

**NEW RULES ON LEGAL PERSONS AND THE
DRAFT OF THE NEW CIVIL CODE OF
HUNGARY**
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1. INTRODUCTION

The partial reform of the legislation related to legal persons preceded the change of the political and social regime in Hungary. First and foremost, the Civil Code regulated foundations (as legal persons) only in 1987 because the Code created in 1959 could not enclose this legal entity due to ideological reasons since the socialist state ‘cared’ for everybody and no private initiative need in the social state for charity purposes². According to the provisions in 1987³, foundation could only be established for the public good and to serve public interest, thus it constituted the legal basis of charity and endowment in the private sphere. In 1988⁴, the act of commercial companies was created, based on which private persons and others could establish commercial companies and conduct business freely.

Extensive transformation of private law followed the political change in 1989/1990, this short paper, however, addresses only the new draft

¹ Act no. IV of 1959 – Civil Code, as amended many times from 1960. Stefan Szászy: *Das neue Zivilgesetzbuch der Ungarischen Volksrepublik*, Rabels 26 (1961) 553-573.

² Kecskés László: *Az alapítványi jog fejlődéséről* [The development of foundation law] 35 *Magyar jog* (1988) 104-116.; Csehi Zoltán: *A magánjogi alapítvány* [The private law foundation], Budapest 2006, Hungarian development, 64ff.

³ Law-decree no. 11 of 1987.

⁴ Act no. VI. of 1988 on Business Companies

rules of associations and foundations of the Draft New Civil Code (2011).

The socialist state-owned companies had progressively lost their importance, these legal entities should have transformed into business associations, either to public limited companies or to limited liability companies. The aforementioned transformation was followed by the privatization of such companies. As a consequence, commercial companies, sole entrepreneurs in economy and cooperatives, commercial companies as well as farmers in agriculture became the dominant legal forms.

New forms of legal persons appeared primarily in the non-profit sphere and the number of non-profit organizations is growing from year to year. The number of foundations has grown during relatively few years over 10,000⁵ while their current number exceeds 21,000. The number of associations has also grown significantly⁶, in 2010 were 31,321.⁷ The 1989 act gave widespread freedom for the regulation of associations which reform has taken place recently.⁸ Charity limited liability company has been implemented as a new legal form which is allowed only to pursue public interest and profit cannot be allocated for the members.⁹

The regulation related to cooperatives has changed several times, the legal form itself applies to somewhat 3,000-4,000 cooperatives¹⁰; nowadays many cooperatives transformed to business associations and since then, they have been liquidated or gone bankrupt.

⁵ Between 1990 and 1995 19,585 – Nonprofit szervezetek Magyarországon, KSH 2005 [Nonprofit organization in Hungary, Central Statistics Office 2005] 33.

⁶ Csehi, Zoltán: A civil társadalom szervezeteinek joga Magyarországon [Nonprofit law in Hungary]. Budapest 2007.

⁷ Central Statistics Office 2011, STADAT data – http://poratl.ksh.hu/pls/ksh/docs/hun/xstadat/xsatad_eves/i_qpg005a.html

⁸ Act no. II of 1989 on Freedom of Association

⁹ By Act no. XCII of 1993, modified the Civil code, Section 57-60 of the Civil Code, the rules on charity ltd. was force from January 1, 1994 until July 1, 2009. The new rules are regulated in the Act no. IV of 2006 on business companies. All business company can be a non-profit company also, ony section 4 shall comply with.

¹⁰ Recently Act no. X of 2006 on Cooperatives, however the Draft New Civil Code shall provide a new regime of cooperatives.

Among legal persons, even the legal regulation of churches has to be mentioned, which were regulated by the 1990 act¹¹ by constitutional means unequivocally and churches were recognized as legal persons. This act has been recently replaced by a new act.¹²

2. CIVIL CODE OF HUNGARY OF 1959

In the history of Hungarian private law, the Civil Code was created at the end of the 1950s, more precisely in 1959, during the most difficult years of communism, and it has been in force up to these days. The Code can be characterized as short and concise, although I believe it does not contain several essential rules and it is incomplete. The Code consists of less than 700 sections and it is divided into six parts: the first seven sections comprise the first part of the Code containing general principles; the second part is composed of sections 8-87 about Persons (it encompasses sections 8-25 on natural persons and sections 27-87 on legal persons), the third part can be found under the title Ownership (sections 94-197), then the fourth part contains the Law of Contract (sections 198-596 about General Provisions, Compensation, Unjust enrichment, rules of certain specific types of contracts), the fifth part contains the rules of Succession/Inheritance (sections 598-684.) and the sixth part governs Closing Provisions.

