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Manuscripts and editorial correspondence should be addressed to

ACTA JURIDICA HUNGARICA
H 1250 Budapest, P.O. Box 25
Tel.: (36 1) 355 7384 Fax: (36 1) 375 7858

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STUDIES

MAGYAR
TUDOMÁNYOS AKADÉMIA
KÖNYVTÁRA

This year, late Professor Gyula Eörsi (1922-1992), member of the Hungarian Academy of Sciences, editor-in-chief of this periodical for decades, would be eighty years old. The editorial board of Acta Juridica Hungarica, his friends, disciples and colleagues pay their tribute to the memory of the editor-in-chief and the professor with the following essays.

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ATTILA HARMATHY*

Hungarian Civil Law since 1990

Abstract. The paper outlines some trends in the development of Hungarian civil law since the political changes. The role of certain social factors having an effect on civil law and trends in court practice are focused upon. In the law of torts the decline of the respect of the State seems to have an importance in recent chases. In the field of contract law problems connected with different kinds of risks are reflected. Both property law and contact law have been concerned in cases where principles of the protection of the owner and those of the protection of bona fide purchaser has been in contradiction. As a result of the growing importance of credit the role of secured transactions has increased.

Keywords: social changes and civil law, torts, contracts, property law, secured transactions

1. The topic of the essay wishes to establish a link with that of one of Gyula Eörsi's works ("On the law of the change-over to a new system of economic management" A gazdaságirányítás új rendszerére áttérés jogáról). This has not really been the only one of his works dealing with the legal solutions of a new era. Ever since the 1930's, Hungarian lawyers faced the question of legal transition appropriate for a new stage of history in short periods of time. It is thus understandable that in several works by Gyula Eörsi the analysis of the legal consequences of changes takes center stage. This essay to be published in the volume in honour of Gyula Eörsi corresponds also with its choice of topic to the goals of preparing such a collection. I consider the analysis of the topic for other reasons as well. The time that has elapsed since the collapse of the Communist system is not long, the first period of transition had nevertheless passed, a new phase has begun. The tendencies of the new paths of legal development should be analysed to prepare the ground for future steps. A short essay is naturally nothing else but one of the contributions necessary for completing the great work.

* Attila Harmathy, Member of the Hungarian Academy of Sciences, judge of the Hungarian Constitutional Court, Budapest, H–1015 Budapest, Donáti u. 35–45., Hungary. Fax: 36 1 488 3170; E-mail: harmathy@mkab.hu

2. As an introduction, may I first of all make a remark of a personal nature. I had been in contact with Gyula Eörsi since 1957. I listened to his lectures at the university, took part in his seminars and I considered it a great honour that without regard to the difference of the level of knowledge between the two of us, he seriously considered my attempts at presenting views differing from his own. Our contact did not come to an end when I was not allowed to get a job in a legal field after the university. Later, it was by his intervention that I found a position at the Institute for Legal Studies of the Hungarian Academy of Sciences and I had been working for two decades under his guidance. He created possibilities for me to work, to learn, to appear in international scholarly circles. I was, however, maybe most grateful because he did not wish to influence me, but allowed me to follow my own path. He provided me with complete independence in research, organisation of research and library-building (the foundations of later work). I wished to learn a lot from him, but maybe first of all his style of leadership allowing for freedom of scientific research. During our long-lasting relationship the opportunity sometimes arose to express my thanks in public. The same is now expressed by this writing to be included in the volume to be published in his honour.

3. Political factors played a decisive role in the transformation of civil law during and following the time of the change of political system; the essay does not, however, deal with these, as their effect may be regarded as well-known. The basic topic of the present work is the effect on law of changes in society and the economy.

In the recent years there has been a growing interest towards developments taking place in the countries of the previous Communist Bloc. From all the conclusions of the many studies concluded in this area, here and now I only wish to point out that the role of sociological and political factors is more and more recognised, what is more, there is even a view which regards these as more important regarding the process of transformation than economic ones.[1] A considerably influential school of economics highlights that, also from the viewpoint of the transformation process, basic institutions defining the framework, the rules of the process (e.g. property law, contract law) play a decisive role. These institutions change only slowly, as they

[1] Furubotn, E. G.: Legal reforms in Russia: visible steps, obvious gaps and the invisible hand? Comment. *Journal of Institutional and Theoretical Economics*, 2000. 120.

are tied to human consciousness, and consciousness changes only over a longer period of time.[2]

In the following I shall not deal with those areas of civil law, the basic rules of which are in direct connection with the changes of the political system, as these may be regarded as well-known. Thus, basic rules of privatisation, the freedom of enterprise, rules on entrepreneurship and company law, moreover the rules of competition law which are unavoidable in today's market economy form a basic ingredient in the transformation of civil law. The creation of the rules pertaining to these areas brought about a spectacular change, the formation of new fields of law. Their spreading indirect effect, the role they play in the transformation of civil law thinking is only fulfilled in correlation with other factors, in connection with the changes of society and the economy.

The present essay also does not include analysis of rules of law included in Acts of Parliament or other statutes. I have been driven by the endeavour to try to present phenomena observed in court practice, as opposed to the general approach which tends to concentrate too much on statutory law.

4. The scientific approach stressing the importance of institutions and social development stands in opposition to the neo-classical economic theories, almost dominant in the 1980's, which regarded the market mechanism as playing the definitive role, wished to minimise the role of the state and disregarded social and cultural factors. The other school (the role of which may also be observed in the activity of the World Bank), gaining more and more ground since the end of the 1980's against neo-classical economic theory concentrates on social transformation and analyses also the factors of policy and state institutions significantly influencing social transformation.[3]

The above-mentioned factors seem distant as regards the institutions of civil law and their analysis is often disregarded in discussing changes of civil law. Studies of the transition process analysing the issue from several, non-legal points of view do, however, regard the transformation of the system of institutions including those governed by civil law as well as their social

[2] North, D. C.: Big-Bang Transformation of Economic Systems: An Introductory Note. *Journal of Institutional and Theoretical Economics*, 2000. 5–7.

[3] Castles, S.: Studying Social Transformation. *International Political Science Review*, 2001. 17–19.

effect as having fundamental importance.[4] Thus, the endeavour at the basis of the present essay to analyse the changes of certain fundamental social institutions in connection with social and economic factors is in line with the view of several authors. Here, the stress is placed on changes occurring in a relatively shorter span of time, and a mention of processes lasting several decades is only made insofar as this is necessary for understanding the developments of the past ten years.[5]

5. In Hungary the consequences of the demographic situation must be taken into account in bringing about decisions of legal policy, also in the area of civil law. Highlighting two phenomena seems to be necessary in this context.

One of the factors to be considered is the decrease of the population of the country, which had to be counted upon since the beginning of the 1950's. Policy decisions born in 1953, 1968, 1973 and 1984 to counter the danger brought, however, only short-lasting, temporary results. The economic problems appearing and later strengthening already before the political transition period nullified even the temporary effects of these population policy measures. The situation turned critical in the 1990's.[6] What we are really dealing with here are the consequences of a negative trend in effect—with short lapses—for a longer period of time. The current situation is represented by the following data:

The rate of live births per 1000 population in 1930–1931 numbered 34.6 a year, in 1959–1960 14.9 a year, in 1989–1990 12.0 a year and in 1999 only 9.4 a year.[7] This is coupled with the increase in the death rate which may be observed since the end of the 1960's. The rate had been per 1000 population

[4] Tian, G.: A Theory of Ownership Arrangements and Smooth Transition to a Free Market Economy. *Journal of Institutional and Theoretical Economics,* 2001. 381, 383.; Blommestein, H.—Marrese, M.—Zecchini, S.: Centrally Planned Economies in Transition, in: *Transformation of Planned Economies* (ed.: H. Blommestein—M. Marrese), Paris, 1991. 12–13.

[5] Changes within a longer span of time were analysed in: Harmathy, A.: A polgári jog a századfordulón. *Jogtudományi Közlöny,* 2000/4, 117–125.

[6] Miltényi, K.: Népesedéspolitika (Policy of demographic). In: *Demográfia.* (Ed.: Kovacsicsné Nagy Katalin), Budapest 1996, 477–479., Vukovich, Gy.: A magyar népesedéspolitika néhány vonatkozása (Some relations of Hungarian Policy of democraphic). In: *Magyarország történeti demográfiája (1896–1995) [The historical demography of Hungary (1896–1995)].* (Ed.: Kovacsics, J.), Budapest, 1997. 395.

[7] Központi Statisztikai Hivatal, *Demográfiai évkönyv 1999. (Hungarian Demographic Yearbook 1999*), 84.

in 1930–1931 16.1 a year, decreasing to 10.3 a year by 1959–1960, then rising to a level of 14.0 by 1989–1990, the rate for 1999 having been 14.2.[8] The decrease in the number of births, the growing number of deaths resulted—as opposed to previous slow growth—in a decrease of 300,000 in the country's population between 1980–1989; the decrease in population in one year had been 19,981 in 1990 and already 48,565 in 1999.[9] Available data show a decrease in the rate of population loss for 2000 and 2001.[10]

The second factor to be considered is the negative change in the proportion of age groups within the population. In comparison with the whole of the population, the proportion of people between ages of 40–60 was 20.1% in 1930, 25.3% in 1980 and 27.9% in 2000; the proportion of those above 60 was 9.8% in 1930, 17.1% in 1980 and 19.7% in 2000.[11] Before the transition the majority of men above 60 and women above 55 were employed, however, already by 1989 a significant change has taken place. Comparative data of 151 countries show Hungary to be in one of the most unfavourable positions. The proportion of economically active persons to the whole of the population had been 44.4% in 1949, dropping to 36% by 1994.[12] Inactive persons per 100 economically active persons in gainful employment numbered 107 in 1975, 119 in 1988 and 174 in 1994.[13]

6. The decrease in population shall have a considerable long-term effect even if population policy and family protection measures will be able to reverse this unfavourable development, even if a favourable change occurs. The death rate deserves a special attention in this regard.

The growing rate of accidents among the causes of death is once again not in connection with the changes of the past ten years, although the economic-social system does have a secondary effect alongside technological development. Between 1930 and 1949 no significant change occurred in the rate of those dying as a result of accidents, the rate being 2–2.5% of all deaths. In the following period, however, the number of accidents grew fast and continuously. In 1989–1990 accidents represented 5.9% of all

[8] Hungarian Demographic Yearbook 1999. op. cit. 156.

[9] *Hungarian Demographic Yearbook 1999. op. cit.* 2.

[10] A KSH jelenti *(Reports of the Central Statistics Bureau)* 2001/9. 43–44, 88.

[11] *Hungarian Demographic Yearbook 1999. op. cit.* 8–9.

[12] Miltényi, K.: A demográfia egyes gazdasági és társadalmi összefüggései. In: *Demográfia. op. cit.* 533.

[13] Katona, T.: Magyarország társadalmi és gazdasági fejlődése. In: *Magyarország történeti demográfiája. op. cit.* 276.

causes of death. Later the number of accidents has dropped and in 1998 and 1999 the rate of fatal accidents to all causes of death represented 4.7% and 4.6%, respectively. Of all accidents resulting in death, traffic accidents represented around 25% according to relevant data for 1999.[14] Thus, although the significance of accidents is not to be neglected, more than 95% of all deaths occur from other reasons. Thus, in the majority of cases, living conditions and the health-care situation have a prevailing significance. In this area we are once again confronted with a phenomenon developing and having effect for decades. Economic historians have stressed as far back as the 1970's that—partly in connection with the backwardness of social policy—the state has volunteered to provide such benefits in the form of full health care free and accessible for all which were well above all financial means. This step had a damaging effect on the quality of these services and resulted in other areas of tension.[15]

7. The Hungarian situation described above causes grave problems in general, but its effect may also be felt in the area of civil law as well. This is shown by a recent discussion of the topic by Atiyah, which argues that in several European states, an explosion of the demographic bomb may be expected within the relatively near future, as the expenses of the welfare state, including those to be covered within the framework of compensation for damages, will not be able to be covered by the decreasing number of persons in gainful employment. According to the highly regarded author, who has dealt with questions of liability for damages for decades, the state effort for the protection of individuals resulted in a great extension of the sphere of application of compensation for damages, in particular with the spread of insurance for traffic accidents—especially as regards personal injuries. Presently, however, welfare expenditures should be decreased as a result of the decrease of population, and liability for damages should also, as a consequence, be relieved.[16]

[14] Demográfiai évkönyv 1999. (Hungarian Demographic Yearbook 1999), op. cit. 242.

[15] Berend, T.—Ránki, Gy.: A magyar gazdaság száz éve (100 years of Hungarian economy). Budapest, 1972. 315.

[16] Atiyah, P. S.: Personal Injuries in the Twenty-First Century: Thinking the Unthinkable. In: Wrongs and Remedies in the Twenty-First Century (ed.: Peter Birks). Clarendon Press, Oxford, 1996. 7–8.

Hungarian analyses of legal policy should also take into account the financial capacities of society and the connections with the social security system in the formation of civil law institutions. In this context especially the trend of the continuous expansion of liability for damages requires analysis. Liability for damages is connected with a lot of factors and in this complicated system in which, among other things, social consciousness and public opinion play a great role, a place for the risk distributed to individual actors of economic life and the financial capacity of the society should also be found. (The requirement, generally accepted by now, that the regulation of liability for damages should be examined in connection with the system of insurance is well highlighted by the recently published study describing and analysing the Scandinavian system, by Jan Hellner, the highly respected expert of the field.[17])

8. The effect of different factors arising in the sphere of liability for damages are also shown by the officially published court decisions of the last ten years. The fact that such decisions were published does not automatically mean that similar cases arise in great numbers in court practice. However, the fact that the Supreme Court considered it justified to publish a given decision does signal the significance of the issue. Conclusions regarding new phenomena may thus be drawn from these decisions.

It may be pointed out as one of the new trends in tort cases that the practice of an expansion of liability for damages, which may be regarded as prevailing in the 20th century in general, has been continued in Hungary, arriving to ever newer fields. In referring to the existence of certain phenomena, I regard efforts at their introduction as decisive, and not whether or not the court has in fact extended the application of liability for damages (this should be ascertained in further analyses).

Of claims for damages appearing previously only in rare instances or not at all, the following are especially spectacular:

— Claims for damages caused in relation to medical activity arise more frequently. In these cases doctors—in consequence of their role played in the given relationship—command respect and are, in reality, not on an

[17] Hellner, J.: Compensation for Personal Injuries in Sweden—A Reconsidered View. *Scandinavian Studies in Law*, vol. 41, 2001. 249–277.; on the system of liability regulation alongside a partial insurance of liability for damages in general see Honoré, T.: The Morality of Tort Law. In: *Philosophical Foundations of Tort Law* (ed.: D. Owen), Oxford, 1995. 73–95.

equal footing with the patient, the damaged party. Here, making claims in court signals a change in the social perception of the doctor—patient relationship as well as the previously mentioned unfavourable development in the situation of health-care services, besides raising specific issues of liability insurance. Decisions brought in such cases appear in much larger numbers than in the previous era.[18]

— Claims for damages caused by courts had previously been rare exceptions, but may be found surprisingly often since 1990.[19] This fact requires examination from several points of view (which is not, however, the purpose of this essay).

— Previously no claims for damages caused by legislation appeared, following 1990, however, decisions on such claims have repeatedly been published.[20]

9. When discussing in the present paper selected trends one may often draw conclusions as to the joint effect of several factors and it is not clear which of these is of grater importance. The above grouping is thus only of a relative value, it only serves to highlight different factors. Thus in the previous trend, as regards claims for damages caused by courts and legislation, an element of a political nature may well be presumed to exist. The process of political transformation went hand in hand with the downgrading of the role of the state and besides that, the previously also existing but less expressed emotional basis of opposition to the state has surfaced. The more frequent appearance of claims for damages caused by administrative actions may also be a sign of this trend.

Several types of damages caused by administrative actions may be found among the officially published cases. Actions against the police, the organs of law enforcement, the tax authority and the customs office are to be mentioned on the first place.[21] Questions of liability caused by official

[18] Bírósági Határozatok *(Supreme Court Decisions)* (hereinafter referred to as B. H.) cases no. 1992/5. 317., 1995/6. 344., 1998/2. 78., 1998/ 380., 1998/12. 585., 1999/11. 501., 2000/8. 347., 2000/12. 536.

[19] B. H. cases no. 1992/1. 60., 1992/2. 103., 1995/7. 403., 1996/2. 91., 2000/2. 55.

[20] B. H. cases no. 1994/1. 31., 1994/6. 312., 1998/7. 334.

[21] B. H. cases no. 1996/6. 312., 1998/5. 224. 1998/10. 484., 1999/5. 207., 1999/8. 359., 1999/9. 403., 2001/7, 319.

actions also appear in housing, registration and social security affairs and in connection with public road maintenance.[22]

10. Following the transition process, the tendency of placing questions of personal rights in the focus of attention has strengthened. In actions started for an infringement of personal rights rulings on awarding damages for non-pecuniary losses often appeared. A lot of problems await analysis and solution in these two topics. Here we just point out the existence of the phenomenon together with stating that an extension of liability for damages may be observed also in this respect.

11. A different group of cases involving claims for damages may be brought into connection with the build-up of the market economy. I wish to emphasize the following cases of such character (not bearing their relative frequency in mind):

— The borders of the freedom of economic activity are defined, among other things, by the law of torts. In this field the sanctioning of illegal conduct towards market competitors with an obligation to pay damages is especially significant. The first appearance of the question may be found in cases published within the last ten years. Similarly, damages awarded for the infringement of tender rules for privatisation sales are also meant to ensure an adequate functioning of the market.[23]

— The fact that claims for damages have been asserted against receivers in liquidation stands in connection with the effect of the market economy.[24]

— Cases similar to those involving receivers include claims asserted in connection with the negligence of bailiffs, the land registry and the activity of public notaries.[25]

12. In a large part of the listed tort cases of varying subject matter, the previously not mentioned feature that the decision on liability has to be brought in connection with some prefessional activity may also be observed.

[22] B. H. cases no. 1991/5. 209., 1992/1. 57., 1993/11. 677., 1993/11. 679., 1996/12. 638.

[23] B. H. case no. 1998/9. 442 and case no. 1997/5. 246.

[24] B. H. cases no. 1995/11. 663., 1996/12., 654., 2000/1. 25., 2000/9. 417., 2001/10. 488.

[25] B. H. case no. 1998/6. 285., cases no. 1996/11. 587., 1997/5. 224. 1998/3. 131., 1999/1. 25., and case no. 2001/9. 423.

This is understandable, as economic data show an increase in the importance of services.[26] A significant circumstance regarding a decision on liability is the fact that the conduct causing the damage is a professional activity, in which case the ruling depends on an evaluation (of a hidden or open legal policy nature) of the requirements of the given profession and the distribution of risk on a case-by-case basis. This element should also be taken into account when re-evaluating the basis of liability for damages.

13. A social change influencing the whole of civil law to a significant extent has taken place after 1948. In order to picture this well-known process it is enough to refer to certain data published already in 1972 by analysts of economic history: as a consequence of agricultural policy, more than 600,000 people left the agricultural sector, the number of townspeople and city-dwellers has grown by about 1 million, to which around 350,000 commuters should be added; as a result of measures against middle-class citizens, around 400,000 people have lost their previous positions.[27] One of the consequences has been a great social mobility,[28] another one being an acute shortage of housing, described at the end of the 1960's as one of the "most neuralgic areas of tension" of social life.[29]

Great social movement has again occured following the transition process. State-owned companies have practically ceased to exist, cooperative membership numbers have gone into a steep decline, the number of private companies has multiplied in a quantum leap.[30] Of all enterprises, individual enterprises accounted for 58%, limited partnerships for 20% and limited liability companies for 17% according to data for the year 2000.[31]

[26] While the rate of those employed in the services sector was 44.9% in 1989, this number had grown to 59.7% by 1997. see *INFO-Társadalomtudomány* 43. Budapest, 1998. 85.

[27] Berend—Ránki: *op. cit.* 290, 308, 312–313.

[28] Ferge, Zs.: *Társadalmunk rétegződése (About our social strata).* Budapest, 1973. 298.

[29] Szelényi, I.—Konrád, Gy.: *Az új lakótelepek szociológiai problémái (The sociological problems of the new housing estates).* Budapest, 1969. 140.

[30] *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 1990.* Budapest, 1991. 192., *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics)* 1997. Budapest, 1998. 30, 120., *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 2000.* Budapest, 2001. 162.

[31] *Magyar Statisztikai Zsebkonyv (Pocket-Book of Hungarian Statistics) 2000. op. cit.* 162.

Following 1990 the situation wherein the numbers of inhabitants in Budapest and certain industrially developed cities had grown year by year has changed, and population has slowly started to decrease in these areas, while starting to grow in villages.[32] The distribution of agricultural production according to types of business entities has significantly changed: while in 1990 individual farmers cultivated 14% of the land, by 2000 this number has reached 42.8%, with companies taking up another 27.5%; as opposed to this, cooperatives cultivated 59.9% of arable land in 1990, while only 13.2% in 2000.[33] All this has a significant effect on legal issues of real estate ownership and the lease of the land.

Turning from owners and individual businessmen into employees in the years after 1948 and then from employees into entrepreneurs after 1990 went together with changes that resulted in, among other things, the loss of traditional social values. After the loss of the previous attitude of awareness of risk, the sudden confrontation with risks in a business environment characterised by high inflation[34] and a high unemployment rate[35] meant a great shock.

The above-mentioned factors had several social, economic and political consequences. In the following, I shall emphasise certain civil law consequences.

14. A large-scale housing scheme had been implemented as early as 1957 to counter the housing problems. In 1960 a house-building programme spanning 15 years was prepared, the objectives of which were not successfully achieved and by 1980 the rate of state-owned flats has dropped (from 27%

[32] *Demográfiai évkönyv 1999. (Hungarian Demographic Yearbook) 1999. op. cit.* 308.

[33] *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 1990. op. cit.* 130., *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 2000. op. cit.* 230.

[34] The rate of increase in the price of consumer goods is shown by the fact that by the end of 1996 the level of prices was four times as high as in 1990, and within this period prices have nearly doubled between the beginning of 1994 and the end of 1996, see Magyar Nemzeti Bank: *Havi Jelentés (Monthly Report of the Hungarian National Bank), 2000.* no. 12., 55.

[35] The number of registered unemployed in 1993 was more than 632,000, slowly dropping afterwards, but remaining as high as 464,000 in 1997, see *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 1997. op. cit.* 37.

in 1970 to 25.6% in 1980).[36] A part of the housing problems was also represented by the facts that, first, satisfactory funds could not be attributed to maintenance, which had become a state activity due to the nationalisation of apartment buildings in cities, the task was not adequately dealt with (around 56,000 flats in Budapest were registered as being in a perilous condition already by the early 1980's), second, that the question of rent was regarded as a political issue.[37]

The housing situation remained unsolved by the time of political changes. In the course of privatisation, housing estates previously owned by the state and administered by housing management companies founded by local councils were handed over to the municipalities with Act XXXIII of 1991. Act LXXVIII of 1993 later regulated the appropriate legal framework for housing management in a market environment and the sale of flats owned by municipalities. These measures naturally did not relieve the housing shortage which has been causing serious problems for decades. Home-building has steeply declined in general, while the sale of flats owned by municipalities has taken a quantum leap in 1994–1995.[38] A fitting picture of the quality of flats remaining the property of municipalities may be given by the following selected data:

In 1997, 43.6% of all flats owned by municipalities belonged to the category of single room flats, temporary accomodation or similar living space; 25.2% of all housing estates (33.9% in Budapest) had been built before 1900, the rate of those built between 1970–1989 being 18.3%, of those built after 1989 being 1.2%; of all housing estates, only 34.2% required no intervention, the rest required renewal or were not even economically renewable (the rate of unrenewable flats is 8.6%).[39]

When evaluating the housing situation, the fact that the differences in wealth of different classes of society have significantly grown should also

[36] Barta, B.—Vukovics, Gy.: A lakáshelyzet alakulása és jellemzői (The development and characteristics of the housing situation). In: *Lakáspolitikánkról (About our housing policy)*. (Ed.: Böröczfy, F.). Budapest, 1983. 205, 214, 216.

[37] Sándor, P.: A lakásvagyon védelmében, and Dávid, G. J.: Lakáskérdés: piac és normák (Housing problem: market and norms). In: *Lakáspolitikánkról. op. cit.* 223 and 304.

[38] *Magyar Statisztikai Zsebkönyv (Pocket-Book of Hungarian Statistics) 1997, op. cit.* 50–51.

[39] Központi Statisztikai Hivatal: *Az önkormányzatok ingatlanvagyona, 1997.* (Central Statistics Bureau: *The real estate property of municipalities, 1997).* Budapest, 1997. 14, 30–31.

be taken into account. In the 1980's the rate of those living below poverty level was around 10%, in 1995 this rate was already estimated at 30–35%. The difference between the lowest and highest income brackets has also grown: from 5.8 a year in 1987 to 7.0 in 1994. To this it should be added that fees for public utilities, kept on an artificially low level until the end of the 1980's, have also significantly risen. In the 1980's expenditures related to housing took up 10–12% of average income, in 1997 this rate was already estimated at 25–30% (this could mean as much as 45% for those with low income). Thus only a relatively small portion of society has been in the position to build new homes, as support for housing in the form of credit has also dropped, the real value of housing loans in 1995 having been only 15% of the value in 1990.[40]

The above-mentioned phenomena did not only result in significant changes in the law of lease of flat contracts. They have had a direct effect on the legal rules pertaining to owner-occupied blocks and the problems arising in their application. A further, indirect effect—through the medium of hardships of execution—may also be felt in the law of contracts and the fulfillment of contractual obligations.

15. The crisis of values generally accepted in society is shown by the rising crime rate. Statistical data show a continuous rise in the number of highest registered criminal offences starting with the 1980's. At the end of the 1980's the number of criminal offences has taken a quantum leap. The numbers are found in data for 1998. Crimes against property represent the largest portion (their rate of all crimes committed was around 60% until 1987, ranging between 70% and 80% in the following years, the rate being 69% according to data for the year 2001).[41] Among crimes against property, theft (larceny) appears at a rate several times that of any other offence (72.4%).[42]

[40] Hegedűs, J.: A magyar lakásszektor piaci átalakulásának ellentmondásos folyamata (The contradictory process of the market transformation of the Hungarian housing sector). *INFO-Társadalomtudomány* 43. *op, cit.* 52–54.

[41] *A KSH jelenti (Reports of the Central Statistics Bureau)* 2001/10. 23–25.; Igazságügyi Minisztérium: A bünözés és jogkövetkezményei (Ministry of Justice: Crime and legal consequences), 10. *A vagyon elleni bűncselekmények miatt elítélt fiatalkorúak 1991–2000.* Budapest, 2001. 1–2.

[42] Igazságügyi Minisztérium: A bünözés és jogkövetkezményei (Ministry of Justice: Crime and legal consequences), 12. *A vagyon elleni bűncselekmények elkövetése miatt elítélt felnőttek 1991–2000.* Budapest, 2001. 4.

The fact that in court practice the interpretation of the rule governing aquisition of property from non-owners has caused problems may be evaluated as one of the civil law consequences of crimes against property becoming more frequent. The Supreme Court has committed itself in several consecutive published decisions for a restrictive interpretation of the rule allowing for aquisition of property from non-owners in transactions with merchants.[43] Beside a restrictive interpretation, the question arises whether the court practice will be able to find a solution for making claims against merchants, who do not themselves formally sell cars later proved to be stolen, merely allow somebody to sell the car on their premises, but do not appear as sellers in the contract of sale. The good-faith buyer does not aquire property in this case (therefore the victim of the crime, the owner is protected as opposed to the buyer), but problems arise in the context of security of transactions if no sanctions may be applied against the merchant at all.[44]

Rules governing aquisition of property from non-owners need to be revised in any case, as a considerable change has occured from the business environment existing at the time of the creation of the Civil Code. In this area the Civil Code differs from both Art. 563 of the Civil Code Draft of 1928 and Art. 299 of the previous Commercial Code. In 1959 the official ministrial grounding to Arts. 117 and 118 of the Civil Code emphasized the sale of second-hand goods, the role of marketplaces and the Commission Shop in this respect. It is questionable, what solution is the most adequate in the present as regards the conflict of the protection of security of transactions and the protection of property. From an overview of regulation existing in different countries the conclusion may be drawn that the German legal solution of the issue which concentrates on the protection of security of transactions (supporting aquisition of property from non-owners) is to some extent not followed even in the Austrian and Swiss regulation which start out from a similar basis, while a very different attitude is taken by French and English law.[45] I believe this issue to be a significant area of

[43] B. H. cases no. 1996/1. 48., 1996/8. 418. and 419., 1997/3. 119.

