposite happened. The era of “meciarism”, named after the first prime minister of Slovakia – Vladimir Mečiar caused further delay in the development of the market and made this country undesirable for foreign investors. This was the result of bad political decision, which ruined the economy of the country. When privatization was introduced it was everything but transparent and its outcome was disastrous. Nepotism played a huge role in it, since through the legal device of privatization family members, the members of the political parties in charge and “friends of the government” received huge factories and firms for the fraction of their prices. Needless to say, that the lack of professionalism, corporate governance and good faith caused that the vast majority of these firms ceased to exist during the first decade after being privatized. It was not until the new millennium that positive changes, introduced by the new government, helped Slovakia out of this shameful position, and opened the door into the European Union.

In the last ten years, Slovakia became the economic leader of the Central – European region. This is a relatively new position that is followed by the incorporation of a higher number of companies.

Emergence of a multitude of new private companies have brought along the first experience with the administration and management of private equity. Corporate governance, initially aimed only at maximizing profit regardless of the sustainability of such development, has been gradually improving. The main influence is the growing competition and new experience from international developments in corporate governance, whereas many changes also come through the change of legislative environment.⁴²

Corporate governance is nowadays a recognized issue in the field of Slovak economy. Just as in case of Hungary it originates from statutory rules. Further similarity between these two countries is that it was the Stock Exchange that initiated the creation of a national, non-mandatory Code of Corporate Governance for Slovakia. This was mainly influenced by the OECD Principles of Corporate Governance.

Hungary and Slovakia have chosen similar paths, and are facing the same troubles and hardship connected with corporate governance. It is, however, interesting that there are some slight differences between the regulations of this matter in the mentioned countries. These differences will be discussed by focusing on the corporate governance rules in Slovakia.

2.1 Sources of Corporate Governance in Slovakia

Just as in the case of Hungary, the sources of corporate governance can be divided into two main groups: 1) statutory sources and 2) the Corporate Governance Code for Slovakia, drafted by the Bratislava Stock Exchange (hereinafter referred to as “BSSE”). However, it was not until 2000 that the legislators started to pay attention to corporate governance issues.

⁴² Central European Corporate Governance Association, Corporate Governance Code for Slovakia 3, (January 2008)

The most important statute regarding corporate governance is the Commercial Code (Act No. 513/1991 – Commercial Code as amended). The corporate governance matters regulated by the Commercial Code cover a large scale, including the establishment of different types of companies, their structure, internal relationship, rights and obligation of the members and the Company Register. The registration procedure alongside with the Companies Act is furthermore regulated by the Act No. 530/2003 on the Company Register as amended. Another statutory act which contains provisions regulating corporate governance is the Act No. 483/2001 on Banks as amended.

The administration itself and management of a company, thus also a bank has its own legislative basis. Along with the Commercial Code the Act no. 483/2001 Z.z. on banks and on the amendment to and supplementing of certain acts (hereinafter referred to as „the Banking Act”) governed in their provisions these areas or elements falling under the term corporate governance: 1. Separation of competences and responsibilities and cooperation. 2. Internal and external control and risk management, 3. Transparency of proceedings and publishing of information.⁴³

Finally, Act No. 7/2005 on Bankruptcy and Restructuring as amended, which based on the EBDR model law, established one of the most up to date and comprehensive bankruptcy procedure in the European Union.

On the other hand, the most compact and important source of corporate governance in Slovakia is the Corporate Governance Code for Slovakia (hereinafter referred to as the “CG Code”). This is somewhat similar to the Hungarian Recommendations mentioned in the previous chapter. Prior to the CG Code there was the Unified Code of Corporate Governance created in 2002 under the Bratislava Stock Exchange’s initiative.

BSSE subsequently initiated the founding of an association with a mission to monitor worldwide developments in corporate governance, to encourage public, professional and political discussion on this subject in the society, to foster professional growth of both current and future members of the boards of directors/supervisory boards, and to create a professional background enabling to

⁴³ Frantisek Hettes, Corporate Governance in the Banking Act, National Bank of Slovakia 11, BIATEC 5/2002

gain the most recent information from the area of corporate governance. With the support of twenty founding members, the Central European Corporate Governance Association (CECGA) was founded in October 2004.⁴⁴

This meant a large step forward and compared to Hungary moved the regulation of corporate governance from a national level to an international level. Later in 2007 it was the CECGA that played an important role in the revision of the Unified Code of Corporate Governance and in the drafting CG Code.

“The Corporate Governance Code for Slovakia is a part of the Stock Exchange rules for securities admission to the regulated market, which are approved by the BSSE Management Board and the National Bank of Slovakia.”⁴⁵ The CG Code used to apply to all companies that have securities admitted to trading on the BSSE’s regulated market. However, this rule was later dismissed. This was caused by the fact that not only local companies list their securities for trade on the secondary market in Slovakia, but international investors, foreign companies and companies that are members of large international groups are also present at the stock exchange. *“This decision, which comes into effect on 1 January 2012, is intended to enable issuers to accede to, and abide by, any accepted Corporate Governance Code in compliance with the legislation in effect.”⁴⁶* Thus, the obstacle caused by obligatory adopting the CG Code in order to be able to be active on the stock market is no longer present. This should unburden the foreign companies. However, the CG Code is not intended only for the companies that trade their securities on the secondary market, although it is not so significant for the other companies. Just as in the case of Hungary, the corporate governance rules play an important role in the case of private and public limited companies. The other

⁴⁴ Bratislava Stock Exchange, What is corporate governance? (March 17, 2013), available at <http://www.bsse.sk/bcpben/IssuersGuide/CorporateGovernance/tabid/965/language/en-US/Default.aspx>

⁴⁵ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 4, (January 2008)

⁴⁶ Bratislava Stock Exchange, What is corporate governance? (March 17, 2013), available at <http://www.bsse.sk/bcpben/IssuersGuide/CorporateGovernance/tabid/965/language/en-US/Default.aspx>

business entities are usually family owned, or too small to be in a need for special, additional regulation.

