



Hungarian Helsinki Committee

## UPDATE ON MILITARY SUPERVISION OF PRIVATE COMPANIES UNDER COVID-19 PANDEMIC IN HUNGARY

26 JUNE 2020

### EXECUTIVE SUMMARY

Under the pretext of the public health emergency caused by the COVID-19 pandemic, the Hungarian government has developed a new legal framework enabling the state to assume control over private companies in a non-transparent manner.

The new construction is based on a previously existing, but purely technical regulation – the legislation on “critical infrastructure” – and practically blurs the boundaries of state control, creating a quasi-preparatory phase for assuming state control that completely lacks constitutional guarantees. The adopted legislation is a striking example of how an issue of public health can be converted into a matter of security and used to fortify political power over private actors. The scheme of this new measure unfolded step-by-step during the period of the state of danger declared by the Hungarian government. A complete picture can only be drawn by looking at a whole series of subsequent legislative steps.

At first, using its unconstrained power to derogate from any law under Act XII of 2020 on the Containment of the Coronavirus (the **Authorization Act**),<sup>1</sup> the Hungarian government vested the Minister of Defence with uncontrolled powers to qualify any asset or company as “critical” in a proceeding that totally lacks transparency. Second, the Act on Critical Infrastructure was comprehensively amended introducing the possibility of constant military supervision of companies, unconstrained access to secrets of any kind and discretionary governmental powers to intervene in the operation of critical companies under special legal regimes. Third, Act LVIII on the Transitional Provisions related to the Termination of the State of Danger and on Epidemiological Preparedness (the **Transitional Act**)<sup>2</sup> vested the government with unlimited powers to establish tasks for military forces in a state of danger or a state of medical crisis. The fact that the government proposed these measures to be included in provisions adopted as cardinal laws by a qualified majority of the Parliament indicates that it seeks to gain the highest possible legitimacy for its future moves.

As the shocking case of Kartonpack Plc. described below proves, the toolbox developed through the extraordinary measures grants full power to the state to interfere with the activities of private companies and leaves the shareholders with practically no room for manoeuvring to protect their interests. Although it may appear as an exception, the Kartonpack-case can be considered as a real scenario for any company under the new legislation. The wide discretionary powers granted to the government enable the discriminatory application of security measures and the manipulation of privately owned assets under the guise of fighting a pandemic.

<sup>1</sup> More on the Authorization Act: <https://www.helsinki.hu/en/background-note-on-the-consequences-of-the-authorization-act/>

<sup>2</sup> More on the Transitional Act: [https://www.helsinki.hu/wp-content/uploads/HHC\\_explanatory\\_note\\_Bills\\_T10747\\_and\\_T10748\\_after\\_adoption.pdf](https://www.helsinki.hu/wp-content/uploads/HHC_explanatory_note_Bills_T10747_and_T10748_after_adoption.pdf)

## INTRODUCTION

At the time of the declaration of the state of danger, the Hungarian legislation allowed the state to assume control over an individual company under specific preconditions and with well-defined competences and guarantees. Nevertheless, the actual steps taken by the Hungarian government during the state of danger failed to comply with these legal provisions and lacked the safeguards set out by law. Within the first month of the state of danger, military task forces were allocated to 104 companies with an uncertain mandate.<sup>3</sup> Although the allocation of task forces was publicly announced, the legal background of the measure remained unclear for long. While some governmental statements expressly referred to voluntary cooperation on the part of the companies,<sup>4</sup> other releases gave the impression that the military presence was imposed on the concerned companies through an unilateral governmental decision.<sup>5</sup> The government's official communication on the allocation of task forces to private companies suggested that armed forces had been applied to safeguard the smooth operation of critical service-providers of the Hungarian market. At the same time, the decree<sup>6</sup> establishing the special task force, expressly mandated it to take preparatory steps for assuming state control over these companies.

This Update describes step-by-step the creation of a legal framework under which (i) practically any company could be qualified as "critical" and, as such, (ii) may be submitted to military supervision (even if it carries out non-military activities), and (iii) may be obliged to provide the state with access to confidential information, and (iv) during a special legal regime, become – without any constitutional safeguards – subject to excessive intervention, (v) implemented by military forces entitled to the use of firearms.

