

International **Comparative** Legal Guides



Foreign Direct Investment Regimes **2020**

A practical cross-border insight into FDI screening regimes

First Edition

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1 Foreign Investment Policy

1.1 What is the national policy with regard to the review of foreign investments (including transactions) on national security grounds?

The Hungarian investment review system was established by Act no. LVII of 2018 on the Control of Investments Detrimental to the Interests of Hungarian National Security (the “Act”). The Act entered into force as of 1 January 2019. According to the reasoning of the Act, Hungary wanted to establish a foreign investment review for the identification and prevention of foreign investment which may harm Hungary’s national security interests. The Minister of Interior, who is also the head of various national security agencies, is the main competent authority to conduct such review. The Minister of Interior can implement a broad spectrum of measures to prevent or stop any foreign investment harming national security. The Minister may, e.g., impose fines or order the disposal of acquired shares.

The investment review is a novelty in Hungary. Thus, no relevant case law or guidelines have been released yet.

1.2 Are there any particular strategic considerations that apply during foreign investment reviews?

The main strategic considerations behind the Hungarian foreign investment review are national interest and national security. The review aims at protecting sensitive industrial sectors from foreign investments.

The review does not refer to any specific economic factors deemed important for the national economy. Moreover, the review does not provide any specific rules for sovereign wealth funds, or state-held entities.

1.3 Are there any current proposals to change the foreign investment review policy or the current laws?

There are no current proposals to change the foreign investment review policy or the current laws.

2 Law and Scope of Application

2.1 What laws apply to the control of foreign investments (including transactions) on grounds of national security?

The control of foreign investments is based on two laws: (i) the Act; and (ii) Government Decree no. 246/2018 (XII. 17.) on the execution

of Act no. LVII of 2018 (the “Government Decree”). However, the following laws are also closely linked to the control of foreign investments: (i) Act no. CL of 2016 on General Public Administration Procedures; (ii) Act no. LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing; (iii) Act no. CLXVI of 2012 on Sensitive Infrastructure; and (iv) sector-specific laws (e.g. Act no. LXXXVI of 2007 on Electricity).

2.2 What kinds of foreign investments, foreign investors and transactions are caught? Is the acquisition of minority interests caught?

The foreign investment review applies to (i) investors from outside the EU, Switzerland and EEA, and also to (ii) any subsidiary of such investor if the subsidiary is established in the EU, Switzerland or an EEA member state and said investor holds the majority of the votes in the subsidiary or has a decisive influence (meaning the right to appoint the majority of the board or supervisory board members, even if such right is ensured through an indirect shareholding or without shareholding) in the subsidiary (“Foreign Investor”). The Foreign Investor must obtain the prior approval of the minister of interior if it intends to:

- directly or indirectly acquire more than a 25% interest (in the case of a publicly listed company, a 10% interest) in an existing or yet to be established company with its registered seat in Hungary, provided that this company pursues activities that are deemed sensitive for national security (“Hungarian Company”);
- acquire decisive influence in a Hungarian Company;
- establish a branch office in Hungary; or
- acquire a right to operate or use sensitive infrastructure or assets in Hungary.

Pursuant to the above rules, any transaction that results in a Foreign Investor acquiring more than a 25% interest in a Hungarian Company is subject to foreign investment control. Moreover, prior approval is required when a Foreign Investor acquires an interest of less than 25% but this acquisition results in more than a 25% interest in the respective Hungarian Company being held by (several) Foreign Investors.

Prior approval must also be obtained if an established company changes its activity to an activity deemed sensitive for national security.

2.3 What are the sectors and activities that are particularly under scrutiny? Are there any sector-specific review mechanisms in place?

The Act contains a complex system regarding the sectors and activities which are under scrutiny. These activities in the specific sectors include activities that:

- a) are classically considered sensitive, e.g. manufacturing of arms, dual-use items and secret service equipment;
- b) fall under the Hungarian Gas Act and Water Supply Act, Electricity Act, Credit Institutions Act and the Electronic Communications Services Act; and
- c) involve the creation, development or operation of communication systems of the Hungarian State and Hungarian municipalities.