[44] The arising questions and problems are highlighted by the decisions published in the Bírósági Döntések Tárának *(Collection of Court Decisions)* 2001/11 nos. 169 and 170.

[45] An interesting comparative law overview of the attitudes accepted in different countries is given by Schwenzer, I.—Müller-Chen, M.: *Rechtsvergleichung, Fälle und Materialien*, Tübingen, 1996. 305–337.; for English law see *Chitty on Contracts*, 28th ed. H. Beale, London, 1999. Vol. 2, 1176. ff.; see moreover Harmathy, A.:

the law of property, having an effect on several questions (including the role of the land register, the legal effect of registration as well). I regard it possible to form the main lines of a new regulation, following an analysis encompassing thorough comparative studies and stretching to several questions of the law of property.

16. Society has not easily dealt with the insecurity resulting from growing crime. This lack of personal security has arisen parallel with the other type of insecurity which many felt to be burdensome because—as it has been briefly mentioned above—the possibility of loss of employment became an everyday problem and development into individual entrepreneurship has occurred beside a high inflation and considerable risk. The factors of insecurity have really been in existence already before 1990 (thus the crime rate has already risen and inflation had been causing problems already earlier[46]), with the transformation process their effect has, however, become manifest and has strengthened considerably.

The functioning of the economy was hampered by the fact that already about ten years before the transition process companies and cooperatives had run into considerable debt which caused serious problems following 1986.[47] During the 1987 reform of the banking system, a significant portion of the credit owed to banks was classified as bad loan. Changes in the local and international economy only increased red tape, as, due to the loss of a large part of the markets in the East, the decline of local demand, the hardships of transformation vast numbers of businesses showed a deficit or went bankrupt. Small enterprises, on the other hand, battled with a lack of capital and lacked sufficient experience. The state was forced—not the least in order to help certain large companies—to execute several instances of bank consolidation, using large sums of money.[48]

The insecure situation of the participants of economic life, inflation, increased market risk appear in a variety of forms in civil law. In the

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Dologi jog — kötelmi jog (Law of property—Law of contract). In: *Liber Amicorum, Studia L. Vékás dedicata.* Budapest, 1999. 130–131, 134–135.

[46] For questions arising in relation to inflation already in 1982, see Harmathy, A.: Az árak változása és a polgári jog (Price amendment and civil law). *Jogtudományi Közlöny,* 1982/2. 73–83.

[47] Magyar Nemzeti Bank: *Éves Jelentés (Yearly Report of the Hungarian National Bank) 1989.* Budapest, 1990. 44–45.

[48] *A magyar bankrendszer konszolidációja (The consolidation of the Hungarian bank system).* 1994/10. 145–150.

following those phenomena shall be discussed which may have a serious impact on the civil law approach.

17. One of the phenomena that deserve attention is the new role of security instruments. Security instruments did not have a great importance under the conditions of the planned economy, the legal issues of security instruments gained emphasis in the countries of the previous Communist Bloc following the transformation of the economic system.[49] It is to be noted that the significance of security instruments has grown all around the world since the end of the 19th century. On the basis of an analysis of the development of law in several countries, Ulrich Drobnig—a well-known expert in the field—has found that the traditional rules of pledges and mortgages have lost much of their significance, the needs of practice required new solutions. As the chairman of the working group on European harmonisation of law in this field, he thus tries to create a future common European regulation along new lines, with a settlement that, among other things, regulates pledges alongside the transfer of receivables as security.[50] This represents a contract law solution of the regulation of property law security instruments—without leaving property law aspects out of account.

In the field of personal securities a development similar to that of securities in property may be observed, insofar as the use of a form of security usually not regulated in codes of civil law has become widespread in commercial practice: the independent guarantee. Differences appear, however, in the field of consumer protection, where the legislative activity in European countries has been intensive in recent years and the statutes protect persons not qualifying as merchants from an ill-advised acceptance of risk.[51]

The growing number of published court decisions relating to security rights in property or in connection with that area since 1990—to a certain degree independently of changes in the regulatory regime—is also remarkable in Hungarian civil law (this deserves attention also because few decisions

[49] In relation to this see essays in the volume *Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten* (hrsg.: U. Drobnig, K. J. Hopt, H. Kötz, E. J. Metsmäcker). Tübingen, 1998. 297–405.

[50] Drobnig, U.: Security Rights in Movables. In: *Towards an European Civil Code* (ed.: A. Hartkamp, M. Hesselink, E. Hondius, C. Joustra, E. Du Perron), 2nd ed. The Hague—London—Boston, 1998. 511, 522–524.

[51] Drobnig, U.: Recent Legislative Trends in the Field of Personal Security. *European Business Organization Law Review*, 2001. 512–513. and 515–524.

have previously been published in this field). Decisions as to a large number of questions in the law of pledges and mortgages have been published by the Supreme Court.[52] By the way, a lot of articles have been published about the law of pledges and mortgages (primarily in the bulletin of public notaries), which shows a strong interest in the field. The transfer of receivables as a security instrument has also appeared in Hungarian court practice,[53] which serves the same purpose as a fiduciary transfer of property of goods (a substitute for mortgages accepted in the law of certain countries). Contractual solutions whereby the creditor does not demand mortgages as security, but attempts to achieve making certain of being reimbursed by other means may also be found. Thus, an aim to provide security may be found in contracts wherein the parties provide for an option to purchase property beside a loan (practically replacing pledges or mortgages),[54] or apply the combination of a temporary lease and a sales contract leasing instead of retention of title.[55]

Personal securities appear relatively rarely among the published cases in comparison with securities in property. In spite of that, cases of typical and atypical suretyship arose more frequently than in the previous era.[56] More remarkable is the relatively frequent appearance of guarantees serving as security (especially taking into account that this type of security—with the exception of export trade prectice—was almost unknown). Most cases dealt with bank guarantees, but "guarantees" taken on by persons other than financial institutions are also to be found.[57]

18. The element of insecurity in contractual relationships may also be found in the form that the party crediting his contractual counterpart is unable to know whether the debtor will fulfill his obligations in accordance with the

[52] B. H. cases no. 1992/11. 719., 1993/1. 46., 1993/4. 245., 1995/10. 584., 1995/11. 649., 1996/5. 267., 1996/6. 308., 1996/11, 601., 1997/1. 20., 1997/5. 243., 1998/1. 38., 1998/3., 147., 1998/6. 290. and 292., 1999/2. 83., 1993/3. 127., 1999/4., 180., 1999/11. 533., 2000/2. 67., 2001/3. 133., 2001/8. 393.

[53] B. H. case no. 2001/10. 489, a similar background may be presumed to exist in B. H. case no. 1996/7. 380.

[54] B. H. cases no. 1996/11. 603., 1998/7. 350.

[55] B. H. cases no. 1992/12. 758., 1994/1. 40., 1994/2. 97.

[56] B. H. cases no. 1992/4. 239., 1993/6. 375., 1993/10. 631., 1994/12. 681., 1995/2. 108., 1994/12. 681., 2000/3. 117.

[57] B. H. cases no. 1992/2. 120., 1993/7. 448., 1993/11. 690., 1997/3. 134., 1998/6. 293., 1999/6. 267., 2000/5. 214.

contract. Under the circumstances of the market economy, several other factors of insecurity and risk have to be taken into account, starting with the change of prices. The planned economy made an attempt to eliminate commercial risk in several ways, or, if this was not possible, to counter its consequences through the economic control activity of the state. The reform of the economic control mechanism did not change a lot in this practice, in spite of that, however, the subjects of economic life were more burdened with business risk after the transformation period, then before that. Accordingly, in contractual relationships the question of business risk has been raised, whether in the context of the application of the rule on obligation to pay damages for allusive conduct, or the voidability of the contract on account of mistake, or the modification of the contract by court, or impossibility arising out of a change of prices.[58] In evaluation of the risk in the past era, the great changes brought about by the transition process, the extraordinary risk has played a great part. Following the completion of the transformation of the economy, however, the effect of the extraordinary circumstances need no longer be taken into account. An important consideration under usual market conditions is how big a role elements of risk should play in the regulation of contracts and in the application of rules on contracts by judicial practice.

The change in rates of interest and prices requires a special analysis among economic risks. Changing prices affect not only contractual relationships but also other areas of civil law (a change in interest rates has less of a direct effect in other issues). The fact that prices are not the same at the time of the damaging conduct and the order by the court to pay damages, and at the time of actual payment is especially important in establishing the amount of damages. A different solution is needed in contractual relationships, where the parties conclude the contract based on an evaluation of eventual risk, from the one in tort cases. In cases of breach of contract, however, considerations similar to those found in tort may have effect. It seems that in the case of both torts and breach of contract the protection of the interests of the damaged party are in the forefront in court practice.[59]

[58] B. H. cases no. 1992/2. 123., 1992/12. 775., 1993/9. 562., 1994/4. 179., 1996/6. 326., 1998/6. 291., 1998/6. 296.

[59] B. H. cases no. 1990/4. 153., 1991/12. 491., 1994/12. 664., 1995/3. 154., 1995/10. 573., 1996/9. 472., 1997/4. 185.

During the transition period high interest rates had been charged in connection with the high inflation. The interest on short-term loans in 1991 was around 33–36% a year, and the interest on deposits was also high.[60] After a temporary drop, rates in 1995 were about as high as in 1991, a decrease having occurred in 1997.[61] In April 2000, the National Bank interest rate was 11%.[62] The high risk involving interest rates was a temporary phenomenon. A significant change from the times of the planned economy in the material of civil law, however, is that the use of money and its price is an important factor regardless of temporary disturbances. Several decisions with regard to interest have been published by the Supreme Court.[63]

In cases of invalidity of contracts, taking into account the risks arising in a market economy, establishing the legal consequences of invalidity needs to be examined when the contract may not be reformed to become valid. Under market circumstances, an uncoordinated change in the value of performance and counter performance (e.g. real estate, seasonal goods, products strongly affected by technological development etc.) and the rate of interest may lead to consequences incapable of being pre-calculated by the parties. This may not always be neutralised by applying the legal consequences of invalidity.

19. In the market economy the actual possibility of the enforcement of rights in contractual relationships, in the lack of a specifically stipulated (or statutorily prescribed) security instrument is another factor of insecurity. In the social conscience of the era following 1948 the precise fulfillment of contractual obligations did not receive great respect. Under circumstances, when connections with state economic management organs was more important than the relationship with contractual partners, when factors outside the realm of law did not require a long-term, reliable partnerly conduct, this approach is understandable. The long time that passed since transition did not prove to be long enough to change this approach, what is more, the period of changes may have even strengthened previous

[60] Magyar Nemzeti Bank: *Éves Jelentés 1991. (Yearly Report of The Hungarian National Bank 1991).* Budapest, 1992. 102.

[61] Központi Statisztikai Hivatal: *Magyarország 1997.* (Central Statistics Bureau: *Hungary 1997*), Budapest, 1998. 84–85.

[62] Magyar Nemzeti Bank: *Havi Jelentés* (*Monthly Report of the Hungarian National Bank*) 2000/12. 141.

[63] B. H. cases no. 1993/5. 311., 1994/10. 551., 1995/3. 154., 1995/6. 342., 1997/5. 223., 1997/12. 594., 1998/8. 391., 1998/10. 495., 2001/2. 78., 2001/4. 181.

trends, or, if it has not strengthened them, it made them conspicuous. The more frequent appearance of contracts concluded in order to deprive creditors from funds may be attributed to this development.[64]

The frequent use of transfer of receivables as security is partly in connection with the hardships of execution. The transfer against money of receivables the execution of which is uncertain appears as a business activity also known in other countries (from the point of view of the economic goal, a similar tool is agency for the purpose of executing receivables, but in that case no transfer occurs). The transfer may, however, also be used for other purposes: different business goals may lie behind the transfer of receivables. In the law of European countries in general, thus also in Hungarian law, the transfer as a whole of all the rights and obligations arising out of a contract of one of the parties to that contract poses a problem. In these cases a transfer of receivables occurs only as regards rights. As regards obligations, one may only talk of an overtaking of obligations which requires the agreement of the other party to the original contract. Taking into account the need arising in practice for the transfer of businesses as a whole, the question needs to be examined, whether one may treat rights and obligations in a given contract as a thing, as a financial unit. This requires a revision of the definition of thing and related categories of property law in addition to the problems of contract law. In the Hungarian court practice of the last few years, alongside the use of transfer of receivables as security, other uses of the transfer of receivables have also appeared, such as transfer used in order to execute receivables, as payment of debt and in order to achieve a change of partners to a contract.[65] This means that today Hungarian law has to treat the transfer as one of those legal methods of forming economic ties which may be used in more ways than one and consequently requires an adequate legal approach and set of rules.

In connection with the hardships of execution and the growing importance of money circulation, the use of bills of exchange has become more frequent. Questions related to bills of exchange often arise in court practice. All this creates a need to analyse abstract obligations, the requirement of making use of such experiences in civil law theory and practice.

[64] B. H. cases no. 1995/8. 458., 1996/5. 252., 1997/11. 549., 1999/5. 220., 1999/11. 508., 2000/8. 365., 2001/2. 62.

[65] B. H. cases no. 1990/7. 268., 1993/2. 114., 1993/7. 446., 1995/5. 294., 1996/7. 379. and 380., 1996/8. 422., 1997/5. 244., 1997/9. 449., 1998/8. 379., 1999/2. 77.

20. During the transition process efforts at taking advantage of the faults and gaps of legal regulation could be pointed out. These phenomena are only mentioned because when evaluating these efforts, court practice has repeatedly ruled that these are "contra bonos mores". An especially interesting feature of the relevant judgements is that in certain cases they reflect a change in social consciousness, whereas in others they show an unchanged attitude. It seems, by the way, that the rulings at issue do not search to find a connection with either the requirement of good faith and fair dealing formulated in Art. 4 (1) of the Civil Code, or the obligation to cooperate, declared in several parts of the Code and often appearing as a command of morality. They are more prone to apply the principles of good morals similarly to requirements of public order.[66] The invalidity of immoral contracts is generally recognised, but its current interpretation is somewhat vague, therefore the creators of common principles of European law did not even attempt to formulate a common rule for this issue.[67] Moral reqirements, the obligations of good faith and fair dealing and of cooperation are adequate methods for the control of the terms of the contract, to regulate the distribution of risk in a way not provided for by the contract. Also with this in mind, it is to be examined, what direction the practice will take in this field.[68]

21. In examination of civil law questions often not enough attention is being paid among the changes occurring in the economy to the growing importance of services. This development has referred to previously in connection with torts (part 12), another one of its significant consequences needs, however, to be separately mentioned. This consequence is the growing significance of public services. Previously, public services had

[66] B. H. cases no. 1993/9. 578., 1993/10. 604., 1997/5. 241., 1997/6. 306., 1998/3. 138., 2000/5. 215., 2000/6. 260.

[67] *Principles of European Contract Law* (ed.: O. Lando, H. Beale), Parts I and II, The Hague, London, Boston, 2000. 227–228., Zweigert, K.—Kötz, H.: *Einführung in die Rechtsvergleichung,* 3. Aufl. Tübingen, 1996. 375.

[68] Mayer-Maly, T.: Die guten Sitten des Bundesgerichtshofs. In: *50 Jahre des Bundesgerichtshof.* (hrsg.: C.-W. Canaris, A. Heldrich, K. J. Hopt, C. Roxin, K. Schmidt, G. Widmaier). München, 2000. Bd. I. 69–79.; Harmathy, A.: A Ptk. reformja, különös tekintettel a szerződési jog fejlődésére, az ingatlanjogra és a fogyasztóvédelemre (The reform of Civil Code wint special regard to the development of the law of contracts, estates, and consumer protection). In: *Második Magyar Jogászgyűlés (2nd Hungarian Jurist Assembly)* (ed.: Erdei Árpád). Budapest, 1994. 291–293.

only been in a marginal connection with civil law. The transition process, the creation of the market economy has, however, strengthened the civil law aspects of the field. In court practice, this appears first, as a property law aspect, in use of property in the public interest,[69] and second, in public utility contracts.[70] This development of transition should be taken into account when elaborating the theoretical foundations of the rules of civil law.

[69] B. H. cases no. 1995/12. 700., 1998/5. 240., 1998/6. 289., 1998/8. 376.

[70] B. H. cases no. 1992/6. 408., 1993/8. 497., 1999/1. 30., 1999/5. 208., 1999/7. 302. 1999/9. 419., 2000/2. 68., 2000/9. 409., 2001/2. 64.

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GYÖRGY KÁLMÁN*

The Problematics of Economic Law in the Works of Gyula Eörsi

Abstract. The essay deals with the debates in Hungary concerning economic law at the beginning of the 1950s. At the time when socialist law penetrated into Hungary, many raised the issue whether economic law could be the adequate branch of law in socialist law. However, as the concept of economic law was defeated in the Soviet Union at the late 1930s, economic law could not be carried on even in Hungary. The essay provides a survey of the fights concerning Hungarian economic law, with special regard to the works of Gyula Eörsi.

Keywords: economic law, socialist legal science

I.

It is not my purpose here to expound, neither in an international nor in a Hungarian perspective, the history of the ideological debate about 'economic law', undoubtedly the keenest debate in the history of socialist law which had even tragic consequences.

I seek to expose how Gyula Eörsi, unquestionably the greatest Hungarian civilist of his age, arrived from the initial strong opposition—through the ingenious idea of the 'internal and external complexity of law', to mention it in advance—to the *de facto* recognition of economic law without having to give up his former theoretical position in any respect.

As human views and scientific propositions cannot be understood without knowing the context: the given age, its atmosphere and the consequential concrete events, at the beginning I shall briefly deal with the character of Hungarian legislation and legal literature in the years after liberation in 1945, the fall of the theory of economic law (which in my view didn't even exist), the cause and origin of this fall, and the history of this subject at the end of the thirties in the Soviet Union.

* György Kálmán, H–1132 Budapest, Visegrádi u. 9. Hungary.
Fax: (36 1) 474 5185

The history of the formation and fall of Soviet 'economic law' is presented in detail in *Contribution to the Theory of Enterprise Law* by Tamás Sárközy, so I don't need to touch upon the topic even in a general perspective.

On the basis of contemporary legal literature and my personal remembrance I would remark that 'economic law', as formed in the Weimar era and continued under Hitler in Germany or as established in the Soviet Union in the 1920's was in this sense non-existent in Hungary.

There hasn't been any Hungarian theory of economic law (the only exception will be treated below) in spite of the use of the term. The term referred to economically relevant positive law on the one hand and the literature interpreting this legal material for legal professionals and the non-lawyer economic specialists on the other.

It is well known and a commonplace that in 1945 Hungary inherited a destroyed economy and a severe inflation. Using the phrase of the time, economic reconstruction was then the crucial link in the chain. This reconstruction, as well as the execution of agrarian reform needed a great-scale legislation. The problems of the 'abandoned goods' waited for solution too, to cite only one example from the long list. The work of reconstruction was linked to the introduction of socialism, initiated already in 1946 with the nationalisation of big banks. It is clear that the focus of legal literature was directed on this topic. Not only the articles of legal journals but also books concentrated on the subject, and after 1947 monographs appeared one after the other dealing with the regulation of the economy, with the term 'economic law' in their title in some form. From 1947–48 on these books and articles referred to the socialist character of the legal material.

However, these books were handbooks without any dogmatics. In any case, there couldn't have been any dogmatics in them, because it simply didn't exist.

The need for these works has been later (after 1951 when the witch-hunt abated) recognised even by the opponents of economic law, moreover their re-edition has been urged (they didn't appear for a long time after the end of forties).

In 1948 the Hungarian Lawyers' Association was formed through the unification of several organisation of lawyers. On this occasion a great international conference was held in Hévíz with the participation of foreign delegations. As usual, the conference worked in sections and of course there was also a section for economic law. A Soviet delegation participated at the conference too. The leader of this delegation, Professor Manjkovsky took notice from the programme with surprise that there was a section for economic law and pointed out to the organisers of the conference and to the

participating leaders of legal life that economic law was rejected in the Soviet Union at the end of thirties as a Trotskyte and anti-socialist tendency.

It needed a piece of time for his warning to begin to take effect. In 1949 and 1950 the term 'economic law' was still used in Hungarian legal literature. Moreover, in 1950 Miklós Világhy held a lecture in the Lawyers' Association with the title *Our Constitution and Economic Law.*[1] In his

[1] The principal statements of his lecture were the following:

"Our Constitution certainly expresses and fixes the achievements of the development of economic law, determines the foundations of economic law and marks the main trends of future development as well. Which are these foundations and trends?

a) According to section 4 paragraph 1 of our Constitution, in the People's Republic of Hungary the bulk of the productive assets is in public ownership. Though productive assets may be hold by private persons, the working people—continues paragraph 2 of the aforementioned section—gradually displaces capitalistic elements and steadily builds the socialist economic order.

From these stipulations of our Constitution we have to draw two conclusions regarding the material of economic law. The first conclusion is that in the structure of our national economy, those enterprises and other organisational forms that hold each a group of the publicly owned productive assets came to have a determinative weight.

The second conclusion is that among the rules governing the operation of people's economy, the process of social economic administration, those which regulate public enterprises, or in general the operation, production and trade performed by the units of public economy, predominate and gain more and more ground.

After the detailed examination of the relation between the constitution and economic law, finally we have to ask the question again: what gives the importance of the constitution for economic law. In the introduction we have answered that the constitution, among others, summarises the main directions for the development of economic law in the people's democracy. It is evident that now, after the detailed analysis we have a more precise answer. Along the detailed analysis we have seen that in the field of organisational law the development of economic law of the people's democracy brought about the establishment of the basic principles of socialist enterprise organisation, and the development is expected to continue in the same direction. In the law of exchange, the result of development is the emergence of the main legal guarantees of socialist plan discipline and the legal regulation of the contract of delivery. We have seen in the law of co-operatives that our legal system is on the way toward the realisation of the different forms of socialist-type co-operatives. Finally, in labour law, we have stated that the constitution declares the basic principles of socialist labour law and determines its main safeguards as well. The economic law of our people's democracy is today of socialist type not only through its character but, for the most part, on the crucial points it has developed to socialist economic law regarding its content and the origin of its rules too. The Constitution of the People's Republic of Hungary reflects this economic law of socialist content, summarises the achievements of its development,

monograph of 1951 entitled *The Problem of Economic Law,* written in the spirit of the era but with a very high professional legal culture, he rejected economic law and went as far as to call out for the banishment of economic law from the education of non-lawyer economic specialists.

At the end of 1950 was published the Hungarian translation of Visinsky's *The Problems of Soviet Legal and Political Science*, which rejected economic law declaring it Trotskyte and anti-socialist.

The Committee for Legal and Political Science of the Hungarian Academy of Sciences put the question of economic law on the agenda.

During the debate on economic law, not limited to the Committee for Legal and Political Science of HAS, there were only some persons to hold aloft the banner of socialist economic law, already with knowledge of the antecedents in the Soviet Union. Among them was György Vadas, the first deputy-director of the Institute of Legal and Political Science of HAS, who paid for his deed not only with his position at the Institute but also with his scientific carrier. During the debate, Vadas explained: it is possible that they have chosen a bad name for the subject analysed in their books but it is not identical neither to German imperialist nor to so-called "Trotskyte" Soviet economic law.

Following the resolution of the Committee for Legal and Political Science of HAS which rejected economic law, was published Miklós Világhy's monograph *The Problem of Economic Law.* This work, using the phraseology of the day but reflecting the fine legal culture of the author, analysed the problematics of economic law in six chapters, from the beginnings of commercial law in Europe to the critique of the Hungarian theory of economic law (which theory, in my view, did not exist). The author stressed with

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and marks the main trends of the further development. This is the essence and importance of the relation of the constitution and economic law.

b) According to Section 5 of our Constitution, the economic life of the Hungarian People's Republic is determined by the national economic plan.

From this stipulation of our Constitution, we can draw again two conclusions regarding the material of economic law. The first states that due to the development in the last few years, the material of our economic law has been broadened by the rules regulating the determination of the national economic plan and the planned operation of the economy. This broadening is not only a simple increase in quantity but—and this is our second conclusion—a qualitative change too. The centre of gravity of exchange law, law of production and trade of goods is no more the material of trade transactions, commercial sale, consignment, shipment and other so-called commercial transactions." Világhy, M.: *Alkotmányunk és a gazdasági jog* (Our Constitution and Economic Law). Budapest, 1950.

emphasis that the scholars of Hungarian economic law (among them the author himself with his co-authored secondary school textbook in 1949, his articles and lectures) can be identified subjectively neither with the scholars of German imperialist economic law nor with mischievous Soviet economic lawyers, the subject of their scholarly work, however, objectively leads to the destruction of the socialist legal system.[2]

In his monograph, representing the culmination of the campaign against economic law, Miklós Világhy divides the (not too voluminous) literature on economic law in groups according to the year of publication (1948, 1949, 1950) and a bit forcibly refers to some qualitative differences among them. Namely

1948: the beginning of the theory of economic law,

1949: the accomplishment of the theory of economic law,

1950: the appearance of fully-fledged socialist theory of economic law.

[2] Világhy summarises his charges against the Hungarian "theory" of economic law as follows:

a) The question of economic law is primarily not a problem about the legal system but for the most part, a question about the character of the popular democratic law and state, about the soundness of the general views on the popular democratic law and state. The Hungarian theory of economic law made serious mistakes in this respect, since

aa) it supposed that there are parts of different character, of different class content within our popular democratic system of law,

bb) did not recognise the position of the individual in the socialist state, especially the inseparable linkage of socialist forms of ownership and it set socialist state and its economy against the individual citizen.

b) Economic law is secondarily also a question of the socialist legal system. The Hungarian economic law theory made a serious mistake when it endeavoured to unite the legal rules on economy in a separate branch of law, because

aa) in this way it separated certain groups of pecuniary relations of the socialist society from other groups of pecuniary relations,

bb) mutilated these pecuniary relations through the exclusion of property and consumption,

cc) the enlargement of the material of economic law is ineffectual since it would result in a heterogeneous legal material without any unifying principle,

dd) the theory of economic law proceeded also wrongly by trying to set the material of economic law on the basis of political economy since in this way, it misrepresented the proper relation of basis to superstructure, especially legal superstructure, and gave a false account of the nature and the characteristics of the legal superstructure. Világhy, M.: *A gazdasági jog problémája* (The Problem of Economic Law). Magyar Jogász Szövetség, Budapest, 1951.

He states the following: the theory of economic law of 1950 declares itself self-consciously and decidedly a complete socialist theory, a representative of socialist legal science which endeavours consistently to apply the Marxist-Leninist scientific method.[3]

II.

There is only one theoretical statement in the history of Hungarian economic law after the liberation in 1945. György Vadas namely wrote in his work *The Outlines of Economic Law*, published in autumn 1950 the following:

"The material of our economic law is held together by the solid steelworks of socialist political economics. We cannot make serious mistakes, cannot loose touch with reality if we endeavour to cast light on the material of our economic law by the laws of political economics. [...] We strive to sum up our legal institutions according to the basic features of the political economics of socialism."[4]

Gyula Eörsi joined the debate at this question of systematisation. In his article "Economic Law and Political Economy", published in the November 1951 issue of *Jogtudományi Közlöny* [Journal for Legal Science] and based on his contribution of 5 July, 1951 at the discussion on economic law in the Committee for Legal and Political Science of HAS, Eörsi refuted Vadas' views. His main argument was that to treat the material of economic

[3] By 1950, the most important characteristics of this theory got fully mature. These characteristics are

— the conception that legal rules relating to social economy mount up to a separate self-contained branch of law,

— the view that economic law practically cuts through the material of a host of other branches of law, separating and embracing in itself every rule that has some linkage to economic life (e.g. the law of economic administration, the part of criminal law dealing with economic crimes, parts of procedural law that are closely related to economic life, the entire financial law, the entire labour law); so economic law appears indeed as an expansive branch of law which deprives other branches of their material, takes the air away from them.

— the view that the whole economic law, or at least its basic part reflects the main idea, the "regulating principle" of planificatedness, the opposition of planification and plan discipline to freedom of contract. (Világhy: *ibid.*)

[4] Vadas Gy.: *A gazdasági jog vázlata* (The Outlines of Economic Law). Budapest, 1950.

law in the system of political economics did not advance the presentation of the interrelation of basis and the material of economic law.

But Vadas was wrong in that he tried to squeeze the material of economic law, being in close connection to the economic basis, in the system of political economics that is treating with this basis. The economic basis is the basis indeed but political economics is nothing else but a system of views: a superstructure.

The material of economic law cannot be separated from other legal material and transposed in the system of political economics because law, the entire legal system is an autonomous (though not independent) system.

