CONTRACT OF ASSOCIATION AS A SPECIFIC CONTRACT IN THE NEW HUNGARIAN CIVIL CODE

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I. Introduction

The first Civil Code in Hungary was enacted in 1959 and came into force in 1960. From the beginning of the 1900's till the end of the 1920's there were some proposals for a general Civil Code, but they were not confirmed by the Parliament, so they did not become effective law, albeit certain parts of them were applied by the courts as if they were laws in force. The connection between these proposals and the Civil Code is far from obvious. In the first decades of the twentieth century, Hungary belonged to the group of European countries going through a delayed capitalistic development. Consequently, the legal infrastructure including the effective laws, the proposed legislation, the jurisprudence and the legal scholarship could have been characterized as capitalistic law.

In 1959, Hungary was in a completely different situation. Because of World War II, our country fell into the Soviet sphere of influence, and was forced to follow a so-called socialist way of development. The paradigms of the socialist system were quite different from that of the capitalistic regime, and the socialist ideology strongly underlined the differences in every respect. The logic of such a discrepancy would have required repudiating any connection with the former proposals when the socialist Civil Code was to be drafted. It is hard to explain how this logic was broken. It does not mean of course that the Hungarian Civil Code 1959 was a classical capitalistic civil code. Certainly, it was not. It had to reflect all the features of the social and economic relationships of that time. Nevertheless, it saved all the classical values of the common European heritage of civil law that were not completely incompatible with the socialist ideology and the existing economic background. The result was a Civil Code, that was in many respects more sophisticated than the socialist economic environment needed. The socialist state tried to eliminate the market and took over the task of organizing the economy, thus the market relations had almost no importance in the orthodox version of socialism.

The Hungarian Civil Code, however, introduced and regulated a number of institutions that were designed for market relations based on private ownership. These institutions were in certain sense superfluous in a socialist Civil Code, but they proved to be very useful when the economic and social changes started at the beginning of the 1990's. Due to the traditional values of the Hungarian Civil Code, it was possible to adapt it to the changed circumstances. Through a series of modifications, the socialist Civil Code of 1959 was turned into a Code that was compatible with the market economy and the changed social circumstances.

However, the great number of amendments made the Code scattered, some incoherence has occurred, and problems in the application of the law emerged regulary. The cause of these problems was not simply that the rules were enacted at different times rather the Code included rules of different approaches. For the effectiveness of a code, it is inevitable to ensure the homogeneity of its rules. In the case of the Hungarian Civil Code, this requirement could not be met by further amendments. In 1988, it was decided by the Government that a new Civil Code had to be drafted.[1] The first draft of the Code must be finished by the end of 2005.

Since the Civil Code is intended to be a general code embracing all the civil law relationships, and regulating these relationships under uniform principles, one of the first tasks of the Codification Committee, appointed by the Government for the civil law codification was to determine the sphere of regulations of the Code, i. e. to decide what kind of relationships should be treated as civil law relationship and what kind of relationships should be subsumed under the regulation of the would be Code.

After some discussion[2] it became a widely accepted opinion that the law of associations in a broad sense (the notion will be defined later in Chapter II) should be deemed as part of the civil law, therefore, this area of law should be covered by the Civil Code. It is a technical question of secondary importance, I believe, whether the Code itself could contain regulations of all types of association entirely or whether the detailed rules should be organised in a separate act (or perhaps in various separate acts). The Civil Code will certainly contain general provisions of all kinds of legal entities, including associations as well as other legal entities. These rules will be applicable to associations even if they will be regulated in separate laws.

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1 Government's Decree No.1050/1998. (IV.24.) Korm.

2 See for example Tamás Sárközy: A Kereskedelmi Törvénykönyv esetleges koncepciója; Gazdaság és Jog 1999/4. 3-6. p., Ferenc Petrik: Az új Polgári Törvénykönyvről; Magyar Jog 2000/3. 135-147. p., András Kisfaludi: A társasági jog helye a jogrendszerben; Polgári Jogi Kodifikáció 2000/3. 3-12. p. Péter Miskolczi Bodnár: Társasági jog a Ptk-ban; Gazdaság és Jog 2001/1. 3-8. p., Tamás Sárközy: A magyar társasági jog Európában. A társasági és konszernjog elméleti alapjai; HVG-ORAC, Budapest, 2001. 387-394.

The place of contract law within civil law is not in dispute, and naturally, the new Civil Code will regulate the contracts. That means that the law of associations and the law of contracts will be subjects of a uniform civil law regulation and as such they will be regulated by the same Code, therefore, it is a justifiable objective to achieve some coherence between their rules. In a single code we cannot allow to use the same words with different meanings, and the parts of a code should work together smoothly.