2.4 How are terms such as 'foreign investor' and 'foreign investment' specifically addressed in the law?

Pursuant to the Act, a "foreign investor" means an investor from outside the EU, Switzerland and EEA, and also a company established in the EU, Switzerland or an EEA member state if it has a shareholder from outside the EU, Switzerland or EEA that holds the majority of the votes in such company or has a decisive influence (meaning the right to appoint the majority of the board or supervisory board members, even if such right is ensured through an indirect shareholding or without a shareholding) in it.

The Act and the Government Decree do not define "foreign investment" directly. The Act uses the definition of "acquisition" which means: (i) the direct or indirect acquisition of more than a 25% interest (in the case of a publicly listed company, more than a 10% interest) in a Hungarian Company; (ii) the acquisition of decisive influence in a Hungarian Company pursuant to the definition set out in the Hungarian Civil Code; or (iii) the establishment of a branch office in Hungary.

2.5 Are there specific rules for certain foreign investors such as state-owned enterprises (SOEs)?

There are no specific rules for state-owned enterprises or other specific Foreign Investors.

2.6 Is there a local nexus requirement for an acquisition or investment to fall under the scope of the national security review? If so, what is the nature of such requirement (existence of subsidiaries, assets, etc.)?

An acquisition or investment is within the scope of the Act if the acquisition or investment aims at: (i) acquiring, directly or indirectly, more than a 25% interest (in the case of a publicly listed company, more than a 10% interest) in a Hungarian Company; (ii) acquiring decisive influence in a Hungarian Company pursuant to the Hungarian Civil Code; (iii) establishing a branch office in Hungary; or (iv) acquiring a right to operate or use sensitive infrastructure or assets located in Hungary.

2.7 In cases where local presence is required to trigger the review, are indirect acquisitions of local subsidiaries and/or other assets also caught?

Pursuant to the Act, in such cases, indirect acquisitions of local subsidiaries are caught by the foreign investment review.

3 Jurisdiction and Procedure

3.1 What conditions must be met for the law to apply? Are there any monetary thresholds?

The law applies if the scope of the Act covers the Foreign Investor's

transaction or investment, i.e. the conditions regarding the Foreign Investor, the specific acquisition of interest and the specific sensitive sector are fulfilled. The Act and the Government Decree do not provide any monetary thresholds, so all transactions subject to the Act require the approval of the Minister regardless of their value.

3.2 Is the filing voluntary or mandatory? Are there any filing fees?

Filing is mandatory in all cases. No filing fee is applicable.

3.3 In the case of transactions, who is responsible for obtaining the necessary approval?

In the case of a transaction, the Foreign Investor who acquires a respective interest in a Hungarian Company is responsible for obtaining the necessary approval from the Minister.

3.4 Can foreign investors engage in advance consultations with the authorities and ask for formal or informal guidance on the application of the approval procedure?

The Foreign Investor may engage in advance consultations with the Ministry. However, such advance consultation is not regulated by the Act. The Ministry may deny such request for advance consultation or formal or informal guidance on the application of the approval procedure at its own discretion.

3.5 What type of information do investors have to provide as part of their filing?

The Foreign Investor must provide the following information:

- A) information regarding the Foreign Investor:
 - i) personal data of the Foreign Investor, e.g.: name; Hungarian or foreign address; nationality; mailing address;
 - ii) data of the legal person, e.g.: name; registered seat; registering country; mailing address; and
 - iii) data of the Foreign Investor's representative, e.g.: name, address, mailing address;
- B) a description of the Foreign Investor's existing business activities;
- C) a description of the ownership structure of the Foreign Investor and its shareholders, and, in relation to this, any document which proves and demonstrates the ownership structure (which must be attached to the filing); and
- D) data of the ultimate beneficial owner of the Foreign Investor, and, in relation to this, any document which proves and demonstrates the ultimate beneficial owner (which must be attached to the filing).

The Foreign Investor must attach to the filing the original or certified copies of the required documents, e.g., a signed contract, agreement, preliminary agreement or any other undertakings for the conclusion of such agreements, and the certified translation of such documents if these documents were not issued in the Hungarian language.

3.6 Are there sanctions for not filing (fines, criminal liability, unwinding of the transaction, etc.) and what is the current practice of the authorities?

If the Foreign Investor fails to file in due time, the Minister may impose a fine of a maximum of HUF 1,000,000 (approx. EUR 3,100) on individuals and a maximum of HUF 10,000,000 (approx. EUR 31,000) on legal entities.