“The Code sets up relations within a company as well as the company’s relations with its environment on the principles of openness, integrity and accountability. An open approach to the disclosure of corporate information - within the bounds given by the company’s position among its competitors - is a basis of trust which must exist between the company and those that participate in its success i.e. shareholders, employees, creditors, suppliers, customers and other stakeholders.”⁴⁷

Yet again, transparency is crucial. After the fall of communism and “meciarism” the legislator and the drafters of the CG Code realized that transparency is the key to create a healthy business environment and to make this region more attractive for foreign investors. Good political maneuvering (e.g. enabling tax holidays for large firms and other benefits) and a well established corporate governance framework made it possible to attract huge motorcar companies as Volkswagen, KIA or Peugeot to Slovakia.

The CG Code follows the “comply or explain” rule as well as do the Recommendations in Hungary. This rule:

allows companies a certain degree of deviation from the principles, provided that it is justifiable by specific conditions and an appropriate explanation is given. Whether such explanation is sufficient will be ultimately judged by, for example, potential investors or creditors. They can decide, based on information provided in the Annual Report, whether to invest in the company or whether and under what conditions to lend it.⁴⁸

Thus, it is better for a company to comply with the rules, or if not they should provide for a better alternative. If not done so, they will become unattractive in the eyes of the investors.

⁴⁷ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 4, (January 2008)

⁴⁸ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 4, (January 2008)

Compared to the Hungarian Recommendations, the CG Code is more readable. It is well organized and easy to follow. It mirrors the structure of the OECD Principles. In addition to the principles there the CG Code contains notes that explain the principles. A tremendously useful idea was to supplement the principles with an indicative list of legal provisions that govern each relevant issue. Even if the legal provisions change from time to time, it is a useful hint where to look for the legal background of the given principle. The CG Code is structured into an underlying principle and five other principles. These include:

- The Underlying Principle: **Ensuring the Basis for an Effective Corporate Governance Framework** – it stresses out the need for a proper legislative framework for corporate governance. Most of all, how to enact laws supporting the competition and corporate governance. Furthermore it supports the view, under which overregulation should be avoided.
- I. Principle: **The Rights of Shareholders and Key Ownership Functions** – it enumerates the basic rights of the shareholders, with the requirement of guaranteeing them. Just as in Hungary, this principle points out the importance of disclosure, connected with the frequent usage of technological devices and the internet. However, it seems like the CG Code is more diligent when it comes to the requirement of disclosing information as the Recommendations.
- II. Principle: **The Equitable Treatment of Shareholders** – focuses on the equality of shareholders rights and the issue of minority shareholder protection.
- III. Principle: **The Role of Stakeholders in Corporate Governance** – as mentioned in the first chapter, the stakeholders play an important role on the company. Their position was neglected for decades, however, it is as crucial as of the shareholders. This principle deals with the employee participation in the bodies of the company,

disclosure of information, protection of rights of stakeholders and it also deals with the position of creditors.

- IV. Principle: **Disclosure and Transparency** – as highlighted before, this is one of the most important principles, closely connected with every other principle in the CG Code. *“The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance ownership and governance of the company.”*⁴⁹
- V. Principle: **The Responsibilities of the Board** – *“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board’s accountability to the company and the shareholders.”*⁵⁰

I shall now discuss the most important matters of corporate governance in Slovakia. By doing this, I will focus on the legal provisions and the principles of the CG Code. Where appropriate, the issue will be compared to the Hungarian solution.

2.2 Shares and Shareholders

The private and public limited companies are primarily regulated by the Commercial Code. A Slovak private or public limited company can issue different types of shares, just as it is the case in Hungary.

“Shareholders have ownership rights that enable their shares to be bought, sold or transferred. Moreover, shareholders have the right to participate in the corporation’s profits to a degree corresponding to the amount of investment.

⁴⁹ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 27, (January 2008)

⁵⁰ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 35, (January 2008)

These basic rights, the right to participate in the corporation's profits and the right to sell one's shares, are the elements that generate value for shareholders.⁵¹

These rights attached to the shares can differ, thus different types of shares exist. First of all, the shares can be divided into *ordinary shares* and *preference shares* according to the voting rights and the right to have a share in the profits attached to the shares. Ordinary shares are the most common shares issued by the company. The basic rights attached to them are the same as in case of Hungary. Preference shares provide their owner with some kind of a privilege, usually when it comes to the distribution of dividends. *"The articles of association may determine the issue of shares to which priority rights in relation to dividends are attached, but the total nominal value of such preference shares may not exceed one-half of the registered capital."*⁵² A statutory restriction exists in the Commercial Code on the issuance of preferred shares, in order to protect the shareholders who own ordinary shares. In addition, a company can issue shares without voting rights, these are mostly preferred shares.

Furthermore, shares can be divided into two groups according to the method of transfer:
1) *shares registered with the company* and 2) *bearer shares*.

Shares registered with the company are ordinary shares registered under the name of the shareholder. The company has to administer a register of the shareholders holding such shares. The acquisition of such shares is usually controlled by the company. Second, *bearer shares* are ordinary shares in printed form, thus can be acquired by handing the share over by the original owner to the new owner. Acquisition of shares can be limited by the articles of association. However, this should be regulated according to the CG Code as follows:

⁵¹ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 11, (January 2008)

⁵² Act No. 513/1991 – Commercial Code as amended Article 159, sec. 1

A company must not gratuitously decline to register a transfer of ownership of shares, as that would affect the ownership rights of shareholders. On the other hand, a company must have the right to decline a transfer of shares, when a shareholder intends to transfer shares to someone who is verifiably involved in illegal activity.⁵³

Employee shares in contrast to the Hungarian regulation, cannot be issued anymore, and had to be changed into ordinary or other kind of shares by the 1 January 2004. However, employees can own ordinary shares and are entitled to dividends. The problem of own shares is regulated also differently in Slovakia. The Commercial Code explicit prohibits the holding of own shares – “*A company may not subscribe for its own shares*”⁵⁴ This provision was, however, amended in order to add certain exemption to this strict rule. According to Article 161a of the Commercial Code this:

„A company may acquire its own shares either itself or through another person acting in own name but on the company's account in accordance with section 1 if