## STEP ONE: UNCONTROLLED MILITARY POWER TO SELECT ASSETS NON-TRANSPARENTLY

Under the state of danger, with effect as of 6 April 2020, **the Minister of Defence was vested with exclusive and uncontrolled powers to qualify any asset or company as "critical"**. The new regulation<sup>7</sup> was adopted by the Hungarian government within its powers granted by the Authorization Act enabling it to suspend the enforcement of certain laws, depart from statutory regulations and implement extraordinary measures by decree. The aforementioned decree practically eliminated the qualification procedure and the judicial overview thereof as set out by law and provided **the Minister of Defence with arbitrary powers to qualify as critical and control private assets and companies**. Contrary to the original legal framework, the Act CLXVI of 2012 on the Identification, Qualification and Protection of Critical Systems and Infrastructure (the **Act on Critical Infrastructure**)

- (i) all competences related to the qualification procedure became **concentrated in the hands of the Minister of Defence**, who was
- (ii) entitled to take an extra-rapid decision, **within two calendar days, i.e. with a practically immediate effect**,

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<sup>3</sup> See our previous note of 6 April on military forces assigned to private companies as a COVID-19 response measure in Hungary: <https://www.helsinki.hu/wp-content/uploads/Military-supervision-of-private-companies-under-COVID-19-2020-04-02.pdf>  
According to the last [information note](#) published on the official website of the government, until 17 April 2020 further 11 companies, including Kartonpack Plc. were taken under state control as of the same date, increasing the total number to 104.

<sup>4</sup> <https://honvedelem.hu/cikk/a-sikeres-es-hatekony-egyuttmukodes-erdekeben/>

<sup>5</sup> <https://www.kormany.hu/hu/tarca-nelkuli-miniszter-3/hirek/jarvanyhelyzetben-strategiai-fontossagu-vallalatok-koze-kerult-a-kartonpack-dobozipari-nyrt>

<sup>6</sup> Government Resolution No. 1101/2020 (III.14.) on further measures necessary to control the Coronavirus

<sup>7</sup> Government Decree no. 86/2020 (IV.5.) on the application of certain provisions of defence in the state of danger.

- (iii) **without a prior assessment report** establishing the fulfilment of the criteria prescribed by law,
- (iv) **on his/her own motion**, without the involvement of the competent authority<sup>8</sup> and
- (v) with **no possibility to legal remedy**.

Although the government decree referred to a “qualification procedure”, in reality, the qualification was so quick, uncontrolled and irrevocable that it **cannot be deemed as a procedure**. Even though the decree itself expired with the termination of the state of danger, **the Minister’s decisions to qualify certain companies as critical have not been withdrawn automatically**.<sup>9</sup>

As a whole, this extraordinary measure has **drastically changed the cornerstones laid down in the regulation concerning critical infrastructure** without providing any reasonable justification on the necessity and proportionality of the introduced changes. Considering the fact that the regulation on critical infrastructure was introduced in 2012, and the eight years that have lapsed since its entry into force would have allowed for a thorough assessment of the Hungarian market, it can be concluded that the necessity of introducing a measure that allows for the immediate and unconstrained inclusion of any company in the list of critical companies is doubtful. Even if the need for an accelerated proceeding can be supported, **the total elimination of an assessment report proving the fulfilment of the qualification criteria cannot be justified**. Combined with the lack of legal remedy against the decision, **the regulation ensued the possibility of military forces appearing at any company with immediate effect**.

Yet, a complete picture of the consequences can only be acquired if the above powers are read in conjunction with the most recent legislative developments.

## STEP TWO: CONVERTING A SAFETY REGULATION INTO A CONTROL-TOOL

On 28 April 2020, the Deputy Prime Minister submitted an omnibus bill to the Parliament “on the modification of certain acts to strengthen the security of citizens” which was adopted on 19 May 2020 with most of its provisions entering into force on 1 July 2020 as Act XXXI of 2020 (the **Omnibus Act**).<sup>10</sup> It comprehensively modifies the Act on Critical Infrastructure.