This is the reason why in this paper I will examine the contract of association. I will start the examination with an explanation of the notion of contract of association under the Hungarian law (Chapter II), and then I will try to give at least a partial justification of the fact that we use the common name of contract of association for different things (Chapter III). Next, I will deal with the consequences of those common features, which bring together quite different phenomena under the umbrella of contract of association (Chapter IV). Then I will give some examples of those areas where the contract of associations requests special regulation, different from the general contractual rules. Such examples will be the breach of contract (Chapter V) and the invalidity of contract of associations (Chapter VI). Finally, I will try to summarise what conclusions can be drawn from the common features and differences of the contracts of associations and contracts in general, and I will conclude with some proposals how to reflect these consequences in the new Civil Code (Chapter VII).

II. Questions of Terminology

Writing in English about law that is not conceived in English, always generates some problems of terminology. One possible cause of such problems is that „non-English-speaking" legal systems might construe and use legal notions and institutions, which are unknown in English-speaking laws, and, therefore, they have no proper English terms. That is the problem in the case of contracts of association, too. In Hungarian law, we have one common name („társaság") for such co-operations, which are clearly different phenomena in English law and, consequently, have different names. For example in Hungarian law, a partnership and a private limited company (in English terms) are treated as subgenera of a general legal category that I translate into English as „association". Since these organisations together with some others are normally founded by an agreement among the parties, in Hungarian legal terminology these acts of formation are called contracts of association. Again, a limited liability company and a partnership are equally formed by a contract of association, though in English law the partnership and the company are sharply distinguished notions.

To give a more or less accurate description of the contract of association we have to emphasise that these are real contracts, i.e., contracts in a strictly legal sense. The theoretical literature on companies and especially on the economics of companies uses the expression: corporate contract, and speaks about the contractual nature of the firm.[3] However, the contract of association in Hungarian Law is not only a theoretical notion. These are real contracts made directly by and among the parties; they constitute legal relationships including rights and obligations, which are enforceable by the state. In contrast to this, the contractual theory of the firm refers to contracts also between those constituents of a company who have never entered into a contract with each other in legal terms. It can be true that in economic sense, there is some equilibrium between the shareholders and the company's creditors, but they are not in a legally binding contractual relationship, the creditor generally is not entitled to claim the company's debt from the company's member.

The contract of association is a contract not only in a metaphorical sense; therefore, its content should be determined by legal terms. Let us see what could be the content of the contract of association. Taking the current law as a starting point, we find that quite different co-operations and organisations are brought together under the notion of association. I would divide these phenomena into four groups.

(1) The present Civil Code classifies a simple factual community between two or more persons as an association, in the case when such a community has financial consequences. Chapter XLVI of the Civil Code – which is a chapter of the Title „Specific Contracts" – bears the title „Association" and it is provided within this chapter that during their cohabitation cohabitants become collective owners in proportion of their contribution to the obtaining of their property.[4] As a matter of course when two people[5] decide to live together without marriage, as cohabitants, their main motives are not primarily of economic character. The purpose of cohabitation is not to pursue joint economic activity, but to livie in common household. It is, however inevitable to mix the finances of the parties. While the partners live together, the financial matters do not cause any problems. However, when the connection comes to an end, the mixed properties shall be separated and this needs legal guidelines. The legislator formulated these rules by presuming a contract of association between the parties.

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[3] See for example Frank H. Easterbrook – Daniel R. Fischel: The Corporate Contract; 89 Columbia Law Review, 1989., 1416-1448., William W. Bratton, Jr.: The Nexus of Contracts Corporation: A Critical Appraisal; 74 Cornell Law Review, 1989., 407

[4] S 578/G.(1) of the Civil Code

[5] Until 1996 only a connection between a woman and a man could have been qualified as cohabitation. Since 1996 cohabitants are two persons living in emotional an economic community, in a common household without marrying each other (see S 685/A of the Civil Code). This modification was initiated by a decision of the Constitutional Court according to which it was unconstitutional that the cohabitation was acknowledged only in case of connections of people of different sexes [Decision of Constitutional Court No. 14/1995. (III.13.) AB].

The regulation is similar to that of cohabitation in the case of relatives living in a common household[6] except for the married couples, because their financial relations are regulated by a separate act of Family Law.[7]

(2) The second group of the associations covers a co-operation between the partners based on a mere contractual relation, without constituting an entity separate from the partners. These associations could be called as civil law partnerships in order to distinguish them from the business partnerships. The main features of the civil law partnerships are that they serve the common aim of the parties, this common aim could be reached at least partially by a common economic activity, and the parties finance the activity of the partnership together, i.e. by making the necessary finances available to the partnership. A civil law partnership can be formed without joint financing if the objective of the partnership is exclusively the promotion of the parties' economic interest and the co-ordination of the parties' activity for the promotion of their interest.[8]

In the case of civil law partnership, there may be an express intention of the parties to co-operate with each other, and not only a factual situation brings them into a position where their financial matters are concerned, basically unintentionally.