- a) if the general meeting passes a resolution on acquisition of own shares; this resolution must determine the details of such proposed acquisition of shares mainly the maximum number of shares which the company can acquire; the time for which the company may acquire its shares, which may not be longer than 18 months; the maximum and minimum prices for which the company may acquire such shares, if they are acquired for a consideration (i.e. against payment);
- b) by the acquisition of shares of the company's own capital does not fall below the amount of the registered capital together with the reserve fund (§ 217), or other funds established compulsory by the company reduced by the value of the unpaid share capital, if this is not already included in the assets shown in the balance sheet under a separate law,
- c) the issue price of the acquired shares is fully paid.”⁵⁵

In addition, according to Article 161b of the Commercial Code, the company can acquire its own shares when it is reducing its registered capital; acts as the legal successor who was the original owner of the shares; the acquisition of shares was compulsory under law

⁵³ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 11, (January 2008)

⁵⁴ Act No. 513/1991 – Commercial Code as amended Article 161, sec. 1

⁵⁵ Act No. 513/1991 – Commercial Code as amended Article 161a, sec. 2

or court order, in respect of the protection of minority shareholders; acquiring free of charge shares, whose issue price was fully paid; acquiring shares whose issue price was fully paid on an auction in the course of enforcement proceedings against an insolvent shareholder of the company; acquiring shares whose issue price was not paid by the shareholder, who as a consequence will be excluded. Except for the case, when the reduction of the registered capital causes the holding of own shares, the company must transfer or its acquired own shares in three years from the acquisition, unless the face value of the own shares does not exceed ten per cent of the registered capital of the company. However, there are no voting rights connected with the holding of own shares. If the company fails to transfer these shares, it can reduce its registered capital and so withdraw the own shares. In the event of non compliance with these requirements, the court will start an investigation, in order to liquidate the company. These restrictions are important, because holding of own shares by the company is undesirable, since it causes a fake image of the true value of the shares and the company itself.

The shareholders rights and obligations under the Slovak law are similar to the Hungarian system. *“The exercise of shareholder rights may be restricted or suspended only under this Act or a separate law.”*⁵⁶ In addition, these rights cannot be exercised to the detriment of other shareholders. The Commercial Code also provides for the equal treatment of all shareholders. It equally sets the general obligation to pay the issue price of the acquired shares and regulates the basic shareholder rights, such as voting rights, right to share the profit – dividends.

⁵⁶Act No. 513/1991 – Commercial Code as amended Article 176a, sec. 3

2.3 The General Meeting

The GM is considered to be the highest body of the company, whose agenda contains the main and basic issues in conjunction with the company, such as modification of the articles, decreasing or increasing the registered capital, electing the members of the Supervisory Board and Management Board. The shareholder can participate on the GM personally or can be represented by a proxy. One proxy can vote for several shareholders if empowered by them. The proxy cannot be a member of the Supervisory Board, however, this prohibition does not apply in case of public limited companies. A recent amendment made it possible to use technological devices as voting tools. According to this the vote of a shareholder is only valid when signed with an advanced electronic signature. This vote can be sent from the time of the invitation to the GM. Although such vote is considered to be valid, it still can be changed by the shareholder by attending the GM personally or by proxy and voting in a different way.

The GM has to be convened once a year and is lead by the Management Board. The invitation to attend the GM should be sent to shareholders thirty days prior to the GM. In case of the company issued bearer shares, the invitation should also be published in a nationwide newspaper. Public limited companies have also the duty to publish the notice of convening a GM in nationwide newspaper publishing news on the stock market. According to Article 186 of the Commercial Code *“The decisions on the General Meeting are made by a majority of shareholders present at the meeting, unless otherwise provided by law or the articles of association.”*⁵⁷ However, certain issues require a higher threshold, usually two thirds of the votes of the shareholders present at the GM. – e.g. modifying the articles, decreasing or increasing the registered capital. This provision was lately amended, in order to ensure transparency and justice in the company. Article 186a prohibits any agreement between the

⁵⁷ Act No. 513/1991 – Commercial Code as amended Article 186, sec. 1

shareholders and any organ of the company, in order to which the shareholder would be obliged to act or vote according to instructions of the company or its bodies.

One of the basic rights connected with the ownership of the shares is to be enabled to vote at the GM. This is ensured by Art. 180 of the Commercial Code. Furthermore the participation on the GM not only enables the shareholder to cast his vote, but he can also gather information on the agenda of the GM from the Management Board. This can be asked in writing as well. Nevertheless, the Management Board can deny sharing information, in case that it would violate the law or would be harmful for the company. However, this does not apply to the information related to the economic management and financial circumstances of the company.

All the above mentioned provisions of the Commercial Code regulating the rights of shareholders regarding the participation and voting on the GM are basically retyped in the CG Code as well. This fact points out their importance. In addition, to reach a higher level of transparency the CG Code suggests that *“shareholders should have the opportunity to participate effectively in decisions concerning the remuneration of board members and key executives.”*⁵⁸ Thus, these issues should be individually discussed at the GM to express an opinion given to the shareholders.

2.3.1 General Meeting of a Public Limited Company

The Commercial Code devotes a section to the regulation of the GM of a public limited company starting with Art. 184a. As the shares of the public limited companies are not solely owned by businessmen, the mentioned provision puts some extra duties on the Management Board, in order to ensure that even shareholders, who are laymen would be well informed. The invitation to the GM of a public limited company has to contain some extra information,

⁵⁸ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 13, (January 2008)

explaining the rights of the shareholder connected with the participation on the GM such as participation rights, voting rights, the possibility to be represented by a proxy or vote by mail or gaining information via the web. The company is obliged to publish the invitation and all the necessary information on its homepage thirty days prior to the GM.

Since public limited companies tend to have a large number of shareholders, it is enabled by law to have a so called correspondent vote (or postal vote), which is regulated by Art. 190a of the Commercial Code. The articles of association have to be changed to enable this kind of vote with the consent of four fifths of all shareholders. The correspondent vote shall be concluded by a preprinted ballot. The signature on the ballot must be officially certified, which is done usually by a notary public. Such ballot can be delivered only to the hands of the addressee, namely the shareholder. However, the shareholder can be represented by a proxy, in that case the proxy has to attach the Power of Attorney to the ballot when sent back.