The Civil Code contains rules related to legal persons but this regulation has effectively been voided of its substance by now. Essentially three sections regulate the general provisions of legal persons, which are followed by parts which do not apply anymore e.g. the rules of state-controlled companies. From this part, there are only six sections applicable about foundations and four sections related to associations.

Beyond the Civil Code, several legal persons were created by single acts or as part of other acts. Schools, universities, local governments, water-supply associations, mutual insurance associations¹³ became legal persons and even about 30 different legal persons could be listed with various names and forms. The question of public law entities in private law was in practice especially problematic. For example, when an entity e.g. a parliamentary faction is recognized by public law, it is a problematic question whether or not private law recognizes that as a legal person. Another related problem was the management of state property – how shall the state manage its property: directly or through

¹¹ Act no. IV of 1990 on Freedom of Conscience and Religion, and on Churches

¹² Act no. C of 2011 on Freedom of Conscience and Religion, and on Churches, Religious Bodies and Religious Communities

¹³ Act. no. XCVI of 1993 on Free Mutual Insurance Associations

special state-legal entities? The non-profit law has several different rules in Hungary.¹⁴

In 1998, the preparatory work of a new Civil Code was launched¹⁵, which prospectively ends in 2011 and Hungary will have a new Civil Code by 2012.¹⁶

One of the first questions at the beginning of codification was whether to create the Civil Code in an organic, monist form or commercial law, business associations and commercial contracts should be regulated in a separate commercial act or commercial code. After a long debate, the monist concept was accepted, thus both business associations and commercial contracts will be regulated in a common Civil Code. Another specialty of the new Civil Code is that EU directives about consumer protection by private law will be built into the Code. The third important element is that the new Civil Code will contain the rules of family law which has been regulated in single code since 1952.¹⁷

It also has to be mentioned that Hungarian company law satisfied every harmonized standard of the European Communities and that of the European Union. These were introduced partly in the single act of company law, partly in the capital market act, partly in other acts of the Hungarian law. The Hungarian law contains the legal forms of the legal forms of the European company law.¹⁸

3. DRAFT OF THE NEW CIVIL CODE OF HUNGARY - OUTLINE

The new Civil Code does not contain any general part, does not expand on precepts for legal transactions and does not acknowledge such a general concept of 'contract' as the German BGB (BGB for section 104.). These abstract legal concepts like contract, representation, etc. are still (partly fragmentarily) determined in contract law similar to the recent regulation. The new Civil Code has

¹⁴ Csehi, Zoltán: Nonprofit Organisations in Hungary, in Hopt - von Hippel (ed.): Comparative Corporate Governance of Non-Profit Organizations, Cambridge 2010, 325-378.

¹⁵ Decision of the Government no. 1050/1998 (IV.24.)

¹⁶ On the history of the codification process, see Csehi, zoltán: Überblick über das neue ungarische BGB von 2009, 51 Jahrbuch für Ostrecht 2010, 255-287.

¹⁷ Act. No. IV of 1952 on Marriage, Family and Guardianship

¹⁸ Karel Van Hulle / Harald Gesell (eds.), European Corporate Law, Baden-Baden 2006; Dornseifer (Hg.), Corporate Business Forms in Europe, München 2005; Act no. XLIX of 2003 European Economic Interest Grouping; Act no. XLV of 2004 Societas Europea; Act LXIX of 2006 SCE

the intent to introduce several novelties into Hungarian law. The reform of the ability to act, the regulation of the private administration of assets, the rules of the new concept about associations and societies, the voidance of contracts or collaterals should be mentioned in this respect.