A special case of the civil law partnership is when the objective of the co-operation is the construction of a building, and establishment of a condominium over that building.[9]

(3) The third category of associations consists of those co-operations that are relatively separated from their partners. These are on half way between the abovementioned unincorporated associations and the incorporated corporations. In some respect, they have legal capacity separated from their members, and as such they are able to obtain rights and to undertake liabilities under their own name (and not in the name of the parties). But in other matters these co-operations are similar to the civil law partnerships, i.e. they are only contractual relationships between the partners, without establishing a separate entity.

Such a hybrid was introduced into the Hungarian civil law in 1997 in order to provide an efficient device for condominium owners to manage the affairs of their condominiums. Under the rules of the Civil Code and the Act on the condominiums, the community of the owners of a condominium has the capacity to obtain rights and assume responsibility under a common name in the fields of maintaining and renovating the building, and managing the affairs concern-

6 S 578/G.(2) of the Civil Code
7 Act No. IV of 1952
8 S 568(1) of the Civil Code
9 S 578/B of the Civil Code

ing of the jointly owned areas. In connection with the joint ownership, the condominium owners' community in its own name exercises its rights and bears the burdens of the owner.[10]

The rules of the condominium owners' community can be found in the Civil Code under the title of Association, which shows that this is a kind of association. The contractual nature is clear, because a condominium can be established only by the consensus of the co-owners (or – as a substitute for the agreement – by a court decision). But the condominium owners' community is more than a simple contract, because in certain fields it creates a separate entity different from its members. In this sense it is not simply a civil law partnership with a common aim to maintain a building, because in respects of the joint ownership the co-owners establish a new entity having legal capacity.

(4) And finally, the fourth group of the associations is the group of incorporated entities, which have their own legal capacity in all respects. Though there is some ambiguity in this respect, we consider associations only those co-operations or organisations, which have primarily an economic goal, and which can be founded by a contract of association. By these restrictions, the list of incorporated associations is the following:

- the economic associations, i.e. business partnership, limited partnership, joint enterprise, limited liability company and company limited by shares;[11]
- the non profit company and
- the union (a company whose objective is to organise the co-operation among the partners, and promote their economic interests).

[10] S 578/I of the Civil Code, S 3(1) of the Act No. CXXXIII of 2003 on the Condominiums. The condominium means a special mixture of the separate and joint ownership. If a land on which stands a building is a condominium, then some parts of the building – generally the apartments – are in separate ownership of the owners, while the rest of the building (normally the main walls, the roof, etc.) and the land are in joint ownership.

[11] It is dicussed whether the co-operative is an economic association. There is a strong position according to which the co-operatives have the same characteristics as the associations in general and the economic associations specially (see e.g. Tamás Sárközy: A magyar társasági jog Európában. A társasági és a konszernjog elméleti alapjai, HVG-ORAC, Budapest, 2001. 95-97. p., Márta Süveges: Az „új szövetkezetről" szóló „új" szövetkezeti törvényről; Gazdaság és Jog, 2001/7-8. 3-10.), however, the regulation of these organisations is still out of the Companies Act (Act No. CXLIV of 1997., hereinafter referred to as Companies Act or Companies Act 1997), and there is no hope that the co-operatives could be classified by the legislation as economic associations in the near future.

If we look at the above categorisations, we can see that the notion of association embraces rather different things. The starting point of the scale is the financial aspect of the cohabitation and perhaps the company limited by shares stands on the other end. Could it be a useful generalisation to subsume such different things under the same notion? What could be common in cohabitation of two natural persons and in a multinational company limited by shares having thousands of shareholders? How could these common features be reflected in a contract of association? Is it justifiable to call by the same name a presumed agreement between cohabitants and an agreement elaborated in details for establishing a company limited by shares? These questions are addressed in the next chapter.

III. Partial Justification of Using Common Name for Different Things

Establishing the system of specific contracts is not merely a logical exercise; the legal aspects should be taken into consideration at least with the same weight.[12] Therefore, in my view, it is not enough to find a common feature for all the contracts of association at any level of generalisation to justify the existence of a specific contract.

It would be really easy to say that the common characteristic of the associations is that they are established by the common will of the parties. Unfortunately this proposal would not solve the problem of classification, because this is a general feature of all contracts, not only that of contracts of associations. Furthermore, it is not without exception. The exceptions are in two directions: on the one hand there are associations whose foundation does not require by all means the consensus of all parties, and still they are treated as being founded by contract of association; and on the other hand there are associations, which are established by the partners' agreement, still the formation document is not called a contract of association. For the first exception the best example is the cohabitation where the common will of the parties usually does not comprise the regulation of the financial matters, yet the civil law treats the situation as if the parties have concluded a contract of association.

