



## CLIENT ALERT – From our office in Budapest

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### Update as to the New Approval Procedure of Foreign Investments in Hungary

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#### **Background**

During the state of emergency related to the COVID epidemic, the Hungarian Government adopted a decree on 25 May 2020 (the “**Decree**”), which introduced a new approval procedure of certain foreign investments in Hungary. The Decree stated that it applied from 26 May 2020 and that the Government extended its validity until 31 December 2020. However, pursuant to the rules concerning the state of emergency, the Decree’s validity may be extended only until end of the state of emergency. On 18 June 2020, the state of emergency was terminated in Hungary and, therefore, the Decree should become ineffective.

Nevertheless, on the same day (*i.e.* on 18 June 2020), Act LVIII of 2020 on the provisional rules in connection with the termination of the state of emergency and on the epidemic preparedness (the “**Act**”) entered into force. The Act covers various subjects and takes over the provisions of the Decree with certain changes. The pertinent provisions of the Act are quite complex and some of them are ambiguous. The below is a summary of the main relevant provisions of the Act.

#### **Notification obligation**

Pursuant to the Act, foreign investments in certain Hungarian companies have to be notified to the Minister of Innovation and Technology (the “**Minister**”) and their completion is subject to the Minister’s acknowledgement.

#### **Definition of Foreign Investor**

Under the Act, a “**Foreign Investor**” is a person who/which is

- (i) a citizen of a state outside of the EU, the EEA and Switzerland or a legal person or other organisation registered in a state outside of the EU, the EEA and Switzerland (“**Third Country Investor**”);
- (ii) a legal person or other organisation registered in Hungary, in another EU or EEA member state or Switzerland if it is under the majority control of a Third Country Investor (“**Foreign Controlled European Investor**”).

#### **Which Hungarian target companies are affected?**

The relevant target companies (the “**Strategic Companies**”) are those limited liability companies (Hungarian abbreviation: “*Kft.*”), private and public companies limited by shares (Hungarian abbreviations: “*Zrt.*” and “*Nyrt.*”)

- (i) which have their registered seats in Hungary,

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- (ii) whose principal or ancillary activities are among those listed in the relevant decree of the Government (see the list at the end of this article) and
- (iii) those activities fall within the
  - energy, transport or communication sector or
  - the strategic sectors as determined on the basis of Article 4 (1) of REGULATION (EU) 2019/452 (establishing a framework for the screening of foreign direct investments into the Union) excluding the financial infrastructure
 the said EU legal provision mentions
  - critical infrastructure (water, defence, health, land and real estate crucial for the use of such infrastructure, etc.),
  - critical technologies and dual use items (artificial intelligence, robotics, etc.),
  - supply of critical inputs including energy or raw materials and food security,
  - access to sensitive information including personal data or the ability to control such information and
  - the freedom and pluralism of the media.)
 (the “**Strategic Sectors**”).

### **Which transactions and investors are concerned?**

Provided that the investment’s total amount reaches or exceeds HUF 350 million (approx. EUR 1 million), the following transactions must be notified to the Minister and require his acknowledgement:

- any transfer of the shares or quota held in a Strategic Company for or without consideration (including contributions in kind),
- capital increase in a Strategic Company,
- transformation, merger, demerger of a Strategic Company,
- issuance by a Strategic Company of convertible bonds, bonds of preferential subscription right and bonds which convert and
- establishment of usufruct over the shares or quota held in a Strategic Company if as a result,
  - **a legal person or other organisation registered in another EU or EEA member state (i.e. not in Hungary) or Switzerland, a citizen of another EU or EEA member state (i.e. not of Hungary) or Switzerland or a Foreign Controlled European Investor directly or indirectly acquires majority control (as defined in the Hungarian Civil Code) in a Strategic Company;** or
  - a Foreign Investor (i.e. a Third Country Investor or a Foreign Controlled European Investor) directly or indirectly acquires at least 10% of the shares or quota held in a Strategic Company; or
  - a Foreign Investor acquires 15%, 20% or 50% of the shares or quota held in a Strategic Company; or
  - Foreign Investors would hold together more than 25% of the shares or quota in a Strategic Company (this does not apply to Strategic Companies which are public companies limited by shares (Hungarian abbreviation: “*Nyrt.*”).

The transfer of infrastructures and equipment, the transfer of the right to use or operate or the pledging of assets, which are indispensable for carrying out the activities belonging to the Strategic

Sectors, for the benefit of a Foreign Investor or a legal person or other organisation in which a Foreign Investor directly or indirectly has significant control (as defined in the Hungarian Civil Code), is also subject to the notification to and acknowledgement by the Minister.

The Act states that the notification obligation does not apply to transactions which

- (i) concern legal persons or other entities having their registered seats outside of Hungary (the “**Foreign Legal Persons**”) and
- (ii) have the above-mentioned results in respect of Strategic Companies being the Hungarian subsidiaries of Foreign Legal Persons.

The wording of this exception is unclear. One may think that it intends to exempt the transactions in which Foreign Legal Persons acquire additional participation in their not fully owned Hungarian subsidiaries. However, the reasoning of the Act’s relevant provision states that those transactions do not have to be notified in Hungary which concern the foreign “mother company”.