2.4 Protection of minority shareholders

*“The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.”*⁵⁹ The protection of minority shareholders in Slovak companies is an important issue which needs to be regulated by the law. Thus, minority shareholders can feel safe in their position. In Hungary it is the Companies Act that deals with this crucial matter. A similar solution to the Hungarian one is provided by the Slovak Commercial Code. Under Article 181 the ownership of shares the face value of which represents at least 5% of the registered capital of the company is the basic

⁵⁹ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 19, (January 2008)

threshold when it comes to protection of minority shareholders. This enables minority shareholders to call an extraordinary GM. However, the minority shareholders have to prove that they had owned the shares three months before the deadline for convening the extraordinary GM.

Furthermore, Article 182 adds some other rights to the minority shareholders. Shareholders controlling shares, which represent at least 5% of the registered capital: can order the Management Board to add some issues to the agenda of the GM; are enabled to ask the Supervisory Board to monitor the activity of the Management Board, regarding certain, specified matters; have the possibility to ask the Management Board to demand on the behalf of the company claims regarding the payment of the issue price of the issued shares; can ask the Supervisory Board to claim damages and to enforce other claims in the name of the company against the members of the Management Board.

In addition, there is a rather hidden provision introducing voting caps as another tool of minority shareholder protection. The voting cap represents *“the most power a shareholder can have in a given company as related to their votes.”*⁶⁰ Thus, even though having a majority of shares there are still limits when it comes to voting. The Commercial Code describes it as follows:

The number of shareholders votes is determined by the nominal value of its shares compared to the registered capital. The method of voting is determined by the articles of association. The articles or the law may restrict the exercise of voting rights by identifying the highest number of votes for a shareholder or grading the number of votes according to certain nominal values of shares, limiting the voting rights by the articles of association must apply to the same extent to all shareholders.⁶¹

⁶⁰ The Law Dictionary, What is Voting Cap?, (March 19 2013), available at <http://thelawdictionary.org/voting-cap/#ixzz2O0IX9XOG>

⁶¹ Act No. 513/1991 – Commercial Code as amended Article 180, sec. 1

Voting caps and preference shares with the voting rights and, at the same time, the right for a preference dividends are mentioned by the CG Code as the “*two exemptions that can disrupt the proportionality principle between ownership and voting rights.*”⁶² In all of the other cases all shareholders holding the same types of shares should have equal rights. “*Voting rights should be, without exception, determined only by the proportion between the nominal value of shares and the amount of registered capital.*”⁶³ Thus, the CG Code supports the one share one vote principle as well.

All in all, this wide array of rights should ensure that minority shareholders are protected against majority shareholders.

2.5 The Supervisory Board and the Management Board

Alongside with the General Meeting, the Supervisory Board and the Management Board are considered to be the three main organs of the Slovak public or private limited liability company. “*The Supervisory Board monitors the performance of the Board and business activities of the company.*”⁶⁴ In order to achieve this goal, the Supervisory Board has wide competence to gain information and to gather documents mainly from the Management Board. In this way is at able to exercise its supervisory duties in a diligent manner. The Supervisory Board has to consist of at least three members, who have to be real person. These persons cannot be members of the Management Board at the same time. The members of the Supervisory Board are elected by the GM, unless the company has more than 50 full-time employees (which will be discussed later). The members of the supervisory organ participate

⁶² Central European Corporate Governance Association, Corporate Governance Code for Slovakia 19, (January 2008)

⁶³ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 19, (January 2008)

⁶⁴ Act No. 513/1991 – Commercial Code as amended Article 197, sec. 1

on the GM, and are obliged to present their findings on the GM. Furthermore, the Supervisory Board can convene a GM, if it is in the interest of the company.

The Management Board is the executive body of the company, which manages the operations of the company and acts on the behalf of the company. The Management Board decides on every issue of the company, unless they are not reserved by this act or the articles to the General Meeting or Supervisory Board.⁶⁵

Besides being the executive body, the main duty of the Management Board is to ensure proper accounting of the company and the publication of the annual financial report. It also has the duty to provide the Supervisory Board with any necessary information on the business activities and plans and financial situation of the company. The articles can provide that the Management Board operates as a body in the name of the company, however, usually every single member operates as an executive officer on his own. Under Article 194 of the Commercial Code the members of the Management Board are elected and revoked by the GM among the shareholders or outsiders for a period with shall not exceed five years. In addition, the articles of association may provide that the members of the Management Board are appointed by the Supervisory Board. However, this happens rather rarely in practice.

The members of the Management Board have to act with due diligence, with professional care and in the best interest of the company. Violating this duty of care would result in the obligation to pay damages, unless acting bona fide or by executing the resolution of the GM. This personal liability of the members of the Management Board cannot be limited or excluded by any agreement or provision in the articles. The principle of duty of loyalty and conflict of interests rules, laid down in the Commercial Code, also limit the position of the members of the Management Board. The main aim of the provision connected with the principle of duty of loyalty is to restrict any activities of the members of the

⁶⁵ Act No. 513/1991 – Commercial Code as amended Article 191, sec. 1

Management Board when acting on the behalf of the company in a manner that would be beneficial to them, but to the detriment of the company. However, the company can grant loan to the members of the Management Board with the prior consent of the Supervisory Board. The mentioned rules regulating the principle of duty of loyalty and the conflict of interest rules apply to the members of the Supervisory Board as well.

The CG Code dedicates its longest section to the responsibilities of the members of the boards. It focuses on the duty of loyalty and care, as it in compliance with the provisions of the Commercial Code suggests that “*board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.*”⁶⁶ These are the two main elements of fiduciary duties of the board members. Furthermore, the CG Code governs the issue the main functions of the boards as the executive function and a monitoring function. All these should be done in a transparent way, impartially and independently, putting the interest of the company and the stakeholders on the first place.