The new Civil Code consists of eight parts, and its scope will exceed 2,000 sections. The parts are the following: I. Introductory rules; II. Human being as legal entity; III. Juridical persons; IV. Family law; V. Ius ad rem – property law rules; VI. Law of obligations; VII. Heritance law; VIII. Closing rules.

From the following, we will outline the structure of the part about legal persons according to the draft of November 2011, and summarize the rules on associations and foundations.

The third Book of the new Civil Code consists of 404 sections, it has a huge scope. Its structure is the following:

Part – general provisions of legal person – sections 1-41

Part – association – sections 42-66

Part – business associations – sections 67-308

Part – cooperatives – sections 309-351

Part – grouping – sections 352-361

Part – foundation – sections 362-388

Part – state – sections 389-390

Part – group of companies – sections 391-404.

From the eight parts, the general rules and the rules of associations and foundations will be presented here shortly.

4. DRAFT RULES ON LEGAL PERSONS – GENERAL RULES

The novelty in the draft of the new Civil Code is the large scope of general provisions related to legal persons. In the 2008 draft, this part consisted of even more than 100 sections¹⁹ which through shortening and long debating resulted in only 41 sections.

These provisions regulate the capacity, liability of the legal person, the freedom of establishment, the minimum requirements of the deed of foundation, the name, seat, activity and assets of legal persons and also the freedom of determining the content of deed of foundation.

¹⁹ Vékás: Über die Expertenvorlage eines neuen Zivilgesetzbuches für Ungarn, ZEuP 2009, 536ff.

Legal persons come into existence through court registration. The nullity of the deed of foundation is regulated separately. The organization of the legal person consists of the supreme body and the management, the draft regulates the manner of convene, quorum and decision-making of the supreme body. It also regulates incompatibility rules, the duty of confidentiality, nomination, withdrawal and liability of members of the management. In order to ensure the supervision of the shareholder, quotaholder, or founder the draft makes for every legal person possible to set up a supervisory board. There are single provisions for the representation of the legal person. Legal person is under state supervision, its legality is supervised by courts, and member of the legal person has the right to bring an action against the decisions of the legal person. Every legal person can nominate an external auditor. Legal persons have the possibility to transform, merge and demerge. This part closes up with the provisions related to the – winding up or – cease of judicial person. A separate act contains the rules of liquidation and bankruptcy which are not part of the new Civil Code.

General provisions of legal persons originate partly from the general part of the actual act of business associations²⁰; while its other part is determined by case law. It is important to know that these provisions are applicable to every legal person, so in case of a given legal person as the foundation, the general provisions shall apply the same way as in case of e.g. a limited liability company.

5. DRAFT RULES ON ASSOCIATIONS

The Civil Code of 1959 provides only four sections for associations (§§61-64), in addition to the rules on so called “social organisations”, a special form of associations. The law on associations recently is a case law, a judge made law.²¹

The New Civil Code will provide 25 sections in addition to the general rules on legal persons, all together over sixty sections relate and applicable for associations. This is an essential extension of written legal provisions on associations. In the structure of the New Code the rules on associations will follow the general rules for legal persons, and rules on business companies will follow the associations.

The possible goal of the association is not changed, association can be created for any purpose with two restrictions: the association cannot

²⁰ Act no. IV of 2006 on business organisations

²¹ Lomnici Zoltán: Az egyesületek. 2. bőv. kiad. [Associations, 2nd. enlarged ed.], Budapest 2006 – a collection of case law by topic.; Közigazgatási-Gazdasági Döntvénytár [Cases in Administrative and Business Practice of the Supreme Court], especially the issue 1999/8-9 on foundations and foundations of public law, and issue 2000/8-9 on registered NPOs and civil organizations – KGD.

do business as primary purpose and the goal and activity of the association shall not violate the constitution. Religious activity shall comply with special rules²², political activity is governed by separate act.²³

The right to be a member of the association is not a personal right, this right can be exercised by proxy. The membership is not transferable, it cannot be inherited and does not constitute any quota in relation to the asset of the association. The member is not a quota-holder of the association, the member has no right to the asset of the association. The New Code will introduce the possibility of termination of the membership, the member can terminate at any time his membership, where the association can terminate the membership only if the member does not comply with the requirements of the deed of association. The member can be excluded by the association if the member violates the deed or law.