Eörsi's view is different from the view of Világhy and the Soviet literature against economic law in that he does not hold economic law for 'expansive law':

"It does not follow from the aforesaid that economic law should be expansive and should divert the law of ownership from private law. As I mentioned in one of my previous articles, it follows rather that as the so called economic law is devoid of the basis, treated in private law, the autonomy of the so called economic law should be terminated and the appropriate part of economic law should be incorporated in private law."[5]

Practising economic specialists and the main part of legal professionals concerned by the material of economic law did not have any idea of this debate on economic law. The more interested and qualified lawyers working in the 1950's of economy were at a loss toward the debate. In the first half of the fifties, after Világhy's book, written with fine legal culture but still blowing the icy wind of witch-hunt, they remained numb and silent. Later they only smiled and considered the whole debate as a university fight of legal theorists around professorships. That is, they did not understand why economic law cannot be a mixed branch of law if labour law does; what is the reason for the autonomy of land law and the law of agricultural co-operatives as a branch of law (not only as a separate university field of study) while economic law is not an autonomous branch of law, not even a main course at the university. To be sure, later on several special courses were dealing with economic law both within the field of private and administrative law but to avoid to "fall into sin", to call a spade, they were held under different intricate titles, specially as long as Világhy still had word and influence in university education.

[5] Eörsi, Gy.: Gazdasági jog és politikai gazdaságtan (Economic Law and Political Economics). *Jogtudományi Közlöny* VI 1951 No. 11, 671–675.

The rather unilateral 1951 debate was followed by a long during silence. The problem of economic law scarcely came into question in the literature until the preparations of the 1968 reform of economic administration.

After the death of Stalin the study of economic law recommenced in the GDR and Czechoslovakia and in the latter even an Economic Code was introduced. This was reflected in the Hungarian legal literature at the beginning of the sixties as Mihály Samu treated the recognition of the autonomy of economic law sympathetically in his monograph on the structure of the legal system and several civilists, including Gyula Eörsi though continued to reject economic law but already on the basis of cool professional arguments, wholly devoid of witch-hunt.

In 1967, the last preparation year before the economic reform began a new debate on economic law on the columns of the journal *Magyar Jog* [Hungarian Law].

Practising lawyers, among them Iván Meznerics, distinguished also as a theoretician, urged for the recognition of economic law, again not as calling for a separate dogmatics or a comprehensive code but as a demand for the recognition of the coherence and complexity of this field of law and especially of the adequate importance of economic law in the literature for practising lawyers as well as in the education.

At this time Eörsi reacted negatively to the demand for the recognition of economic law. I remember an (unpublished) impromptu contribution of his at a meeting, chaired by Rezső Nyers, in which he answered to the contributions of economists calling for the recognition of economic law. He exposed that even if there might have been place for autonomous economic law in a system of economic administration based on breaking down the plan which was combining the method of administrative commands and civil contracts, there is no place for it in the new system of direction which reject the method of plan and breaking down and is based on the autonomous organising role of contracts.

Eörsi expounded his view systematically in his monograph *On the Law of the Switch-over to a New System of Economic Administration,* published in 1968.

In this work he does not mention yet internal and external complexity or the complex method but there appears the idea that the codification of private law shall be based on the specificities of the contract relations of socialist organisations and the specificities required by mass production shall be reflected in auxiliary acts, decrees and fundamental trading conditions of a complex character.

"Thus our conclusion is that the 'economic law oriented' conception of codification which proposes an autonomous code, co-ordinated to the Civil Code is not the best method to regulate legal relations of the people's economy. The same holds for the 'commercial law oriented' solution which equally urges a separate code for the regulation of legal relations of the people's economy but in which the Civil Code would be the background law for this separate code. Against these two conceptions the conception of a unitary Civil Code shall be accepted, reorganised on the level of codification in the necessary measure according to the model of socialist organisations. The specificities deriving from the socialist character of the people's economy and from mass production shall be reflected in auxiliary acts, government decrees and fundamental trading conditions of a complex character. This offers the required stability and mobility for the legal material of the people's economy. However, it is evident that an economic code is in no way more mobile than the civil code."[6]

The reason for Eörsi to reject economic law was invariably his persistent view that the systematic division of law shall rest on legal and not directly on economic reality.

The system of law cannot be built directly on economic reality. Though in the last resort determined by economy, law is a relatively independent system of views and institutions.[7]

"The difference between the traditional and the 'economic law oriented' conceptions lies not in that the traditional conception uses highly abstract concepts (property, legal person, contract etc.) as some representatives of economic law alleges, but in that the traditional socialist conception thinks in legal institutions while the socialist conception of economic law thinks in economic activities. So the latter reasoning is regrettably far too obvious within the circle of non-lawyers, among whom especially economists have an extremely great influence on decisions which irradiate to law as well.

It follows that such statements according to which the growth of economic law to a separate branch of law is the same phenomenon as the separation of labour law, the law of co-operatives or family law as independent branches of law, cannot be substantiated. In these we are dealing with small collectives; by this way the unity of social relations shows up clearly and

[6] Eörsi, Gy.: *A gazdaságirányítás új rendszerére való áttérés jogáról* (On the law of the Switch-over to a New System of Economic Administration). Budapest, 1968. 133.

[7] *Id.* 88–89.

also unitary legal principles and methods come to existence, fitting to the relations of the small collective. But in the domain of economic law there is no such perspective because as Világhy pointed out, economic law does not embrace the economy; that's why its boundaries can be laid out only arbitrarily."[8]

Thus after all this said, we have to conclude that on the level of codification, the most convenient solution, for this country too, is a single civil code. This solution on the level of codes implies also that, on the basis of codes, which are separated mainly according to legal branches, auxiliary acts, government decrees and fundamental trading conditions shall be created, to meet the requirement of complexity and greater variability.[9]

III.

Eörsi's outstanding theory on "internal and external complexity" which was leading to the gradual recognition of economic law without retracting his former theoretical position was comprehensively expounded for the first time in 1972.[10]

Already in the introduction he is more indulgent toward the conception of economic law than the Hungarian literature till then.

"Present-day conceptions of economic law are based on a particular interpretation of economic determination and service role of law. They declare a certain scheme of economic activity for the backbone of the system of law, directly attach legal provisions to economic institutions, brings law 'closer to the practice'.

So even the most determined opponents of economic law can not say that it is only about an infectious mistake."[11]

Eörsi noted that the adherents of the conception of economic law and of civil law and administrative law were dealing with the same material. Their references were at variance not because they put different theoretical straitjackets on facts. The thing is that there was a difference between evaluations. For systematisation the first group emphasised economic structure, the second

[8] *Id.* 32.

[9] *Id.* 133.

[10] Eörsi, Gy.: Külső és belső komplexitás. A gazdasági jog kérdéséhez (External and Internal Complexity. On the Question of Economic Law). *Gazdaság és Jogtudomány*, MTA IX. Osztályának Közleményei. Budapest, 1972.

[11] *Id.* 81.

accentuated legal institutions. The very close connection between state regulation of the economy and the administration of public property was clear for everyone. Some considered this fact as constituting branches of law, others did not, but both had a common purpose: more effective legal assistance for people's economy and the society.

Eörsi sketched two models of the mechanism of people's economy. The first-essentially the model of GDR—conceived the entire people's economy as a single immense centrally operated "machinery". The second-essentially the Hungarian model—was a "system" achieving the dynamic equilibrium within a space regulated by the national economic plan.

In the "machinery" model legal elements constitute internal complexity, in the "system" model external complexity.

By internal complexity he means that legal units integrate elements which are heterogeneous from the perspective of legal function and method (e.g. elements of civil and administrative law)—this is the conception of economic law. External complexity means that legal institutions essentially retain their contour and branch-of-law specificities. The institutions of different branches of law operate together without dissolving, in a way that they maintain their functional and methodical characteristics. The "machinery" model is the hotbed of internal complexity (the economic law) because it essentially consists in the mingling of administrative and economic elements, i.e. administrative law and civil law. External complexity corresponds to the "system" model as it separates administrative and economic, i.e. administrative law and civil law elements. Internal complexity is reflected in the branches of law as the maintenance of the traditional socialist division of the legal system.

So, Eörsi relates the "machinery" model to the conception of internal complexity and economic law and the "system" model to the conception of external complexity. It is not the same as to link economic law to the planned economy with direct commands and the traditional socialist conception to indirect, decentralised systems, viz. to contend that the situation in socialist states before the reforms encourages economic law while the situation after reforms is favourable to the conception of external complexity. This view, which previously also Eörsi himself advocated, is to some extent simplifying and contradicts certain facts. It is very easy to grasp the system of direct plan commands by the conception of external complexity: this was the predominant practice in the law of European socialist states. It is not direct plan command system which is favourable to economic law but the "system" model, although, as we shall see, internal complexity, i.e. economic law leads almost by nature to the dominance of

centralism. Hence, the conceptions of internal and external complexity connect not with direct and indirect economic administration mechanisms but with "machinery" and "system" models.

One of the important differences between the two conception subsisting on this common ground is the following: The conception of internal complexity which realises *staatliche Leistungspyramide,* is conceived in a vertical cross-section. Every relevant theoretical construction is built from the peak of central organs to the base, by its nature with a strong orientation toward central elements. Market can find a place in this construction only artificially as it would imply, within the conditions of socialism, the "system" instead of "machinery".

In contrast, the conception of external complexity is neutral from the point of view of orientation. Within this conception vertical and horizontal cross-sections as well as the internal relations of firms and co-operatives can be distinguished. In this way a space is created within which the current economic administration may determine the place and importance of different elements. The conception of external complexity is equally apt for the service of a more centralised directive mechanism and a decentralised one with a considerable role for the regulated market.

The second important divergence of the two conceptions is essentially that they attach law to economy on different levels.

Of course, the conception of external complexity seeks to influence economic processes too but in this respect the conception of internal complexity is specific inasmuch as it directly adjusts the legal system to the regulation of the economic process. The machinery of *staatliche Leistungspyramide* needs to attach law to certain elements of the economic mechanism at a considerably lower level so that the autonomous system of law loses importance. There is no sense to think about institutions of law here.

In contrast, according to the conception of external complexity law serves the economic mechanism as a specifically legal system based on legal institutions, operates comprehensive legal abstractions and attaches great importance to the institutions of law.

The conception of internal complexity is *a)* linking the most divergent legal means to each element of the economy and in this way *b)* substitutes an economic system for the specific legal system, thinning away the legal element on a great scale. Often the writings on economic law can be hardly distinguished from practical economic works: instead of institutions of law they primarily deal with legal means attached to economic ends, methods and organisation.

In contrast, the conception of external complexity considers the relative autonomy of law as a condition of the development of special, characteristically legal means and so the more effective service of the economy; that is what the conception of internal complexity denies.

It involves, however, that the conception of internal complexity is hardly suitable for becoming the conception of codification since a code is characterised by the systematisation of a large area in law, i.e. it embraces law in a legal system. But, as explained, there is no much place for the legal system within the conception of internal complexity. It is due to this fact that in the country which enforces this conception the most consequently, the GDR, the great difficulties with the codification led at least temporarily to renounce to establish an economic code and to regulate the people's economy on government level, through a fragmented and not a unitary system. Meanwhile the codification of the civil code was being continued. In Czechoslovakia the Economic Code was effectively an act on economy systematised according to the branches of the people's economy. Under the title "general provisions" only 26 sections out of 400 comprised the provisions on the relations of direction. Other provisions were such that for the most part they could equally take place within a socialist civil law codification: 272 sections related to the law of obligations, all of them appertaining except for 43 sections to the particular provisions of the law of obligations.[12]

In the final account, legal regulation of the people's economy means the regulation of human activity, though it necessarily contains a great number of purely technical element. The legal element not only provides the official sanction for the economic element but transposes the ends posited and processes designed by economists and engineers. That is a not unimportant reason for the existence of law as a specific establishment, i.e. one which is not identical to its determinant, the economic system. This being granted, the "machinery" or "system" character of the economic mechanism orientates in different directions. The conception of internal complexity intended for the service of the "machinery" is dominated by the "regulation of processes". In the conception of external conception, intended for the service of the "system" the "regulation of activities" is dominant. In turn, the prominence of the regulation of activities brings about the prominence of the legal system.

Eörsi points out two practical shortcomings of the conception of internal complexity. It does not take into account that civil law contracts need some common provisions, nor that a great number of contract types equally

[12] *Id.* 90–92.

apply for the public property sector and the personal property sector (credit, carriage, insurance, lease, deposit etc.).

The conception of economic law, however, cannot include the common provisions about contracts, only the provisions for those concluded between socialist organisations.

According to the conception of internal complexity the integrity, namely practical economic integrity is formed by the obligations of the people's economy; contracts between socialist organisations and individuals or between individuals themselves are excluded. For the conception of external complexity, however, the unity is made out of all commodity-related obligations (which relate relatively autonomous parties) irrespective of subjects and sectors; this excludes in turn the systematic integrity with the obligations deriving from the relations of governmental economic direction and of intra-firm management.

The replacement of the legal system by a system based on the scheme of economic activity or organisation leads to split asunder institutions of law through the denial of systematising relevancy of high-order generalisations (socialist property law, contract of commodity or autonomous structure, responsibility etc.). The conception of internal complexity comes nearer to the everyday practice than the conception of external complexity does, both in the choice of its system, of the still useful level of generalisation and in the tendency of descending from the level of institutions of law to the level of legal rules. Before considering this as an absolute advance let us remind that the system nearest to the practice is that of the *common law*; it cannot see the wood for the trees, becomes pragmatist and remains in spheres that provide a natural medium for theoretical indifference. This of course does not hold for the conception of internal complexity; on the contrary, the manifestations in the GDR are the most ideological; but from a legal perspective, the result of these considerations come close to practicism because they tend to see in law nothing more than an administrative–technical auxiliary device of the economic practice.

The final conclusion of the work is that the compilation and especially the codification of the entire legal material of the people's economy is both unnecessary and impossible. It is unnecessary because nobody needs it in entirety. He who works as lawyer in the construction industry does not need the whole system of rules for internal commerce. It is also impossible because legal activity reaches back to general institutions overlapping the scope of economy (delay, invalidity, termination etc.).

While the conception of internal complexity commingles legal instruments at the outset and causes the sketched problems in theory, policy of law and

practice in this way, the key issue of the conception of external complexity is to find the suitable level, measure and method to junction the institutions of different branches of law in the different areas of legal work: legislation, jurisprudence and legal education etc. This is a practical problem in all these domains.

Different tools does not become similar as being used in the work on the same object: drill remains drill and hammer remains hammer. We have to manufacture and get the mastery of both tools separately but we have to apply them together. That is the essence of the conception of external complexity.

Thus in this work of Eörsi we cannot find the recognition of economic law even as a secondary branch of law or as a discipline.

In spite of this, Eörsi's theory of internal and external complexity gave full satisfaction to the needs of lawyers working in different fields. These lawyers were repugnant and at a loss toward the debate about the qualification of economic law as a branch of law from the beginning.

They held for natural to unite legal institutions of the economy in a harmonic construction irrespective of their place within the branches of law. Eörsi's theory, determining the content of external complexity satisfied this need. They considered this theory as the recognition of the coherent work in the different domains of economic law and of the unconditional necessity of this work. The debate on the rejection or recognition of the autonomy of this branch of law was looked upon, a bit sceptically as one about the establishment of another professorship. None of these lawyers raised a claim to duplicate the general part of the law of obligations as it was done in Czechoslovakia by framing the Economic Code. But they surely claimed for the recognition and the legislative expression of the specialities of economic contracts by the framing of an economic code. They used in this respect a trivial but sound argument: although the re-soling of a shoe and the complete construction of a nuclear power plant are both realised through a contract of enterprise there is a great difference both in the content and the legal characteristics of the two contracts.

After the reforms of 1968 Eörsi already accepted that by the regulation of the particular contract types in the Civil Code the requirements of the contracts important for the people's economy shall be taken into account as rules and the contracts for mere consumption shall be reckoned with when determining the exceptions.

Why did the theory of internal and external complexity satisfy the needs of legal practitioners?

1. A practising lawyer is cognisant of the importance of the limits between criminal law and civil law, substantive law and procedural law,

recognises the speciality of political law as a separate branch of law in the conditions of socialism but beyond that he does not care about the division of branches of law. For him it is indifferent whether law reflects the economy by internal complexity, i.e. by an autonomous branch of law or by external complexity i.e. by the harmony of institutions of law established within separate branches of law.

2. They needed an accord among different legal institutions of the economy, that the important gaps of law shall not be filled or the collision of legal rules within different branches of law shall not be resolved by the practice. The theory fulfilled this need.

3. This theory recognised also in civil law the dominance of economic phenomena by the formation of principal rules.

The theory of complexity allowed for the silent, orderly and peaceful retreat of legal theoreticians in this stormy question.

In my view the theory of complexity was, even before its full exposition in 1977, a *de facto* recognition of economic law without theoretical retreat. That makes the theory ingenious.

IV.

The further development of the theory of internal and external complexity is due to a further advance on the way of *de facto* recognition of economic law. Eörsi's last monographic work, *Law, Economy and the Structure of the Legal System* was published in 1977.[13]

As a point of departure he made a remark on the relation of law and extra-legal social phenomena. Law always regulates social relationships which do not respect its system. That lies behind the enchantedness of law, as Imre Szabó expressed it. However, the intensity of the state-controlled plan economy pushed this problem to the extremes. Instead of the regulation of behaviour, norms relating to the economy contain regulations characterised by the enumeration of a great number of parameters.

"The structure of the legal system unites the internal and external aspects of law in a self-referring manner with respect to the structure of the special legal sphere: in reality we are dealing with the organisation of the 'external' (socio-economic relations) into a heterogeneous 'internal' system (the law). From the point of view of the special characteristics of

[13] Eörsi, Gy.: *Jog — gazdaság — jogrendszer-tagozódás* (Law, Economy and the Structure of the Legal System). Budapest, 1977.

law, the legal system shall be, as we will treat it at length, a closed system of logic, while a branch of law shall form a legally regulated complex of socio-economic relations into a sub-system. Thus, the type of socio-economic relations and the legal regulation, i.e. the 'external' and the 'internal', the social and the legal aspects are equally important for us. It is quite obvious that economic law, for instance takes into consideration only the first aspect. What concerns the specifically legal element, there is a danger here, that of legal formalism which may lead to a mere logical system. It can be avoided by not isolating the specifically legal element, as law cannot be isolated from the subject it refers to. Law shall be considered as determined by society in order to bring to bear its social effects in an optimal way. Thus the specific character and mechanism of law come into prominence. Socio-economic relations, otherwise groupable in a number of ways, shall be sorted into branches of law according to their identical or similar legal character and mechanism. That's what law as a specific objectivation requires and the character of these socio-economic relations itself plays an important role in the grouping."[14]

The structure of the legal system is thus given by the dialectics of socio-economic relations and the specific legal method. Based on this, the arrangement is determined by this pair of phenomena as filtered by cognitive and volitional media of legislation and jurisprudence and as finally expressed across certain fractures.

The traditional theorem which says that the structure of the legal system is divided on the basis of certain groups of social relations *and* specific legal methods, is not exact entirely. These two are not joined together by an 'and', because in real these are the external and internal side of the same thing. Although on the final account social relations determine law, the way it happens will substantially depend on the specificities of law, i.e. the methods which are available. From an external perspective the social relations are determinant, from an internal view, the legal methods. The social relation can determine the structure of the legal system on the final grade only by "putting on the dress of law", by adapting to legal specificities.

Eörsi drew a difference between the structure and the division of the legal system:

"Beyond the aforementioned double determinant of its structure, the division of the legal system is specified by every social or individual factor which determine how the effectual 'dividers' of the legal system express the needs of the legal system.

[14] *Id.* 92.

There are three determinants of the final result, of which the first two appear from the beginning as inseparably interrelated:

a) The final basis of the structure of the legal system lies in the socio-economic relations.

b) A social fact becomes legal fact only by integrating in the legal complex. This complex, however cannot 'smack itself on the face', social facts have to be 'transcribed' in law according to the functions of law in compliance with the interests of the ruling class. These functions require the transformation of the social facts into teleological propositions of a concrete practical program. The relatively autonomous regularities of law formed in this way specify the integration of social facts in the system of law, and, in turn specify the second determinative element of the structure of the legal system, permanently leading to contradictions.

c) The expression of law is not exempt of the intrigues of false consciousness, i.e. the expression of law may be 'good or bad'. At this point, deformations may be brought about by elements which are accidental from the perspective of the legal system but well determined on another line. This third determinative element relating to the division of the legal system is nothing else but the inadequate expression deriving from the above-mentioned transcription."[15]

Eörsi put the question whether the scientific–technical revolution makes the theoretical conception about the necessity of the division of law into homogeneous branches needless. Modern western pragmatism takes the distinction between branch of law and discipline for unnecessary because it does not hold for important whether a branch of law consists of homogeneous institutions of law.

The dogmatic conception of the division of branches of law resulted also in the remission of the entire division problem into the mere practice.

Finally, Eörsi concluded that the tension between the structure of the relations to be regulated and the structure of the legal system was increasing because socio-economic relations become more and more complex. This fact influences but does not eliminate the requirement that the legal system should have a structure suitable to its own regularities. This influence consists in the formation of quasi-branches of law which are still founded on genuine branches of law based on legal homogeneity.

Eörsi's final conclusion, the summit of the development of the theory of complexity is the following:

[15] *Id.* 90–96.

"However, beside branches of law the socialist conception recognises fields of law—usually called disciplines, but it is perhaps better to reserve the expression 'discipline' for a category of education and to speak here about quasi-branches of law—which form a unit from political or practical point of view without being branches of law. From a legal point of view these are characterised by internal complexity: they organise legally heterogeneous elements around a circumscribed socio-economic purpose. This conception subsisted especially about the legally heterogeneous land law. Furthermore, many regarded the law of agricultural co-operatives (which does not include every co-operative nor the entire agriculture) as such a field. Environmental law etc. may grow to such quasi-branches too.

In this way, according to the socialist conception, law is primarily divided into legally homogeneous branches of law on an objective basis and secondarily, so to say "under the branches of law" it mixes the tools and methods of different branches, establishes legally heterogeneous complex domains or cuts out legal fields to unite certain complexes of relations for practical purposes, irrespective of the requirement of the legal homogeneity of the system. The system of legislation corresponds to this conception as it unites, although not in their entirety, the branches of law in principal codes, supplementing it by the complex regulation of certain fields of law."[16]

We have accompanied Gyula Eörsi, the greatest Hungarian civilist of the second half of the twentieth century along his way, clearly not free of internal struggle, dealing with the recognition of economic law until he arrived to reconcile the purity of his theoretical views with the manifest serious requirements of the social practice. He was able to do that without need to recant his former views. He did not have to do so because he had not taken part in the witch-hunt at the beginning of the 1950's, even if he had not "compromised himself" with works on economic law. His views and debating manners were all along resolute but conciliatory to the opposing views at the same time.

It is not my duty to evaluate his oeuvre here. I would not even entertain it. First, being without an aptitude for it and second because, owing to our sixty-year-long friendship started at the school-bench I miss the necessary impartiality to do that. But I can undoubtedly assert that his magnificent oeuvre contains some works (e.g. his theory of responsibility) which are more important than the ones reviewed here. But still these certify his great factual knowledge and legal creativity.

Eörsi's oeuvre was regrettably interrupted too much early. Within the field of the law of economy it was for his disciples to continue and accomplish it.

[16] *Id.* 116.

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VILMOS PESCHKA*

Gyula Eörsi: Philosopher of Law

Abstract. The essay presents and praises the legal philosophical aspects of the works by the civil law jurist, Gyula Eörsi. It pays attention especially to the analyses in his works on civil law that concern issues of legal theory and legal philosophy, let alone his par excellence legal philosophical treatise title „Jog — gazdaság — jogrendszertagozódás" (Law—economy—structure of the legal system). The present essay analyses the "external" and „internal" points of view by which Eörsi explored the relation of law to economy, the reflective relationship of content and form in respect to oaw, the complexity of legal phenomena, the internal and external complexity of law as elucidated by Eörsi, and, finally, the legal system and its structure on the bases of legal philosophical aspects and an approach of legal philosophy.

Keywords: philosophy of law, internal and external aspect law, content and form in law, economy and law, the complexity of law, the legal system and its structure

1.

"...because law is a matter of erudition rather than professional skill,
and erudition is one and indivisible,
and it is a misconception that law can be learnt by learning;
law can only be learnt by becoming erudite."

(Béni Grossschmied)

A Philosopher of Law?

Applied in a discussion of the oeuvre of Gyula Eörsi, the term "philosopher of law" is likely to sound surprising to many readers. Eörsi is widely known to have been an outstanding, internationally recognised scholar and professor of civil law whose works wielded considerable intellectual influence. It should in no way strike us as extraordinary that a legal scholar of positive law should expound abstract principles in a self-contained theoretical

* Vilmos Peschka, Member of the Hungarian Academy of Sciences, Budapest, H–1014 Budapest, Országház u. 30., Hungary.
Fax: (36 1) 3757-858; E-mail: pardi@jog.mta.hu

monograph on jurisprudence, drawing a final balance of several decades of research in some particular branch of positive law, summing up his experience and knowledge at the general level of the philosophy of law. In fact, this is rather common, especially among outstanding experts of civil law, as the relevant work of Karl Larenz,[1] Alois Troller[2] or Albert Ehrenzweig[3] testify. Written during the latest years of his life, Eörsi's book "Law, Economics and the Systematization of the Legal System"[4] fits into this illustrious series. It is not only a theoretical epilogue to the *magnum opus* on "Comparative Civil Law",[5] but it is at the same time a general philosophical reformulation of the ideas which derive more or less directly and obviously from his earlier investigations, an attempt to seek ways of developing further the problems and solutions he had previously formulated. This is not to say that an interest in and a sense for general philosophical problems inherent in law first came to be felt late in his intellectual career. It would be an exasperating task even to take stock of all the general philosophical questions he discussed in his works on civil law, beginning with his voluminous book on the evolution of property law,[6] which he wrote in the early phase of his career, in which we can read discussions of law in general, the relation between subjective and objective law, security in the law, arbitration, the relationship between natural and positive law, the pure theory of law, the concept of a legal system and its articulation: there are few pertinent questions of central importance to anyone interested in legal philosophy—such as legal responsibility, unlawfulness, link of causality in the law, culpability—which he had not treated in a thought-provoking monograph,[7] not to speak of his investigations of legal sources and relations which are

[1] Larenz, K.: *Methodenlehre der Rechtswissenschaft.* Berlin–Göttingen–Heidelberg, 1960.

[2] Troller, A.: *Überall gültige Prinzipien der Rechtswissenschaft.* Frankfurt am Main–Berlin, 1965. 1971.

[3] Ehrenzweig, A.: *Psychoanalytic Jurisprudence.* Leiden, 1971.

[4] Eörsi, Gy.: *Jog — gazdaság — jogrendszertagozódás* (Law, Ecomonics and the Systematization of the Legal System). Budapest, 1977.

[5] Eörsi, Gy.: *Összehasonlító polgári jog* (Comparative Civil Law). Budapest, 1975.

[6] Eörsi, Gy.: *A tulajdonjog fejlődése* (Evolution of Property Law). Vol. I–II., Budapest, 1951.

[7] Eörsi, Gy.: *A jogi felelősség alapproblémái.* A polgári jogi felelősség (Fundamental Questions of Legal Responsibility. Responsibility in Civil Law). Budapest, 1961.

available in his book devoted to the fundamental problems of civil law.[8] Last, but not least, the circle of problems of legal philosophy addressed in the grandiose monograph[9]—types of law, the concept of law, subjective and objective law, legal adaptation, legal interpretation, legal analogy, codification, judicial practice as a source of law, law and justice, fairness and many others. One would have to write an independent monograph if one wanted to analyse the many threads of thought woven into the fabric of all his works. From the perspective of the philosophy of law this is not necessary as his work which concentrates on philosophical questions[10] offers us the quintessence of Eörsi's position on philosophical questions of law and hallmarks his quality as a philosopher of law. In what follows, therefore, I will try to offer a glimpse of this quintessential *opus*.

Internal and External

Our first question is that of the internal and external aspects of law, an examination of law in terms which can be said to have been rather neglected in the literature. To avoid misunderstandings, I must say in advance that the internal and external aspects of law are most intimately connected, and can only be understood in terms of the mutual reference they make to each other and in of their interdependence. Investigations which shed light on the point and meaning of the internal and external view of law in general are of the greatest interest and worth for the philosophy, especially the ontology of law. Eörsi sums up this point and meaning as follows: law can be viewed from an external point of view, in terms of social and economic conditions, which are definitive of the genesis of law, on the one hand, and are the object of the effect of law, on the other. But law can also be looked at from the inside, which results in an emphasis on the specific laws of motion and structural features of law, in one word: on the special features which mark it off from other modes of social objectification. Obviously enough, this must not be emphasised at the expense of a total suspension of the external point of view or of an exclusion of links with social and economic reality, and the internal view of the law is not tantamount

[8] Eörsi, Gy.: *A szocialista polgári jog alapproblémái* (Fundamental Questions of Socialist Civil Law). Budapest, 1965.