**In its original form, the Act on Critical Infrastructure is a purely technical regulation** aiming to enhance prevention of and preparedness and response to risks (like terrorist attacks or environmental catastrophes) endangering the operation of entities that are critical to the society. The original set of rules on the protection of critical infrastructure is based on cooperation and dialogue and imposes some extra obligations on the entities concerned to reduce their own vulnerability, mainly by preparing a security operation plan and designating a security liaison officer. It shall also be noted that the scope of **“critical infrastructure” largely coincides with the companies considered strategically important (in the energy, banking, telecommunications and retail sector), operating in areas that have long been in the focus of the attention of the ruling party’s clientele**.

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<sup>8</sup> According to the original legal framework on critical infrastructure, the authority vested with the right to qualify assets as critical differs depending on the relevant sector. For example, with respect to the financial sector, the legislation entitles the Central Bank of Hungary acting in its capacity as supervisory authority to qualify financial institutions as critical infrastructure. In case of agricultural holdings, the competent authority is the National Food Safety Office. Originally, the Minister of Defence only had competence with respect to military-type critical infrastructure.

<sup>9</sup> The Minister of Defence has joint powers to review the selection within sixty days after the termination of the state of danger.

<sup>10</sup> The final text as it entered into force is available: [http://njt.hu/cgi\\_bin/njt\\_doc.cgi?docid=219745.383605](http://njt.hu/cgi_bin/njt_doc.cgi?docid=219745.383605)

With the adoption of the modifications, the former, purely technical regulation will contain provisions qualifying as cardinal and applicable during special legal regimes. **The adopted modification allows the state to severely interfere with the operation of any company identified as critical infrastructure without formally assuming state control.** In reality, the proposed legislation incorporates into – cardinal – law those measures that were taken by the government during the state of danger, only framed in more general terms.

- (i) First, **a new section<sup>11</sup> incorporated into the Act on Critical Infrastructure and labelled as part of the cardinal law applicable during a special legal regime** (such as the state of danger) expressly authorizes the government to introduce extraordinary measures with respect to critical infrastructure and deviate from rules on scope of competence, the responsible authority, deadlines, the exclusion of experts, the possibility of legal remedies or judicial review and the execution.

This section **reinforces on a constitutional level the above described government decree vesting the Minister of Defence with uncontrolled and arbitrary powers to qualify assets and companies as critical.**

- (ii) The same new section empowers the government during a special legal regime to appoint a member of the government to coordinate the operations of the critical infrastructure, delegate experts as governmental contact persons to the critical infrastructure and **determine the tasks and competences** of these, **define the terms of cooperation** of the critical infrastructure and the **conditions and methods of assuming control** over the critical infrastructure.

This part of the new legislation **elevates to a constitutional level the practice of allocating task forces to private companies.** The proposed regulation is all the more alarming as it is **automatically applicable in a special legal regime** without requiring a concrete deficiency or problem in the operation of the company concerned.

In contrast to the cardinal provisions on assuming state control incorporated in Act CXXVIII of 2011 on Disaster Preparedness,

- a) this measure of the government **does not need to be justified with a direct threat of the aggravation of the state of danger and does not need to effectively serve its prevention,**
  - b) **the government is not required to justify in any way the intervention,** the application of which can be totally automatic,
  - c) **no responsibilities are attached to the measures** introduced by the government, and
  - d) the **law does not provide for the possibility to claim compensation** for damages caused by the measure.
- (iii) Another **brand new section<sup>12</sup> applicable even outside special legal regimes completely removes confidentiality rules** and allows every responsible authority involved in the qualification and supervision of critical infrastructure to acquire qualified data, personal data or special data, business secrets, banking secrets, payment secrets, insurance secrets, securities secrets and fund secrets. The provision does not contain any requirement for the authority to

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<sup>11</sup> Section 135 of the Omnibus Act incorporating the new Title 6/A into the Act on Critical Infrastructure.

<sup>12</sup> Section 127 (2) of the Omnibus Act supplements Section 4 of the Act on Critical Infrastructure with a new subsection (3) fully eliminating confidentiality provisions.

weight the necessity and proportionality of dismissing secrecy principles, granting **unlimited power to state authorities to acquire trade secrets of private entities**.