The transactions/investment may also be reviewed *ex officio* and retroactively. If the minister prohibits the acquisition during an *ex officio* review, the Foreign Investor must sell its shares or eliminate its influence in the Hungarian Company or the Hungarian Company must modify its activity within three months, or the Foreign Investor must close its branch. During the sale, the respective ownership share will be encumbered by an *ex lege* pre-emption right in favour of the Hungarian State. If the Foreign Investor acquired the right to operate sensitive infrastructure or an asset that falls under the Act and has not obtained approval for such, the Minister must initiate an action before court to declare the underlying transaction or agreement unenforceable.

Because of the novelty and undisclosed nature of foreign investment review in Hungary, solid practice has not yet been formed by the authorities.

3.7 What is the timeframe of review in order to obtain approval? Are there any provisions expediting the clearance?

The Foreign Investor must file its request for approval within 10 days from: (i) the date of execution of the underlying agreement, preliminary agreement, or undertaking; or (ii) the date of registration of activity change by the respective commercial registry. The Minister gives confirmation of receipt of the filing within eight days. Pursuant to the Act, the Minister has 60 days to decide whether or not to approve the Foreign Investor's application by considering national security aspects. The Minister may extend the deadline by a maximum of 60 days.

3.8 Does the review need to be obtained prior to or after closing? In the former case, does the review have a suspensory effect on the closing of the transaction? Are there any penalties if the parties implement the transaction before approval is obtained?

The review needs to be obtained prior to closing. The review has a *de facto* suspensory effect. Without the Minister's prior approval, the Foreign Investor may not be registered as a shareholder in the list of shareholders or the book of shares and the Foreign Investor may not exercise its shareholder rights. The right to operate or use the infrastructure, equipment and facilities necessary for the Hungarian Company's activities may be granted only after the issue of such approval; without the prior approval of the Minister, the underlying agreement on the right to operate or use sensitive infrastructure will be unenforceable. A newly registered sensitive activity must be deleted from the company registry if the Minister prohibits such activity. The Minister's approval also constitutes a pre-requisite for other approval proceedings related to sensitive industries.

If the parties implement the transaction before approval is obtained and the Foreign Investor is registered in the book of shares or list of shareholders, the Foreign Investor may not exercise its shareholder rights. Moreover, the relevant authority may initiate an *ex officio* and retroactive review of the transaction. The relevant authority may initiate such review within five years (i) from the date of acquisition of the interest or right of operation or use, or (ii) from the date on which the decision regarding the registration of the sensitive activity became final and binding (objective time limit) but not later than six months after the relevant authority has become aware of an infringement (subjective time limit). As a result of an *ex officio* review, the Minister may impose a fine and is also entitled to prohibit the investment if it harms Hungarian national interests, with retroactive effect.

3.9 Can third parties be involved in the review process? If so, what are the requirements, and do they have any particular rights during the procedure?

Third parties may not be involved in the review process. Based on the decision of the Minister, other authorities may be involved pursuant to their statutory competences.

3.10 What publicity is given to the process and the final decision and how is commercial information, including business secrets, protected from disclosure?

The review is not public. There are no official publications during or after the review process. Regarding commercial information, the relevant authority must ensure that business secrets are not disclosed. The relevant authority may process only the data that is necessary for its procedure.

3.11 Are there any other administrative approvals required (cross-sector or sector-specific) for foreign investments?

Other sector-specific or cross-sector administrative approvals (e.g. merger control approval by the competition authority or approval by the Hungarian energy and public utility regulatory authority) may also be required, depending on the relevant sector. However, these are general approvals which also apply if the investor is not a Foreign Investor.

4 Substantive Assessment

4.1 Which authorities are responsible for conducting the review?

The Minister of Interior is the competent authority to conduct the review. The *ex officio* review is conducted by the Constitution Protection Office (in Hungarian: *Alkotmányvédelmi Hivatal*), which is the Hungarian internal security intelligence agency. During the review, the minister of interior appoints a contact person who must act as a link between the Minister and the Foreign Investor.