[9] Eörsi: *Összehasonlító polgári jog. op. cit.*

[10] Eörsi: *Jog — gazdaság — jogrendszertagozódás. op. cit.*

to a merely formal analysis of law. Of greater importance than these evident methodological points is the enlightening insight that a view of law as a totality can only be arrived at when the internal and the external point of view are applied in conjunction: "...the totality of law can only be grasped via a joint application of the two points of view. Yet, clearly, ... the two are not of equal rank. Investigations from the external point of view take their starting point from the determinative elements, while those from the internal point of view focus only on the 'how', the specific ways in which law lends real effect to the intents and purposes which fall, more or less fittingly, within its range."[11]

Applied to the law, the internal and external point of view bring to the surface the internal and external aspect of law as a social complex. I may not be mistaken in believing that Eörsi is applying both the internal and the external point of view to the law in order to get a close-up on the specific features of law as a mode of social objectification which make it a special variant of social objectification. Eörsi always draws attention to those features, regularities and specifics which manifest themselves in the legal "transcription" of social and economic relationships. We have to do here with the specific features of the legal reflection of socio-economic conditions, of construing the law not as a description of material conditions but as an active, creative and formative "transcription" into a homogenous medium, not a mode of photographic imaging but a specific way of reflecting which homogenises socio-economic conditions in a specific "ought" pattern, as a result of the practical character of the law, in such a way that it will result in an inevitable incongruity between socio-economic conditions and the law. Following Imre Szabó, Eörsi speaks of the "social insensitivity"[12] of law, emphasising that this insensitivity of the law is an appearance produced by the external point of view, "the internal manifestation of social activity".[13] This apparent "social insensitivity" of law which strikes the eye when it is viewed externally, shows that law reflects socio-economic conditions in such a way that it transforms and elaborates them, and it does so in order that the law should thereby become able to fulfil its social mission: the regulation of socio-economic conditions. "If law involved an *internal* social sensitivity, it would merely map the external relations and would lose much of its efficacy (it would e.g. put at risk the necessary level of the

[11] *Ibid.* 9.

[12] Szabó, I.: *A jogelmélet alapjai* (Foundations of Legal Theory), Budapest, 1971, 169.

[13] Eörsi: *Jog, gazdaság... op. cit.* 9.

generality of the legal rule, the internal, specifically legal typicality of legal institutions). This appearance therefore, when viewed *from the inside*, is a kind of reality which is necessary: the social sensitivity of the law can become effective only through this kind of social insensitivity."[14] This incongruity between law and socio-economic relations is the primary object of interest and the primary subject to be investigated. It is the fact that law does not reflect the existing conditions of society in an adequate manner, the special "transcription" of these conditions in the homogeneous medium of the law, with special regard to the unequal evolution of the two spheres.

Content and Form

As we have seen, we can only arrive at a relatively faithful picture of the totality of law if we complement an external view of the law with an internal one, i.e. if we apply the internal view to the end of unravelling those internal relations and properties of law which, from the external point of view, produced the appearance of a "social insensitivity" on the part of the law, resulting in the incongruity and inadequacy between socio-economic relations and the law. Viewed internally, law can be distinguished into two relatively separate spheres, according to Eörsi, acts of norm-setting which mediate socio-economic demands, on the one hand, and acts of norm-setting designed to lend practical effect to these settings (rules of organisation and procedure).[15] The distinction we have here is that between substantive and procedural law and—as we shall see shortly—their relation.

It is undoubtedly with respect to the relation between substantive and procedural law that the application of the external and especially of the internal approach to law leads to the most surprising discussions and statements. In the internal view of law as espoused by Eörsi it is, surprisingly, the substantive part of law that is portrayed as external, while internal relations are identified as organisational, operational and procedural relations: "...when law is viewed under its *internal* aspect, i.e. not from the point of view of society, *procedural law* is *internal* and *substantive law* is *external*: the former is law directly related to law, the latter law directly

[14] *Ibid.* 10.
[15] *Ibid.* 11.

related to society."[16] This no doubt contradicts the tenet of traditional legal theory, according to which substantive law is internal and procedural law is external. This, Eörsi thinks, is not in contradiction with the claim which derives from the internal view of law, because it conceives of law from outside, from the point of view of society, and in the *external* view, "looked at from the vantage point of *society substantive law* becomes internal and procedural law (the form) becomes *external*."[17] The appearance of substantive law as something external and of procedural law as something internal revealed by the internal view of law opens up the way for a more detailed analysis of the *par excellence* legal, i.e. the law of procedure, their special position and features. It turns out that the internal relations within law are relations pertaining to the functioning of law itself, that procedural law is the area which "is saturated with the specific features which are unique to law".

However, Eörsi goes further than merely characterising the relation between substantive legal dispute and procedure as external and internal in terms of the internal view of law: to make this connection emerging in the internal view clearer, he brings the categories of *form* and *content* and their interdependence to bear on the connection in question, critically analysing the question whether substantive and procedural law, and a substantive legal dispute and procedure are or are not related as form and content. Finding the relation between form and content ambiguous, Eörsi starts out from the statement that these phenomena have a homogeneous content of their own, on the one hand, and a heterogeneous, extrinsic content: the law of procedure has the procedural relation as its homogeneous, the substantive legal dispute as its heterogeneous content. "It has an *internal* relation to its own content, and an *external* relation to its extrinsic content."[18] As far as substantive law and procedural law are concerned, these are heterogeneous in terms of their own homogeneity, and as law receives impulses from economy, likewise procedural law receives impulses from substantive law. "Now," via teleological acts of norm-setting? "the extrinsic content, *the external* becomes *only* teleologically determinative, while intrinsic content, 'the internal' is *essentially* internal as a result of the homogeneity of the procedural relation."[19]

[16] *Ibid.* 14.
[17] *Ibid.*
[18] *Ibid.* 13.
[19] *Ibid.*

As a friend of Gyula Eörsi's I am sure he would welcome the doubts and reservations which I might be pardoned for voicing in connection with the foregoing arguments. The doubts and reservations spring from my conviction, based on the views of Georg Lukács and Hegel, that content and form are reflective determinations, "which means that form and content as applied to the individual object, the complex and the process etc. always determine their specific nature, their being as they are (including generality), in combination. But exactly for this reason it is impossible that one of them should contribute only as content, the other only as form, to the determination of really different complexes".[20] Although Lukács' ideas can be shown to have been far from foreign to Eörsi's philosophy of law, he clearly departs at this point from the tenets of the "Social Ontology", indeed, he positively contradicts them when he sees the connection between economy and law in terms of form and content. It must be admitted that he, too, sees them as heterogeneous,[21] and therefore portrays the relation between law and its extrinsic content—the economy—as external. Yet, as we have mentioned, the same applies, according to him, to the relation between substantive law and the law of procedure, despite the fact that substantive and procedural law are parts of the same social complex. viz. law, and are thus, as law, homogeneous. Thus what we have here is a reflective relation between content and form, while the relation between economy and law as separate, heterogeneous complexes can hardly be put down as a relation between content and form. The problem springs from several sources, primarily from the fact that the conception of the internal and the external view seems to be dubious in its application to the relation of content and form. Equally dubious is the pairing of the internal as determinative and of the internal as determined. This is especially highlighted by Eörsi's outstanding discussion of the historical evolution of the relation between substantive and procedural law, which raises the question whether the law of procedure has the procedural relation as its content or substantive law, whether in other words, the relation between substantive and procedural law as a relation between content and form are determined by the approach (external or internal) taken to them, or their actual relations which manifest themselves in ontic genesis and existence.

It would take an entire book to answer these questions in merit. In the present connection I have to restrict myself to raise a few doubts and

[20] Lukács, G.: *A társadalmi lét ontológiájáról* (On the Ontology of Social Being), Vol. I., Budapest, 1976, 408–409.

[21] Eörsi: *Jog, gazdaság... op. cit.* 44.

make a few remarks concerning the categories and links mentioned. It is interesting to follow through Eörsi's arguments with an eye to the motifs of the internal, content and the determining factor, on the one hand and the external, form and the determined, on the other, especially in terms of whether these relations appear in the external or the internal view. Considering that in the relation between content and form content, i.e. the internal, is the dominant feature, when the reflective relation between content and form is applied to that between the internal and the external, it is content, i.e. the internal, that determines form, the external. In other words, when categories are considered in the abstract manner envisaged here, content, the internal is the determiner, and form, the external is the determined. We might wonder how this basic categorial relation is affected in law, as internally viewed, more specifically in the link between substantive and procedural law, and the substantive legal dispute and the procedure? If we remain consistent, then we must hold, as we have argued, that in the internal view of law, procedural law is the internal, substantive law the external aspect, procedural law emerging as the content and thus the determiner, while substantive law is the determined, the form. To avoid misunderstandings it must be emphasised that this is just the result of the logical inferences carried through on the categories as they are interpreted by Eörsi rather than a claim explicitly made by him. Eörsi's extraordinary sensitivity to reality, the inherent realism of his knowledge of law and society prevent him from reaching this conclusion, which is logically correct but dubious in terms of social ontology. He himself shows the socio-historical absurdity of this logic of the internal view in his ingenious exposition of the historical genesis of substantive and procedural law. Primitive systems of law conjure up the appearance "as though procedural law determined substantive law, since substantive law was imbued with life by its recognition in procedural law, an entitlement existed only to what was appropriately related to an 'actio' or 'writ'." Accordingly "What we call substantive law today was the content of an act of procedural law then. From the legal point of view, this act of procedural law was the determining factor, in the sphere of law 'form' determines 'content', the 'internal' determines the 'external'."[22] This is all but appearance, however; in the reality of social ontology the situation if just the reverse. That this is clearly sensed by Eörsi is shown by his argument which casts a shadow of doubt on this special link between the internal and the external, content and form, the determiner and the

[22] *Ibid.* 18.

determined, saying "Something has gone astray here: the 'internal' can determine the 'external' only if the determiner is inside rather than outside, in the present case in law rather than in society. This, however, is evidently not the case. In fact, if we pose the question from the point of view of society, then in *this* more basic context the case we have is just the reverse. The social demand for the entitlement in substantive law determines 'actio' and 'writ'."[23] The misleading appearance of the relation between substantive and procedural law resulting from the internal view is dissolved by the external view of law, which thus brings back into focus the real, ontic state of affairs. In the external view substantive law is the internal, the content, the determiner, while procedural law is the external, the formal element, the determined. This state of affairs is the exact opposite of what we saw in the internal view of law revealed to us. We can even add, in harmony with Eörsi's views, that the structural properties of law revealed in this external view, are none others than the real, ontic processes of the social-economic genesis and existence of law. But this should not be taken as meaning that the internal and the external view, the distinction between internal and external structures and their application is without a *raison d'être*. On the contrary, we have to view law internally if we are to uncover the specific movements and features of law, just as we have to dispel the appearances thus discovered if we are to get within our grasp the real, ontic regularities of law. But it seems certain that the relation between content and form, the determiner and the determined just will not depend on their being viewed internally or externally: ontological structures are not affected by the gnoseological approach we adopt.

Complexity

Eörsi's thought-provoking discussions of the internal and external aspects of legal *effect* and the *internal and external complexity of areas of law* bear out the fruitfulness of the distinction between the internal and the external in law and between the two kinds of point of view in legal studies. An analysis of the internal and external aspects of legal effect provides a sturdy underpinning to the legal investigations of the relation between law and morality and the moral influence of morality in law. The starting point of Eörsi's philosophical ideas on this area is the fact that law as a mode of influencing human conduct always exercises influence on the human psyche

[23] *Ibid.* 19.

on the one hand and that through this it exerts influence on the external world, aiming to set off or prevent certain processes. "In this sense the legal effect is a unity between the internal and the external, exerting its influence through the psyche (internal) on the society (external)."[24] Keeping in view the general pattern of legal history Eörsi arrives at the statement that while in the beginning, in the times of primitive societies when societies and thus the law were interested one-sidedly only in the effect, the result, law was indifferent toward the psyche, it did not take into consideration the quality of human acts, their culpability. Legal consequences would be applied automatically on the basis of external effect and result, irrespective of the quality of the individual psyche of the doer. The real psychological background to conduct became important in law as a result of the expansion of private property and the exchange of goods. This meant the beginning of the influence of ethics on law, the appearance of the idea of culpability in the notion of legal responsibility. This ethical undercurrent can be seen to be at work in modern legal development and legal systems. Eörsi makes an interesting distinction in this respect: "Regarding the tenet of the legal effect being an union between the internal and the external, one must distinguish between cases in which the external effect dominates although, even then, the legal element has to make its way into people's thoughts, and there are cases in which the internal effect dominates although, even then, the ultimate end is directed at the external, viz. society."[25] The internal effect is directed at a "transformation of the set of motives entertained by people", while the external effect aims at a definite kind of conduct, the mere result externally arising in society. This distinction is important especially for legal dogmatics and legal regulation as it makes possible the right choice of legal means in dependence on whether the desired effect is internal or external. The basis of the ethical influence on law is thus provided by the direction of law at the internal effect. Moral categories become relevant undoubtedly when an effect on the psyche of the person expressing the conduct is aimed at, although, it is equally obviously, the final end of this effect on the psyche is the external effect. It is at this point that the philosopher of law is presented with the exciting philosophical problems of ethics and law that as far as its direct operation and validity is concerned, law remains indifferent to the psychic make-up of legal subjects. In contrast, when we come to think of the ontic existence and transformation of law, the situation is different. The outlines of the internal and

[24] *Ibid.* 36.
[25] *Ibid.* 37.

external effects of law and their historical evolution offered by Eörsi are a fruitful ground for a philosophical clarification of these problems and a position which is worth thinking through.

The Legal System and its Systematization

The problem of legal theory indicated by the title has been extensively discussed and has not yet been brought to a satisfactory solution. It provides Eörsi with an opportunity to relate the external and internal view of law to the concrete phenomenon of law. We have to address a different aspect of the internal and the external, the internal and external complexity of the area of law. The distinction between the internal and external complexity of areas of law runs through Eörsi's entire oeuvre: it can be found in his work on plan contracts written in 1957[26]as well as in his grandiose *Comparative Civil Law,* which we have already mentioned. The internal and external complexity of law means quite briefly that external complexity is realised when in a given area of law different branches of law, i.e. legally homogeneous elements are effective together, while complexity is internal when an unified area of law is organised from legally heterogeneous elements, when different branches of law are dissolved via an abolition of their differences. With respect to the legal system and its branching this usually entails that the first is characterised by "a grasp of the area from a legal point of view (*internal* understanding of law), the second by a *social-economic* understanding (the *external* understanding of law) as bearing on a question—the question of the legal system—which is an *internal* question of law".[27] Thus, in the question of the internal articulation of the legal system, Eörsi takes a stand contrary to internal complexity.

Before examining more closely the role and significance played by the complexity of law in the articulation of the legal system as presented by Gyula Eörsi, it will be worth our while to observe the remarkable way in which Eörsi develops the prior question of the legal system and its articulation as an internal question of law. The branches of the legal system are shaped by the dialectic of branching and becoming branched. In this statement the old and much debated question of what the basis of the articulation of the legal system is finds new expression. Eörsi sees the legal system as the summation of the internal and external aspect of law related

[26] Eörsi, Gy.: *A tervszerződések* (Plan Contracts). Budapest, 1957.
[27] Eörsi: *Jog, gazdaság... op. cit.* 42.

to itself: "in fact we have to do here with the organisation of certain 'externalities' (social and economic relations) into a heterogeneous sphere (the law) into an 'Internal' system".[28] It is equally important therefore from the point of view of the legal system and its articulation what kinds of social-economic relations and what kind of legal regulation we have to do with. Although it is true to say of the legal system and its articulation that law is in last analysis determined by economic relations, it would be a grave mistake to disregard the specific features resulting from the legal "transcription", especially the fact that if law is to serve its social function, it has to reflect social-economic relations in a special homogeneous medium. "Thus the essential point of a legal system is that *legal homogeneity* organises into an union the social relations which underlie the particular branch of law"[29] It follows from all this that what Eörsi considers the foundation of the systematization of the legal system is the combination of sets of social relations of a certain quality and the specific methods of legal norms regulating them, together. "For this reason the traditional tenet according to which certain groups of social relations and the special legal methods are the foundations basis of the systematization of the legal system. The two are not linked by 'and' because they are in reality *the internal and external aspect of one and the same thing*."[30] Eörsi bolsters his conception of the branching of the legal system with a genuine jurisprudential *trouvaille*, víz. the category of a *quasi branch of law*. The area of law he refers to by the name "quasi branch of law" is not a branch of law because it embraces legally heterogeneous elements in internal complexity. They "form an unity from a political or practical point of view without being branches of the law".[31]

What is the aim underlying this theory of the legal system and its branches? It is designed to provide theoretical assistance in coping with the crisis of the development of legal systems, which is, pessimistically, diagnosed by the author. It is a recurrent leitmotif in Eörsi's thought to seek for the internal specific feature of law. The "transcription" of social-economic relations into law draws attention to ever new specific features. Thus the insight that law is incapable of directly and adequately reflecting contradictions is the starting point for the pessimistic diagnosis and the vantage point from which a solution emerges into sight. Social and economic

[28] *Ibid.* 91.
[29] *Ibid.* 98.
[30] *Ibid.* 92.
[31] *Ibid.* 100.

processes are saturated with internal contradictions which foster change and further evolution. Law however cannot reflect these adequately. If it did, it would let the contradictions gnaw at its own foundations, they would explode the internal consistency and logic of the legal system. This is one way in which the incongruity between law and economy manifests itself. Law finds itself driven to express the elements of the contradictions in separate institutions (property law and contract law, company management law and trade union law etc.) within the framework of a dominantly harmonious system which lets these elements impinge upon each other only at the periphery. "Thus law is an imperfect instrument for the expression of contradiction: it is *not suitable* for adequately expressing either simultaneously prevailing, or evolving contradictions. This is a consequence of the same special nature of law which *makes it capable of* serving these contradictions with almost infinite dexterity in the interest of the prevailing social system within the confines of the objective possibilities of the system."[32]

Examining the evolution of the branching of the legal system in terms of the general claims about law and contradictions, Eörsi unravels a whole series of critical details which all point to the conclusion that the development of branches of the legal system on a legal basis is in a crisis.[33] Signs of this crisis include e.g. the fact that alien elements make their way into public law, on the one hand, and into private law on the other, that the boundaries between branches of law are becoming blurred in many respects, that the division of law into branches is losing much of its respectability, and that legal generalisations are being discredited, that homogeneous legal institutions become divided in the course of integration, that legal institutions are being relativised and legally heterogeneous units are being formed. "The division of law into branches is lying in ruins".[34]

The situation is better described as one in which, with the theoretical foundations remaining the same as ever, as a result of scientific and technological revolution and especially of social transformations social-economic relations are becoming increasingly complex and tension grows between the structure of the relations which demand regulation and the structure of the legal system. This comes to be felt in developments such as the increase in the number and weight of quasi legal branches, a certain kind of dogmatic luxury, the increase in the number and weight of alien elements incorporated into civil law and the becoming blurred of the boundary areas of certain

[32] *Ibid.* 72.
[33] *Ibid.* 74.
[34] *Ibid.* 88.

between certain branches of law. "As a result of all this, *the system of legal branches safeguards primarily the basic order of the legal system, provides underpinning for the entire legislation, but gives unity to the entire system of law much less than it used to.*"[35]

The Motto

"Draw beginning and end/Together in a union"—Goethe writes. In light of this dictum perhaps there is no need to justify the motto standing at the beginning of the present essay. This review must have revealed to the Reader the fact that Gyula Eörsi was not only a distinguished lawyer but also a most erudite man, well-versed not only in law and jurisprudence but also in literature, the arts and—as we have seen—in philosophy. His eminence as a lawyer, which ranged from civil law to comparative law and to philosophy and made him an internationally renowned expert in jurisprudence, was founded on his breadth and richness of learning.

[35] *Ibid.*

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ANDRÁS SAJÓ*

Promise and Contract: On the Limited Role of Social Ideas

Abstract. The essay is devoted to the role of promise as a moral concept, and, more narrowly, the relationship of promise and offer in contract law. First, it considers the difference between "ordinary" promises and promises having a legal effect. Secondly, the analysis explores to what extent does promise generate obligation. Thereafter, the essay attempts to point to the concept of obligation that provides the best way to establish the moral force of contract. It reaches the conclusion that the relationship between promise as a moral category and facts treated as promise in law is almost accidental. Law is at least indifferent to factors that give rise to moral obligation based upon a promise. However, law (emancipated from the dictates of morals) served freedom better than legal norms formulated in morally coloured terms.

Keywords: Promise, contract, obligation, self-obligation, freedom and autonomy, offer in contract law.

"Tonio Kröger ... stood before the cold altar,
full of regret and dismay, at the fact that
faithfulness was impossible upon this earth.
Then he shrugged his shoulders and went his way."**

Gyula Eörsi, in his principal work titled *Comparative Civil (Private) Law: Law Types, Law Groups, the Roads of Legal Development* [*Összehasonlító polgári jog*] by taking the role of law in society as a starting point, justifies a theory of legal development governed by practical needs. According to Eörsi, the "ultimately determining economic factors produce interests which unvariably have an influence on law through the transmission of ideas. Social ideas, as products of the mind, have a relative independence, but ideas which have an important bearing on society always have their roots

* András Sajó, Member of the Hungarian Academy of Sciences, Budapest, H–1014 Budapest, Országház u. 30., Hungary.
E-mail: sajoa@jog.mta.hu

** Thomas Mann, "Tonio Kröger", in: Thomas Mann: *Death in Venice and Seven Other Stories*, H. T. Lowe-Porter (trans.); New York: Vintage Books, 1930, 91.

ultimately in economic factors."[1] He characterises the role of social ideas as "important but not basic".

The following analysis is devoted to the role of promise as a moral concept and, more narrowly, the relationship of promise and offer in contract law. Does law enforce the morals of promise, or, instead, does it enforce contractual obligations on the basis of more practical considerations determined by economic factors? Shifts in the public perception of the binding force of promises seem to have an impact on the law of contracts. However, Gyula Eörsi is right even after a quarter of a century: although the social idea of promise might have a significant impact on the law of contracts, it still is of secondary importance compared to economic interests that shape (or abandon) the social idea itself.

The questions to follow are dictated by moderate outrage. It is disturbing that the given word is not respected, or, more precisely, that even this very proposition concerning the normative basis of expectation is disrespected. It is embarrassing when moral norms are violated, but it is bothersome when the moral norm is taken as non-existent. Those who keep their promises and especially those who hope that others will do the same are taken as queer fish in our days. True, the principle of *"ein Mann, ein Wort"* was professed by merchants and by otherwise rather unattractive military officers. Characters of long passed times: it is a recurring motive of Eörsi's book that the time of the Buddenbrooks is over.

No era is marked for decline. In the words of Shakespeare: "Then fate o'er-rules, that, one man holding troth, A million fail, confounding oath on oath."[2] Yet, the decline of respect for promises is an important indicator of the state of a society. "To breed an animal which *is able to make promises*—is that not precisely the paradoxical task which nature has set herself with regard to humankind? Is it not the real problem *of* humankind?"[3]—asked the great German philosopher. No, not Kant but ... Nietzsche. Nietzsche—in surprising conformity with Kant—celebrates the success of man in the ability to promise, in the "will's memory", in "an active desire not let go, a desire to keep desiring what has been, on some occasion, desired".[4] The

[1] Eörsi, Gy.: Comparative Civil (Private) Law: Law Types, Law Groups, the Roads of Legal Development. Budapest, 1979, 45–46. The Hungarian original of the work was published as Összehasonlító polgári jog: Jogtípusok, jogcsoportok és a jogfejlődés útja. Budapest, 1975.

[2] Shakespeare, W.: A Midsummer-nights Tale; Act Three, Scene II.

[3] Nietzsche, F.: On the Genealogy of Morality (ed.: Keith Ansell-Preason). Cambridge, 1994, 38 (emphasis original).

[4] Nietzsche: *op. cit.* 39.

man of promise, learning to render himself predictable, is able to have the future at his disposal. The man of promise can live up to his own image of the future. By making himself predictable, he became "a sovereign individual, ... like only to himself, having freed itself from the morality of custom, an autonomous and supra-ethical individual."[5]

As we live in an unhappy (but even in this respect unexceptional) age that needs heroes,[6] the heroism of obligation-generating promises could do no harm. This is so, even knowing the sins of faithful perseverance. Those sins hardly affect the mystery of the promise, so long as a promise is seen as a means of human autonomy, and not of subordination.

The decline of the morals of promise is due to social and economic reasons, which can hardly be influenced. Still, may law, as a relatively independent normative system, come to the rescue of promise? After all, rumour has it that law is a manifestation and a pillar of morals. Considering the connection between contracts and promises that constitute contracts, and taking into account the central role of contracts in the functioning of law, it seems worthwhile to analyse how a promise may give rise to legal obligations.

In legal philosophy, turning Is into Ought is just like the philosophers' stone. How does an obligation emerge? Why are we obliged to do something? A realist would hold that and obligation is not more than a self-deceiving expression of our desire to avoid punishment. An alchemist of legal philosophy may attempt to locate the source of obligations in some specific feature of promise. Promises can really give rise to moral obligations. Kant made gold but could not pour it into bars or turn in into fancy legal bijouterie. Law can not really make use of a moral obligation stemming from promise. Although Kant discussed promises giving rise to contracts in his theory of right, and not in his theory of morals, the discrepancy is even bigger than he would have ever had imagined.

Consider first the difference between "ordinary" promises and promises having a legal effect. A promise appearing in the context of the law of obligations, and especially in contract law, is a "promise aimed at a legal effect", "offer and acceptance", or declaration. Although this distinction is utterly justified under modern circumstances, a historical survey would suggest that there was another possible connection. Theoretically, it was

[5] Nietzsche: *op. cit.* 40.

[6] One of Eörsi's favourite Brecht quotations. Brecht, B.: *Life of Galileo*, Scene 12, in: Brecht, B.: Collected Plays, vol. 5, (eds.: Ralph Manheim and John Willett); London, 1972, 85.

and, even today, it is possible to establish a system of contract law, which consistently asserts that a promise in itself constitutes an obligation, and, even more, an enforceable one. Conceptual analysis is followed by a detailed discussion of this issue. This discussion, however, will not explore in detail why modern systems of contract law distanced themselves from the legal protection of moral obligations arising from promises.

Thereafter, the analysis explores to what extent does promise generate obligation. While there are several theories on this, the present discussion is centred around the Kantian concept, because the Kantian concept is based on freedom. Kant's metaphysic of morals provides moral norms of action as found in the state of freedom. Furthermore, the Kantian concept is the most consistent theory that locates the source of obligation in the person assuming an obligation. In comparison other theories appear to be heteronomous, as they justify obligations from the perspective of society or of the promisee, or they explain an obligation rising from a promise with reference to customs or coercion. Also, contemporary theories of contract, drawing on Aristotle, proceed from the aim of the promise, and not from the free expression of will exposed in a promise. These theories accept a promise as binding and a contract as valid, if the aim pursued by them is acceptable. Needless to say, such efforts seek the reformulation of law in terms of material justice, being in overt tension with other concepts of law based upon the autonomy of the promisor or the parties.

According to rivalling concepts, moral obligations stemming from promises differ in character and consequences—even for the purposes of law. The fourth section of the analysis is devoted to exploring which concept of obligation seems to provide the best way to establish the moral force of contract, and, in regulating contractual relations, what kind of moral order is reinforced and accepted by law. Experience suggests that the modern contact law is not guided by Kantian conceptions. Indeed, the same stands for modern legal systems in general, although allegedly the point of modern law is to safeguard liberty and a sphere of action for autonomous human beings. Legal norms—the promises of law—are indeterminate and disobeyed, features which suggest that the sovereign itself is not serious about its promises. Nonetheless, as suggested in the fifth part, this shall not prevent attempts to accord modern contract law with an individual moral of obligations pursuing Kantian conceptions of autonomy. May such efforts fail, an instrument for the critique of law has still been made available.

1. Promise and Contract

Kant deals with promises in the context of acquisition by contract in his theory of right, when discussing the private law valid in the state of nature. Promise is an offer that can be pleasant for the one who accepts it.