- (iv) The modifications define the category of **non-military critical infrastructure falling under the authority of the Minister of Defence**.<sup>13</sup> According to the new rules, entities qualified as critical – just like the ones included in the list during the state of danger as a result of the arbitrary and uncontrolled decisions of the Minister of Defence – can fall under the supervision of the Minister of Defence irrespective of the fact that they carry out non-military type activities. The Minister of Defence can qualify any critical entity as such without the fulfilment of the qualification criteria and avoiding the participation of an expert. **The introduction of this new category allows military supervision to be extended to non-military sectors, even after the state of danger terminates. As a consequence of the modifications adopted, once a company qualifies as critical, the Minister of Defence has discretionary powers to decide on assuming supervisory functions.**

It is clear that by the adoption of the Omnibus Act, the Hungarian government has opened the way for **the application of a purely technical regulation in a distorted way enabling excessive control over private assets and companies**. Whereas the previous legal framework required a critical company to take steps to reduce its own vulnerability by preparing a security operation plan and designating a security liaison officer, the new legal framework requires a critical company to accept the intervention of the authorities in the form of sharing secrets or cooperating with the state during a special legal regime as prescribed by the government.

The legislative framework poses a threat to basic freedoms of the European single market – especially the principle of free movement of capitals – due to the non-transparent rules of qualification of assets and the lack of guarantees against an arbitrary application. The Act on Critical Infrastructure in its modified version enables the government and the Minister of Defence to treat companies differently even in factually comparable situations. While some undertakings may be qualified for military supervision, others may remain within the competence of their sectoral supervisory authority, without any justifiable reason. Similarly, under special legal regime, the government may assume control over a critical company, while its competitors remain void of restrictions, for non-transparent reasons. For this purpose, the qualification as critical infrastructure may become a tool in the hands of the Hungarian government to fortify national economic sovereignty against foreign investors and privilege national ownership, contrary to the fundamental freedoms of the EU.

### **STEP THREE: FORTIFY THE SOLUTION WITH THE POSSIBILITY OF USE OF FIREARMS**

The latest legislative step was introduced by the Transitional Act adopted in connection with the termination of the state of danger, with effect of 18 June 2020. The Transitional Act supplements the Defence Act<sup>14</sup> with new provisions – qualified as cardinal based on Section 45 (5) of the Fundamental Law – that **radically widen the possibility to apply military forces with the right to use of firearms** during a state of danger and the so-called state of medical crisis.<sup>15</sup>

- (i) The Transitional Act **authorizes the Government to establish by decree the tasks of the military in a state of danger** and the state of medical crisis.<sup>16</sup> This provision grants the

<sup>13</sup> Section 124 (1) of the Omnibus Act amends Section 2 of the Act on Critical Infrastructure in a comprehensive manner, introducing new provisions under Sections 2 (9) to 2 (12).

<sup>14</sup> Act CXIII of 2011 on Defence, the Hungarian Army and the Measures Applicable under Special Legal Order.

<sup>15</sup> The state of medical crisis is not one of the special legal orders provided for by the Fundamental Law, but a stand-alone regime ordered when certain epidemiological and public health scenarios described in the Health Care Act occur

<sup>16</sup> Section 351 of the Transitional Act.

government full discretion to decide on the allocation of military forces and to order the involvement of armed forces even in areas not covered by the Defence Act.

- (ii) Further, **the Transitional Act automatically attaches the right to use firearms by the military with respect to the tasks defined by the government by decree** under a state of danger or a state of medical danger. The right to use firearms in practice means the most severe coercive measure, during which soldiers may intentionally trigger shots targeted at a person, even in cases falling outside the scope of self-defence or force majeure.

**The above legal framework also entitles the government for the future to attach the use of firearms to the military forces entrusted with the supervision of critical companies, by merely establishing tasks by decree.**

### **A SHOCKING EXAMPLE: THE KARTONPACK-CASE**

An example illustrating the possible application of the new set of rules is the case of Kartonpack Plc. (Kartonpack), a Hungarian company publicly traded at the Budapest Stock Exchange. The ownership over shares of Kartonpack have for years been reported to be a target of the political clientele of the ruling party and even the Hungarian state.<sup>17</sup> The fight over ownership has caused numerous lawsuits and legal disputes, amongst others, between Kartonpack and the Hungarian National Asset Management Inc. (the company managing state-owned assets).<sup>18</sup>

**On 17 April 2020**, Kartonpack was announced to have been included within the group of **critical companies** where **military task forces were allocated** by the Minister of Defence. The same day, the Hungarian government issued an **individual decree on assuming state control over Kartonpack** (the **State Control Decree**).<sup>19</sup> The State Control Decree was electronically signed at 10:48 am and **entered into force within 12 minutes**, at 11 am.