The other example for the formation of an association without consensus of the parties can be the foundation of a company limited by shares by way of the public offer of shares. In this case, the foundation is a process that starts with the issuance of the prospectus and ends with entering of the company into the

[12] For a survey of the development of the contractual system see Lajos Vékás: A szerződési rendszer fejlődési csomópontjai; Akadémiai Kiadó, Budapest, 1977.

company register. One step of this process is the first general meeting where the majority of the subscribers can decide on the formation of the company. For the quorum of the first general meeting, it is requested to be present as a minimum so many subscribers who represent at least 50 % of the share capital.[13] This means that in an extreme situation subscribers having only one quarter of the whole share capital plus one vote can decide the formation of the company. It is obvious that the majority voting is not a proper way of reaching consensus. Nevertheless, the consensus is a necessary element of the contract; therefore, in the absence of it we cannot speak about contract. So, it is not a mere coincidence that the Companies Act does not recognise the formation document of a company limited by shares established by public offer of the shares as contract of association. Due to this differentiation, the formation document of a public company limited by shares should not be subsumed under the notion of the contract of association.

The other type of the above-mentioned exceptions is when the association is formed by the consensus of the parties, but the formation document is not called as contract of association. If a company limited by shares is founded without public issuance of shares (i.e. when the founders themselves subscribe for all the shares to be issued), the foundation requires an agreement among the founders, and any dissenting founder can obstruct the formation of the company. Still the foundation document is not qualified by the Companies Act as a contract of association.[14]

We can draw the conclusion from the aforementioned that the consensus of the parties is not a proper attribute on which the notion of the contract of association as a specific contract could be built. Therefore, we have to look for the core of the notion at a lower level.

It is quite a common method to define a type of contract by its object. Following this method, we could say that contracts constituting associations can be named contracts of association.[15] However, if the association is not a homogeneous notion (and it was demonstrated in the previous chapter that it is not), how could we base a notion of a specific contract on it? If the object of the contract is different from that of another contract, then the two contracts must be also different.

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[13] S 218 of the Companies Act

[14] S 206(2) of the Companies Act

[15] This approach can be observed in Tibor Nochta – Bálint Kovács – Zoltán Nemessányi: A Magyar polgári jog, Kötelmi jog, Különös rész; Dialóg Campus Kiadó, Budapest-Pécs, 2004. 186-187.

However, it would not be true if I argued that there is nothing common in those contracts, which are now called as contracts of association. These really common features can provide some – at least partial – justification for a common type of contract. For defining a contract it is not enough to find the common characteristics, but we need features, which – at the same time as they are similar – differ from other contracts. So, we have to find the specific characteristics, which are different from other contracts, but the differences are uniformly peculiar to the given type of contract. By this uniformity of differences could the contract of association be described more or less precisely and this could explain to a certain extent the existence of such a specific contract.

One striking difference of all contracts of association from any other contracts is that the contract of association does not carry out a direct exchange of performances between the contracting parties.[16] In case of other contracts, the result of the contract is generally an obligation on one party's side to realise a performance described in the contract and a right on the other party's side to claim the same performance. In other words, one party owes its duties to the other party, and the contents of this duty are determined by the contract. In this sense the contract is an intermediary between the parties, the contract determines the nature of the performance and the way it should be delivered. In these contracts the rights and obligations of the parties are in reciprocal relationship, i.e. the right of one party corresponds with the obligation of the other. It is true even if the contract itself is a so-called gratuitous contract. For example in the case of a donation the donor is obliged to transfer the ownership of a certain thing, but he is entitled also to claim that the person receiving the donation took over the object of the contract. In this sense, the donor is in one person both an obligor and obligee. The same is true for the other party as well: he is entitled to claim the thing that was promised to him, but he has an obligation, too: he has to take over the offered gift. The refusal of the take-over is a clear breach of the contract, and can involve sanctions. (As a matter of course, it is not compulsory to accept the offer to conclude a contract of donation but once the acceptance happened, the person receiving the gift has the obligation to take over it.)

Generally, in the case of contracts of association, such an exchange of performances cannot be observed. Though the parties of the contract in most of the cases have to carry out the transfer of some money or property for serving the association's goals, they do not promise their performance to each other, rather to the association itself. This is true even for those associations which are not independent legal entities.

[16] See Péter Miskolczi Bodnár: A társasági szerződés sajátosságai a Ptk.-ban szabályozott szerződésekhez képest; Gazdaság és Jog 2001/7-8. 27-28. p.

The civil law partnership cannot be the owner of the properties devoted to the partnership's objects, because this kind of partnerships is not a legal person; it cannot have rights and cannot incur liabilities. However, the property serving the partnership's goals must be separated somehow. The solution is that the partners of the partnership transfer their financial contributions to the joint ownership of the partners.[17] This is a specially bound co-ownership. It cannot be terminated at any time at any partner's will. As long as the partnership or the membership exists, the partners are not entitled to terminate the joint ownership; they have to keep their commitment of contribution for the partnership's disposal.[18] Consequently, if any of the partners breaches the contract of association by not performing the promised contribution, the other partners individually are not entitled to enforce the contract claiming specific performance or damages. They are not entitled to do so, because the performance of the breaching party is due not to the individual partners, rather to the co-ownership of the partners. Therefore, the performance could be claimed in the name of all other partners. It is another question that in order to facilitate the activity of the partnership the Civil Code provides that each partner is entitled to represent all the other partners in the dealings of the partnership.[19] So, a single partner can act to enforce the contract of association, and he can do this as a representative of all other partners, not for himself exclusively.