### **What is the procedure to follow?**

The notification should be submitted to the Minister within 10 days after the signature of the relevant transactional documentation.

The Minister shall decide within 30 business days after receiving the notification, but this deadline may be extended by an additional period of 15 days.

If the Minister prohibits the transaction, he shall provide an explanation.

This decision may be challenged before the Metropolitan Court which renders its decision within 30 days. In case the court finds that the Minister’s decision was unlawful, it annuls the decision and orders the Minister to conduct a new procedure.

### **In which cases can the Minister prohibit the transaction?**

The Minister prohibits the completion of the transaction in case

- the realisation of the transaction leads to the violation or endangerment of the national interest (*i.e.* the public interest – not regulated by sectoral EU law and national law – in (i) the security and operability of networks and equipment and (ii) the continuity of supply), public security or public order of Hungary or to the possibility of such violation or endangerment, with special attention to the security of meeting the fundamental needs of society, in accordance with Articles 36, 52 (1) and 65 (1) of the Treaty on the Functioning of the European Union;
- the applicant is directly or indirectly under the control of a non-EU state’s administrative body (including state organs and armed forces) either due to its ownership structure or due to its significant financing;
- the applicant was involved in an activity concerning security or public order in another EU member state;
- there is a high risk that the applicant will pursue illegal or criminal activities.

### **What are the legal consequences?**

- In case the Minister prohibits the transaction and also in the absence of an acknowledgement, the acquiring person cannot be registered in the book of shares or the members’ list of the Strategic Company and cannot exercise any rights in the Strategic Company on the basis of the shares or quota concerned.

- In the court registration procedure related to a transaction concerned, the Strategic Company has to file a declaration stating its strategic status and the Minister's acknowledgment of the transaction.
- The contracts, declarations and corporate resolutions which breach the rules on the notification obligation or were prohibited by the Minister, shall be null and void. However, if the breach is that notification was not made to the Minister, the latter may still acknowledge the transaction and thereby cure the nullity.
- Failure to comply with the notification obligation may trigger a fine capped at the double of the value of the transaction but being at least (i) more than HUF 100 000 in case the Foreign Investor is a natural person and (ii) more than 1% of the net turnover of the Strategic Company realised in its last financial year in case the Foreign Investor is a legal person or other organisation.

### **Until when does this system apply?**

Pursuant to the Act, the notification to the Minister and his acknowledgement is necessary until 31 December 2020.

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### **List of sectors and activities**

	Sector	NACE code	Division
1.	Chemical sector	19	Manufacture of coke and refined petroleum products
		20	Manufacture of chemicals and chemical products
		21	Manufacture of basic pharmaceutical products and pharmaceutical preparations
2.	Commercial establishments	45	Wholesale and retail trade and repair of motor vehicles and motorcycles
		47	Retail trade, except of motor vehicles and motorcycles
		46	Wholesale trade, except of motor vehicles and motorcycles
3.	Communications sector	61	Telecommunications
4.	Critical industrial sector (including electronics, machine industry, steel production and the manufacturing of transport equipment)	26	Manufacture of computer, electronic and optical products
		27	Manufacture of electrical equipment
		28	Manufacture of machinery and equipment not elsewhere classified
		29	Manufacture of motor vehicles, trailers and semi-trailers
		30	Manufacture of other transport equipment
		24	Manufacture of basic metals

		25	Manufacture of fabricated metal products, except machinery and equipment
5.	Defence industry	25.4	Manufacture of weapons and ammunition
		30.4	Manufacture of military fighting vehicles
6.	Dams	42.91	Construction of water projects
7.	Energy sector	35	Electricity, gas, steam and air conditioning supply
8.	Services related to emergency situations	84.22	Defence activities
		84.24	Public order and safety activities
		84.25	Fire service activities
9.	Food sector and agriculture	10	Manufacture of food products
		11	Manufacture of beverages
		12	Manufacture of tobacco products
		1	Crop and animal production, hunting and related service activities
		2	Forestry and logging
		3	Fishing and aquaculture
10.	Governmental establishments	84	Public administration and defence; compulsory social security
11.	Healthcare	86	Human health activities
		87	Residential care activities
		88	Social work activities without accommodation
12.	Information technology	62	Computer programming, consultancy and related activities
		63	Information service activities
13.	Nuclear sector	24.46	Processing of nuclear fuel
14.	Construction industry	41	Construction of buildings
		42	Civil engineering
		43	Specialised construction activities
15.	Water supply and sewerage services	36	Water collection, treatment and supply
		37	Sewerage
16.	Waste management	38	Waste collection, treatment and disposal activities; materials recovery
		39	Remediation activities and other waste management services
17.	Construction material industry	8.1	Quarrying of stone, sand and clay
		23	Manufacture of other non-metallic mineral products
18.	Transport, transportation, logistics	49	Land transport and transport via pipelines
		50	Water transport
		51	Air transport

		52	Warehousing and support activities for transportation
		53	Postal and courier activities
19.	Manufacture of medical and dental instruments and supplies	32.5	Manufacture of medical and dental instruments and supplies
20.	Tourism	55	Accommodation
		56	Food and beverage service activities
21.	Administrative and service support activity	78.2	Temporary employment agency activities