

Salans News

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The Potential Remedies for the Unfavourable Equity Situation of Companies

Experience shows that when a company's capital falls below a certain level (i.e. when the annual report of the company shows that the company's equity is below zero or less than the required amount) it may unfavourably impact the company's operation in several ways. In the case of certain company forms, legal regulations set forth the minimum equity required for the lawful operation and the mandatory steps to take if the equity of a company falls below the minimum amount required by law. In addition to ensuring the company's lawful operation, it is important to have the appropriate amount of equity for practical reasons related to the operation of the company, such as certain criteria of tenders and state subsidies, bank financing or simply suppliers' and buyers' confidence. Since we found that the issue of inadequate capital is not uncommon, in this newsletter we wish to present a brief summary of the potential solutions frequently applied in order to remedy unfavourable capital situations and the most important legal implications of such solutions.

1. Increasing the registered capital

In order to remedy the unfavourable capital situation, a potential solution applicable to all company forms is increasing the registered capital of the company. The legal provisions on increasing the registered capital vary in detail depending on the company form. In case of limited partnerships and general partnerships they are less detailed, whereas in case of limited liability companies and limited companies, the regulations set forth the rules on increasing the registered capital in detail. The registered capital of a company may be increased by the quotaholders providing a cash contribution, in-kind contribution (also called non-cash contribution) or both simultaneously, and it requires filing corporate changes with the court of registration in all cases.

1.1 Increasing the company's registered capital by cash contribution

In most cases, capital is increased by the quotaholders providing cash contribution. The capital may be increased by the respective resolution of the company's quotaholders.

A capital increase is usually implemented in two stages, which can be combined in certain cases. In the first stage the quotaholders of the company decide on increasing the capital and call upon the quotaholders to exercise their priority rights. In the second stage the quotaholders amend the articles of association as required

A company's unfavourable equity situation adversely impacts the company's operations in several aspects. However, several possibilities are available to remedy the company's equity situation from increasing the registered capital to forgiving the company's debts.



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to reflect the amount of the increased capital. A consequence of increasing capital may be that the quotaholder's quota held in the company and the related rights may change.

In order to have the capital increase registered in the company registry a request for registering the changes must be filed with the court of registration along with the corporate documents required for the registration of the capital increase.

1.2 Increasing the registered capital by in-kind contribution

To increase the registered capital of the company, the quotaholders may provide any goods or valuable rights as in-kind contribution. Among valuable rights, the quotaholders may also offer claims acknowledged by the debtor or based on court decision.

A particularly popular way to increase the capital of a company is where the quotaholder transfers to the company a claim of a significant amount as an in-kind contribution. In this case, in order to register the capital increase in the company registry, it must be verified that the claim provided to the company as an in-kind contribution is an existing debt of the company acknowledged thereby. In addition, the quotaholders or the auditor must evaluate the claim provided to the company in accordance with the rules of in-kind contributions and the statement thereon must be attached to the request for registering the capital increase.

2. Increasing the capital reserve

In case of any company form, it is possible that the quotaholders resolve to increase the capital reserve constituting a part of the equity of a company. It is an important rule, however, that the quotaholders may only resolve to increase the capital reserve and the conditions thereof simultaneously with increasing the registered capital of the company. The method of increasing the capital reserve is less regulated, thus it is advisable to proceed with due care taking into account the regulations on increasing the registered capital.

3. Supplementary contribution

In case of limited liability companies the quotaholders may provide for supplementary contributions to increase the equity of the company to cover the losses of the company. A supplementary contribution may be applied when set forth in the articles of association. The supplementary contribution is an obligation which does not affect the quotaholders' quota held in the company. The failure to perform it, however, may entail detrimental corporate consequences for the defaulting quotaholder. When the financial situation of the company has improved the supplementary contribution provided by the quotaholder may be repaid. If such possibility is not yet contained in the articles of association in order to apply supplementary contributions, an amendment of the articles of association is required.

4. Forgiveness of debts

To improve the capital situation, forgiving the company's debt towards one of its quotaholders (such as forgiving the loan debt of one of the company's quotaholders) may offer a potential solution. The forgiveness of debts is less regulated by law and it does not require corporate filing. Debts may be forgiven on the basis of the civil law contract between the company and its quotaholder or in some cases a unilateral statement of the quotaholder.

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We sincerely hope that our newsletter will be useful to you in improving or further strengthening the capital situation of your company. Since this newsletter is a summary, it presents only certain legal aspects of the potential remedies for improving companies' capital situations. Therefore, we wish to emphasize that other, such as taxation, accounting and bookkeeping aspects of improving the companies capital situation should be thoroughly reviewed even in the course of selecting the potential solution.

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