If the contract of the parties constitutes an entity with its own legal capacity, the situation is simpler and the deviation from the other civil law contracts is more obvious. In such a contract, the parties promise to each other to perform their contribution to a third party, i.e. to the association formed by the contract. It is quite peculiar that the person who becomes entitled to the performance defined by the contract, is not a party to this contract, furthermore, the said person does not exist at the time of concluding the contract (since the association itself is just being founded).

The distinction between the identity of the contracting parties and the obligees exists in respect of not only the partners' obligations but concerning their rights as well. The partners agree with each other on the formation of the association and as a result of this they become obligees to the association. The rights of the partners within the legal relationships of associations are exercisable not towards the other partners, rather towards the association. It could be true, of course, that indirectly, or in an economic sense the membership rights are exercised ultimately against the other partners, however in strict legal terms the legal relationship is constituted between the partner and the association. For

[17] S 569(1) of the Civil Code
[18] S 570(1) of the Civil Code
[19] S 572(2) of the Civil Code

example dividends of a company limited by shares can be claimed only from the company itself (and not from the other shareholders), however, it is clear that the more dividends are paid to one shareholder, the less remain for the others, and in this way the rights against the company transmit an economic connection to all the shareholders.

Because of the fact that under the contract of association the contracting parties become obligees and obligors not towards each other, but towards the association, it is also said to be a special character of the contract of association that – in contrast to other contracts – the parties' interests are not antagonistically opposing.[20] It is held that in a sales contract, for example, the parties' goals are completely and irreconcilably contradictory to each other, because the seller wants to sell his goods at as high a price as possible, while the buyer wants to buy at as low a price as possible. If one of them is successful, it can be only to the disadvantage of the other. It is impossible that both the seller and the buyer win.[21] Even though this argument is not indisputable, it is worth considering whether we can really take it for granted that the members of an association are necessarily, by definition in harmony with each other. On the surface, there is really a common goal of the parties that could explain a presumption of common interests. However, this appearance can be deceptive. The ultimate reason for the partners to participate in an association is not to help others to achieve their goals, or to do something for the society as a whole or for communities of various sizes, but to obtain benefits for themselves. As long as this individual goal can be reached by co-operation, the individual will co-operate with others, because he is forced to do this. But he will follow his own interests beyond the necessary level, even against those, with whom he earlier co-operated. On closer examination, we will find that the partners of a company for example are interested in co-operation until joint profits can be achieved. However, the division of profit does not belong to the field of common interests. The partners want to have as high a proportion of the profit as possible. At a given amount of distributable profit, one can assert one's interest only to the detriment of the others. The same can be said about the other membership rights as well: each

[20] See for example Ödön Zoltán: A polgári jogi társaságról; Jogtudományi Közlöny, 1983/3. 142-149.

[21] Analysing the situation very formally this argument seems to be true; however, it is possible to find a special viewpoint from which the antagonism becomes apparent. The economic analysis of the law teaches us that a contract can be concluded only if both parties win. In fact, it is possible, because the value of the goods and the money are different for the seller and the buyer. At a given purchase price the contract is advantageous for the seller because for him the money is more valuable than the goods and at the same time and at the same price the transaction could be advantageous for the buyer as well, because for him the goods are more valuable than the bargained price. See for example Richard Posner: Economic analysis of Law (2nd ed.); Little, Brown and Company, Boston/Toronto, 1977. 2-14. p.

partner is interested in having as much power in corporate decision-making or in corporate control as possible. However, somebody can enhance his power only to the detriment of the other partners. Therefore, it is – in my view – only an illusion that the parties to a contract of association are on the same side, and that there is no conflict of interests among them. In fact, one should not overlook that the field of co-operation among a company's partners falls mainly out of the object of the contract of association. Profit is made by the company in the outer relationships, where the contract of association is not effective. In this respect, the corporate contract has only a very general impact: the company, which enters into the profit making relationships, is founded by this contract. But apart from the declaration of formation of the company the other covenants of the contract of association refer to the relationships among the partners, where a conflict of interests may prevail.

IV. The Consequences of the Common Features of Contracts of Association

Chapter III discusses two features that are particular to the contracts of associations: first, that they are generally real contracts and second, that they generate rights and obligations not towards the contracting parties, but towards a newly formed entity, i.e. the association. These features have some further implications in the law, which are worth examining.

The contract law has a special structure. It consists of two parts: general rules and the regulation of specific contracts. The general contract law regulation is applicable to all contracts (whether or not they are regulated as specific contracts) except for the cases when the special rules dictate it otherwise. To the extent that we treat the act of formation of an association as a contract, this approach entails the application of the whole general contract law regulation in the law of associations. In the case of those associations that are regulated within the Civil Code as specific contracts, this connection with the general rules follows simply from the structure of the code. For those associations that are regulated in separate acts, the connection with the general contract law should be specifically provided. Such a provision can be found in the Companies Act. Section 9(2) prescribes that for the legal relationships among the partners and between the partners and the company, concerning their personal and financial affairs, the Civil Code shall be applied if the Companies Act does not provide otherwise.

