University Doctoral (PhD) Dissertation Abstract

THE CIVIL LIABILITY OF THE MANAGING DIRECTOR OF A COMPANY IN ROMANIAN AND HUNGARIAN COMPANY LAW

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1. The topic of the thesis and the reasons for the choice of topic

The focus of my thesis is on the civil liability of the managing director of a company. I examine the civil liability of the managing director mainly in light of the current Romanian and Hungarian company law. Within this framework, I have sought to explore and to examine in parallel a *sui generis* set of problems centred around the intersection of two distinct and independent legal institutions: while civil liability is traditionally dealt with in the context of contract law, the institution of the company officer, who plays a prominent role in the functioning of the economy, is brought into the spotlight through the filters of company law. Thus, the civil liability of the officer is mainly determined by the framework of company law rules, which may bring the purely private law rules and principles of civil liability into conflict, at least apparently if not in fact, with the mostly autonomous rules of company law.

The topicality of the issue of directors' liability stems from the simple fact that companies subject to the rules of economic law are the driving forces of the economy, which are interconnected in a specific way. If one of them 'fails', the failure can have a knock-on effect on other companies or, worse, on the economy as a whole and thus on society as a whole. In this respect, one need only think of the recent and very significant wave of bankruptcies caused by the crisis in the real estate and mortgage bond markets that spilled over from the United States in 2008; the (global) economic and geopolitical tensions that exist at the time of writing are also capable of triggering causal processes of this kind. The disruption of supply chains, or even sanctions policies, can lead to the emergence of new businesses or the resurgence of

previously marginalised businesses, which require a more dynamic mobilisation of financial and other assets. The dynamic pursuit of economic goals often requires bold decisions.

Many corporate ‘failures’ are caused by human error, negligence, incompetence or irresponsibility in the form of excessive risk-taking. To avoid these, the law seeks to prevent damage resulting from human error, negligence or even bad faith by means of sanctions. Civil liability is one of the sanctions which, while being preventive, can be used to correct the damage caused by persons who behave in a way that deviates from legal and social norms, and thus to restore some degree of social equilibrium. In this context, in capitalist economic systems organised on the basis of the free market, the role of the chief executive is extremely important. The function of the chief executive is to manage the company, the enterprise, which, by definition, also includes the statutory functions of asset management and representation. The management of an undertaking requires the manager to perform a number of complex activities and, in order to carry out these activities, to possess the competence, knowledge, insight and moral stability which enable him to improve and increase the assets and economic strength of the company he manages. At the same time, it must be seen that, in an ever-changing economic context, risk-taking is an intrinsic element of managerial activity. To avoid these potential risks, the manager must act with the utmost care and prudence. Acceptance of a management mandate can therefore be understood as an essentially voluntary assumption of responsibility, which implies a series of appropriate business decisions and actions aimed at managing and accumulating outside assets. This in turn provides an opportunity for speculative operations, even in the pejorative sense of the word.

2. Objectives of the thesis and research questions

One of the main objectives of my research is to provide a comprehensive overview of the existing Romanian and Hungarian positive legal regulation concerning the civil liability of the managing director of a company. In addition to presenting the existing legislation, the legal history of the topic will be explored. In my thesis, the civil liability of the managing director is analysed in general terms, regardless of the forms of companies regulated in the two countries, but, given that the issue arises primarily in relation to joint-stock companies and limited liability companies, both in case law and as the subject of academic analysis, I will go into more detail with regard to these two companies. This is a deliberate shift of emphasis.

In the area of executive liability, the analysis essentially proceeded along three groups of questions. The first group of questions was, since a company, as a separate legal entity with legal personality, is in principle entitled and bound by the conduct of its legal representative, which are the conditions that must be met for the legal representative to be held liable as a manager. The second set of questions, which follows on from the first, is the direction of the liability of the chief executive officer, i.e., the entities to which he is liable. In this context, it is common to distinguish between two types of liability of the chief executive officer: internal liability and external liability. In my thesis I analyse both the internal and external liability of the chief executive.