The deed of the association can be freely drafted by the members; the rules on the general meeting, its competence, the detailed provisions to convene, place, quorum, voting, protocol of the general meeting shall be laid down in the deed of association. The general meeting has exclusive competence to modify the deed, to make a decision on winding up, merger and demerger of the association, to accept the annual report, appoint and withdraw the member of the board and the member of the supervisory board. The management of the association can be a single manager or a body, the management can be appointed by the members of the association. The deed of association may allow non-members management to be elected, in this case up to one third of the members of the management board can be elected by non-members. The New Code gives rules on the competence of the management.

A supervisory board is to be elected if the number of the associations exceeds one hundred, or more than a half of the members are not natural persons (legal persons). Legal disputes between the organs of the associations, or between members and association can be decided by arbitration.

The remaining asset of the association, after its termination, shall be transferred to a nonprofit organization defined in the deed of association. If the deed does not define any person, the registration court shall make a decision on the remaining asset. If the association ceases to exist without any legal successor, and the association has a claim against its management, the member has a right to bring legal action against the management within one year from the date of the deletion of the association from the court register.

²² Act no. C of 2011 on Freedom of Conscience and Religion, and on Churches, Religious Bodies and Religious Communities

²³ Act no. XXXIII of 1989 on Political Parties

Special rules for sport²⁴, assurance²⁵ and other special activity associations²⁶ will be amended accordingly.

6. DRAFT RULES ON FOUNDATION

The regulation related to the establishment of a foundation (as a legal person) will not essentially be changed by the draft; a deed of foundation and its registration into the court register is necessary in order to establish a foundation as a legal person. The foundation is capacitated by the act of registration.

A foundation can be established by deed of foundation, testament or contract of succession. A special form of establishment by testament is the establishment by the legacy of the testator, in which case the founder will be the person burdened by the legacy. According to the draft, this kind of trust can be enforced by the state prosecutor.

As far as the foundation is concerned, the most important novelty is that foundation can be established not only to pursue a 'long-term public interest' (section 74/A (1) of the 'old' Civil Code), but also for private purposes. The foundation can be established only for 'long-term', continuous attainment, for single, temporary goals, there is the foundation grounded by legal transaction as the right form (which will be presented briefly below). It will be possible to establish the so-called 'family foundation' and foundation for conducting non-commercial, but economic business. The foundation's goals cannot aim at the infringement of law or against morality; its primary activity cannot be commercial business activity. However, the draft does not specify the meaning of 'primary activity'. Except for 'family foundation', the beneficiary of the foundation cannot be the founder, the joiner, the trustee and the members of management and their relatives. The draft contains explicit rules about the disqualification and incompatibility of beneficiaries.

The limit for the operation of foundations is the inability to establish a foundation (which was already expressed by the earlier case law, and which became part of the draft). A further limitation was introduced due to which foundations cannot join another foundation. Latter means that the activity of the foundation has to be direct, this activity has to be performed by the foundation itself, e.g. its property has to be used directly for the realization of the goals signed in the deed of foundation thus its activity becomes more controllable. The property of the foundation is secured to some extent also by further rules: it cannot be a member of another legal entity with unlimited liability; it can only conduct commercial business activity as a secondary purpose

²⁴ Act. no. I of 2004 on Sport

²⁵ Act no LX of 2003 on Assurance and Assurance Activity

²⁶ Act. no. XCVI of 1993 on Free Mutual Insurance Associations

with the restriction that its output cannot be materialized for the founder, the joinder, the trustee or the members of management.

The draft intends to introduce several new legal definitions into the law of foundations, as the definitions of the joinder, the beneficiary and their legislation. The joinder is not a founder because the foundation is already established; the joinder provides assets or endowment for a registered foundation in return for the exercise of rights stated in the deed of foundation. These rights, as the right of information or presence at decision-making procedures, are determined by the founder freely. In case, the founder decides for that, the joinder can get founder's rights as well. In this case, the draft shall state that the joinder can exercise his founder's rights collectively with the founder or in case of more founders, with the founders.