This rule ties the entire company law to the Civil Code. But it is not all the same to which part of the Civil Code is company law bound. In different fields of regulation, the Code applies different methods of regulation. In the field of law of persons – including legal persons – the regulation was mandatory, while the law of contracts is generally regulated by default rules, i.e. they are applicable only if the parties to the contract do not agree otherwise. If we implemented the company law regulation and the contract of association into the system of civil law as if the contract of association was a simple specific contract, then the principle of freedom of contract would prevail. However, this idea is not acceptable for those who think that in company law the regulation should focus on the companies as institutions (sometimes institutions having social importance) and not as contractual relations between the partners. This approach was very strong at the time of preparing the Companies Act 1997. It was in my opinion an exaggerated reaction to the fact that under the former Companies Act many economic frauds were committed by companies. It was thought that if the company law regulation was made stricter, the companies would not be able to pursue their activities, which would be at the detriment of other companies, business partners, consumers and the society as a whole. Therefore, the former regulation, which basically consisted of default rules was turned into a regulation where the basic principle is the application of mandatory rules. The members of the companies may deviate from the rules of the Companies Act 1997 only if it is specifically allowed by the act.[22] This regulation demonstrated that the legislator did not want the company law to have its roots in the contract law, because the method of contract law regulation and the idea of freedom of contract did not fit to the legislator's vision of the companies. Fortunately, the mandatory regulation is valid only for the Companies Act 1997, but as far as general contract law rules are applicable for contracts of association, they preserve their character, i.e. their application is generally not compulsory.

Though the rule regulating the co-operation between the Companies Act and the Civil Code seems to be simple and clear, there are some problems in the practice, because it can be a matter of qualification whether a certain question is regulated by the Companies Act – and being so the application of the Civil Code is excluded – or not. Sometimes the resolution of such a dispute is depends on how the question is formulated. For example, the Civil Code contains a rule about the modification of a contract by court decision.[23] This rule says that the court is entitled to modify a contract if the contract constituted a long-term legal relation between the parties, and after entering into the contract, the circumstances change to an extent that due to the changes the fulfilment of the

[22] S 9(1) of the Companies Act
[23] S 241 of the Civil Code

contractual obligations in their original version would harm any party's interest. The court practice adds to these conditions that only those changes could be taken into consideration, which were unpredictable at the time of making the contract. The Companies Act does not provide the modification of contract of association by the court, but it certainly gives some rules about the procedure of the modification by the members of the companies. When a plaintiff brings an action and requests the court to modify the contract of association by the application of the Civil Code, the courts examine whether or not the plaintiff's claim is covered by the Companies Act. Then a play with the questions can be started. If we ask whether the Companies Act gives any regulation about the modification of contract of association, then the answer must be in the affirmative, consequently, the application of the Civil Code is excluded. However, if we ask whether the Companies Act regulates the modification of contract of association by the court, then the answer is in the negative, and the way to the application of Civil Code is open. The Supreme Court formulated the first question and resolved the dispute by dismissing the claim.[24]

Even if we can solve the basic problem of whether or not to apply the general contract law rules of the Civil Code in the field of contracts of associations we still have some problems with the application of these rules. As I tried to demonstrate, the contracts of association have such peculiarities, which necessitate an adaptation of general rules to the special features of these contracts. I will highlight two areas of regulation and practice where such fine-tuning is inevitable, namely the breach of contract and the invalidity of contracts.

V. Breach of Contract

1. The Identity of the injured party

Normally, if a party breaches a contract, the consequences of the breach occur at the other party, and the sanctions provided by the law will be imposed against the party in breach by the other party. However, in the case of contracts of association the picture is more complicated. As I have described earlier it is a basic characteristic of these contracts, that the contracting parties are not obliged towards each other, rather towards the association founded by the contract (see Chapter III, above).

[24] Bírósági Határozatok (Court Decisions – a monthly periodical published by the Hungarian Supreme Court; hereinafter referred to as BH) 1994/610

This feature of contracts of association is articulated also in court practice. There are cases in which the Hungarian Supreme court decided that if a party to an economic association does not fulfil its obligation under the contract of association, especially if it does not perform its promise to transfer its capital contribution to the company, an action could be brought to the court only by the company itself and not by its members.[25] It shows clearly, that instead of the contracting parties the association becomes the obligee under the contract of association. This conclusion is backed also by the rule of the Companies Act under which the company (and not the other members) has the right to claim compensation for the damage that was caused by a member by failing to perform the capital contribution.[26]

2. Exclusion and Limitation of Liability for Breach of Contract

Under certain conditions, the Civil Code allows the contracting parties to exclude or limit their liability for breaching the contract.[27] Such a limitation does not necessarily break down the equilibrium of the contract, because the parties can evaluate their risks and adjust their obligations according to the other party's promises. Since the interests of the contracting parties are at stake, and the parties are generally in a bargaining position, they can efficiently defend their own interests.