Promise as a sign or phenomenon is quite different from legal phenomena. Using a term common in Hungarian legal terminology, a promise is not always of legal relevance [a "legal fact"], and even when it is a legal fact, it is often problematic to explain why it does *not* have a legal effect. In the ordinary sense of the word, any resolution addressed (communicated, intended to be directive or relative) to someone else concerning my actions amounts to a promise. In law only such public statements of will addressed to someone else are considered to be relevant, the addressee of which is identifiable. Certainly, such statements can be addressed to the general public. In his theory of right Kant discusses legally relevant promises in essentially similar terms.

According to Kant, it is only "the juridical relation of Man to Beings who have both Rights and Duties"[7] that results in an actual connection between legal rights and duties. In Kant's analysis, however, although the binding force of law lies in itself, law must still correspond to morals. The notion of right implies the ability to bind others. Nonetheless, if law obliges one to do things that he should do anyway in compliance with his moral duties, then the legal order is a legal order of freedom. Thus, law derives from freedom, from moral law determined by our-selves. If my promise is not morally binding on me, no one can impose on me a legal obligation. Others who oblige me take advantage of the situation, which was created by the obligation implied in my promise. Taking advantage of an opportunity opened up by moral law, however, does not give rise to an obligation. Nevertheless, as soon as a moral obligation has been created, legal regulation takes advantage of it in a rather arbitrary fashion and allows others to make use of it as well, thereby distancing law from morals. For instance, contract law (i.e. legal regulations applicable to the enforcement of contractual obligations) treats the obligee's claims mainly without respect to the contents of the actual promise, and, thus, refusing to follow the morals of promise. Such ignorance is possible even for Kant: "it is not in Ethics, therefore, but in Jurisprudence, that the principle of

[7] Kant, I.: *The Philosophy of Law, An Exposition of the Fundamental Principles of Jurisprudence as the Science of Right* [Metaphysik der Sitten: Metaphysische Anfangsgrunde der Rechtslehre]. Clifton, 1974, 26.

the legislation lies, that 'promises made and accepted must be kept'. Accordingly, Ethics specially teaches that if the Motive-principle of external compulsion which Juridical Legislation connects with a Duty is even let go, the idea of duty is sufficient itself as a Motive."[8]

Kant was not at all the first to distinguish the moral binding force of promise from the binding force of contractual offer and acceptance, or contract itself. Kant—among others—dealt with the theory of right and virtue because it was obvious that actions, which follow the law of reason that was rendered possible in the state of freedom, do not necessarily occur in real life. Something must bring human actions closer to the state of freedom: this is what law is for. According to Kant, in contrast with moral law, legal rules provide for action not solely on the basis of moral obligations. If an action complies with the rule because it was guided by the idea of duty, then the action has morality ("duty of virtue"). At this point, Kant refers to promise as an example.[9] A promise, which must be kept because of its enforceability, is a matter of legal obligation. But keeping a promise without external compulsion is an act of virtue ("fidelity").

According to Hungarian, French and German legal terminology and jurisprudence, a declaration which is not *aimed* to have a legal effect, does not give rise to a contract. The teleological character of the term "aim" might certainly become problematic. What should will and consciousness cover in order to trigger legal effects? An invitation to dinner might have connotations of boredom, dishwashing or a juicy stake for host and guest alike, while law does not cross their minds. Still, may one make a cruel joke out of a dinner invitation, when enforcing various legal consequences, the court will hold him for failing to seriously consider the foreseeable legal consequences of his actions.

Pursuant to classic common law, a gratuitous promise (where there is no consideration) does not give rise to a contract. Due to lack of acceptance (consideration) the promise is not legally binding. A sheer promise to transfer rights can not bring about a contract, since without consent there is no free act of will on the other side. In this case a promise does not establish and obligation, rather, it is a prolegomenon to self-binding. That is, anything that takes another person to consent qualifies as an attempt of self-binding. Binding force is attached to acceptance (consent, consideration), reliance, or confirmation by another person. Hegel's position highlights this point: "the two wills are associated in an identity in the sense that one of

[8] Kant: *op. cit.* 22.
[9] Kant: *op. cit.* 22.

them comes to its decision only in the presence of the other".[10] "My will may become objective to me."[11] From the perspective of the morals of promise, however, acceptance is not constitutive, it reinforces the irreversibility of a promise at best. Kant himself says that a believed promise can not be withdrawn, since—using a modern term—it induces legal effects. Withdrawal is self-contradictory. More precisely, a person is bound by his promise until its withdrawn. Acceptance functions as a limitation on withdrawal, it bans withdrawal for the benefit of the acceptor.

Promisory estoppel and prompted interest (*bíztatási érdek*), its Hungarian equivalent, show that a promise (actions inducing it or the impression thereof) may give rise to an obligation without acceptance (consideration). This happens when a promise induces action or forbearance of another reasonable person, who suffers damages as a result. Thus, it seems that promise as a moral obligation has limited relevance for law: it is necessary to exclude the arbitrariness of the enforcement of a consequence, which corresponds to the promise made. Consent implied in a promise, its voluntariness repeals the arbitrariness of legal coercion.

Modern legal systems distinguish promise from contractual offer and acceptance. Contract law applies to such promises which are about creating or transferring rights. From another perspective, legal consequences are manifested before performance if and only if the other party relied upon the declaration in question and was adversely affected. As Fuller and Perdue submitted in 1936,[12] expectations generated by the offer or interest associated with actions based upon those expectations are protected by contract law.

In contemporary law, no one would be surprised if a statement concerning an expensive gift would only be enforceable if made in writing. (Hungarian professional discourse is likely to centre on who gets to counter-sign it and for how much exactly.) Why does law not recognise an obligation stemming from a sheer promise? Why does a simple declaration not suffice? Why is there a need for acceptance in case of a gift? The reason is not that law is hostile to promises, rather, it is because law serves legal policy considerations as well. And, mainly, without a requirement of writing, highly uncertain situations could emerge, raising innumerable problems of

[10] *Hegel's Philosophy of Right* [Naturrecht und Staatswissenschaft im Grundrisse/Grundlinien der Philosophie des Rechts]. London—Oxford—New York, 1967, 58 [s.74].

[11] *Hegel's Philosophy of Right. op.cit.* 58 [s. 73].

[12] See Fuller. L. L. and Perdue, W. R.: The Reliance Interest in Contract Damages, *Yale Law Journal*, 1936, 52.

evidence. Practice and theory are content with insisting that insignificant promises are irrelevant; legal policy considerations are not questioned; for they are obvious. Zweigert and Kötz take the casebook example for granted: if someone is invited for dinner but not allowed to enter the house, he can not successfully claim compensation for his taxi bill. In the name of seriousness, issues of promise, offer and legitimate expectations are put aside without any theoretical analysis. English law goes as far as stating that "An Englishman is liable, not because he has made a promise, but because he has made a bargain."[13]

2. Protection of Promise in the History of Contract Law

Roman law denied the binding force of a mere promise, and as such, the binding force of a promise of a gift. Canon law recognised the legally binding nature of promise, but its validity and enforceability depended on the aim served by the promise. Probably there was one moment in history—at the heyday of scholasticism—when contracts were meant to enforce promise-based obligations. In Gordley's view, however, this connection was based upon a conception of justice referring back to Aristotle.[14]

According to jurisprudence influenced by late scholasticism (Connanus, 1508–1551), the promisor was bound only in respect to belief.[15] In a legal sense, a promise created an obligation to the extent breaching the promise would have violated the principle of "do no harm to others". Damages were adjusted to the credibility of a promise. Connanus' position was unacceptable for Grotius. First, Grotius, an advocate of natural law based on the law of reason, rejected Connanus' methodological presuppositions. Secondly, Connanus' position would also have destroyed Grotius' theory of international law. If a sheer promise is not legally binding, agreements of monarchs are irrelevant until they are being performed. And what is performance in the case of a peace treaty? Stopping the attacks, disbanding

[13] Cheshire—Fifoot (-Furmston): *The Law of Contract*; 1991, 28. On quote in: Zweigert, K.—Kötz, H.: *Einführung in die Rechtsvergleichung*. Tübingen, 1996, 385.

[14] This commutative justice consideration has been raising problems in law ever since. In this respect, in Hungary it is sufficient to refer to the confusion surrounding *laesio enormis*, abuses and unpredictability of public and private law.

[15] On this point, Atiyah and Gordley exceptionally seem to agree. See Atiyah, P. S.: *An Introduction to the Law of Contract*. Oxford, 1989, 10. Gordley, J.: *The Philosophical Origins of Modern Contract Doctrine*. Oxford, 1991, 73. See also Atiyah, P. S.: *Promises, Morals, and Law*. Oxford, 1981.

troops, or what else?[16] For a promise to be binding, or, for a promisor to be obliged to keep his promise, an a priori rule is needed. Grotius found this a priori rule in natural law: promises are binding by nature.

Grotius' position[17] dominated social contract theories for a long time. Note that, although Grotius insisted that promises are binding, he was of the view that a promise is enforceable by the other party only if the promise was for transferring rights and if it was made in the proper form. In a similar fashion, Pufendorf believed that only those promises are "perfect" and, thus, enforceable which were made to transfer rights. It is not entirely clear whether by way of a perfect promise the promisor creates a claim, or whether it actually confers the right about which the promise was made.[18] Natural law dictates that promises shall be kept. Still, the obligation itself is based on the voluntary consent to transfer something that belongs to one. A simple expression of future intent does not make a promise enforceable.

The idea to connect the binding force of promise with the binding force of contract gained further support in the Continent: in the sway of 18th-century freedom movements the concept of liberty was tied to autonomy. For the purposes of an attempt to make law correspond with liberty, the claim that "I am obligated because I obliged myself in my promise" sounds more attractive than any other competing explanation (e.g. I am obliged because the other party expects me to do something or did something).[19] This is so since in all other cases the source of obligation is external. All this might be of little significance today, but in the 19th century the craftsmen of the basic—and still used—principles of contract law were eager to accord their conceptual devices with contemporary concepts of freedom.

This emancipation based upon the principles of freedom was not at all accomplished by legislatures of bourgeois revolutions—revolutionaries

[16] See Grotius, H.: *De Jure Belli ac Pacis*, II, XI.

[17] Grotius: *op. cit.*, II. 11, IV.

[18] See von Pufendorf, S. F.: *On the Duty of Man and Citizen According to Natural Law* [De Officio Hominis et Civis Juxta Legem Naturalem], Cambridge, 1991, 70 [IX. 7.]

[19] There is a moment in Hungarian law, which is clearly dominated by promise. An offer sent by mail becomes irreversible from its receipt until the arrival of the response. Suppose that initially the addressee was hesitant to accept the offer and believes that no contract was made. Then, at the very last moment, he accepts the offer on the phone.

were not concerned about moral elements of still preserved in law. Rather, they were bothered by the substantive and structural arbitrariness of law.

Members of the drafting committee of the *Code Civil*, while constantly referring to natural law and liberty, did not do more than editing Domat's ideas—ideas which were formulated before the revolution. In his remarks on contracts Domat did refer to freedom and will, in reality, however, all he (and others) did was cleaning law from concepts of scholastic theology, i.e. considerations of justice in *quid pro quo*. The creative jurists of the 18th and 19th century were busy with trying to identify those promises among all morally binding undertakings, which could have a serious legal effect. In doing so they relied on technical factors independent of ethics and morals: they used tools as "*causa*" and "consideration". In lack thereof, a promise could not amount to an expression or will or offer. At the same time, "promise" was replaced by "will" in the terminology of continental private law. It is worthy of attention that early advocates of the will theory occasionally did refer to will as a manifestation of private autonomy. Law, even when it becomes positive, can serve the morality of freedom—to this extent Savigny summarised the Kantian concept properly. Law safeguards the sphere of individual freedom of action. Law promotes morality not by executing moral norms. Rather, via legal institutions law makes it possible for everyone to realise their inherent moral qualities in conformity with the nature of things.[20] In sharp contrast with justice based approaches, Savigny insists that besides freedom "there is no need for a second principle in the name of the common good".[21]

According to Gordley, however, Savigny's concept of freedom and his will theory are not connected to Kant.[22] It is not longer promise that is binding—promise was replaced by will itself. A contract originating from the conformity of wills is but a metaphor. Nothing follows from two (expressions of) wills. Wills and words standing for them are not two atoms bonded in a molecule, the existence of which generates a new physical reality. Initially, craftsmen of the modern (Pandectist) contract theory did acknowledge this. In the words of Savigny, the act of willing is "an invisible event". An act of willing can only be inferred from an expression of the will. Still, an expression may only be relied on to speculate about the *possible* will expressed.

[20] Savigny, F. C.: *System des heutigen römischen Rechts*, I. 55.
[21] Savigny: *op. cit.*, I. 54.
[22] See Gordley: *op. cit.*, 226.

The legal treatment of the binding force of an offer demonstrates how limited respect for freedom is, when it is contingent upon the respect of will. Law determines the unilateral binding force of the offer—including its commencement and duration—in an automatic fashion, without regard to the intent of the offeror. Considerations about trade security serve as a standard justification for the rule, which is appropriate. Nonetheless, it clearly shows how law distanced itself already in the 19th century from the idea of will and from the promisor.

Replacing the problem of promise with the problem of the expressed will successfully detached contracts from the issue of moral binding force associated with promise, emancipated it from the confusing remains of moral thinking. The man of practice does not have to consider why a contract is binding. Promise emerged *a novo* as the moral basis for contract in the name of the protection of private autonomy when will theory lost its strength, owing not only to social and justice considerations, but also due to its own operational difficulties (e.g. problems of long-term co-operation, etc.). A purely formal theory of corresponding wills was hardly able to provide a justice-based revision of contract law, to reject its modern limitations. A morality-based theory that can refer to autonomy may be more successful in this respect.

3. Is a Promise Binding, And If So, Why?

Stricto sensu, promise gives rise to moral obligation if it commands the promisor "from inside", without reference to external reasons, that is, if the promisor obliges himself by the promise. This position is clearly reminiscent of the Kantian concept of establishing obligations. The most convincing are those moral theories, which derive the moral obligation to keep a promise from individual autonomy. The promisor's freedom receives its fullest recognition in this approach: the promisor is bound only with regard to himself, he is the cause of his own action. Other conceptions of the binding force of promise take the position of the recipient, the acceptor or beneficiary as a starting point. These theories explain the binding force of promise as a matter of responsibility triggered by the acceptor's reliance on the promise. Furthermore, due to their influence on contract law, it is important to mention those moral conceptions which explain promise as a convention necessary for the functioning of society, without reference to corresponding duties. Also, there are theories which connect the binding force of promise with coercion mobilised in response to non performance.

Hobbes and Locke established the state by way of a contract. According to Locke, the power of government is based upon keeping mutual promises.[23] As Hume pointed out, however, Locke could not succeed in justifying why the contract itself was binding. The idea that promise in itself might have some particular quality that makes it binding did not occur to Locke. As he argued against Aristotle, concepts and things had no essence for him. By rejecting essentialism Locke held, that promise is binding for otherwise the concept would not make sense. May this be the case, it still is no answer to the question. Promise certainly embodies the notion of acting upon an obligation that was undertaken voluntarily, and the concept is used in this sense. Still, a given use of a concept does not lead to an obligation to act according to a certain meaning, or, at best, it directs behaviour in the conventional sense of the word: meaning would be impossible without a certain correspondence of actual actions. Those who use the word "promise" generate expectations in the addressees.

While this solution is popular even today, Hume was not content with it. According to him, the true explanation of binding force is a matter of convention. Within the context of direct relations of small societies, sanctions against those who failed to keep their promises generated a convention, which was then partly reinforced by law. In small societies, promise is aimed at co-operation (motivated primarily by self-interest). Breaking a promise renders this co-operation impossible. Expectations developed this way were internalised by time. This is why people act upon promises.[24] [25]

According to Hume, one does not abandon up the benefits of his natural freedom without compensation. Promise, thus, is conditional: it becomes unconditional and binding only in exchange for consideration (in politics, it is the protection provided by government / the sovereign). Of course, other than the rationality of interests, nothing explains why keeping a promise should be tied to the performance of others. According to this approach, only those promises are binding which are kept due to

[23] Although the democracy of ancient Athens knew no constitution, was not based on promise—its political organisation existed without simultaneous events, any specific act of obligation, or any act of obligation concerning the future.

[24] See Hume, D.: *A Treatise on Human Nature* (eds.: Sir L. A. Selby-Bigge and P. H. Nidditch). 2nd ed. Oxford, 1992. 541 [Book III, Part II, s.8].

[25] This explanation, however, undermines the binding force of promise, since breaching a promise will only amount to the violation of a convention. See Fried, Ch.: *Contract as Promise: A Theory of Contractual Obligation.* Cambridge, Mass., London: Harvard University Press, 1981, 15.

the dictates of self-interest (and of conceivable compulsion)—the rest does not count. This, however, makes promise an impracticable social institution, since the interests of the promisor are hard to foresee. This perception is in conflict with the concept of promise itself: under this approach a promise is not a statement about one's future actions.

Note, however, that Hume made an attempt to turn fidelity into a moral obligation via a self-limiting argument. He holds that people keep their promises, because society would crumble if promises were abandoned upon the dictates of self-love. Thus, rejecting the submission that promise is an act of self-biding brings by an even more absurd explanation. After all, the alternative explanation presupposes self-interested people caring for society, people who "limit themselves" by an *ex post* judgement driven by their concern for society, thus solving the bootstrapping problem.[26] Still, when building a system on an empirical basis one has to acknowledge that people are free-riders. According to Hume, however, there is no need to base the obligation to obey the sovereign on some concept of promise (i.e. citizenship in modern terminology)—everything is "justified" by admitting that there is no society without allegiance and fidelity. The standard counter-argument holds that acknowledging the above will compel anyone to participation in upholding the institution. In a situation when self-interest commands to the contrary, one is not likely to observe the binding force of a promise simply because otherwise the necessary institution will not function in the long run. That is, except if one is a moral being in the Kantian sense, or, if one is afraid of disclosure or coercion.

Furthermore, Hume submits that in local communities, breaching a promise has extremely serious consequences among the members of the community. Aristotle claims that the one who does not keep a promise in a community, can not be virtuous. This consideration, however, does not apply in relation to outsiders: deception of strangers does not matter, more precisely, it is an admirable feint. As to legal agreements, Roman public and private law alike attributed little significance to promises (the institution of *naturalis obligatio* gained significance only later, partly due to Greek influence). Enforceable promises were established by sacral acts. What mattered was transfer (*traditio*), performance itself—this was the bar to reclaiming a promised and transferred object, or recalling performance. While this solution is appropriate for the legal needs of closed societies, it became inconvenient for the purposes of trade in imperial Rome. The tribal

[26] Hume, D.: *Of the Original Contract* (1748), in: Hume, D.: *Politcal Essays*, (ed.: Knud Haakossen); Cambridge, 1994, 197.

way of thinking, which attributes binding force to promises only within the group, is completely dysfunctional in modern, anonymous societies utterly settled upon exchange of goods. With the disappearance of the tribe as the natural background of binding promises, and in lack of a natural community within which promises should be kept, the fate of promise is sealed. There is no community any longer in which promises are to be kept: public sphere consists of strangers.[27]

According to sociological or (in the Kelsenian sense) pure concepts of legal theory, a promise giving rise to a right shall be kept due to *external* legal coercion. Quoting La Rochefoucauld: "we promise according to our hopes, and we hold according to our fears."[28]

While for Locke contract is a means to construe government, for Hart promise is the baseline of the entire modern legal system. Hart regards legal rule itself as a promise. Legal rules are binding as promises. The legislator, the executive and the judiciary promise the application of the rule. For Hart, promise (and the legal rule that is in itself a promise) binds the promisor by way of external rules upon which the action promised is to take place. The binding force is dependent upon the external condition (the existence of

[27] On the other hand, transactions, both commercial and political, are not synchronic but lasting and multitudinous, thus, the need for mutual trust is increasing. In the anonymous mass society, social co-operation can function successfully only as an autonomous relation of free human beings, or in free relations of autonomous human beings. Empirically, it is hardly possible, perhaps because people lack the rationality necessary for making and keeping promises. A series of legal and social institutions is set up to substitute it—endangering autonomy itself, hindering the promises of the autonomous human being from being realised. Furthermore, contracts are not made by men anymore, they are made by organisations. The man of organisations is, of course, anonymous and enjoys the irresponsibility of anonymity. And as contracts that are dictated by organisations play a decisive role, the model of promise disappears, and even the people who creep forth from the mouth-hole of organisations behave as they are accustomed to. E.g. product liability (which is limited even today) exist for mainly political reasons and not owing to the logic of private law. Also, and more importantly, law tends to accept that one shall promise almost nothing to enter into a contract. Roughly speaking, a bank is keeping one's money as a deposit according to terms it wishes and conditions it sees fit. (Pursuant to the practice of the National Savings Bank ["OTP"] major cash disbursements may take place several days following prior notice—allegedly for security reasons. Nobody seems to care that this does not at all serve the interests of the depositor.) Does a statement that is subject to constant change fit within the concept of promise? And if the statement of bank is not a promise, then what is it? Mightiness based upon involuntary consent?

[28] de La Rochefoucauld, F.: *Maxims.* Baltimore, 1959. 38.

the rule and some further factors behind the rule). Promise is to be kept for heteronomous, external reasons that do not concern the promisor.[29] Hart takes promise as a means necessary in economic relations, as an instrument of self-biding. Empirically this approach might be close to contract law's notion of recognition of promise, but as a practical or utilitarian consideration, it amounts to an component of moral theory on law, and not a moral basis for law.

According to Kant, the action following one's own act of choice (reason) presents the action as objectively necessary, i.e. makes it *a duty*[30] by adjusting it to the moral law. Just to avoid misunderstanding: "The activity of the Faculty of Desire may proceed in accordance with Conceptions; and in so far as the Principle thus determining it to action is found in the mind, and not in its object it constitutes a *Power acting or not acting according to liking*. In so far as the activity is accompanied with the Consciousness of the Power of the action to produce the Object, it forms an act of Choice".[31] It means (simplifying the point) that the act of choice is the action governed from inside and recognized as that. One keeps a promise because of the dictates of the law of reason. Any other action would be contradictory: if keeping promises is not rendered as the general standard of action, it will be impossible for anyone to promise. Promise ceases to exist just like the possibility of autonomous action.

"For, the universality of a law that everyone, when he believes himself to be in need, could promise whatever he pleases with the intention of not keeping it would make the promise and the end one might have in it itself impossible, since no one would believe what was promised him but would laugh at all such expressions as vain pretenses."[32]

[29] Hart, H. L. A.: *The Concept of Law.* 2nd ed., Oxford, 1998.

[30] See Kant: *op. cit.*, 18.

[31] Kant: *op. cit.*, 12.

[32] Kant, I.: *Groundwork of the Metaphysics of Morals* [Grundlegung zur Metaphysik der Sitten], (ed.: Mary Gregor); Cambridge, 1997, 32.

The first part of the above quotation reads as follows: "Another finds himself urged by need to borrow money. He well knows that he will not be able to repay it within a determinate time. He would like to make such a promise, but he still has enough conscience to ask himself: is it not forbidden and contrary to duty to help oneself out of need in such a way? Supposing the he still decided to do so, his maxim of action would go as follows: when I believe myself to be in need of money I shall borrow money and promise to repay it, even though I know this will never happen. Now this principle of self-love or personal advantage is perhaps quite consistent with my whole future welfare, but the question now is whether it is right. I therefore turn

As the promisor follows his own law, his action corresponds to moral duty. But why does the rule of reason command promises to be kept? Duty is to be followed, says Kant. But why? When criticising Mendelssohn, Kant rejects the question itself. In his theory of right Kant submits: "The question is put thus: 'Why *ought* I to keep my Promise?' for it is assumed as understood as understood by all that I *ought* to do so. It is, however, absolutely impossible to give any further proof of the Categorical Imperative implied... It is a Postulate of the Pure Reason..."[33] This remark applies to promise in contractual relations. So the question makes no sense in law—and only in law. George Fletcher, commenting upon Kant's above mentioned standpoint, finds that in contract law freedom of action falls under limitations by way of promise, as certain decisions are handed over to the other party. "The different outcomes under the moral and legal theory highlight divergent concerns: the former with the promisor's internal struggle and the latter with the problem of power and control between two distinct individuals."[34]

Kant does not elaborate on the origin of the binding force of offer, finding that it is impossible to prove and shall be accepted as a categorical imperative. Nonetheless, outside the theory of right it well might be possible to find some moral reason that explains the binding force of promise. Then, this moral basis might affect law, and, by the same token, contract as well.

Certain versions of the Kantian conception do not take the promisor's relation to himself as the basis for the obligation to keep promises. In this respect, Charles Fried's attempt is remarkable. In his book of 1981 Fried establishes the binding force of modern contract upon promise: "since a contract is first of all a promise, a contract must be kept because a promise must be kept."[35] According to Fried, men are free for they can

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the demand of self-love into a universal law and put the question as follows: how would it be if my maxim became a universal law? I then see at once that it could never hold as a universal law of nature and be consistent with itself, but must necessarily contradict itself."

The Kantian tenet of self-contradiction and the collapse of the social institution of promise as its consequence can also be found in Locke and in Hume's conventionalism. Kant, however, connects those elements to autonomous action, and turns them into an internal law of action.

[33] Kant: *The Philosophy of Law* / Metaphysik der Sitten. *op. cit.*, 103–104.

[34] Fletcher, D.: Law and Morality: A Kantian Perspective. *Columbia Law Review*, 1987. 533, 547.

[35] Fried: *Contract as Promise. op. cit.* 17.

establish contacts with others, human freedom is realised in those relations, and this is the source of the binding force of promise—and, at the same time, its moral basis, as it is an act of freedom. "An individual is morally bound to keep promises because he has intentionally invoked a convention whose function it is to give grounds—moral grounds—for another to expect the promise performance. To renege is to abuse a confidence he was free to invite or not, and which he intentionally did invite."[36] Immorality consists in abusing someone's confidence and, by way of that, not treating the other person as an autonomous being. This is morally wrong.

A variation of Fried's approach is to hold that the promisee's trust is an assumption regarding the promisor as an autonomous being. In this context failure to perform undermines the promisor's autonomy. One, who wants to be autonomous, also has to act as an autonomous being in relation to others. Promises must to be kept to avoid being seen as an abuser of confidence. Moral duty is replaced by virtue, or, perhaps, by the social sanction.

While Fried takes into consideration the promisor's morality, other theories seek the binding force of promise in its impacts on others who rely upon it. Promise triggers an expectation (confidence), and violating it is unjust or morally wrong. Scanlon,[37] for example, derives the binding force of promise from the detrimental consequences caused by the violation of the promise to those who relied on it. According to principles requiring the avoidance of harm, a breach of promise adversely affecting another person is morally wrong. Everyone, including the promisor, is under a duty to refrain from causing disadvantage or harm to others. Avoiding wrongfulness is the promisor's moral duty. (Consequently, if a breach of promise is not detrimental, there is no violation of duty. The same applies when some greater harm is avoided by breaching a promise.)

When focusing on how the promisor may be discharged of the promise it is easy to point out the difference between this external justification of the binding force of promise implied in the assertion of claims and the Kantian justification that centres around the promisor. A promise is not to be kept if the promisee releases the promisor. Did the person released this way keep his promise? Shall he still condemn himself *in foro interno*? Furthermore, how shall an external observer view the ones favoured by

[36] Fried: *Contract as Promise. op. cit.* 16.

[37] See Scanlon, T. M.: Promises and Contracts. In: *The Theory of Contract Law* (ed.: Peter Benson). Cambridge, 2001.

benevolence and equity? What kind of a freedom can be completely dependent upon others?

I regard a stricter version of moral obligation as valid. This approach seeks the basis of the obligation in the act itself, and not in the relationship with the addressee. If a promise is kept because someone else expects it (or enforces it), then the cause of the action does not lie in the actor. What makes a being autonomous is the reason *why* he keeps his promise. He does not keep his promise for he promised to someone else, but because of himself. The duty to oneself becomes the basis for keeping a promise. The obligation derives from one's own freedom and autonomy and not from the recognition of another's autonomy via a promise. Assuming an obligation is an act and a consequence of freedom. Following Kant, the person who acts upon an obligation, is a moral being—who chooses to follow the law of reason. Thus, acting in fulfilment of an obligation that originates from a promise amounts to a duty (unless the duty is not contrary to the law of reason, that is a very low standard). It means that by keeping a promise without regard to any other person, one justifies himself as a moral being.

Promise leads to self-obligation as follows.

Suppose that I have an idea concerning some future action of mine. I may go jogging in the park today. It is time to go jogging in the park, etc.