The State Control Decree – delivered under the unconstrained powers conferred to the government by the Authorization Act – had practically nothing to do with the aim and scope of assuming state control as originally foreseen by the Disaster Management Act. It did not provide for a sound justification on how assuming state control over Kartonpack effectively serves the prevention of the aggravation of the state of danger. The assigned government commissioner (the activity of whom is controlled by the Prime Minister under the relevant regulation)<sup>20</sup> was **vested with irrationally wide powers**, including

- (i) **exclusive right to decide in matters falling within the competence of both the shareholders and the executive board of the company;**
- (ii) right to restrict or terminate any power to represent the company granted to any person (including lawyers);
- (iii) **right to terminate or rescind contracts concluded by Kartonpack with third parties with immediate effect** (a right that severely undermines contractual freedom and affects third parties as well);

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<sup>17</sup> See [here](#), [here](#) and [here](#).

<sup>18</sup> An [announcement](#) of a failed attempt by the Hungarian National Asset Management Inc. was published on the website of the Budapest Stock Exchange.

<sup>19</sup> Government [Decree No. 128/2020](#) (IV. 17.) on taking state control over the operation of Kartonpack Plc.

<sup>20</sup> Government [Resolution](#) 1365/2018 on the appointment and tasks of governmental commissioner responsible for exercising ownership rights.

- (iv) right to **give orders to the members of the executive board and the supervisory board** (the latter being totally absurd considering the protective role of the supervisory board).

Military units were most probably involved in order to secure smooth takeover. The first week of the government commissioner's mandate clearly proved that the state control was executed with thorough prior planning and due timing.

On 17 April 2020 (still on the same day of assuming state control and allocating military task forces), the mandate of the whole management was withdrawn and a new management was appointed.<sup>21</sup>

On 20 April 2020 (the next working day), the general meeting was postponed for an indefinite period of time until the operation and financial status of the company is reviewed.<sup>22</sup>

On 21 and 22 April 2020, five lawsuits (ongoing for years) were terminated, most probably by withdrawal or recognition of the claims by Kartonpack.<sup>23</sup>

On 30 April 2020, the government commissioner terminated the mandate of Kartonpack's auditor. As a consequence, the company's annual report was not audited and the financial supervisory authority suspended the dealing of the stocks at the Budapest Stock Exchange.<sup>24</sup>

The scope of application of the state control decree was prolonged even after the termination of the state of danger.<sup>25</sup> Yet, any deadline for state control is a pure formality, as **the measures taken by the government commissioner** – termination of contracts and mandates, ending up lawsuits and taking decisions in the name of the shareholders – **are irreversible and can change the operation of the company in the long run irrespective of the termination of the state of danger.** Although **Kartonpack was formally not nationalised, the extremely wide powers of the government commissioner and the series of steps taken under these powers factually yield the same result.**

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<sup>21</sup> The same day, the official notification to investors was published on the website of the Budapest Stock Exchange; <https://www.bse.hu/newkibdata/128394918/Rendk%C3%ADv%C3%BCli%20t%C3%A1j%C3%A9koztat%C3%A1s.pdf>

<sup>22</sup> The investors were notified by an [announcement](#) published on the morning of the same day.

<sup>23</sup> Announcements on the termination of lawsuits were published in the Company Gazette.

<sup>24</sup> The Central Bank of Hungary [announced](#) the suspension with effect of 11 May, 2020.

<sup>25</sup> Section 159 of the Transitional Act upholds state control over Kartonpack until at latest 15 August, 2020 and attaches the effective date of termination to a symbolic unilateral act of the government commissioner (namely, handing over the documents and providing information to the management and supervisory board of the company).