In the case of a contract of association the contracting parties do not become obligees towards each other, therefore, if they exclude or limit their liability for breach of contract, the harmful effect of such a covenant will hit the association who is not a party to the contract and cannot protect his interests. Furthermore, the parties' obligation to transfer capital contribution to the association does not serve exclusively their mutual interest, or the interest of the association, but through providing the association with an initial capital the interests of company creditors are served as well. But the creditors are not involved in the corporate affairs, they are not parties to the contract of association, thus it would be unreasonable to expect them to protect themselves. This task must be completed by the law.

As a conclusion of the above-mentioned points, I argue that the exclusion or limitation of the liability for breach of contract of association would not be acceptable.

[25] See BH 1996/355.
[26] S 13(3) of the Companies Act
[27] S 314 of the Civil Code

3. Special organisational consequences of the breach

The system of sanctions in the Civil Code is designed for the general structure of the contracts and cannot take into consideration special needs of certain specific contracts. The contract of association constitutes an organisation in which the partners co-operate with each other in order to turn into reality their common aims. If the breach of the contract of association makes impossible the co-operation among the parties, then the general financial sanctions can prove to be insufficient.

Therefore, the Companies Act provides that if a partner of an economic association does not transfer his contribution in time, the management of the company has to call the member of delay to fulfil his obligation within 30 days, and if this additional deadline is also missed, the party in breach ceases to be a member of the company without any further action.[28] It means that after the additional time limit the company cannot enforce specific performance, while under the general civil law rules such a claim would be legitimate in any case.

Furthermore, the rules of associations provide additional sanctions for the case of breach of the contract of association. At the associations, which are mere contractual relations, the right to terminate the contract is an extra consequence, while in the case of incorporated associations the partner in breach of contract (other than delay with transfer of capital contribution) can be expelled from the association, if his membership would jeopardise the company's aims.[29]

VI. Invalidity of the Contract of Association

If the associations are founded by a special type of contracts, then the general contract law rules regulating the invalidity of contracts shall also be applied to them. According to the Civil Code a contract is invalid if the contractual will of a contracting party, the expression of the will, or the aimed legal effect of the contract suffers in such a serious deficiency that the law cannot allow the contract to take legal effect aimed by the parties. The concrete causes of invalidity are numerous and quite different. A contract can be invalid for example if the contracting party was incapable at the time of concluding the contract (e.g. a minor under 14), if the law prescribes that the contract should be concluded in written form, and the parties omit to put the contract in writing, or if the contract is illegal, i.e. the parties' aims are against the law.

[28] S 13 of the Companies Act

[29] See for example S 575(2), 578/D of the Civil Code, S 49(1) of the Companies Act

The invalidity can emerge in two forms. Some causes of invalidity result in a contract being voidable, that means that the contract is invalid only if the injured party or otherwise interested person expresses his will to declare the contract invalid. Such a decision can be made within a one-year period. The contract is voidable for example in the case of misrepresentation or excessive disproportion between the performance and the counter-performance.

The other form of invalidity is the category of null and void contracts, which are invalid without any further statement from the parties. For example, an illegal contract is void whether or not the parties challenge the contract. Claims based on the invalidity of a null and void contract can be enforced without any time limit.

These rules can properly work in those relations where the contracting parties owe their performances to each other, and the contract has no third party effect. But, as it was discussed earlier, the contract of association has a different structure. The main contradiction following from this special structure is that as a result of the contract of association a new legal entity may be established whose existence is not dependent on such circumstances which are unknown for those third parties who enter into any connection with the association. It would be especially unacceptable if the validity of the contract of association was a function of the untraceable will of the parties, and for example, the creditors had to bear the risk of vanishing of the association.

The picture is further coloured by the fact that the associations having legal capacity are entered into a register which is intended to be authentic and open to the public. It would be hardly explainable that a company whose existence was confirmed by the authentic register can be deleted from the register because of the invalidity of the contract of association.

This contradiction is handled in Hungarian law by the legislation on the firm register.[30] Since the associations being independent legal entities must be entered into the firm register, the special regulation on invalidity of contract of association is applicable to all of them. The essence of the regulation is that after the court of registration made its final decision on the registration of a firm, the contract of association on which the registration is based, cannot be challenged any more, and one can refer to the fact that the contract is null and void only if the cause of invalidity is among the causes listed by the Firm Registration Act. The said list is very limited, containing only the most serious and, therefore, least frequent mistakes of contracts of association.[31] It is easy to see the connection between this regulation and the First Company Law Directive of the European Economic Communities, which follows more or less the same logic of regulation.