To this idea, I attribute the character of a decision. The question is what makes the idea of a future action into a resolution. The issue can be approached in an empirical way—I adjust some of my plans and particular actions to it. The connection can be rather weak when this adjustment remains on the level of ideas. But if I go to bed earlier or prepare my shoes, I actually reinforce my decision by actions. I may also underpin my resolution by means of social representation: I make a vow. For a religious person, this is a serious obligation as the believer exposes himself to the judgements and sanctions of an imaginary external force. The force can be external in the sense that in the case of breaching the vow, one anticipates the punishment of fate—that is, one attaches a sanction to it. But one does not have to be a believer to be able to self-oblige. Self-obligation might be a case of normal schizophrenia or the ability of man to reflect upon himself. What transforms an idea into a resolution is that one renders the realization of the resolution to become the measure of his moral judgement on himself. Certainly, this is possible on different levels of consciousness, and can work not only in anticipation but subsequently as well. I have not gone jogging for a week (with all sorts of excuses)—if I do not go tomorrow, I am a good-for-nothing (lazy, stupid, etc.) man. (The

condemnation might be not only moral, but also intellectual, although even in the latter case it has a moral fault behind it. Stupidity or ignorance of health is one's moral fault.)

Suppose that I announce: from now on, I will go jogging every morning (I make an announcement that I made a vow to myself on jogging).[38] This promise will already be subject to sanctions (backbiting, contempt, etc.). What will be the ground for contempt? My own breach of obligation. I will be condemned for breaching my obligation, although my action was not detrimental to anyone else, no one could establish any material expectation on me: the action concerned only myself.

Telling someone that "I promised myself to go jogging from now on" is not a promise in the legal sense of the word. It is different than saying: "I promise you to go jogging every morning". In a legal system based on the morals of promise, it would be a promise giving rise to an obligation, an enforceable promise. Whether law will really provide protection against breaching this promise is a different matter. After all, what kind of right did I confer upon the promisee? A right to see me jogging? Without conferring a right, there is no contract, no legal obligation.

Before dwelling on the possible legal relevance of the concept of "promise as obligation", it is in place to mention a potential practical counter-argument. With becoming widespread such a practical approach undermines the very possibility of moral existence in everyday life. "Undermining" describes a situation where insisting on promises results in a recurrent failure of one's way of living. The counter-argument holds that it is completely irrelevant how one defines himself—all that matters is the social context. The whole line or argument is foolish, it is the logic of the blockhead. Why would it be wrong to depart from one's resolution? Why should one do something that is unpleasant or that is against his interests? The principle of *pacta sunt servanda* is based on the premise that an offer can not be against the offeror's interests, as there is consideration for his performance. Where public opinion does not find the interest satisfied, promise is not binding and it does not have to be kept. Adaptation is freedom itself. Even the promise made to someone else is not to be kept unless the other party can force me to perform. As others have expectations, and costs based on those expectations, others put a system [like law] in motion if observing a promise is instrumental to their interests.

This line of argument allows for the existence of promise only as mere reflectivity. Empirically a promise is binding to the extent there is a chance

[38] Atiyah deals with this issue in another context. See Atiyah: *Promises. op. cit.* 54.

for successful enforcement. This approach may culminate in destructive tendencies: the less likely it is to expect a promise to be kept, the more resources are needed for the enforcement thereof. In the meantime, the chances of calling an amoral promisor to account are diminishing, due to the availability of limited resources. Various dubious and desperate efforts were made in modern times to devise techniques for securing performance; solutions range from expensive guarantees to blacklisting violators and non-performers. Still, modern law and modern standards of conduct widely tolerate non-performance, they settle for paying damages. In these cases the amount of damages is adjusted not to the value of a promise, but to the "reasonability" of the expectation generated by the promise. In trade relations it is acceptable to breach a promise and to deliver to someone else, if the other person pays a higher price. A seller is reasonable as long as the profit made this way is higher than the damages to be paid, that is, as long as the contracting party suffering harm can obtain the goods at a price lower than the price received by the seller. According to economic analysis, this is about cost-effective expenditure, and, thus, constitutes a reasonable course of action. Morality seems to be irrational. Coercion to enforce a promise is expensive. Then why keep a promise? No one will be caught anyway.

Any conception that takes promise as generating some obligation must respond to the following problem.[39] I receive a thousand pounds in exchange for promising that I will pay it back. Do I have to pay it back because I received it? Or because I promised to repay it? More people believe that they would pay the money back because they had received it, because it does not belong to them. It may well be that this conception is backed by respect for property, and not by ethical premises upon the principle of promise. It would be unjust to keep what belongs to someone else. As a result of a failure to follow the rule voluntarily, what is owed might be taken away in line with the requirements of corrective justice. Logic behind the rule of positive law also promotes the interest in seeing a loan returned: it has to be returned because it was given. The enforcement of returning a loan is not based on the binding force of promise; promise is almost irrelevant from a legal perspective, or from the perspective of the creditor. For law a promise to repay is less relevant than restoring the state of affairs that conforms with justice. That is, regardless of promise, a usurious interest rate on a loan does not have to be paid. Morally, for autonomous morals of obligation, one is not condemned for having obtained

[39] Atiyah: *Promises. op. cit.* 34.

something, but because of the promise made in regard to that thing. Otherwise this case would be similar to finding a banknote, even knowing to whom it belongs—and not handing it over. This is not a great honour, but is not a problem of fidelity either.

Promise is an act of freedom by which one establishes a rule to himself. If someone does not admit to being bound by his promise, he excludes his own freedom. Freedom is justified by way of voluntary (in Kantian terms, arbitrary) constraint, by voluntary self-denial. One has free will (one is free) only in case what is willed derives from himself, if one sets tasks for himself.

4. The Relationship of Promise and Obligation Asserted in Contract and in Contract Law

Contract law preserves something from the moral characteristics of promise. According to Fried contracts can be understood in light of promise as a moral concept. Scanlon holds that the similarities between promise and contract are due to shared values they are rooted in. Although, as Scanlon adds, these values trigger different reactions in law and in moral theory, thus, promise and contract are parallel concepts.[40]

There are various, competing conceptions on the moral binding force of promise. Furthermore, despite all attempts of international unification, legal families provide different solutions. What is the role of obligation established by a promise in legal solutions?

Kant sharply contrasts duties of virtue and duties of right, i.e. duties that can not be based upon the sense of duty that is to be found in every rational being.[41] A creditor can not tell a debtor that "you are obliged to pay it back by your own reason". Still, there is such a moral obligation. In principle, it would be possible for a legal rule to enforce promise-based obligations. At certain points in history, law was not far from this, and the established principles of modern continental legal systems seem to correspond. Law, even if it becomes positive, can serve the morality of freedom. Even Savigny, this rather authoritarian Prussian minister of justice, thought that he had to believe and proclaim it.

Regarding the relevance of promise for contract law, it is important to examine certain factors which create the impression that promise (the contents of an offer) is of secondary significance, if not irrelevant al-

[40] See Scanlon: *Promises... op. cit.* 86.
[41] See Kant: *The Philosophy of Law* / Metaphysik der Sitten. *op. cit.*, 24–26.

together. Especially German jurisprudence excels in reading clauses into contracts never contemplated by the parties. Nonetheless, promise, or offer may be relevant even if it does not cover the promised performance or its conditions. Also, if a party is released from a contract due to the change of circumstances [*clausula rebus sic stantibus*], it is not to mean that promises are not binding. The promisor's intent does not have to extend to complicated future situations. In principle—unless there is a reason to suppose otherwise—it is acceptable as a premise that a promise covers everyday, common or foreseeable situations,[42] and it is binding to such extent. Note that a promise is an act of freedom and is universalisable to the extent it complies with rules of reason.

In order to examine the validity and predictive force of various moral conceptions, it is instrumental to compare their views on the moral binding force of promise and the legal regulations of performance at the three stages of the contract's existence. Such an analysis might reveal moral conceptions underlying contemporary legal regulations. The three stages to examine are: *conclusion of the contract*—with particular reference to the binding force of offer; performance—focusing on the requirement of good faith and co-operation; and *breach of contract*—concentrating on the target of legal sanctions.

1. How long is the offeror bound by the offer without any contractual stipulation in this regard? And, provided that promise has any significance, may the offeror set a date for that *ex post*? Regarding the binding force of an offer, common law and civil law jurisdictions developed radically different solutions.[43] Under common law, an offer may be revoked any time before its acceptance, even in if the offer contained an express stipulation on its validity. This is an instance of complete disregard of the principle of promise. This effect is somewhat eased as the rule does not apply to offers made upon consideration. The binding force of an offer, thus, depends on an external factor, although not on the expectations of another person. In U.S. jurisprudence an offer is not revocable irrespective of consideration, when another person acted relying on the offer. The freedom of revoking an offer is further relaxed, as acceptance does not have to reach the offeror: an offer becomes irrevocable when acceptance is placed in the mailbox of the offeror.

In Romanist legal systems, and, thus, in French jurisprudence, damages are due if an offer is revoked before its acceptance. Courts determine the

[42] BH 1986/11. 469.
[43] See Zweigert—Kötz: *op. cit.*, 351.

binding force of offer on a case–by–case basis. Some hold that damages are due because the revocation of an offer breaches a fictitious preliminary contract on the binding force of the offer. This is the fiction of the promise principle. According to another conception, however, this is a tort—a conception which is in accord with Scanlon's views.

Pursuant to the promise-based solution of Art.862(3) of the Austrian Civil Code (ABGB), the offeror is bound by his offer, he could not be released by any act of revocation. S.145 of the German Civil Code (BGB) provides a similar solution. The offeror has to state that the offer was made *ohne obligo*, this way turning the offer into a call for offers (tender), which upon acceptance is then transformed into a consent by silence on the basis of the principle of co-operation in good faith (*Treu und Glauben*). In theory this is a case for the morals of promise. Courts, however, are tampering with such promises. In addition, an offer is effective until it reaches the addressee. Regarding this rule the findings of Zweigert and Kötz are characteristic of a legalistic approach. They hold that the German solution is rational because the events are controlled by the offeror, thus, it makes perfect sense to allocate risks on his side.

The approach of the Hungarian Civil Code is also radical: an offer, a promise, is transient unless the will wants it otherwise. But the offer (the "expression of intent") by its nature seems to disperse into air, unless the watchful acceptor catches it with the butterfly-net of his will before it would vanish altogether. This solution is utterly reasonable for the purposes of trade security. Still, what kind of promise is this, from the perspective of the binding force of promise? In the case of transactions between parties who are not present, the offer is binding as long as a response may be expected under ordinary circumstances. Pursuant to Art. 211(2) of the Hungarian Civil Code, the usual period is to be estimated with regard to the means of transmission. To this extent the Hungarian Civil Code is closer to the promise-principle, although it supplements the promise principle with trade customs and practices. The means of sending the offer may indicate the durability of a promise. To the extent the validity of a promise is established on the basis of its form, the reference to trade customs is used to establish the binding force of the promise. Still, the custom applicable to the arrival of the offer is about the qualities of performance, and not of promise itself. No matter how reasonable, the rule reinforces trade customs and practices, but not promise. Therefore, it does not follow the logic of self-binding reflected in promise. Promise, or will, creates an occasion for applying legal conventions.

Promise as a source of obligation is secondary even in German and Hungarian law. Will mainly stands to make it possible for a party to

subject himself freely to the rules of the game prescribed in law. Even if it is supposed that the moral of promise is acknowledged in positive law, unless there are express reservations, an offer does not serve the observance of a promise—it binds the promisor pursuant to conventions defined in contract law. The logic of these conventions is by no means adjusted to the promisor's moral absolutism. Instead, it is guided by considerations on trade security and risk allocation. Conventions on the binding force of offer do not maximise the binding force of promise. Without an express disposition of the offeror, the choice of an autonomous subject is rather limited: he makes an offer by mail, by telephone, his offer is about sale and purchase, lease, etc. What is not mentioned in the offer, is added by statute and by courts. Such supplements, however, do not respect the presumable will of the offeror. With a rough offer, the offeror submits himself to contractual conventions. Like a chess-master, the offeror may pick an opening. A contracting party, however, has less freedom than a chess player, as parties to a contract shall make their further moves in compliance with the law. This is far stricter of a constraint than deciding which figure to move. A contracting party who is silent about cogent and dispositive rules is like a chess player with no creativity, a player who opts for Nimzo indian defense and, after the opening, sticks to the moves of game 21 of the Capablanca-Alekhine title match of 1927.

2. Co-operation upon good faith is the guiding principle of the Hungarian Civil Code. This would even follow from the concept of promise: if a promise is binding, one has to act upon it as long as the promise is effective. Good faith concerns primarily the promisor. Secondarily and consequently, it also concerns the other party who makes a promise in respect to his consideration. The promisor—according to the convention concerning promise or his own law of reason—has to suppose that his partner is acting in good faith. Indeed, promise corresponds to a "univerzalisable" law of reason in the sense and to the extent that every promise establishes an obligation. Hence, one has to regard as binding not only his own promises but also those promises made by the other party, at least until the other party breaches his promise, or until one can reasonably suppose that the other party will breach his promise (the latter being recognized by English law as anticipatory breach). Without a specific meaning attributed to it in law, an expression of will would mean that a promise is to be taken seriously, one can not be released from it upon random excuses. According to Cicero, it is unjust to breach a standard created for ourselves: "justice rests upon the foundation stone of good faith, that is to say, truthfulness

and scrupulous observance of promises and covenants ... [T]he term *fides*, 'good faith', originally signified a promise which has been kept (*fiat*)".[44] Law can do nothing about it. Economy needs average dishonest people who set up rules for themselves, or at least such judges are needed who would decide accordingly. In the name of fairness and good faith, one does not have to do everything at all to keep a promise. The standard of liability for cooperation is what is generally expectable in a given situation.

3. Breach of contract. In order to render the rules of the game unambiguous, the accomplishment of private law is to provide sanction for breach of conventions. Primarily this is achieved not by enforcing a proper step, i.e. a convention. A solution unusual in private law is to punish the mischief (although see the crimes of bankruptcy). Or, as a far more typical reaction, it proceeds from the assumption that the other party is expected to follow the law, and, thus, private law puts the party who (supposedly) relies on the behaviour of the other party to a state in which he would have been if the rule had been complied with. But private law does not restore or create a state called for by the promise. When contract law, or civil law in general, concentrates on damages caused by a certain conduct, it turns out to be indifferent about the conduct itself.

As to expectations concerning the performance of a contract, at the outset, there is a remarkable difference between common law and civil law legal systems that were under Pandectist (and later German) influence. By now these systems, despite textual and doctrinal differences, have remarkably converged, just as it was predicted by Eörsi's "veiled convergence" theory.[45] Contrary to common law, civil law legal systems are based upon the principle of performance in kind, thus, promise appears to be enforceable, performable. "The principle of *pacta sunt servanda*, as has already been pointed out, was not merely a tenet enforced by the State but was on a highly respected place in the moral value scale. (...) The *pacta sunt servanda* principle was based on the 'sanctity' of private ownership and the

[44] Cicero: On Duties (De Officiis). In: Cicero, M. T.: *Brutus, On the Nature of the Gods, On Divination, On Duties.* Chicago, 1950, 473–474. Of course, Cicero is not duty-absolutist. "But occasions often arise, when those duties which seem most becoming to the just man... undergo a change... It may, for example, not be a duty to restore a trust or to fulfil a promise, and it may become right and proper sometimes to evade and not to observe what truth and honour would usually demand." See *ibid.* 475.

[45] See Eörsi: *Összehasonlító polgári jog* and *Comparative Civil (Private) Law. op. cit.* 216.

will of the private owner: it protected private ownership by attaching to the freedom of will the acceptance of responsibility for freely resolved acts."[46]

In practice, however, legal systems that insist upon *pacta sunt servanda* offer a choice to the adversely affected party between performance in kind and damages. Despite the culture of will, promise is a ticket to a game where one either performs or pays according to the intent of the other party. Why would one insist on performance in kind by a party who already caused much trouble, when the problem can be easily settled through the market? The market of modern economy offers innumerably more options of covering purchase than closed society that was familiar to the Pandectists. The binding force of promise is weakened further in the light of the object of compensation, i.e. what damages are meant to cover, what state should the promisee be put via compensation. Does compensation really put a promisee in a state which he would have been, had the promise been kept? The answer goes in the negative in the legal systems of virtually modern market economies. The state of affairs as promised is rarely ever the *sole* controlling factor. Typically, courts take into consideration the actual (or reasonably expectable) conduct of the acceptor. In this respect, the reliance theory of common law provides the most straightforward example, allowing compensation only for damages occurring in relation to conduct in reliance of the promise. Thus, compensation is based not on promise, but on the trust of the other party. In cases where only actual damages are covered the concept of restitution delivers a similar outcome in continental legal systems. In addition, Hungarian law imposes an active duty on the promisee to mitigate damages. The notion of damages does not cover the collapse of the promisee's personal expectations. Law is indifferent to mental frustration. *De minimis non curat.* Humiliation and unremedied resentment, even if cause by public authorities, belong to human condition. The other is not hell, but the business partner is at least purgatory.

Consequently, while modern contract law, and especially continental contract law, preserves some components that refer to an obligation stemming from promise, the predicting force of a heteronymous concept of obligation is still greater. Nonetheless, even the latter is not asserted in a consistent manner, partly because of legal policy considerations (i.e. the

[46] Eörsi: *Összehasonlító polgári jog. op. cit.* 247. and Eörsi: *Comparative Civil (Private) Law. op. cit.* 265. Eörsi, at this stage of the discussion, points to the impact on others (contractual partners and third parties) as the basis for the social bindingness of the contractual obligation (for "bearing liability").

judiciary's convenience), and partly on the basis of references to material justice.

When contract is cleaned from the ornaments of the phraseology of legal ideology, the difference between promise based on individual autonomy and facts constituting contracts is striking. From the perspective of moral of autonomy, contract, and even law as such, is amoral, or more precisely, immoral. Considerations relevant for concluding contracts can not contribute to the respect for promises, to reinforcing the moral order of freely assumed duties. Contract law turns its back on autonomy. In Germany, perhaps because it was impossible to live with the burdens imposed by omitting to repair the flaws of the BGB, courts reformulated contract law in the name of the principle of *Treu and Glauben*—and not only in cases where the parties were silent. Working against allegedly insensitive and selfish private autonomy, reformulation took place in the name of ad hoc social justice.

In the history of contract law there were several attempts to link contracts with moral concepts other than the one based on promise. While such attempts may comply with the political agenda of the day, due to their judicial arbitrariness and desultoriness, they can not serve predictability. In order to define ethical standards, they refer to vague ideas of justice expressed in legal norms; such ethical standards are meant to determine which elements of a promise should be kept.[47] According to this approach, justice dictates that a promise may establish a contractual obligation only by way of acceptance. The disciples of Pythagoras taught that justice lied in reciprocity. "Therefore the just is intermediate between a sort of gain and a sort of loss, viz. those which are involuntary; it consists in having an equal amount before and after the transaction."[48] It would be unjust in respect to commutative justice if one party failed to react in exchange for the actions of the other party. Promise becomes binding by way of acceptance and performance: as a gesture of avoiding injustice. Only such promises are binding that serve a just purpose, leading to the requirement equivalence of values exchanged.

Still, there are logical difficulties concerning the assertion of just promises. The requirement of commutative justice will not resolve the problem arising

[47] As an advocate of this standpoint, see Kronman, A.: Contract Law and Distributive Justice, *Yale Law Journal,* 1980. 472.

[48] Aristotle: *Nicomachean Ethics.* In: The Complete Works of Aristotle. The Revised Oxford Translation (ed.: Jonathan Barnes). vol. 2.; Princeton, 1995, 1787 [1132b].

from situations where both parties had made their promises but neither has performed yet. This problem is typical in consensual theories. When neither promise is enforced, commutative justice is not violated. Benevolent donations may cause further problems. Following Aristotle, Thomas of Aquinas proclaimed that, in respect to promises and gifts there is no reciprocity, while there clearly is a duty. Law must enforce promises serving virtue and justice. This ethical approach is reinforced by claims concerning material justice and by the entire social conception of law.

Suppression of the moral of promise in contract law is more than a simple change in ideology. Reference to morality affects obedience to law. It does matter whether the glaze is made of paper or burned sugar. Crème brulee is all about the glaze—try to replace it with cardboard. In the context of contracts, governmental coercion to enforce contracts or damages is accepted, and—even more—expected, because in doing so government acts in accordance with the requirements of good morals. It takes a closer analysis to show that moral expectations are irrelevant for the state, and that the state considers not the position of the one who is acting, but the position of the one who is expecting. Moreover, law determines when and to what extent a promise is worthy of enforcement without being consistent about moral standards. It is certain that law tends to promote the cause of the victims quiet inconsistently, at least as a *pro forma* gesture of self-justification. This still seems to be sufficient to preserve the façade of law's "morality". This is all what is left from the concept of "law's ethical minimum". It is still another issue, whether society is willing to acknowledge legal norms and their enforcers as effective safeguards of moral order on the basis of actual legal norms and their enforcement.

5. What is Contract Law For, or, To What Extent is It Possible to Divert Legal Conventions Towards an Individual Moral Course?

Gyula Eörsi would be right in finding the lament on the decline of the morals of promise outdated.[49] After all, the mobilising slogans of contemporary law are stabilisation of monopoly capitalist economy, social-welfare issues, the "protection of the weak", economic and legal efficiency. However, there is no lamentation here, since as Vilmos Peschka rightly observed, subjective morality in itself can not determine the ethical.[50] It is still considerable whether autonomy may influence law at all via ethics, this

[49] Eörsi: *Comparative Civil (Private) Law. op. cit.* See his discussion of Riperts ideas.
[50] See Peschka, V.: *Az etika vonzásában* (Attracted by Ethics). Budapest, 1980, 128.

distillation of momentary truths. Keeping in mind the characteristics of law, a consistently promise-based law might not even be necessary. It is still noteworthy, though, that moral as reflected in socially filtered ethics determining law appears as distant memories of a teenage love affair.

Even Kant did not hold that morals may determine law, or may determine actions against the law. He regarded legal obligations as autonomous. Nonetheless, it is worth reconsidering the critical and assertive role moral premises may have vis-à-vis law. The mirror held by the morals of autonomy in front of the contracting party and contract law reflects a rather unattractive image. Codification attempts in the 19th century aimed to save the world from jurisprudence and unjust customs.[51] Legislation could not find a better task ever since. What is the task of contract law, that is, of legal rules applicable to contracts? Can it promote the autonomy of the parties, if that holds one of the parties captive? What kind of justice can it impose upon the parties, and to what extent? By what dictates of reason does it remedy the weak predictive capacities of contracting parties and their treatment of unforeseeable events?

Upon the morals of promise it was (and still is) possible to draft such laws for contracts, which would be more consistent about justice than the kind of material justice that invades contracts jurisprudence and suppresses autonomy. Promise-autonomy could become a basis for more stringent legal rules, which are not based on reliance. Such rules are not necessarily less effective than contemporary solutions. One-sided mightiness may well be reduced on Kantian premises, keeping in mind that one's freedom does not go beyond the boundaries of the freedom of other's. Within such a concept, abuse of power may result in invalidity without having to give way to convoluted attempts of judicial paternalism in the name of material justice. As Lajos Vékás observed "social requirements concerning social justice proved stronger than any ideal and classical principle ... [I]n industrialised societies assuring the common good to the greatest possible extent is possible by way of a democratic form of government".[52] It does not follow, however, that this would require a kind of openness that renders possible nothing but judicially assisted business pragmatism and statutory intervention that satisfies the needs of political populism without consistent governmental enforcement measures.

[51] See Wieacker, F.: *A History of Private Law in Europe.* Oxford, 1995, 258.

[52] Vékás, L.: Gondolatok az új polgári törvénykönyv elé (Preliminary Thoughts to the New Civil Code). In: *Van és legyen a jogban: Tanulmányok Peschka Vilmos 70. születésnapjára* (Is and Ought in Law: Essays for the 70th Birthday of Vilmos Peschka). Budapest, 1999, 358.

It is not at all peculiar for dispositive (and, incidentally, cogent) statutory provisions to remedy gaps opened by carelessness or lack of time. The question rather is when comes the time for legal intervention to fill those gaps. According to Oliver Wendell Holmes, the point of departure for law is the "bad man". This is a reasonable and justified assumption, especially if one expects law to protect society from "bad men", including those cheating and lying when entering into contracts. But legal regulation based on a pragmatic conception may collide with a legal order based on autonomous morality. The latter being a legal order envisioned by legislators who do not intend to protect the members of society, but rather, intend to create such circumstances within which a person is a human being of moral choice.

Promise may give rise to moral obligation if the promisor is rational, if he is able to render his actions universal (as demonstrated in the case of the promisor not willing to repay a loan). But this is regarded, even by Kant, not as an empirical but a normative condition: man has to be seen this way in order to be able to free him from his age of infancy one day. Knowledge, time, and information instrumental to reasonableness are limited. As an intellectual exercise, it is hard, costly, and—for the same reason—almost impossible to foresee the entire scope of an undertaking, to settle the risks in advance. Within certain limits, the legislator takes care of establishing a universal law, which contracting parties were not capable of, due to their intellectual or moral infancy, or hedonism. Legal provisions regulate some eventualities not foreseen by the promisor, in a manner as it is expectable from a reasonable man. (Then, the empirical legislator soon arrives at trade customs as depositories of universalizable maxims of action.) Most rules of contract law are dispositive, and that allows for deviations from this supposed reasonableness. In certain cases, the legislator's efforts to make universal moral law into law might also mean including Kantian requirements therein. The legislator, playing the role of the Kantian man in place of contracting parties, declares that contractual clauses that treat other people as mere instruments are contrary to good morals. While a theory of law might promote morals, when following such laws one's actions will be only legal, and not moral.

There is a further difficulty regarding intellectual capacities and characteristics of everyday knowledge, which shall be remedied by law. In the Kantian examples, the promisor's determination to perform is unlimited as much as his ability to perform is. The promisor did not only decide (and, thus, obliged) to pay 50 pounds, but he is able to do so. In reality, however, as promises are attempts to rule the future, even such a simple case is heavy with uncertainties that may disturb the fulfilment of a promise, or

may require its ex post revision. What if the 50 pound note was stolen, before it could have been handed over? What if by the time performance is due, the promisor becomes impoverished and lives on begging? What if by the time of performance the 50 pound note is worth nothing? The promisor's consciousness can not encompass such cases—law has to make up for it. And, especially in the case of contracts with consideration, law can not let the promisor determine ex post about what he wanted in the first place. May one insist upon a principle or a narrative of promise, will, or declaration, one has to hold that in law promise continues its own legal existence. Autonomy turns into heteronomy. What remains of freedom is submitting to a game by—at least from one's perspective—arbitrary rules. To conclude, in contrast to the Kantian assumption, law attributes legal significance to a will which is not fully determined: in real life, economic and other relations are run upon indeterminate obligations and partial promises. There is room for conditional promises and options. There is engagement before marriage that has legal consequences in many legal systems. The factual is taken as an obligation, it is elevated to the status of promise.

Law can not handle promise as giving rise to moral obligation, for — as in law and in everyday life — the preconditions of autonomous promises are lacking. Regulations substitute these deficiencies with other assumptions. The first unrealised assumption is that a promise is made by a reasonable man, who can universalise his actions and their consequences. For this reason, many legal prohibitions prohibit promises. For instance, a contract is against good morals if it binds one party, while the performance of the other party depends on the occurrence of some event depending exclusively on his own intentions. This rule, already incorporated in the law of the European Communities, intends to secure universalisable promises.[53] (From the perspective of Aristotelian ethics, such a rule might constitute a violation of distributive justice. One does not have to go that far, since such rules may also be made to protect autonomy.)

If the binding force of promise is explained by submitting that in a promise the promisor recognizes himself as an intelligent and autonomous being (without which one can not expect to be recognised as such), why

[53] Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. Annex 1). Cf. 10. § (3) of the German Allgemeine Geschäftsbedingungsgesetz: "(Rücktrittsvorbehalt) Klauselverbote mit Wertungsmöglichkeit, In Allgemeinen Geschäftsbedingungen ist insbesondere unwirksam die Vereinbarung eines Rechts des Verwenders, sich ohne sachlich gerechtfertigen und im Vertrag angegebenen Grund von seiner Leistunfgsplicht zu lösen; dies gilt nicht für Dauerschuldverhältnisse."

does this have such a minimal relevance in contract law? The answer lays in the amorality of the world, of human relations and of law. Or, to phrase it in an even sharper manner, in a contract one does not only make a promise about goods or services: when concluding a contract, one also enters into an agreement about his trustworthiness (fidelity) and establishes a standard of expectations concerning the other party. This is demonstrated in contractual default penalties and liquidated damages, although indemnification, unilateral termination, and exemption from performance (even if they typically concern external circumstances) may also be mentioned here. Liquidated damages are far the best example: in case of breach of contract by the other party, in exchange for proper assignment, the obligee agrees to settle for part of the expected benefit. Thus, the obligee gives up part of the initially expected performance in exchange for a secondary, more secure performance.[54] Promise is transformed in the contract. It is not promise that matters but the extent to which the acceptor takes it seriously: the more seriously he takes it on the level of facticity (see reliance), the stronger the binding force of promise will be—although it is all a matter of agreement. Damages are not adjusted to reliance generated by the promise, but to the extent to which it was possible to rely on the promise on the basis of the agreement, or to the extent the obligee did actually rely on the promise. But even this brings by a practical legal twist: acceptance does not justify the obligee's unconditional confidence; it justifies what the court regards as acceptable according to trade considerations. At best, the standard is efficiency and de facto custom.