There is also the question of the legal nature of the liability of the manager, and whether the nature of the liability towards the

aforementioned group of injured parties is the same in all cases. In this context, I have examined which broader legal facts form the starting point of the liability vectors of the Hungarian and Romanian legal systems. Two points of departure were identified: the contract and the wrongful conduct giving rise to the damage. Before examining the nature of liability, however, it is necessary to approach it from the angle of the legal relationship between the company and its manager, which implies an analysis of the rights and obligations that constitute the content of the legal relationship. Ultimately, it is the breach of the latter that may give rise to liability.

As my thesis is mainly concerned with the imposition of civil liability rules on the managing director of a company, it is necessary to approach the problems outlined above from the perspective of civil liability rules. In this context, the objectives of the thesis include a sketch of the existing private liability rules and the prevailing doctrines in the two countries chosen as models. The reason for this sketch is that a detailed description of the Romanian and Hungarian civil liability regimes and the related authoritative literature and jurisprudence presupposes a significantly different approach from the one adopted in this thesis.

3. Research methodology

In my research I used a combination of several methods of social science research. Of the available research methods, it is primarily the legal comparison and the descriptive-analytical method that has been consistently used throughout the thesis. In addition to these, the development of the institution and liability

of the corporate officer is also presented from a comparative legal-historical perspective.

The main argument for the application of the comparative method to the chosen topic is, on the one hand, that there is no comprehensive comparative legal analysis of the civil liability of the managing director of a company in Romanian and Hungarian law. Another argument in favour of using the comparative method is that the economic interests of the two countries chosen overlap under many respects, mainly due to their neighbouring location. Since I have identified the company as one of the driving forces of the economy, it is also logical to explore the differences and similarities between the laws on directors' liability.

The primary object of comparison is the part of the Romanian and Hungarian substantive law that relates to the civil liability of the managing director of a company, including the literature explaining the substantive law provisions. From a methodological point of view, the thesis also puts special emphasis on the comparison of the literature on the basic doctrines of liability that underlie and explain the regulation of managerial liability in the two countries under study, starting from the development of the institution of civil liability to the prevailing doctrines today. However, as it is customary to distinguish between modern and pre-modern liability regimes in terms of the development of liability law. I will not deal with *pre-modern* liability doctrines in this context. The secondary object of comparison is the Romanian and Hungarian judicial practice on the civil liability of directors and officers.

On this basis, the sources of law to be compared in Romania are Act No. 31 of 1990 on companies and Act No. 85 of 2014 on the

prevention of insolvency and insolvency proceedings, and in this context the provisions of the Romanian Civil Code to which the two separate laws just mentioned refer directly or indirectly. Of the Hungarian sources of law with the same function, the Civil Code, Book III and the relevant provisions of Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings are the subject of the present comparative analysis. Since legal regulation is a man-made phenomenon that follows social conditions, periodic changes to the law are a matter of course. Therefore, I will also consider as part of my analysis the legislation amending the above-mentioned legislation, the subject matter of which (also) covers or affects the liability of directors and officers.

In the comparison, I will focus on the forms of liability applicable to the executive officer under Romanian and Hungarian law. In this context, the main aspects are the elements of civil liability and the additional elements of liability laid down in separate acts of legislation (which will be specified in the following sections of the analysis). Thus, I will discuss how Romanian and Hungarian law regulate and deal with the concept of tort, the concept of damage, the concept of fault and the problem of causality.