2.6 Representation of other stakeholders in the company

As mentioned in the previous chapter every type of stakeholder plays an inevitable role in the life of a company. “*Competitiveness and final success of the company are a result of teamwork, which is shared by various parties including investors, employees, creditors and suppliers.*”⁶⁷ However, their proper representation is still neglected. The CG Code tries to stress out the importance of every stakeholder in the company. It focuses on their rights that should be respected such as the right to obtain relevant information and the possibility to freely communicate their concerns about illegal or unethical practices in the company.

⁶⁶ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 36, (January 2008)

⁶⁷ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 23, (January 2008)

The Commercial Code only deals with workers representation at the Supervisory Board, just as it is the case in the Hungarian Companies Act. As mentioned before in the previous chapter, if the number of workers employed by a Hungarian company exceeds two hundred, the employees shall have the right to be represented in the Supervisory Board of such Company. Compared to this, the Slovak Commercial Code is even more favorable to workers, since it states that *“Two thirds of the members of the Supervisory Board shall be elected and revoked by the General Meeting and one third shall be elected and revoked by the employees, if the company has more than 50 full-time employees at the time of the election.”*⁶⁸ Nevertheless, this provision can be changed by the articles of association, which can prescribe a higher degree of employee representation or a lower number of full-time employees as the threshold for obligatory representation. The number of employee representatives shall not, however, outnumber the representatives appointed by the GM. The election of the employee representatives is organized by the Management Board and Labor Union and shall be in form of a secret vote. The candidates of the employees shall be proposed by the Labor Union or by 10% of the employees. In order to elect the representatives more than the half of the employees (or their proxies) are required to cast their vote. In addition, the Commercial Code guarantees these rights even in the event of trans-border fusion of companies, when the seat of the so created company will remain in Slovakia.

The 50 employee threshold is much lower as the Hungarian 200. This can be beneficial, when it comes to restriction of employee strikes and providing better communication inside the company, but can easily backfire as employees may not be suitable for such position.

⁶⁸ Act No. 513/1991 – Commercial Code as amended Article 200, sec. 1

2.7 The Protection of Creditors

Creditors play an important role in the life of every company. They provide the company with credit, which is crucial for the existence of the company. *“The conditions, volume and type of loans for companies are to a great degree dependant on the rights of creditors and enforceability of their claims.”*⁶⁹

However, creditors are standing on thin ice, as it can easily happen that their contribution will not be repaid, not to mention the interests. Thus, creditors need to be protected, to feel safe in their position. The Commercial Code protects the creditors in case of merger of companies as under Article 218f the creditors are entitled to enforce their due claims against the so created legal successor. Furthermore, in the event of reduction of the registered capital, the creditors may ask the company to secure their claims in an adequate way (Article 215).

As private and public limited companies enjoy limited liability, the doctrine of lifting the corporate veil is inevitable to be applied. The Commercial Code enables creditors to claim damages directly from the members of the Management Board:

“The company’s claims for damages against the members of the Management Board may be applied by the creditor on his own behalf and on his own account, in case that he cannot satisfy his claim from the assets of the company. ... The claims of the creditors against the members of the Management Board do not cease, if the company waives its claims for damages or enters into a settlement agreement with the members of the Management Board. If bankruptcy proceedings have been initiated against the assets of the company, the claims of the creditors are applied by the bankruptcy trustee.”⁷⁰

This provision is applicable when in case of insolvency of the company the company’s assets are not sufficient to satisfy the claims of the creditors. Important fact is that this

⁶⁹ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 25, (January 2008)

⁷⁰ Act No. 513/1991 – Commercial Code as amended Article 194, sec. 9

unfavorable financial situation way caused by bad operation of the members of the Management Board by violating its fiduciary duties. It guarantees as well that the claims of the creditors will be enforced during the bankruptcy proceeding. In addition, under Article 220 when it comes to distribution of assets at the end of the liquidation proceedings the creditors shall be satisfied first. The bankruptcy proceedings can be initiated by the creditor as well.

All this is supported by the CG Code, according to which: *“The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.”*⁷¹

However, when the bankruptcy is initiated by the debtor himself there is no need for creditors consent. Just as in Hungary, the bankruptcy proceedings are widely abused, in order to obtain a fresh start. In this case creditors are left unpaid, or usually paid no more than 10% of their original contribution.

2.8 Judicial Review

The possibility of judicial review is an important factor that serves several functions. First of all, it forces the shareholders and the members of the company's bodies to act in a lawful manner. This is caused by the fact that there is always a possibility to initiate a judicial process in order to review suspicious activities of the members of a company. This process can be triggered even by the shareholders. On the other hand, it serves justice. Throughout this proceeding it can be achieved that the right person is held liable, and has to bear the

⁷¹ Central European Corporate Governance Association, Corporate Governance Code for Slovakia 25, (January 2008)

consequences. In order to that the company gets unburdened, while the ones causing the damage have to face the consequences of their acts.

Furthermore, shareholders rights are ensured by enforcing them via the court. For example, the Management Board can refuse to provide a shareholder with information, however this decision can be overruled by court (Article 180, section 4). Another example is connected with the protection of minority shareholders. As mentioned above, under given circumstances they can ask the Management Board to convene an extraordinary GM. However they cannot force the Management Board to do so, thus without the right to bring an action at court the shareholders would be powerless. All this is ensured by Article 181 Section 3 of the Commercial Code. In addition, the minority shareholders (holding shares representing at least 5% of the registered capital) are granted several rights to ask the bodies of the company to act in a specific way. If not done so, according to Article 182 section 2 and 3, these claims can be enforced by the shareholders in the name of the company, however, they have to bear the judicial fees instead of the company. This may have a negative effect on the application of this right.

Regardless of the mentioned examples, it is primarily the duty of the Management Board to represent the company at court. This can be changed by the articles. However, when it comes to the liability of the members of the Management Board, the action is brought by and the company is represented by the Supervisory Board. *“The Supervisory Board shall appoint its member, who represents the company against a member of the Management Board at court and in front of other different bodies.”*⁷²

The mentioned rights are the guarantee that the operations of the company and inner relationship will be conducted in fairly and in a lawful way. However, when it comes down to

⁷² Central European Corporate Governance Association, Corporate Governance Code for Slovakia 25, (January 2008)

initiating a judicial review it is never a good omen for the company, as it indicates that the inner relationships are disturbed.