4.2 What is the applicable test and who bears the burden of proof?

The Minister prohibits the acquisition of interest and right of operation or use of sensitive infrastructure if reasonable grounds exist to believe that the Foreign Investor would harm the national interests of Hungary or the Foreign Investor aims to mislead, make the foreign investment review more difficult or circumvent the rules of the Act. This is the case if the Foreign Investor does not pursue real economic activity in its country of incorporation and the operation of a stable business activity is not justified (e.g. lack of business premises, no employees). However, the Act does not define what would harm the national interest of Hungary. Thus, the Minister of Interior has a broad discretionary right in prohibiting a transaction. However, in his decision, the Minister must describe the respective national interest that is deemed to be at risk. This description of the cited national interest can be appealed before the respective court in the course of a judicial review.

The Foreign Investor must provide the Minister with any documents and data required by the latter for his decision-making. If the Minister deems the application to be incomplete, the Foreign

Investor will have 45 days to supplement its application from the date of the request of the Minister for additional documents/data. If the Foreign Investor fails to provide the required documents and data before this deadline, the Minister may provide an additional 45 days. If such additional cure period elapses without sufficient result, the Minister is entitled to close the procedure without any decision on the merits. Moreover, the Minister may request the Constitution Protection Office to conduct an *ex officio* review of the respective transaction.

4.3 What are the main evaluation criteria and are there any guidelines available?

The main evaluation criterion regards national interests. National interests are not defined by law. This means that the Minister has a broad discretionary right to allow or prohibit a transaction based on national security considerations. As mentioned in question 4.2 above, there are some other criteria which will be considered (e.g. real economic activity in the country of incorporation of the Foreign Investor).

There are no guidelines available to the public.

4.4 In their assessment, do the authorities also take into account activities of foreign (non-local) subsidiaries in their jurisdiction?

No. The authorities take into account the activities of the Foreign Investor only. However, the ownership structure and the business activity of the Foreign Investor must be disclosed during the filing, which may require the activities of subsidiaries to be revealed. If the Minister requires a description of the activities of subsidiaries, such description must be submitted to the Minister.

4.5 How much discretion and what powers do the authorities have to approve or reject transactions on national security grounds?

The Minister has the sole discretion and the power to approve or reject transactions on national security grounds. The Minister of Interior has the sole discretion to decide what harms the national interests of Hungary because of the lack of a statutory definition.

4.6 Can a decision be challenged or appealed, including by third parties? Is the relevant procedure administrative or judicial in character?

Prohibition decisions are subject to a limited judicial review. The Foreign Investor has only a limited right to appeal against the decision of the Minister to the Municipal Court of Budapest (in Hungarian: *Fővárosi Törvényszék*). An appeal may be made because of the transaction's qualification as "harming the national interest of Hungary" and/or the violation of essential procedural rules. In such cases, the Municipal Court of Budapest delivers a judgment in a simplified procedure. If the Municipal Court of Budapest find that the foreign investment review or the qualification was unlawful, it can repeal the decision of the Minister and order for a new procedure to be conducted by the Minister.

The procedure is a judicial procedure before the competent administrative court. The judicial review is governed by Act no. I of 2017 on the Code of Administrative Litigation. In simplified procedures, no interim measures or immediate actions are permitted. Furthermore, an appeal against the judgment of the court is also excluded in a simplified procedure. As a general rule, the court does not schedule a hearing and decides only on the basis of the written submissions of the parties. The court schedules a hearing only if it is required for the fulfilment of the principle of a fair trial.

4.7 Is it possible to address the authorities' objections to a transaction by providing remedies, such as undertaking or other arrangements?

No, it is not possible. The Act and the Government Decree do not provide any grounds for such remedies.

4.8 Are there any other relevant considerations? What is the recent enforcement practice of the authorities?

Due to the novelty of foreign investment screening, the authorities have not yet formed a solid practice regarding enforcement.



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Schoenherr Hungary was established in 2008. It has a long track record of representing foreign investors, mainly in acquisitions and green field investments, corporate, employment law, merger control filings and other competition matters, finance and insolvency matters as well as real estate transactional mandates, construction and development, including large-scale infrastructure and energy projects. Additionally, the team advises numerous sizeable corporate clients on an ongoing basis on issues such as general corporate, commercial and regulatory matters, real estate and employment law. Recently, the office has been attracting a growing number of international and domestic corporate clients in the energy, food, technology and banking and insurance sectors.

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