[30] Act No. CXLV of 1997 on the firm register, on the publicity of firms and on the procedure of the courts of registration (hereinafter referred to as Firm Registration Act)

[31] The list of relevant causes of invalidity can be read in S 48 of the Firm Registration Act.

Apart from the relevant causes of invalidity another deviation of the Firm Registration Act from the Civil Code is that it determines who is entitled to start an action based on the invalidity of the contract of association. While the Civil Code provides that anybody can refer to the voidness of the contract,[32] the Firm Registration Act says that the voidness of the contract of association can be referred to (even on the basis of a good reason) by the public prosecutor and by a person who can make likely that he is legally interested in such an action. The role of public prosecutor backs our proposal that in this case the public interest is also protected by the legislation.

VII. Conclusions: The New Civil Code and the Contract of Association

I hope that the above arguments have some conclusions, which can be used in the drafting of the new Civil Code. I summarise these proposals as follows.

1. I think that the drafters should weigh thoroughly at what level the attributes of a specific contract can be determined. It would be a mistake to use the same technical terms for different contracts. I am positive that the financial affairs of the cohabitants must not be regulated as associations. The contracts, constituting associations differing in their merit, should be referred to differently.

2. The connection between the new Civil Code and the Companies Act must be regulated more transparently. We should avoid that the application of the Civil Code in the company law become a function of accidental and uncertain court decisions, which can be changed as the court reformulate the legal problem to be solved.

3. It is clear that the rules of the breach of contract cannot be applied without changes in the field of contracts of associations. The differences should be clearly articulated either in the Civil Code or in the Companies Act.

4. Special treatment of the problem of invalidity of contracts of association is necessary only in the case of associations that are registered in a public and authentic register. For these the relevant causes of invalidity should be limited after the registration happens.

It does not seem justifiable that the question of invalidity should be treated differently in the case of firms and other incorporated bodies. Since the same requirements have to be met and the same interests are at stake (namely the public order or the safety of the market mechanisms), the solution of the problem of invalidity must be also the same.

[32] See S 234(1) of the Civil Code. It is worth mentioning that the courts interpret this rule narrowly, and they acknowledge the right to refer to the voidness of those persons, who have justifiable interest in doing so.

RESÜMEE

Der Gesellschaftsvertrag als ein Vertragstyp im neuen Bürgerlichen Gesetzbuch

ANDRÁS KISFALUDI

Bei der Vorbereitung des neuen Bürgerlichen Gesetzbuches muß der Gesetzgeber die theoretischen Grundlagen aller zu regelnden Institutionen erneut unter die Lupe nehmen, um die Detailfragen der Regelung effizient beantworten zu können. Im Hinblick darauf untersucht die Studie, auf Grund welcher begrifflichen Merkmale der Gesellschaftsvertrag als ein einheitlicher Vertragstyp konstruiert werden kann. Als Ergebnis der Prüfung stellt die Studie fest, daß es keine akzeptable Lösung ist, wenn in einem Kodex für im Prinzip unterschiedliche Institutionen die gleichen Begriffe verwendet werden, und inhaltlich verschiedene Verträge als zum gleichen Vertragstyp gehörend behandelt werden. Um alle Institutionen, die zurzeit als Gesellschaft behandelt werden, dem Begriff Gesellschaftsvertrag zuordnen zu können, müssten die gemeinsamen Merkmale auf einer sehr hohen Abstraktionsebene definiert werden, was die Effizienz der Begriffsbildung und die Verwendung dieses Begriffs als juristischen Terminus gefährden würde. Da die Regelung der Wirtschaftsgesellschaften aller Wahrscheinlichkeit nach außerhalb des neuen Bürgerlichen Gesetzbuches bleiben wird, während die Regeln des Vertragsschlusses im Kodex enthalten sein werden, müssen die Prinzipien und Regeln der Zusammenwirkung der beiden Normen sorgfältig erarbeitet werden. Es ist unvermeidlich, den Vertragsbruch bei Gesellschaftsverträgen speziell zu regeln, denn im Gegensatz zu den Verträgen über Warenaustausch verpflichten sich hier die Parteien nicht unbedingt gegenseitig zu Leistungen, sondern grundsätzlich wird die zu gründende Gesellschaft zum Gläubiger der Leistung. Ähnlich können auch die allgemeinen Regeln über die Unwirksamkeit von Verträgen nicht ohne weitere Überlegungen angewendet werden, denn mit dem Gesellschaftsvertrag entsteht ein selbständiges Rechtssubjekt, das überdies auch im Marktverkehr erscheint und auch mit Dritten in Vermögensverhältnisse tritt. Es können also die auf die Beziehungen der Parteien unter einander zugeschnittenen Rechtsfolgen nicht an die allgemein formulierten Unwirksamkeitsgründe geknüpft werden. Die spezifischen Regeln der Unwirksamkeit dürfen nicht ausschließlich auf die Unternehmen beschränkt werden, sondern sie müssten auf alle juristischen Personen angewendet werden, die durch Eintragung in ein öffentliches Register zustande kommen.