Concluding Remarks

The place of corporate governance in the corporate sphere in Slovakia is basically the same as in Hungary. Small limited liability companies dominate the corporate life, and as such they do not deal with corporate governance issues. However, the importance of corporate governance rules is without a doubt recognized. The establishment of the Central European Corporate Governance Association is a clear example of starting to take corporate governance seriously in Slovakia.

3 Applying the Corporate Governance Rules in Practice

It is generally true that the issue of corporate governance is recently gaining on popularity in Central Europe, however, the application of corporate governance rules is not as widely spread in this region as it would be desirable. This is caused first of all by the lack of large public or private limited companies in Slovakia or in Hungary. Typically, small family owned businesses of one-man limited liability companies prevail on a long range. In addition, time was needed for the Central European society to mentally reach the level of the western societies regarding the issues of the business sphere.

3.1 MOL, the Hungarian Giant

However, there are some exceptions to the mentioned tendency of small firm domination. Large firms are appearing on the Slovak and Hungarian markets. One of the largest and most know of these companies is the MOL plc, which later established the MOL Group. MOL Group is an integrated oil and gas group. *“The Company’s share capital amounts to HUF 104,519,063,578.”*⁷³ The magnitude of MOL Group is demonstrated by the fact, that the Slovak oil refinery Slovnaft a.s. is also member of this Group. *“As of 31.12.2010. MOL Plc is the dominant shareholder. Small portions of SLOVNAFT shares are owned by other legal entities and individual shareholders (natural persons).”*⁷⁴ To be more precise, MOL Nyrt. (hereinafter referred to as “MOL”), which was established in Hungary in 1991, holds 98.4% of Slovnaft’s shares. MOL is a public limited company, whose shares are listed at the Budapest Stock Exchange. Therefore, it is essential for MOL to comply with the Stock Exchange Recommendations of the Budapest Stock exchange.

⁷³ MOL Group, MOL capital and shareholder structure (approximate), (March 21 2013) available at <http://ir.mol.hu/en/corporatebrgovernance/ownershipbrstructure/>

⁷⁴ Slovnaft a.s., Shareholder Structure, (March 21 2013) available at http://www.slovnaft.sk/en/about_slovnaft/for_investors/shareholder_structure/

*MOL shares are also listed on the Warsaw and the Luxembourg Stock Exchange. MOL shares are also traded in the US OTC and International Order Book (London) systems. MOL primarily follows the Corporate Governance Principles set out in Hungary and, in a wider context, the corporate governance standards and related statutory and regulatory requirements applied in the European Union.*⁷⁵

To be in compliance with the disclosure and transparency recommendations of the Budapest Stock Exchange every requested document can be found on the official web site of the MOL Group. First of all, the MOL Group Corporate Governance Code (hereinafter referred to as “MOL Group CGC”) provides the public with basic information related to corporate governance. In particular it gives a general overview about MOL and MOL Group. It is more specific when it comes to shareholders rights, bodies of the company, risk management and remuneration principles. The provisions of the MOL Group CGC are in accordance with the Hungarian legal norms and also with the Budapest Stock Exchange Corporate Governance Recommendations. However, the MOL Group Corporate Governance Report in accordance with Budapest Stock Exchange Corporate Governance Recommendations (hereinafter referred to as the “Declaration”) reveals some slight differences between the recommendations (“R”) and the MOL Group CGC provisions. This can be easily spotted as in order to comply with the “comply or explain” principle, all of the differences are highlighted and explained in the Declaration. Based on the Declaration, these differences are as follows:

- 1) **MOL does not apply the "one share - one vote" principle (R 1.1.2)** – First of all, there are three groups of shares issued by MOL. According to Article 7.2 of the Articles of Association of MOL Hungarian Oil and Gas Public Limited Company the face value of the “A” series shares is HUF 1.000 and the face value of “C” series shares is HUF 1.001. There is only one issued “B” series share with a par value of HUF 1.000, which

⁷⁵ MOL Group Corporate Governance Code 2, (2012)

is a voting preference share and which is held by the Hungarian state. The “one share - one vote” principle is violated, because even though the face value of “A” and “C” series shares differ, *“the rights attached to these shares, taking into account the different par value, are identical. Currently all “C” series shares are held by MOL.”*⁷⁶ Furthermore, a voting cap was introduced in 1995 by the GM. According to this limitation *“no shareholder or shareholder group... may exercise more than 10% of the voting rights with the exception of the organization(s) acting at the Company’s request as depository or custodian for the Company’s shares or securities representing the Company’s shares.”*⁷⁷

- 2) **All the proposals that are proposed on the GM do not necessarily include the suggestions of the Supervisory Board. (R 1.2.9)** - The Supervisory Board *“submits written report only on the proposal on the annual report and the distribution of the profit after taxation.”*⁷⁸
- 3) **The terms and conditions of insider transactions (e.g. between board and executive manager), that fell outside the normal course of business are not approved by the Supervisory Board. (R 2.6.2)** – Mol explains this by stating that it is the role of the Board of Directors to approve such terms and conditions. The chairman of the Supervisory Board is just notified on such approval.
- 4) **Board members do not inform the Supervisory Board on the fact that they have received an offer of Board membership or executive management position in another company outside the MOL Group. (R 2.6.3)** – The Board of Directors shall be informed when such an offer was received. However, the Chairman of the

⁷⁶ Declaration MOL Group Corporate Governance Report in accordance with Budapest Stock Exchange Corporate Governance Recommendations 14

⁷⁷ Articles of Association of MOL Hungarian Oil and Gas Public Limited Company 10, (December 13, 2012)

⁷⁸ Declaration MOL Group Corporate Governance Report in accordance with Budapest Stock Exchange Corporate Governance Recommendations 14

Supervisory Board will be informed as well, as he participates in the meetings of the Board of Directors as a permanent invitee.