It is necessary to apply the classical methods of legal interpretation to the legal texts that set out the elements of the facts listed here, since only in this way can the textual envelope hiding the true content of the relevant legal norms be deciphered. Since the legal systems of the two countries chosen as samples for this research are based on positive legal foundations that form part of the continental family of laws, I will begin by explaining the content of the legal norms applicable to the subject matter selected, in each case by interpreting the grammatical meaning of the text as constructed by the legislator. This necessarily implies

the use of logical interpretation. In this context, I will first of all try to identify the semantic differences and similarities between the language of the Romanian and Hungarian legal texts on the liability of directors and officers, and to identify the normative significance of these linguistic and semantic differences and similarities and how they are reflected in the case-law of the two legal systems in the field. I use taxonomic and teleological methods of interpretation in a complementary way. They are thus used only when and to the extent that the normative text bearing the liability formulation under analysis does not provide sufficient help in understanding the actual content of the norm.

In addition to the classical methods of interpretation, which can be used to explore the meaning of the existing legislation on the civil liability of directors and officers, the comparative legal history method is also used. The significance of the legal-historical method of analysis is that there has been a break in the development of company law and, within it, in the development of the liability of directors and officers, due to the Soviet-type political-economic system and the interference of Soviet-type law within it. The result was that in the Soviet-type social and planned economic order, which prevailed for almost five decades after the Second World War, the issues of corporate governance responsibility, which had been based on free market principles and efficiency considerations, were eroded, thus interrupting the previously organic and natural development of managerial liability. However, following the collapse of the Soviet-type political and economic system, corporate governance issues have been brought back to the fore. This time, however, in a neoliberal economic environment the operation and ‘ebb and flow’ of which states in the post-Soviet sphere had no chance to prepare for. Thus, the comparative legal-historical approach to the subject is

necessary because the solutions that emerged from the natural convergence of civil liability and company law before the Second World War are the starting point for the issues that are still the subject of debate today, given the anomaly of the planned economy that has lasted for almost fifty years. In these debates, it is therefore necessary to be aware of and apply historical arguments.

Using a comparative legal-historical method, I will examine the most important issues concerning the civil liability of the managing director of a company, based on the Romanian and Hungarian company law in force between the last quarter of the 19th century and the first half of the 20th century. This essentially covers the period between 1870 and 1948, with the proviso that the two sources of law to be compared in the period in question are Article XXXVII of Act No. 1875, i.e., the Hungarian Act on Commerce (hereinafter referred to as the 'Act on Commerce'), and the Romanian Commercial Code of 1887 (hereinafter referred to as the 'Romanian Commercial Code'), or amendments or supplements thereto.

The aim of applying the legal-historical method is therefore to outline those solutions of the legislature and judiciary of the time which, in my opinion, are suitable for placing the foundations of the institution of civil liability, which has been transferred to the company law in force today, in a (legal) historical context, and thus to help the interpretation and application of the liability rules of the law in force, even by reopening new – or rather old and new at the same time, or more precisely forgotten – perspectives of application and interpretation.

4. Structure of the thesis

My thesis is divided into three parts, comprising three chapters each including one chapter each containing sub-conclusions. The thesis is thus essentially composed of nine chapters.

The first part deals with the legal history of directors' liability.

In the second part of the thesis, I examined the various aspects of the civil liability of directors and officers on the basis of the provisions of the law in force.

The third part also deals with problems related to the law in force in the two countries, but here I have examined the problem of directors' liability specifically in relation to the insolvency of the company.

5. Key conclusions and findings

Following the structure of the thesis, I will first present the main findings of the legal history section.

Both regimes base the legal relationship between the director and the company on the relationship of agency, the content of which could be defined either by law or by contract and distinguish between an agency that includes a right of representation and one that does not. For reasons of creditor protection and because of the importance of the representation of the company, both legal systems regulated the content of the right of representation by means of a set of rules.

As regards liability, it should be stressed that both systems operated with a liability regime based on the culpability of

directors, and that there is a difference between the two legal systems in determining the degree of care used as a measure of culpability. While Hungarian legislation differentiated between the criteria used as a yardstick for liability according to the type of company, the Romanian legislation treated this in a uniform way. The Act on Commerce applied a subjective standard (*culpa in concreto*) to the liability of directors of partnerships, as opposed to the liability of directors of limited liability and joint-stock companies, to which an objective standard (*culpa in abstracto*) applied. In all cases, Romanian legislation required a higher degree of diligence from the managers, and their liability was therefore assessed according to an objective standard.