Conclusions

The relationship between promise as a moral category and facts treated as promise in law is almost accidental. If, at the outset, there was some ground to believe that law, and contract, should correspond with moral requirements of promise on an elementary level, now it seems that law is at least indifferent to factors that give rise to moral obligation based upon a promise. Perhaps it is beneficial that law was liberated from the tutelage of morals, as this way law was made more efficient. Nonetheless, law has become morally empty. Even public law references to autonomy serve the limitation of freedom.

[54] See Craswell, R.: Against Fuller and Perdue. *The University of Chicago Law Review*, 2000. 114.

Law uses terms that refer to morals and legislation—at least for public purposes—has insisted for a long time (and perhaps even today) that it asserts at least a moral minimum. In fact, however, for internal use, law is proud that its ethically tainted terms gained predictable doctrinal content as seen in the case of good faith or intent. That pride is truly justified for arbitrariness begins with the application of dogmatically undigested terms, where cases are decided with reference to brute public interest. Those cases follow the bare logic of power, the dictates of private interests. The separation of law and morals was widely celebrated—and there was something emancipating in it, paradoxically in the same sense as morals were sought in the present analysis. When emancipated from the dictates of morals, law served freedom better than legal norms formulated in morally coloured legal systems until the 19th century.

Other moral critics hold law responsible for the loss of freedom, presupposing that, following bourgeois revolutions, freedom was to be served by law. Indeed, even if law was a means of social liberation, it is to be received with reservations. Bourgeois revolutions—taking the French Declaration of 1789 seriously—promised freedom only within the framework of statutes: the private law of the *Code Civil* was freedom-loving only in its rhetoric. The record of classical private law in guaranteeing freedom is certainly remarkable, since it made possible all sorts of transactions among a growing number of people and even enforced these under certain conditions. However, freedom was of secondary importance for law, although, in respect to freedom (as can be experienced once again today), it is pleasing when public administration is bound by law. As far as private law, and contract law, is concerned, beyond rhetoric, it did not centre around freedom and autonomy. It strived for a kind of institutional or economic efficiency. Ethical or moral rhetoric has survived at least in part, but gradually it is losing its significance. According to Eörsi's summary—that does not sound melancholic or resigned at all—modern law is centred around problems that can not be solved by axiomatic methods as society is too complicated for their application. "Legal system as a coherent conceptual system has failed, and its constituents are now independently used for part-purposes which are often mutually contradictory."[55]

[55] Eörsi: *Comparative Civil (Private) Law. op. cit.*, 167.

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TAMÁS SÁNDOR*

Take-Over Legislation in Hungary

Abstract. In the first part of the paper, the author provides an extensive analysis of the take-over regulation of 1997, the first of this kind in Hungarian law. The author examines the relationship of take-over and antitrust law pointing out the ambiguities of the regulation of 1997. The second part of the paper is dedicated to the recent Hungarian take-over regulation of 2001, containing more strict and detailed rules at the same time increasing the regulative competence of the government agencies considerably. The paper concludes on a note of doubt concerning the reasonableness of such an powerful extension of state regulation.

The relationship between the rules of company law and securities law governing the acquisition of shares of Hungarian public companies is an important problem of legal dogmatics. Since the acquisition of shares is an issue essentially governed by company law, the decision of the legislator both in 1997 and in 2001 to include the rules concerning take-over into securities law (thus rigidly separating them from the rules of company law) must be considered unreasonable.

It is argued that the fundamental problematic of the new regulation is that the purport and the signification of the take-over legislation receded in the process of recent legislation to give way to the prevalent and unjustifiably omnipotent requirements of rigour and „restoration of order". The author, however, admits that the Hungarian legislation has adopted rules very similar to other European jurisdictions.

Keywords: take-over, antitrust law, company law

Take-over legislation is a comparatively recent development in Hungarian law. Until the mid-1990s the issue of take-over legislation had not been assigned particular importance, however, with the increasing significance of the stock exchange and, consequently, of public companies limited by shares (hereinafter referred to as companies), it gained momentum in Hungarian law. As a result, in parallel with framing of the new Act on Business Associations (hereinafter referred to as Companies Act), the first law, which considered the principles of the European Union Directive 13, under elaboration and discussion at the time and rejected in the middle of 2001, was drafted. Law

* Tamás Sándor, advocate, Member of Penton International, Budapest, H–1276 Budapest, Pasaréti út 59., Hungary.
Fax: (36 1) 392-4949; E-mail: office@advocat-sbsz.hu

enforcement, apart from some relevant litigation cases, practically did not take place. At the end of 2000 and the beginning of 2001, however, the issue overrode the professional scope and was given publicity in connection with the case of Borsodchem Co. Ltd., as further in the paper I will revert back to that.[1] The case also delivered a number of lessons and revealed problems of legislation and law enforcement, besides, undoubtedly, boosting the process of the revision of regulations in the relevant field.

I. The Regulation of 1997

1. Primarily, it is the *notion* itself that should be clarified. In terms of take-overs, an "enterprise" is construed as a business association, a *public company*. Take-overs do not cover either the acquisition of shares of a private company or of a stake in a limited liability company, even if the respective transaction results in a one-person company. That could imply an issue in antitrust law (see definition below), but does not pose a problem of take-over legislation. Although the effect of the regulation of 1997 was not confined to quoted companies, it explicitly covered public companies, the majority of which are quoted at the stock exchange, however, in principle, public operation is not necessarily subject to official quotation at the stock exchange.

A further notional element consists in the proportion of shares to be acquired, which has been limited at a rate of 33 per cent under 1997 statutes, and as I will point out, this rate didn't change under 2001 regulations, apart from relevant exceptions.

Before revising the underlying principles of the 1997 regulation, I will look into the question whether and why the specific regulation is necessary, i.e., in what way the regulation of "take-over" relates to the regulation of the so-called *acquisition of control*, commonly known as antitrust law on the one hand, and *competition law* on the other hand.

Concerning competition law, the crucial issue from the point of view of take-over and antitrust legislation to be highlighted is that neither antitrust law, nor take-over legislation can aim at gratuitous prevention of acquisitions of company stakes. The objective of state regulation, however, and Hungary is not peculiar in that respect, is the sustention of control over and transparency of corporate structure and the acquisition of stakes.

[1] See below in Part 1.4.

Antitrust regulation has limited justifiability in case of private enterprises, which therefore remain relatively irrelevant to the following exposition.

The primary and substantive role of the (antitrust) regulation of *acquisition of control* consists in the protection of minority shareholders' interests in associations, which poses a complex and manifold problem. Thereby, certain facilities that make information on acquisitions of various proportions accessible for minority shareholders are legally guaranteed. That objective of publicity in antitrust law is specified under Paras. (1) and (2) of Art. 292 of Companies Act on notification liability, the neglect of which is sanctioned by the reduction of voting rights. The facts of control acquisition (significant holdings over 25 p.c., majority holdings over 50 p.c., and direct controlling interests over 75 p.c.) are stated in the framework of the Companies Act as ideal models of the way voting rates and the decision-making mechanisms are related in the association. A further legal instrument is provided by granting minority shareholders the right to sell their shares under given conditions on the one hand,[2] or exercise specific minority rights if they retain their membership in the association, on the other hand.[3] These legal instruments are supplemented by guaranteed protection for creditors, which gained momentum under Para. (3) of Art. 292 and Art. 296 of Companies Act. According to the principle of shifting responsibility, the provisions concerning the protection of creditors establish the direct responsibility of the acquirer under given conditions.

With respect to the above mentioned facts, the limit of 33 p.c. specified under the *take-over* regulation of 1997 does not seem justifiable in the first approach, which, however, reveals the implementation of a distinctively different legislative purpose and the application of according instruments. As a matter of fact, the purpose of antitrust regulations is that minority shareholders and creditors of the association are notified about the acquisition of a specific proportion of shares, so that according decisions could be made in the event of the acquisition of majority holdings or direct controlling interest. Being aware of the acquisition, minority shareholders may opt for selling their shares to the acquirer. Pursuant to creditor protection, however, minority shareholders may also determine the scope of operation of the acquired control, i.e. the limits beyond which the principle of company law, stipulating that members are not held responsible for debts in specified forms of associations, is ineffective. On the grounds of take-over statutes (as

[2] See Act CXLIV of 1997, Para. (1) of Art. 295 of Companies Act.
[3] Para. (3) of Art. 295 of Companies Act.

expounded below), the buyer is obliged to make a public offer to the shareholders of the association for their shares.[4] The public offer shall be implemented in a manner and on condition that both the association and, although that aspect is usually not referred to, its management are protected, whereas elements of creditor protection are completely neglected by take-over regulation. The consideration of the aspect of creditor protection points to basic differences between antitrust law, which also covers transactions following the acquisition of shares, on the one hand, and the 1997 regulation, which confines the scope of take-over regulation to the transaction of the public offer, the completion of which concludes the case from the legal point of view, on the other hand.

With regards to the underlying causes of take-over regulation, the most frequently mentioned factor is the publicity of the company. The operation both in case of a quoted and a non-quoted public company presupposes a wide scope of holders and the consequent fragmentation of company stock, which, furthermore, implies the potential control of the company owing to a relatively minor share. Of course, what is at stake is the assertion of the level, so as the regulation should not impede, restrain or prevent transfer of shares, which would contradict the structure and the role of a company limited by shares. The optimal solution is taking a middle course, which shall facilitate the achievement of goals favoured from the viewpoint of legal policy without hindering free movement of capital or the realisation of investments. The problem is not specific to Hungarian law, all countries that intend to settle the problem encounter this specific regulatory dilemma.

Another problem is the relationship of take-over regulation to *competition law*. While antitrust law, as mentioned above, seeks to protect minority shareholders' rights and creditors' interests, competition law purports to maintain fairness of business and competition. Take-over regulation, however, concerns both fields, when, on the one hand, it protects minority shareholders, on the other hand, applies its own legal instruments to protect companies and prevent cases that present so-called hostile take-overs, which is a function similar to that of competition law.

2. In retrospect, the exposition of the development of take-over legislation in Hungary will also focus on the relationship of *company law* to *securities law*. The fact that Act VI of 1988, i.e. the first Act on Business Associations, avoided the definition of that relationship is down to several reasons,

[4] See Part 1.7. below, on the potential collision of rules concerning acquisition of control and take-over.

primarily, that at the time of making the law, companies limited by shares were not considered as a major field subject to company law. Although, companies limited by shares were established at the time, the majority sprang up as the outcome of the transformation of large state-owned companies and the number of owners was comparably limited even after privatisation. Furthermore, the operation of these companies was private, whereas the first Companies Act confined the terminological distinction of public and private formally to the foundation of the company, thereby constructed public operation as the principal case and misinterpreted both the situation and the foreseeable trends. The 1988 regulation also limited the scope of antitrust statutes, by providing for legal proceedings exclusively in the event of acquisition of control of a Hungarian company limited by shares by another Hungarian company limited by shares.[5] Such regulation, however, was unreasonable in 1988 and the following years in view of the situation in Hungary.

Accordingly, the first Act on Securities (hereinafter referred to as A.S.) didn't cover take-overs, nor did Act VI of 1990, although it provided for publicising securities and shares. The take-over issue was accentuated as a consequence of the development of European legislation on the one hand, and the change of Hungarian circumstances in the second half of the 1990s on the other hand.

The Companies Act of 1997, as it is known, revised the regulation of companies limited by shares substantively, and instituted profound changes in the field of antitrust law by significantly extending its personal effect. The relationship between the law on shares and law on securities, however, remained unsolved or became even more problematic. Unexpectedly, with reference to alleged or real interests of legal policy, the law on securities preceded the Companies Act under elaboration, and provided for several issues, in an objectionable way, which would be subject to the regulation of shareholders' rights, i.e. the Companies Act.[6] After Act CXI of 1996,

[5] The Supreme Court made an attempt at an interpretation *propter legem* by the purported extention of the term of "companies limited by shares" to foreign "corporations" on the part of the acquirer, which as a concept could be construed logical, but could not be not inferred from the text of the law, therefore it confronted with the resistance of both theory and lower courts, expressed in e.g. one of the rulings of the Court of Budapest.

[6] Considering the limited scope of this paper, without further exposition let me refer to the fact that the Companies Act bans the transformation of dematerialised shares into printed shares under Para. (7) of Art. 22 of A.S., while it practically disallowed the establishment of public companies, and prescribed the transformation

i.e. the Act on Securities, had taken effect on 1st January, 1997, the makers of the Companies Act were confronted with a *fait accompli* and the primacy of securities law was unquestionable in the codification process of company law. Another implication was that the passing of the Companies Act made amendments to A.S. necessary, since take-over regulation was contained by the latter (see Arts 94–94/H of A.S.), whereas doctrinal, structural and substantive considerations would have justified its integration into the regulation of shareholders' rights, i.e. the Companies Act.[7]

3. The basic principle prescribed under Art. 180 of Companies Act, concerning both bearer and registered shares, is that shares are *freely transferable*. Which fully complies with the principle that a company limited by shares is an explicitly capital-based, not a person-based form of association and, motivated by the aspect of mobility, securities as the exclusive form of association representing membership rights shall be issued to members. Notwithstanding, the Companies Act contains *restrictive* provisions. Art. 200 provides for pre-emptive, repurchase and purchase rights and purchase obligations concerning shares, Art. 201 specifies that the memoranda of private companies may confine the scope of transferable shares and categories of shares to specific persons, while Art. 202 allows for protection from hostile take-overs of private companies. According to a comparative analysis of the rule of the Companies Act and A.S., the transfer of public company shares under Art. 180 of Companies Act is feasible exclusively under the regulation of A.S. Which implies that the acquisition of shares under the limit of 33 p.c. is circumscribed under the Companies Act, however, the acquisition of shares surpassing that limit as specified by A.S. shall comply with the regulation of A.S. Under Para. (3) of Art. 94/H of A.S. of 1997, the violation of these rules incurred the *nullity* of the transfer of shares.

The *regulation* was provided under Para. (1) of Art. 94 of A.S., which made the acquisition through direct or indirect transfer of voting shares of

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of bearer's shares into registered shares in case of private companies under Para. 3 of Art. 231 of A.S.

[7] According to judgement of the author of that article, this proposition is still valid. Since issues of the conditions of share transfer are covered under the regulation of 2001, it should have been integrated into the Companies Act. As far as the relationship between securities law and company law is concerned, the second part of this paper will point out that it has not changed, the amendments to the A.S. under Act L of 2001 and the new draft law on capital markets are close to ignoring the viewpoints of both the Companies Act and company law.

a public company in excess of 33 p.c. subject to *public offering*. The text definitely implied that the acquisition of non-voting preference shares was not a matter of consideration with respect to the limit of 33 p.c. The acquisition of shares, not pursuant to transfer, but other ways, e.g. inheritance, was not covered by A.S. According to the provision of Para. (2), the proportion of shares of a company in excess of 33 p.c. is subject to public offer, which shall cover a further proportion of 50 p.c. of voting shares and convertible bonds if the company issued any. In other words, according to the statute, the acquirer of 33 p.c. of the shares can expect to be liable to buy a proportion of 83 p.c. of the company shares in case the public offer is accepted.

The 1997 regulation included another crucial element, when it stated that making a public offer was mandatory only once, i.e. following the acquisition in excess of the limit of 33 p.c., since, according to the general rules of the Companies Act concerning the transfer of shares, the buyer, who later wished to increase the rate of control of 33 p.c., could do so without making a public offer. The rule was not stated *expressis verbis* under A.S., but, implicitly, the intention was obvious according to Para. (1) of Art. 94.[8] On the other hand, since the application of take-over rules was person-based, if the first buyer wished to transfer the acquired proportion of shares in excess of 33 p.c. to another person, who thereby transgressed the limit of 33 p.c. through the respective transaction, the new buyer was liable to make a public offer.[9]

4. The text of Para. (1) of Art. 94 of A.S. includes reference to the requirement of consideration of both direct and indirect transfer of shares upon the assertion of control, which exceeds the limit of 33 p.c. Para. (5) basically amended the previous rule by stating that shares indirectly held by the offerors need to be considered upon the calculation of the level of control as specified under Para. (1). That particular issue is worth thorough examination, since the existence or non-existence of indirect stock, at least formally, was a crucial point in the Borsodchem Co. Ltd., case referred to in the introductory part of the paper, furthermore, the formulation of the draft law left some room for improvement. Then again, the new regulation brought into effect in the summer of 2001 elaborates in detail on that point, making radical amendments, as further expounded in Part II.

[8] Commentary on the Companies Act includes an according statement, in: *Társasági törvény, cégtörvény* (Companies Act, Act on Firms) Sárközy, T., 2nd revised edition, Budapest, 2000, 569.

[9] Commentary on the Companies Act, 570.

I will start with the interpretation of the letters of the law. If, according to other conditions and the proportion of acquired shares, the necessity of making a public offer shall be asserted, i.e. whether the proportion was under or over the 33 p.c. limit, then the calculation shall concern not only the shares acquired directly by the respective person, but the shares acquired indirectly and those to be acquired and directly or indirectly in the future. The primary problem was posed by the fact that A.S. in this part didn't define the term of *direct acquisition of shares*. Point 36 of Para. (2) of Art. 3 of A.S., however, provided a definition of the term of *indirect interest* under the interpretative provisions. Accordingly, indirect interest is constituted by a share of holding in an enterprise or a share of voting and holding rights of the original enterprise, or by the voting and holding rights of another enterprise, the calculation of which shall be made as specified under Appendix 4 of Act on Credit Institutions (hereinafter referred to as A.C.I.).[10] Owing to the definition, the calculation of the indirect acquisition of shares, not circumscribed in A.S., became feasible. Appendix 4 of A.C.I., referred to under the passage "Calculation of indirect interest" in A.S., specifies the calculation method of the proportion of indirect interest as follows: the share of holding in the "intermediate enterprise" circumscribed under Point III/12 of Appendix 2 of A.C.I. (defined as another enterprise in A.S.) shall be multiplied by the share of holding or voting rights of the intermediate enterprise in the original enterprise. With the following example, I will model the scheme above. If a person intends to acquire a share of 20 p.c. in a public company (i.e. original enterprise), whereas the given person owned a share of 50 p.c. in an enterprise (i.e. intermediate enterprise), which held a share of 30 p.c. in the original enterprise, according to the rules, that person will own an indirect share of 15 p.c.. That proportion shall be added to the direct share of 20 p.c., which makes up a total share of 35 p.c. Since the proportion of acquired shares surpasses the limit of 33 p.c. in that case, making a public offer is mandatory.

Appendix 4 of A.C.I., however, *narrowed* the scope of application of rules concerning the acquisition of indirect interest in two respects. It stipulated in one respect that the holding or voting rights under the rate of 25 p.c. in the intermediate enterprise shall be ignored, in another respect, that a share of holding in an intermediate enterprise through more than one enterprise shall not be considered. As for the implications of these two rules applied to the example above, it follows that if the share of

[10] See, Act CXII of 1996 on Credit Institutions and Financial Enterprises.

holding in the intermediate enterprise is only 20 p.c. instead of 50 p.c., it shall be ignored, even if the share of holding of the intermediate enterprise is higher than 30 p.c., for instance 50 p.c. The explanation is obvious and makes both the purpose and meaning of the regulation understandable: what is at stake is not a matter of quantities, but a matter of the quality of *control* the buyer will exercise through the intermediate enterprise in the company to be acquired. Which, furthermore, explains the second rule mentioned above. The rule of the A.C.I., apparently and explicitly, broke the links of enterprises by taking exclusively *one intermediate enterprise* into consideration. If further enterprises, even one-person enterprises, interpolate, they shall be ignored, therefore indirect ownership of shares shall not be taken into consideration from the viewpoint of the 33 p.c. limit.

With respect to the above, the case of Borsodchem Co. Ltd., is worth paying attention. As it is publicly known, Borsodchem Co. Ltd., is a public company with quoted shares, and a proportion of its shares was acquired by Russian and Austrian companies at the end of the year 2000. The Hungarian Financial Supervisory Board (hereinafter referred to as Supervisory Board), allegedly upon the incentive of the company, however, quite justifiably, conducted investigation with the intention to reveal if any of the share-holders had exceeded the 33 p.c. limit. If that had been the case, a public offer should have been made with special respect to Para. (3) of Art. 94/H of A.S., which states *expressis verbis*, that any agreement on transfer of shares shall be nullified in the event of violation of rules concerning the public offer transaction.

The investigation revealed that Russian and Austrian companies, which acquired the shares, hadn't exceeded the legal limit, and the context was irrelevant to the case of the indirect transfer of shares prescribed in A.S. or A.C.I.. As a matter of fact, Appendix 4 of A.C.I., referred to above, apparently stipulates that the concerted acquisition of shares by distinct parties otherwise unrelated, or if the organisational alliance between them doesn't present a case defined under A.S. and A.C.I., shall not qualify as indirect transfer of shares. The Supervisory Board stated explicitly that, although, substantive legal offence hadn't been perpetrated in the trans-action of the acquisition of Borsodchem Co. Ltd., shares, the transaction violated the spirit of the law, which (would have) served as a basis for intervention. No argument is necessary for the indefensibility and unlaw-fulness of the statement above, which reminds me of an age-long doctrine recognised by every citizen in democratic states constituted on the rule of law, that exclusively the presentation of a legal case may incur sanctions in the event of statutory interdiction.

An interpretation *propter legem* wouldn't offer solutions, whereas the amendment of the statute on the basis of the constitution, finally realised under Act L of 2001, certainly could. Nevertheless, the consequences of the effective law and the way it affects public companies raise further concerns.

5. According to Para. (2) of Art. 94/B of A.S., at the request of the offeror and preceding the announcement of the offer, the board of company directors shall provide the necessary *information* on the operation of the company as a basis for definition of the terms of the offer. In practice, this provision led to serious problems and the collision of interests, because, on the one hand, the offeror obviously demands sufficient information for the elaboration of the offer, on the other hand, the boundary between the information reasonably demanded and the trade secrets of the company was ambiguous. In other words, the regulation does not make a clear-cut distinction between the data to be provided and the data that shall be or must be exempt from this obligation. Underlying the issue is the dilemma that no publicly accessible data needs to be requested from the company, and again, publicly inaccessible data, i.e. trade secrets, cannot be demanded until the offeror has acquired holding in the company, since the potentiality that the offeror is a competitor, cannot be ignored. The dilemma has remained unsolved both by the secrecy agreement applied in such case and the rule of Para. (3) of Art. 94/B of A.S., according to which the data obtained shall be treated and used according to regulations concerning trade and securities secrets. Neither could Para. (2) of Art. 94/A of A.S. supply remedies by obliging the buyer to publicise its conceptions on corporate policy and the future operation of the company to be acquired, or, if the buyer was an economic organisation, to compile an information brochure on its former business activities.

An array of problems emerged concerning the application of the provision above. On the one hand, A.S. didn't specify the stage the offeror had to publicise the information at. According to the legal context, publication was due at the time of making the public offer, consequently after the information had been obtained from the company to be acquired. Which logically follows, since the elaboration of corporate policy on the part of the offeror is unfeasible without sufficient information. On the other hand, and obviously inconsistently with the law-maker's underlying purpose, the term of "business association" was once again introduced, which, in the Companies Act, had already proved inapplicable to foreign companies, which were not definable as business associations according to Hungarian law.

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No argument can be made for the requirement of the provision of information on the company to be taken over or for the motives of the regulation except that the public operation of the company confers both rights and obligations. While the take-over regulations above have been formulated to protect the shareholders' rights, confidential data of the company thereby could become public. In such cases the risk lies in the fact that, upon the assertion of the purported take-over, the competitor may request the board for and get access to data, whereas that competitor is later entitled to decline to make an offer without consequences. The rule of A.S. of 1997 did not supply remedy for the problem.

6. The text of the law left no doubts about the transaction of the offer. It had to be made for all shareholders and bondholders, and all the offerees had equal rights to decide whether to accept or turn down the offer (Paras. (3) and (4), Art. 94 of A.S. of 1997). The content and the elements covered by the offer were meticulously defined under Para. (1) of Art. 94/A of A.S. The quotation of the offer price regulated under Points a) and b) of Art. 5 of A.S. is crucial in case the respective share is not registered. According to the rules concerning the transaction, the offeror shall simultaneously notify both the Supervisory Board and the board of directors (Para.1. of Art. 94/B. of A.S.) about the offer. The authority of the board of directors was restricted for a period between 30 and 60 days provided for the acceptance of the public offer, since it was not entitled to make any decisions that could interfere with the transaction. The A.S. included two modelling cases: even if the board of directors is entitled to, it shall not decide to increase the registered capital or to acquire company shares. Of course, the ban applies to the shareholders, therefore rights related to the ordinary meeting were not affected.

7. The Hungarian Financial Supervisory Board was given an extended field of authority over public offering and the transaction of the take-over. As mentioned above, the offer was reported by sending the material to the Supervisory Board. Under Para. (1) of Art. 94/C of A.S., the Supervisory Board was entitled to prohibit the acquisition of shares and notify the board of directors accordingly within 15 days of receipt of the report, if the offer didn't comply with legal requirements. If the Supervisory Board, however, didn't make a statement within the specified period of 15 days, that incurred acknowledgement of the report.

A further authority of the Supervisory Board was that if the offer concerned unregistered shares, the equivalent of which was not quotable

under Point b) of Para. (5) of Art. 94/A,[11] the Supervisory Board was entitled to quote the equivalent of the shares within the 15-day-period granted for the supervision of the report.

Finally, the question concerning the relationship between the take-over rules exposed above and antitrust law is still unanswered, since the A.S. didn't provide explicit rules on the relationship. The still effective Para. (2) of Art. 295 of Companies Act provides minority shareholders may offer their shares for purchase to the acquirer of majority holding or direct controlling interest, however, the rule shall not apply if the majority holding or direct controlling interest is acquired through a take-over as specified in A.S. The exemption is relevant exclusively under Para. (1) of Art. 295 of Companies Act, other antitrust law regulations shall certainly apply. Therefore, if the offeror has acquired a proportion of shares in excess of 50 p.c. as a consequence of a public offer, i.e. has acquired majority holding under the Companies Act, relevant antitrust regulations shall be applied after completion of the take-over procedure, such as, Para. (3) of Art. 295, under which the specified limit of 10 p.c. to 5 p.c. for minority shareholders was decreased, or Para. (1) of Art. 296 on creditors' rights.

Parallelly, if the offeror acquired a share in excess of 50 p.c. or 75 p.c. in a public offer transaction, the provision of Para. (1) of Art. 295 of Companies Act was ignored. The exemption concerned exclusively that particular provision of the Companies Act, other antitrust regulations were applied. Therefore, under the provisions of the Companies Act, if the offeror had acquired 65 p.c. of the company shares before a further acquisition of 11 p.c., then, as explained above, the public offer transaction was unnecessary upon the acquisition of 11 p.c., whereas the increase in acquisitions from majority holding to direct controlling interest had to be disclosed. In that case, the status of minority shareholders was specified under Para. (1) of Art. 295, and creditors' rights were provided under Paras. (2) and (3) of Art. 296 of Companies Act.

[11] According to the provision, the offer price in case of unregistered shares shall not be under the average price quoted by the stock exchange for a period of 180 days preceding the date of the public offer.

II. Take-over Regulation under Act L of 2001

1. As an outcome of the Borsodchem Co. Ltd., case, both the financial circles and the press called for the urgent and overall revision of securities law. Before actual legislative work started in 2001, the prospect of the establishment of a so-called unified Act on Capital Markets including the fields of securities law, stock and commodity exchange, investment funds, and the comparatively small, nevertheless significant field of take-over rules, had already been discussed for a long time. The significance of the latter had been apparently demonstrated by the amendment of take-over regulations in line with tax regulations, fee and other financial rules under A.S., even before the new Act on Capital Markets was drafted. As a consequence of the amendments, Chapter XIV/A. of A.S. ceased to have effect and was replaced by new provisions, i.e. Arts. 94–94/O. Specific provisions defining the sphere of authority of the Supervisory Board were also amended with respect to the new law.[12] Simultaneously, certain regulations of the Companies Act concerning public companies were modified in view of the objective of harmonising the Companies Act with the new law.[13]

I need to remark finally, that while this paper is written, the draft of Act on Capital Markets has already been introduced to the parliament, as the outcome of an endeavour to broadly and meticulously regulate the entire fields of securities law, commodity exchange and investment funds under a single act.[14] The rules are embodied in a highly detailed Code of 435 Sections, while the Third Chapter (Arts. 65–80), substantively incorporates the rules of Act L. of 2001 (hereinafter referred to as A.S. of 2001), which regulate the field of take-over, that is, according to the text of the law, the acquisition of shares in a public company.