- 5) **The Remuneration Statement was neither prepared nor submitted to the GM. Furthermore the Remuneration Statement does not provide information about the remuneration of the individual members of the bodies and executives. (R 2.7.7) –**

The company provides detailed information on the remuneration principles of the Board of Directors, Supervisory Board and management in the corporate governance chapter of the annual report. It also publishes the cumulated sum of key management compensation as part of the annual financial statements, as well as the remuneration as paid in cash and non-cash for the members of the Board of Directors and Supervisory Board per person, in relation to this position, is published simultaneously with the annual general meeting announcement.⁷⁹

- 6) **The Internal Audit does not report to the Audit Committee. (R 2.8.7) –** The Internal Audit reports to the Risk Management Committee.
- 7) **The Managing body failed to disclose reasons for combining the Remuneration and Nomination Committees. (R 3.5.1) –** Mol explains this by pointing out that the Company's corporate governance rules were rated several times by international rating and advisory firms and *"none of the rating firms have commented the combination of the remuneration and nomination committee functions."*⁸⁰
- 8) **The duties of the Remuneration and Nomination Committees were not carried out by the Managing Body, and therefore no reasons for doing so were disclosed. (R 3.5.2) –** In case that the Managing Body would carry out the mentioned duties, the reasons should be disclosed. However, as these duties were carried out by the Corporate Governance and Remuneration Committee no disclosure of reasons was made.
- 9) **MOL failed to inform the public in the annual report and in the Remuneration Statement on the company's website about the applied remuneration guidelines**

⁷⁹ MOL Group, Declaration MOL Group Corporate Governance Report in accordance with Budapest Stock Exchange Corporate Governance Recommendations 17

⁸⁰ MOL Group, Declaration MOL Group Corporate Governance Report in accordance with Budapest Stock Exchange Corporate Governance Recommendations 20

and the remuneration and fees provided for the members of the Company's bodies. (R 4.1.11) – To explain this, MOL copied its explanation used in point R 2.7.7, which is the fifth difference on this list.

The Declaration also provides the public with information on the level of compliance with the suggestions (“S”). However, when it comes to the failure to apply a suggestion no explanation is needed. The sole indication whether a suggestion was applied or not is enough. Altogether twelve suggestions were not applied by MOL out of the listed fifty. Although not required, in four cases MOL explained why the given suggestion was not applied.

3.1.1 Rating of the Corporate Governance of MOL

In 2007 the quality of corporate governance in MOL was rated by an independent, international rating institution, the ISS Corporate Services, Inc. (hereinafter referred to as “ISS”). This rating was based on the interviews with board members and the public and non-public information provided by MOL and was published in the Corporate Governance Rating & Investor Report (hereinafter referred to as the “Report”). The following aspects of corporate governance were rated: 1. Rights and Duties of Shareholders; 2. Commitment to Shareholder Value; 3. Disclosure on Corporate Governance; 4. Board Structure and Functioning.

In the first category (**Rights and Duties of Shareholders**) MOL received 8 points out of 10. The ISS pointed out that the *“only voting issue missing to meet best practice standards not featured on MOL’s agenda for the general meeting is the approval of last year’s report on board remuneration.”*⁸¹ Furthermore, in connection with this category the ISS mentioned the

⁸¹ ISS Corporate Services, Inc., Corporate Governance Rating & Investor Report MOL plc. 2, (June 7 2007)

voting cap, well established minority shareholder protection and the equal treatment of the shareholders.

The second category (**Commitment to Shareholder Value**) scored slightly less as it was given 7.5 points out of 10. This was the category to receive the lowest number of points, however, 7.5 still represents an impressive figure. The main reason for the lower score is the lack of stakeholder influence of the company, except for the Hungarian state who holds the only one issued “B” series preferential share.

Thirdly, **Disclosure on Corporate Governance** was the category to receive the highest score as it received 8.5 points out of 10. *“MOL achieves a very good standard of financial reporting and disclosure. Most of the documents that are considered crucial for shareholders are available in English on the corporate website in a timely fashion. The website features a special corporate governance section giving access to a wide range of relevant documents.”*⁸² However, the ISS points out that when it comes to the disclosure on board remuneration there is still some room for improvement.

Finally, the category of **Board Structure and Functioning** scored 8 points out of 10. At this point, the ISS focuses on the election of the board members by the GM and the rights and duties of the bodies of the company. Additionally, it points out the role and function of several committees, such as the Audit Committee or the Corporate Governance and Remuneration Committee.

All in all, the ISS praises MOL in its Report and gives the following summary evaluation on the corporate governance structure and rules of the largest Hungarian company:

ICS Corporate Services (hereafter “ICS”) assigns a DR 8.0 to MOL Plc (hereafter “MOL”). This rating reflects the excellent overall performance of the company regarding its current corporate governance structures and functioning.

⁸² ISS Corporate Services, Inc., Corporate Governance Rating & Investor Report MOL plc. 2, (June 7 2007)

MOL is a leading corporate governance actor in Central and Eastern Europe and exceeds the average performance of companies in developed economies particularly in its disclosure standards and its board structure and functioning. Further governance reforms and the planned reduction of state involvement in the company's affairs create a positive outlook for further improvement.⁸³

3.2 The Central European Corporate Governance Association and Slovakia

As it was mentioned in the previous chapter on the corporate governance rules in Slovakia, the Central European Corporate Governance Association (hereinafter referred to as “CECGA”) played a tremendous role in the creation of the Corporate Governance Code for Slovakia. *“The main objective of the Association is to monitor worldwide trends in the area of corporate governance, to bring information and to cultivate knowledge in this area and to generally support public, professional and political debates on the current corporate governance topics.”*⁸⁴ Although the CECGA supposed to be the ultimate corporate governance association of the Central European region, it seems to be more Slovak than Central European. This is reflected also by its homepage, where most of the articles can be read only in Slovak language. Although the main points and some important articles are available also in English, there are no other translations provided. Nevertheless, the CECGA is a key player in the process of development of the Slovak corporate governance rules. To this it contributes not only by giving advice and drafting documents, but also by monitoring the activities of the Slovak companies regarding corporate governance.