There were more pronounced differences between the Hungarian and Romanian legislation as regards the direction of liability. Under the Act on Commerce, the liability of the managing directors existed towards the company, towards the members/shareholders and towards the creditors. For partnerships, this was due to the joint, unlimited and direct liability of the members. In contrast, in the case of joint-stock companies, the three-way liability of the managing directors was already based on the legal text, as set out in the Act on Commerce § 189. The liability of the managers of partnerships governed by the Romanian Commercial Code was also essentially based on unlimited and joint and several liability of the members, but here the members had indirect (underlying) liability. A further difference in this context was that the Romanian Commercial Code referred back to the rules of the Romanian Civil Code of 1864 regarding mandate, which had the consequence that the principal was liable for the transactions and acts of the representative. Managers were liable to third parties under the rules of disguised representation. However, the liability of the

officers of a limited liability company was joint and several, both to the company and to third parties.

The above shows that the legal concept behind the normative material on the management of companies regulated by the Hungarian and Romanian commercial laws (codes) in force at the end of the 19th century – first half of the 20th century can be said to be identical, albeit with minor differences, despite the fact that the two laws were based on different regulatory models.

In relation to the law in force, I would like to highlight the following:

There are significant differences in the two countries' general liability regimes, particularly in relation to contractual liability. While Romania's private law liability is basically regulated on a uniform conceptual basis, but with a two-tiered approach, and therefore there is a relatively large overlap between the contractual and non-contractual liability regimes, Hungary's private law liability rules are characterised by a stronger dualism. While in Romania the civil liability regime is based on a uniform fault-based approach, in Hungary the non-contractual liability regime is based on attributability, and contractual liability is based on a quasi-objective foundation.

The differences are also striking as regards the necessary elements of civil liability, in particular the concepts of causation, fault and damage. In Hungary, the prevailing doctrine of causation in liability for tort is the principle of adequate causation, while the *sine qua non* formula prevails in the case of contractual liability. In Romania, on the other hand, the doctrine of the unity of cause and conditions has been adopted in a more or

less uniform way. Both countries' tort liability systems are based on the principle of full compensation, and both regulate the amount of compensation for contractual liability slightly differently. In this context, the Hungarian legislator divides the notion of damage into consequential and incidental damage, and the principle of full compensation is, as a general rule, only applicable to incidental damage. As regards consequential damage, the foreseeability clause becomes inactive only in the case of intentional breach of contract. In Romania, on the other hand, the concept of damage is uniform, but the Romanian legislator also limits the amount of compensation to damages foreseeable at the time of the conclusion of the contract. An exception to this rule is made where the breach of contract is the result of intent or gross negligence. In such cases, the principle of full compensation applies as in the case of liability for tort.

With regard to the legal relationship between a director and a company, it can be seen as similar that both legal systems identify the contract of engagement as the basis of the legal relationship. In this context, however, the difference is that while Hungarian law allows the holding of a management position in an employment relationship irrespective of the form of the company, the same is possible in Romania only in the case of general partnerships, limited partnerships and limited liability companies. A member of the board of directors or the management board (or supervisory board) of a joint-stock company may not be employed during the term of office.

Again, there are marked differences as to the nature of the civil liability of the chief executive. While in Romania there is an intense academic debate on the legal nature of the internal liability of the managing director, in Hungary the issue is clearly

regulated. In Hungary, the manager is liable to the company under the rules of liability for breach of contract. In Romania, the dominant position – on the margin of the mixed mandate of the company officer – is that liability is of a dual nature, depending on the source of the breached obligation.