The beneficiary is entitled economically, for the beneficiary provides the foundation its services to reach its goals. Concerning the beneficiaries, the draft outlines rules regarding the disqualification and incompatibility and it defines who cannot be a beneficiary while it also gives the right to the founder to determine the beneficiaries in the deed of foundation. If the deed of foundation does not contain such provision, the trustee – management – decides both about the personality of the beneficiary and about the nature of his/her support. In case of a family foundation, the draft determines who can be its beneficiary such as the founder, the joinder and their relatives, if the purpose of the foundation is the support of the scientific or art work of the founder or the joinder, the management of their work or the financial support of the devoted care, maintenance and health provision of these persons, or the financial support of their studies through scholarship or any other means.

As far as the operation of the foundation is regarded, the new regulation eases the hostile nature of the Hungarian case law towards the founders, in case of more founders, it does not always demand the consensual decision of the persons involved. The founder's rights will be transferable but not heritable. The founder can authorize the management body to exercise certain founder's rights, while another person can also be appointed for the exercise of founder's rights as a whole (latter was possible in our former law as well).

Regarding the organization of the foundation, the draft regulates the management body and it determines that as the executive and representative body of the foundation. The members of the management body can be appointed by the founder but other solutions can also be specified in the deed of foundation. The revocation of members of the management body is only possible in case the management endangers the purposes of foundation. A supervisory committee can be set up in order to control the management body which committee provides control for the founder. There is another change in the provisions compared to the former case law, since the new regulation outlines that further executive, consulting and supervisory bodies can be created through the deed of foundation. The draft contains more rules concerning the property and the assets of the

foundation compared to the current regulation: the founder must provide the assets for the foundation within a year from the registration, and the management body is entitled to demand these assets in the name of the foundation. In case the founder does not fulfill this obligation, his/her founder's rights could be suspended by the supervisory court. In case of the withdrawal or the cessation of the foundation, the persons indicated in the deed of foundation are entitled to receive the remaining assets after the satisfaction of creditors with the special limitation that the assets, which could be provided for the founder, the joinder or the grantor or their relatives, cannot exceed the assets which were provided by these persons.

Concerning the rules of withdrawal or cessation of foundations, the provision could be emphasized, which is contained by the general provisions of the draft and which enable the transformation of the foundation. The possibility of the merger or demerger of foundations could also be enumerated here.

The legal supervision of the operation of the foundation will be provided by the public prosecutor.

Similar to the old Civil Code, the new Civil Code recognizes the form of the so-called foundation grounded by simple legal act; however, it can only be established for public purposes. The historical roots of the regulation go back to the 1959 Civil Code, since the 1959 Civil Code did provide for the establishment of foundations due to ideological reasons, instead it regulated the undertaking of a public obligation as special obligation which is the same as the foundation grounded by legal act. The draft also contains in four sections the legal transaction for the undertaking of a public obligation. Any person could undertake an obligation for providing free financial assets for a determined public interest. These assets shall be delivered by the grantor for asset management. This person handles these assets for realizing the special public interest. In case the grantor does not appoint the person for asset management, the court appoints this person based on the action of the state prosecutor. The draft regulates the withdrawal of such trust and also the cessation of the undertaking of obligation.

7. NON-PROFIT COMPANIES

The Act no. IV of 2006 introduced into the Hungarian legal system the so called non-profit company. Before that, from 1993 the charity limited liability company was the charity form of business companies. Charity limited liability company could have been established only for public benefit purposes and the non-distribution constraint was applicable. Since 2006 non-profit company can be established in different forms, such as limited liability company, or partnership, or limited liability partnership, or limited liability company by share, but the “public purpose” requirement was eliminated. The non-profit company cannot do business for profit sharing but the “charity” purpose is not required and no other restriction given except the non-distribution constraint. It is doubtful whether non-profit companies will survive the New Civil Code or not.

The new charity law²⁷ is recently discussed in the Hungarian Parliament, the old act will be replaced soon.²⁸

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²⁷[Charity and donation law in Hungary], Gemeinnützigkeits- und Spendenrecht in Ungarn, in R. Walz-L. von Auer – Th. von Hippen (Hrsg.): Spenden- und Gemeinnützigkeitsrecht in Europa, Tübingen 2007, 511-570.

²⁸ Act no. CLVI of 1997 on Nonprofit Organizations