The latest monitoring operation was devoted to the Corporate Governance Compliance Statements in Slovakia (hereinafter referred to as the “Statement”) for the year 2011. Generally the Statement reflects the intention of the company to adopt the provisions of the

⁸³ ISS Corporate Services, Inc., Corporate Governance Rating & Investor Report MOL plc. 1, (June 7 2007)

⁸⁴ Central European Corporate Governance Association, Home (March 21 2013) available at <http://cecga.org/en/home/>

Corporate Governance Code for Slovakia, in order to be able to subscribe its shares on the Bratislava Stock Exchange. The outcome of this monitoring was published and can be found on the homepage of CECGA. This article is named *Monitoring of Publishing the Corporate Governance Compliance Statements for the Year 2011 in Slovakia*. At the end of the year 2011 there were 96 companies registered at the Central Register of Regulated Information of the National Bank of Slovakia (hereinafter referred to as the “CRRI”). These companies were mostly issuers of shares, however, some of them were issuers of bonds or both.

By the end of June 2012, 72 companies in total (out of the 96 surveyed ones) sent their year report for the year 2011 to CRRI. Out of that, 41 companies published their compliance with the corporate governance principles only to the extent of requirements of §20, Sections 6 and 7 of the Act on Accounting.⁸⁵

This reveals that a total number of 24 companies failed to send their report at all. Furthermore, nearly twenty per cent of the companies (a total number of 13) who filed their report, referred to the older Unified Code of Corporate Governance, which is no longer used since 2008. *“Another very surprising fact resulting from the survey is the finding that 16 companies have understood the information duty, as regards the implementation of corporate governance principles, in their own way and created their own Code of Corporate Governance - a static document approved in the year 2008 or 2009.”*⁸⁶ This happened by the misinterpretation of the fundamental “comply or explain” principle. The question whether this misinterpretation was done purposefully or by negligence cannot be answered. However, it reflects the lack of information provided to the companies. The article defines it as an encouraging finding that 26 companies used to form of the Statement to file their report. This should be rather distressing. The example of MOL and its Declaration elaborated in this

⁸⁵ JUDr. Jana Pagáčová, Ing. Barbora Lazárová, *Monitoring of Publishing the Corporate Governance Compliance Statements for the Year 2011 in Slovakia*, (March 21 2013), available at <http://www.cecga.org/en/news/about-us/monitoring-of-publishing-the-corporate-governance-compliance-statements-for-the-year-2011-in-slovakia>

⁸⁶ JUDr. Jana Pagáčová, Ing. Barbora Lazárová, *Monitoring of Publishing the Corporate Governance Compliance Statements for the Year 2011 in Slovakia*, (March 21 2013), available at <http://www.cecga.org/en/news/about-us/monitoring-of-publishing-the-corporate-governance-compliance-statements-for-the-year-2011-in-slovakia>

chapter, clearly demonstrates the importance and beneficial character of using the prescribe forms when reporting on corporate governance. Only in this way it is possible to give an accurate report on compliance with the CG Code and only this way enables to point out the differences between the provisions and their application in the most accurate manner. So the number of 26 companies using the prescribed form to report their compliance with the CG Code provisions cannot be viewed as a positive result, as the compliance with these rules should be the established practice.

To sum up, establishing the CECGA, as the organization to provide for the promotion of the importance of corporate governance and to provide for the proper application of corporate governance rules in the Central European region was a good idea. Unfortunately, this association focuses only on Slovakia, neglecting totally the other Central European countries. Furthermore, it lacks regular activity, as during its nearly nine years of existence its presence and operating was literally unnoticeable.

Conclusion

The presented thesis revealed that corporate governance rules are present and important in the life of the public and private limited liability companies in Hungary and Slovakia. The relatively low number of such companies causes that corporate governance is not a frequently discussed issue in the Central European region. However, it seems that transparency and a healthy corporate environment are the keys to the future wellbeing of these countries. The need for foreign investments and properly functioning companies made the establishing of an effective corporate governance framework inevitable. In both of the discussed countries this is reached first of all with the help of corporate law.

There are relatively small differences between the Hungarian and Slovak corporate law regarding corporate governance rules, nevertheless some slight divergence can be perceived. First, the option to choose between the two-tier and one-tier business structure model in Hungary is one of those major differences, while Slovakia employs a strict two-tier model with respect to public or private limited companies. Second, workers representation at the Supervisory Board is stricter in Slovakia. Here the threshold represents only fifty full-time employees, while in Hungary two hundred full time employees are required in order to enable the workers to nominate their representatives. Furthermore different approach to the company's own shares and employee shares is present.

In addition to the legal rules, corporate governance is governed by the non-mandatory set of provisions, which are drafted by the local stock exchange in both countries. The content of these codes is similar, however, the structure and clarity differs. While the Hungarian Corporate Governance Recommendations are structured in a more complicated way the Slovak Corporate Governance Code for Slovakia mirrors the OECD Principles of Corporate

Governance. The Recommendations are based on the recommendation – suggestion – explanation structure, which confuses the reader of the document. The CG Code is clearer and provides a useful addition by pointing out the legal provisions related to the discussed corporate governance issue. Both documents concentrate on the shareholder rights, responsibilities of the boards and disclosure connected with transparency. It has to be mentioned that the Slovak CG Code devotes a whole unified part to the issue of stakeholder rights in the company. These provisions can be found in the Hungarian Recommendations as well, however this is a more demanding task as they are scattered throughout the whole text of this document.

The application of corporate governance rules in Hungary and Slovakia is primarily connected with the aim of the companies to enter into the secondary market and to be enabled to trade their shares there. The stock exchanges of both countries follow the “comply or explain” principle, in order to make the participation on the stock market as transparent as possible. However, the number of participating companies on the Central European stock exchanges is lower than in the West European countries. This is caused mainly by the fact that the business environment has not been suitable for the establishment of the large companies.

Eventually, there are no other options for these two transition countries, but to use corporate governance rules in order to catch up to the more developed countries. The main benefit of well established corporate governance rules is a transparent business environment and it can be agreed that transparency is the key element which is needed in the companies and business dealings in both Hungary and Slovakia.

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