Both legal systems have incorporated the *business judgement rule* familiar from common law systems. However, there is a difference between the legislation of the two countries in that while in Hungary the rule applies uniformly regardless of the form of company, in Romanian law the rule is only relevant for the management of a joint stock company. Thus, in Romanian law, there is a difference in the level of standards depending on whether the person is a managing director of a limited liability company or a joint-stock company. Whereas the criterion for the managing director of a joint-stock company is that of a *good manager,* i.e., a careful and prudent manager, the managing director of a limited liability company must act with the diligence of a good owner. In other words, Romanian law is currently characterised by the parallel application of two standards: the duty of care and business judgment in the case of joint-stock companies and the good owner standard in the case of limited liability companies. These two standards could be described in terms of Hungarian legal reality in the sense that, while in the case of a joint-stock company, the standard of expectation in a given situation generally conforms to the position of chief executive officer (i.e. he must act as a reasonable officer would act in a given situation), in the case of a limited liability company, the standard is that of taking action in conformity with general expectations in any given situation.

With regard to the civil liability of the manager towards third parties, it can be said that the company law of the two legal systems under consideration is based on similar principles, since in both countries the main rule is that, due to the autonomous legal personality of the company and its separate legal personality from its members, the transactions and acts of the company's organs (manager) must be attributed to the legal person. At the same time, however, there is a specific legal requirement in both legal systems to establish the direct liability of the managing director towards third parties in certain circumstances. In Romania, the manager has both contractual and tortious liability towards third parties. Contractual liability is governed by the Act on Companies, while liability for tort is governed by the Romanian Civil Code. In the case of tortious liability, the legal person is jointly and severally liable with the officer against the person who has suffered damage. In Romania, the direct liability of a manager towards third parties may be established not only in the case of intentional conduct but also in the case of negligence. In contrast, in Hungary, the Civil Code only allows the liability of a director to third parties in the case of intentional tort, and – according to the prevailing view – only on the basis of tort.

In the context of the third part, it can be said that, although the substantive regulatory solutions of the two legal systems differ in several respects, there are no marked differences in the judicial assessment of the substantive law of tortuous conduct due to the basic concept of *wrongful trading* and the practices that have been introduced in Hungary and Romania as a result of the globalised economy.

There are differences at the level of legal issues and glaring differences in the procedure for establishing liability and claiming

damages. One of the most significant differences is that, while the Romanian legislator chose a fact-based solution, the Hungarian legislator did not list in the relevant texts the acts that are explicitly mentioned as the cause of the company's insolvency. The Hungarian legislation is more abstract, and, from a substantive law point of view, the focus of the norm is on the occurrence of a situation threatening insolvency, the obligation of the managing director to act in the best interests of the creditors from the moment he becomes aware of it (or, if he does not become aware of it, should have become aware of it). In comparison, Romanian law identifies the occurrence of insolvency as a circumstance that arose as a result of the conduct of the manager. Romanian law does not require that the interests of creditors be given priority.

The other major difference arises in relation to the enforcement of damages. While Hungarian law operates with a two-step enforcement mechanism (declaratory action + action for damages), Romanian law provides for a unified enforcement mechanism.

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List of publications related to the dissertation

Articles, studies (7)

1. **Pál, E.**: Ügyvezetői felelősség a társaság fizetésképtelenségének előidézése miatt. *Erdélyi Jogélet. Megjelenés alatt*, 1-22, 2023. ISSN: 2734-6226.

   Level of HAS Committee on Legal and Political Sciences: B

2. **Pál, E.**: A vezető tisztségviselők.
   In: Román társasági jog. Szerk.: Veress Emőd; Fegyveresi Zsolt; Pál Előd, Forum Iuris Könyvkiadó, Kolozsvár, 165-212, 2021. ISBN: 9786069061336

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9. **Pál, E.**: A társaságok státusváltozásai.
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10. **Pál, E.**: Contractul de depozit.
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