2. A major change was introduced as far as legal terminology is concerned. While A.S. of 1997 discussed the take-over of a company, A.S. of 2001 covered *acquisition of control*. Before dealing with the crucial and far-reaching substantive demarcation, I have to point out that the *acquisition*

[12] See, i) of Art. 123; Para. (5) of Art. 128; Para. (3) of Art. 133; Para. (1) h) of Art. 136; Points a) and f) of Para. (3) of Art. 136; Para. (2) a) f) and l) of Art. 137; Para. (3) of Art. 137; Para. (1) of Art. 142; Para. (2) of Art. 143 of A.S. of 2001.

[13] See, Para. (6) of Art. 51; Para. (3) of Art. 229; Para. (4) of Art. 295 of Companies Act.

[14] Completion date of the present paper is 10th November, 2001.

of control meant to be regulated by A.S. of 2001 has other reference basis than the *acquisition of control* in Chapter XVI. of the new Companies Act. Unprecedented rules have been introduced into Hungarian law by A.S. of 2001, which extends the scope of regulation in an extraordinarily broad manner. The application of the term of *take-over* would not be proper with respect to the law-maker's intention, because there is more at stake, however, antitrust law had already "reserved" and institutionalised the term of *acquisition of control*. Therefore, the "not perfectly in place" terminology of A.S. of 2001 is slightly bewildering.

3. The differences from A.S. are obviously intentional and conceal serious, substantive incongruities. According to the definition of Para. (1) of Art. 94 of A.S. of 2001, the term of "*acquisition of control*" covers the acquisition of holding or voting rights guaranteeing participation in decision-making at the shareholder's assembly of the company. That covers both the enforcement of purchase and redemption rights, or of a dated purchase agreement related to voting shares, and the exercise of voting rights on the basis of using or beneficial rights. The same conditions apply, in case the control hasn't been acquired owing to directly coherent behaviour, but owing to other circumstances, i.e. inheritance, legal succession or the decision of the shareholders' general assembly, which modifies either the proportional number of votes concerning voting rights or the reinstatement of voting rights.

According to Para. (2), acquisition of control covers any *agreement between the shareholders*, pursuant to which, on the one hand a shareholder is granted electing or recalling rights concerning the majority of the members of the board of directors or supervision, on the other hand the parties undertake unified control of the company.

Rules of Paras. (1) and (2), are amended under Para. (3), which states that upon the assessment of the case and the rate of the acquisition of control, both *direct and indirect* acquisitions and these of next of kin shall be considered and added up. According to Para. (4), acquisition of control shall be established if it isn't the outcome of a transaction by related parties as specified under Para. (3), but the consequence of the *concerted action of unrelated parties*.

Para. (5) broadens the scope further, and provides, in compliance with preceding sections, that the exercise of a shareholder's right on behalf of a third party is considered a voting right. According to Para. (6), non-resident third parties are exempted from the effect of the rule above, if they register not as a shareholder's proxy, but as a shareholder (residents are not covered by the exemption) into the stockholders' register.

The law-makers' intention is apparent in view of the meticulous definition, besides acquisition through transfer of shares, other share acquisition cases also have to be regulated and controlled in case of public companies. An even more fundamental step is the extension of the regulation to cases that don't concern devolution of the ownership of shares, but *an agreement between shareholders on the management of the company.* That endeavour is not peculiar to Hungary, almost all European countries with that kind of regulation, including the EU regulation attempt, have dealt with the concept.[15]

The logical consequence of bringing the above case under the effect of the law is that several statutes had to be incorporated into the law, so that it was capable of regulating the case that was obviously more complex than a "mere" acquisition of control by purchase of shares. As an example, without asserting a claim for completeness, I refer to Para. (3) of Art. 94/C providing that a public offer is mandatory for all parties to the shareholders' agreement, unless the parties consent to appointing a party. Therefore, the party denouncing the right to appoint a member of the board of directors or supervisors for the benefit of another shareholder, *ad absurdum*, shall have to make a public offer. Besides, the agreement on the person of the public offeror, shall not exempt other parties concerned from the responsibilities related to public offer.

4. Para. (3) of Art. 94 of A.S. of 2001 concerns not only direct but *indirect* acquisition of control. Beyond formal congruence with preceding rules, a major difference has been established concerning the scope of reference of the term "indirect interest".

Under point 36 of Para. (2) of Art. 3 of A.S. of 2001, rendering definitions, the scope of indirect holding or control has been remarkably extended. Reference to the A.C.I. was avoided, a definitely beneficial decision with respect to editing, therefore two rules regarding the case above have expired. One of these rules provided that the share of holding below 25 p.c. is ignored or not taken into consideration in case the owner holds a share in the intermediate enterprise through more than one enterprise. However, A.S. of 2001 states that assessment of the rate of indirect holding and indirect interest of the acquirer shall be made by multiplying the higher rate of voting or holding rights of the acquirer in the intermediate enterprise by higher the rate of voting or holding rights of the intermediate enterprise in the respective company. In case the rate of voting or holding rights in the

[15] See, e.g. Clause 1 of Chapter 5 of the draft of EU Directive 13, withdrawn.

intermediate company is in excess of 50 p.c., it shall be considered as a whole ownership.

As a consequence of the omission of the rules under Appendix 4 of A.C.I., the issue of *how many links of interest* in intermediate companies should be taken into consideration remains ambiguous under A.S. of 2001. Although, the currently standard interpretation of taking one link into consideration can be inferred from the definition, the omission of the preceding rule confers a message, which might be directive in interpretation. Rejection of the rule of consideration of "one link" results ultimately in the requirement of considering several links of interest, which poses the problem of where to set a limit. The law evades the definition therefore further problems will arise. A likely interpretation of the reference to a share over 50 p.c. is that such a share of holding or voting rights shall be considered not indirect but direct interest, which suggests the likely interpretation again, that all links of indirect interest shall be considered.

A further issue is the regulation of *the share of voting and holding rights* stipulating that the larger proportion should be considered. Disregarding the fact that the intermediate company may take any organisational form, provided that a party has no or a different share of voting rights from that of holding rights in the respective enterprise, that party may participate in decision-making with the voting rights, not with the holding rights. Possession of holding rights but no voting rights does not grant the right to participate in decision-making. The rationale underlying that particular regulation of A.S. of 2001 can be challenged, which the law itself also seems recognise when it provides a further rule. The requirement of making a public offer under Para. (2) of Art. 94/C is subject to the acquisition of a 25 p.c. share, in contrast with the main standard. Reasonably, the regulation in that case provides exclusively for voting rights and does not refer to the share of holding rights.

5. A further, very essential change is the assertion of the standard share from the viewpoint of take-over or acquisition of control. With respect to the above, the only determining standard specified by previous rules was the 33 p.c. limit. A.S. didn't construe these as subject to the issue of take-over and provided no rules concerning acquisitions under the 33 p.c. limit. The regulatory concept underlying A.S. of 2001, as relevant from the above, is fundamentally different. Art. 94/B. of A.S. of 2001 provides that an acquisition of control up to a share of 5 p.c., then every further acquisition of a share of 5 p.c. shall be reported both to the Supervisory Board and the board of directors of the respective company within two calendar days

following the date of acquisition. Similar reporting obligations pertain to the *decrease* of interest of an equivalent rate. Para. 9 of Art. 94/B. allows for the memorandum of the company to extend the reporting and disclosure obligation to "an increase or decrease of interest at a rate of 2 p.c." That rule, apart from the fact that the assertion of an acquisition of control at a rate of 2 p.c. is rather peculiar, does not specify whether the reporting liability is applicable to each case of increase or decrease in acquisition at a rate of 2 p.c. or it concerns the lowest limit, exclusively. The latter supposition is justified by the text, the former is supported by the context, and more likely. According to my knowledge, this rule concerning the rates of both 5 per cent and 2 per cent is unique with respect to the European Union regulations, none of which supplies us with precedence of such rigour.

The introduction of the five-per-cent rule incurred crucial changes in the *structure* of the regulation. The acquisition of a share of 5 p.c. shall not imply the requirement of making a public offer, which is still confined to an acquisition of a share in excess of 33 p.c. under the normative rule of Para. (1) of Art. 94/C.[16] However, each time an acquisition of a share of 5 p.c. is made under the limit of 33 p.c. reporting shall be mandatory within an extremely rigorous and short period, the neglect of which, like all offences, is sanctioned by a fine imposed by the Supervisory Board according to Point (m) of Para. (2) of new Art. 143 of A.S. of 2001. The value of the fine is fixed between the broad limits of amounts of 500 thousand and 100 million HUF. Since rules concerning fines have not changed in other respects, according to Para. (1) of Art. 143, the conditions and basis of imposition of the fine are subject to the discretion of the Supervisory Board. A further and ultimate sanction of the neglect of reporting liability, not subject to discretion, is the withdrawal of the exercise of membership rights in the company until compliance with the reporting liability.

The most fundamental change incurred by the new regulation is that the former focus on making a public offer pursuant to an intention of acquisition of 33 p.c. has shifted to the *requirement of* the practically incessant *provision of information* to the Supervisory Board, since the reporting liability pertains to a relatively minor change in the status of shares of public companies and is extended to shareholders' agreements. According to the rule of Para. (6) of Art. 94/B., the reporting liability pertains upon the

[16] See, Part 6 below on the exemption under Para. (1) of Art. 94/C of A.S. of 2001.

acquisition of a rate of 50 p.c. control, whereas the disclosure liability is pursuant to the event of reaching the limits of 75 p.c. or 90 p.c. control. Which, on the one hand, provides evidence that the reporting liability in each event of the increase of control by 5 p.c. shall be construed separately from the requirement of making a public offer in the event of exceeding the 33 p.c. limit. On the other hand, the rule above severed another link with the Companies Act, in the framework of which an acquisition of control of 75 p.c. is construed as the upper limit with respect to antitrust law. Furthermore, Para. 8 of Art. 94/B., which bans the exercise of membership rights in the event of delay is applicable exclusively to the reporting liability, shall not concern the neglect of the disclosure liability, which, again, exemplifies that the law-maker attached great and exclusive importance to the provision of information to the Supervisory Board.

Nothing is more revealing as to the rigour of the regulation than Para. 7 of Art. 94/B, which extends reporting and disclosure liabilities to agreements between shareholders that project the acquisition of control *at a later date*. The text of the regulation explicitly asserts that reporting and disclosure liabilities pertain to any, indefinitely postponed, foreseeable acquisition under specific conditions. As for deadlines, the date of the agreement shall be authoritative, and reporting liability shall be complied with within two calendar days of conclusion of the agreement disregarding holidays and disclosure shall also be initiated.

Para. (4) of Art. 94/B of A.S. 2001 specifies what the report shall *state*. Accordingly, the name(s) of the acquirer or of the parties to the agreement, data on the location of the headquarters, the company registry code, the rate of control and definition of the relationship as specified in Para. (2) of Art. 94 shall be stated. Simultaneously, the acquirer or each party to the agreement shall proceed to disclose the report, implying that besides the Supervisory Board, the public shall also be notified about, formerly confidential, agreements between shareholders of the company. Concerning the media of disclosure, Art. 94/A provides that agreements shall be announced in the company and stock exchange journals and on web-sites.

6. The transaction of *public offer* is regulated under Art. 94/C and the subsequent articles. The primary change concerns rates, since, whereas the limit of 33 p.c. remains normative, making a public offer for the acquisition of control in excess of 25 p.c. shall be mandatory, if no other party possesses voting rights, directly or indirectly, in excess of 10 p.c., except for the party intending to acquire control in the company.

It is to be regretted that the text is inaccurate, again, concerning the case when the party, who intends to acquire control, does not possess voting rights in excess of 10 p.c. either (for the time being). The text presumably implies that in that specific case the 25 p.c. limit is ultimately disregarded with respect to the acquirer, with or without a share of 10 p.c.. However, that should have been unambiguously and literally formulated in the text.

The new rule of Para. (2) of Art. 94/C follows from the extension of the term of acquisition of control. In the standard case, when the acquirer intends to buy a certain amount of shares, a public offer shall be made upon the permission of the Supervisory Board under Para. (1). Notwithstanding, under Para. (1) and further paras. of Art. 94, several other types of buyer behaviour and cases are specified as acquisition of control, Para. (2) of Art. 94/C, with reference to these cases, provides that the fact of acquisition of control completed in an according manner shall be reported, disclosed, and at the same time, the public offer shall be made within 15 days following the date of reporting the acquisition. This rule applies to cases when acquisition of control is not the consequence of the acquirer's directly coherent behaviour, but results from the enforcement of purchase or redemption rights, or the completion of a dated agreement. The same rules apply to acquisition according to a shareholders' agreement or an investigation conducted by the state receiver syndicate.

According to A.S. of 1997, besides voting shares, convertible bonds, if any, issued by the company *shall be subject to a public offer transaction.* On the other hand, according to the regulation of 1997, the offer shall concern a minimum of 50 p.c. of the shares. However, A.S. of 2001 has made amendments to both of the above rules. On the one hand, it does not cover bonds, the text, emphatically and consistently, refers to shares, therefore, convertible bonds shall be disregarded from that aspect. On the other hand, under Para. (1) of Art. 94/F, public offers shall not be confined to a proportion of 50 p.c. of voting shares, however, they shall be made to cover *all voting shares and all holders of voting rights.* Which, in view of the above, implies the potential that a share acquisition above the 25 p.c. limit isn't feasible unless the acquirer purchases 100 p.c. of the shares, since the offer must concern the whole amount of shares.

As a matter of fact, according to a more professional and accurate rendition, Para. (2) of Art. 94/K of A.S. of 2001 has incorporated the provision of Para. (5) of Art. 94/H of A.S. of 1997. Accordingly, on condition that the offeror has acquired more than 90 p.c. of the company shares as a consequence of a public offer transaction and fully complied with the liability of payment of the equivalent, the offeror shall be legally due

purchase rights for the shares not yet acquired within thirty days following the date of reporting to the Supervisory Board. In such cases, furthermore, for the benefit of other shareholders, a *purchase liability* applies under Para. (5) of Art. 94/K of A.S. of 2001, since at the request of the holders of the rest of the shares, it is the acquirer's obligation to buy their shares, basically in accordance with the provision of Para. (1) of Art. 295 of Companies Act.

7. Before entering upon an exposition of the detailed rules of the public offer transaction, I have to refer to the fact that A.S. of 2001 imposes different sanctions in the event of a share acquisition, which *violates the rules of the public offer*. As expounded above, A.S. of 1997 nullified such transfers of shares, which was ignored by the amendment of 2001. According to the recent Art. of 94/L of A.S. of 2001, if the acquisition of shares was implemented in a manner different from that specified by the rules of the public offer, membership rights in the company shall not be exercised. The acquirer shall be liable *to alienate* voting shares in excess of a rate of 33 p.c. or 25 p.c., respectively, within 60 days. Membership rights unrelated to shares subject to the alienation liability shall be exercised exclusively after compliance with that liability. As a matter of fact, denouncing the radical nullity sanction on the part of the law-maker is remarkable, however, what may have accounted for that specific amendment were presumably practical reasons and, as an underlying consideration, incongruity with the effective rules of transfer of shares. According to the new settlement, transfer of ownership of shares implemented in compliance with relevant and effective rules shall be construed as valid, whereas the acquirer that violates these rules shall be subject to sanctions and face the risk of alienation liability.

8. Effective rules of a public offer *transaction* differ from preceding A.S. regulations since they are more specific and provide for issues not covered by the rule of A.S. of 1997. What is of major practical importance, however, poorly constituted in the preceding regulation, is the accurate specification of the binding substantive elements of the offer under Para. (2) of Art. 94/D. A significant aspect of the new regulation is that besides its provision for the requirement that the offeror submits a public statement on the conceptions concerning company policy,[17] under Para. (4) of Art. 94/D of A.S. of 2001 there is a reference to Appendix 8, which specifies

[17] See, comments on the rule in Part 1.5.

the aspects the operation plan to be submitted should cover, i.e., the content and the media of publication, which had not been regulated under Para. (2) of Art. 94/A of A.S of 1997. *Inter alia*, the plan should include details on the foreseeable effects of the acquisition on the employees, and if the offeror wishes to alter the profile of the company significantly, an explanation on the objectives and reasons underlying the decision shall also be given.

The rules concerning the report on the economic activity of the acquirer, which was not provided for under A.S. of 1997, are more relevant to my argument. The new regulation settles the terminology problem of "business association" by highlighting that related rules include foreign companies. On the other hand, this section of Appendix 8, tellingly, is a lot more specific than the provision on the operation plan, which, again, supports the view that information on the acquirer is of primary importance from the point of view of the Supervisory Board and the government. Let me refer to the requirement of submission of a report on the acquirer's company history, on leading officials and the members of the supervisory board, on all agreements, whatever, between the acquirer, including controlling parties in the acquirer, and the company, on the one hand, or, provided that they might affect the public offer, leading officials of the company, on the other hand.

Concerning the requirement of appointing an external expert for the transaction of the public offer, there is no modification with respect to preceding rules. According to A.S. of 1997, the external expert could be an investment company, whereas A.S. of 2001 extends the scope by specifying that party as a *distributor* that, under Para. (5) of Art. 94/D, shall take *responsibility*, jointly with the offeror, for the truth value of the report on the offeror's economic activity, which obviously complicates the distributor's situation. Which, also, may appear as a major snag in case of less familiar foreign investors, since both the distributor and the offeror shall be held liable for damages incurred by the submission of a misguiding report or the concealment of information. Another issue is, of course, who is damaged and in what way, since the liability of attestation of damages lies with the injured party under Hungarian law, and a further ambiguous point is what the term of the injured party covers.

The regulation specifies the appendices to be attached to the request for the approval of the offer under Para. (6) of Art. 94/D, which shall justify the offeror's possession of the equivalent of the shares subject to the offer (funds, state bonds issued either in Hungary or an OECD member state, a bank guarantee issued by a credit institution based in Hungary or an OECD state).

A statement on an agreement on the offeror's person shall also be submitted, if the acquisition of control is transacted upon a shareholder's agreement and the offer is not made jointly by the parties to the agreement. Furthermore, purchase and repurchase agreements shall also be included in the appendices provided that the acquisition of control is made with reference to these.

The new regulation specifies a peculiar arrangement on the information to be provided for the offeror by the company. As pointed out above, the regulation of 1997 (Para. (2) of Art. 94/B), obliged the company to provide information, and compliance with the requirement was not exempt from problems considering the respective circumstances. The new regulation does not contain such a requirement, Para. (1) of Art. 94/H stipulates that in the event of provision of information by the board of company directors at the request of the offeror, the acquired data shall be treated according to the rules pertaining to the confidentiality of bills and notes on the one hand, and the prohibition on insider dealing, which is a new element, on the other hand. Accordingly, the provision and the quality of information shall be made dependent on the decision and the discretion of the board of directors. The significance of these changes can hardly be estimated in the first approach. On the one hand, they manage to ward off the apparent danger of release of trade secrets to a potential competitor, on the other hand, they can be assessed to model a legal policy, which expresses the intention to reinforce and benefit the existing structure of companies and demonstrates its non-preference for new investments.

However, Para. (3) of Art. 94/H stipulates that the board of directors shall respond actively by *giving an opinion* on the offer and publicise it at the same place where the offeror's operation plan and report on its economic activity are displayed for inspection by the shareholders. The recent Appendix 9 of the law specifies the aspects according to which expert opinion shall be given. The opinion shall contain a statement on the support or objection of the board of directors concerning the offer, and include any member's dissent with an explanation. The board of directors has legal entitlement to employ, at its own cost, an independent financial expert for the assessment of the offer. In that case the expert opinion shall be publicised and made available for the shareholders in compliance with the above.

9. As for the specific rules of a public offer transaction, the following points will be accentuated:

Under Paras. (1) and (2) of Art. 94/E, no changes have been made to *expiry dates*, the Supervisory Board shall make a decision within 15 days of the date of submission of the offer. In case the board does not respond, the

offer shall be considered approved. This rule has been amended by the provision of a peremptory term of 5 days by the Supervisory Board, on condition that the request is incomplete, therefore, subsequently completed requests shall be processed within 5 days.

Under Para. (5) of Art. 94/E, the maximum period of the decision-making procedure on the offer was reduced from 60 days to 45 days.

As a logical consequence, Para. (7) of Art. 94/E includes a new provision, according to which neither the offeror, nor the parties to the share acquisition agreement or the business association, in which the parties above hold a share in excess of 25 p.c., *shall transact* transfer, alienation or debit of shares subject to the public offer in the approval period. Neither shall the distributor make a bill of sale concerning the respective shares during that period. In both cases, the transfer of shares subject to the offer are, of course, exempted.

10. A binary amendment has been made to the way of setting the *offer price*. On the one hand, in contrast with the 90-day-period specified under the 1997 regulation, under Para. (1) of Art. 94/G of 2001 the average price of 180 days preceding the date of the offer shall be considered. This rule is, however, amended by the requirement of considering both the highest price stated in any agreement on the transfer of shares between the offeror and related parties during the above period, and the highest price and charge demanded in the agreement on purchase or repurchase. The offer price can't fall short of the highest price listed above. In case the equivalent of the shares can't be set according to the rules specified by the law, Para. (2) of Art. 94/G provides that the offered equivalent can't fall short of the price formed according to the calculation method specified in the offer and approved by the Supervisory Board.

11. The preceding regulation failed to answer several questions concerning the transaction of the *transfer of shares*. According to Art. 94/I of A.S. of 2001, the statement concerning the acceptance of the offer shall not be withdrawn, furthermore, the offeror shall purchase all the shares covered by the accepted offer, unless offeror would acquire control that does not exceed 50 p.c., in the event of which the right to resist included in the offer applied. The agreement on the transfer of shares shall be uniformly concluded on the last day of the acceptance period, unless the offeror has arranged for a competition supervision procedure. In the event of which, under Para. (1) of Art. 94/D, the disclosure of the offer submitted to the Supervisory Board for approval shall include the details of the arrange-

ment for a competition supervision procedure, as a consequence, the agreement on the transfer of shares shall be concluded on the date of permission following competition supervision under Para. (5) of Art. 94/I.

Concerning the *payment of the equivalent*, the regulation, quite reasonably, specifies extremely rigorous rules. On the one hand, payment of the equivalent shall be made within 5 working days of the date of conclusion of the agreement on the transfer of shares. On the other hand, in the event of delayed payment of over 30 days, besides stating a claim for interest on default payment, the offeree may cancel the agreement. According to a specific rule, the cancelling party shall report the cancellation to the Supervisory Board within two working days. The regulation does not specify the consequences the neglect of such reporting liability may incur, nor does it state compliance with reporting liability as a criterion of the effectiveness of cancellation. Nevertheless, Para. (8) of Art. 94/I provides that irrespective of cancellation or a claim for interest on default payment, the Supervisory Board may sanction the offence of rules concerning payment, which basically implies the imposition of a fine under Art. 141. The offeror, however, shall report compliance with the payment liability, or its failure and the underlying reasons, to the Supervisory Board within two calendar days after expiration of the payment period under Para. (1) of Art. 94/K.

12. Finally, I cannot fail to mention that the new regulation also provides for the institution of *counter-offer* under Art. 94/J, with no changes to preceding rules. The period specified for the opportunity to make a counter-offer has been shortened by 5 days. Since the new regulation stipulates that the offer shall cover all shares, the attractive aspect as a condition for the acceptance of the counter-offer is confined to the price. Nothing has changed in that respect, the price in the counter-offer is considered more attractive if the stated equivalent is at least 5 p.c. higher in HUF.

13. Whereas the preceding rules didn't foreclose *voluntary offer* as a potential, the new regulation explicitly institutionalises it under Art. 94/N, applicable under the above rules with specific and according exemptions. As such, the provision of Art. 94/F specifies as requirement that the offer shall cover all shares, while Art. 94/H provides a rule concerning the liability of the board of directors to give an opinion and employ an independent financial expert. Furthermore, the rules of counter-offer are inapplicable, since making a counter-offer is foreclosed in the event of a voluntary public offer.

14. As mentioned in the introduction of this part, Act L of 2001 *amended the regulations of the Companies Act* in several respects. The amendments are meant to harmonise with the regulations concerning acquisition of control and logically follow from the rules propounded above. Para. (3) incorporated into Art. 229 of Companies Act is of particular importance, since the rule of Para. (2) of Art. 229 had allowed that the memorandum of a public company defined the highest rate of voting rights exercised by a shareholder with respect to registered shares. According to the recently incorporated regulation, the specific stipulation of the memorandum shall lose its effect, if the acquirer purchases shares in excess of 50 p.c. through a public offer transaction. The rule of this act, however, according to Para. (6) of Art. 82 of Act L of 2001, shall not concern the effective memorandum regulations for the time being, in as much as the rule of Para. (3) shall not be applied until the last day of the fifth year following the the date of enactment of the international agreement on Hungarian accession to the EU.

According to Para. (4) of Art. 295, introduced as a new rule into the antitrust regulations of the Companies Act, in the event of acquisition of majority holdings or direct controlling interest in a public company, the value of the shares offered for purchase shall not fall short of the equivalent defined according to the rules concerning the acquisition of shares through a public offer transaction. In other words, with respect to a public company, the "market value" as specified under Para. (1) of Art. 295 is construed as effective according to the amendment of the new rule of Para. (4).

The amendment that annuls Para. (1) of Art. 292 of Companies Act is somewhat ambiguous. The text annulled specified the requirement of reporting both an acquisition of significant or majority holdings and of direct controlling interest, including a statement on "the form and rate of control", to shares, and extend to limited liability companies, therefore, the the registry court. Antitrust regulations of the Companies Act concerning the controlled company cover both public and private companies limited by underlying reasons for the annulment of the requirement of "inclusion of a statement on the form and rate of control" as a consequence of the amendments to financial law are not clear. Since the law specifies registration as mandatory, regulation of the contents of the registration statement would only be proper.

In other respects, the regulations of the Companies Act haven't been revised, therefore, the antitrust provisions shall apply according to the rules of A.S. of 1997.

15. *Effect.* After the exposition of the recent regulations above, I will finally discuss the issue of the effect of the new provisions, which, according to my

viewpoint raises grave *concerns in view of constitutionality*, when they implicitly mean to introduce the statute with retroactive effect. The starting point is clear and right, in as much as the amended regulations of A.S., according to Art. 82 of the closing provisions of Act L of 2001, are applicable to acquisition of control following 18th July, 2001, i.e. following enforcement of the law. If transactions of take-over of a company had commenced before the law took effect, they shall be conducted according to preceding rules.

However, Para. (2) of Art. 82 states that if, before its entry into force, liabilities of reporting, disclosure or public offer as specified by A.S. of 2001 had not been established by effective law, the obligor shall be liable to report and disclose the form and rate of its existing control, according to the new rule, within 60 days of the date of enforcement of the law, practically by mid-September of 2001. A detailed explanation is presumably not necessary to point out that here a subsequently issued statute defines the existing control as acquisition of control, which, consequently, binds the shareholder to procedures (reporting and disclosure), which were legally not provided for at the time of the acquisition.

Furthermore, I need to refer to Para. (3) of Art. 82, which stipulates that if the holder had acquired shares in excess of 25 p.c. or 33 p.c. before Para. (3) took effect, and in compliance with preceding law hadn't made a public offer, then the rate of that control can be increased exclusively under effective rules of public offer transaction. The provision above is problematic from a further aspect. If the acquisition of control was not subject to a public offer transaction, which may have motivated the acquisition of shares under specific circumstances, and the acquirer could expect to increase that stake under effective rules at the time of the acquisition, then the new regulation, with retroactive effect, ultimately prohibits the transaction formerly legal and specifies rules that the acquirer could not take into consideration.

Para. (4) of Art. 82 stipulates a requirement that after its enforcement public companies amend their memoranda at their first ordinary meeting, i.e. at the spring annual meeting of 2002 at the latest, unless their memoranda regulations are in compliance with the new rules. The provision exempts memorandum regulations concerning the limit of the offer and the calculation of the minimum amount of offer price, which shall be harmonised with effective law by 30th June of 2004. A further exemption concerns the later application of the recent Para. (3) of Art. 229 of Companies Act expounded above.

16. *Conclusion.* The assessment of a recently enforced statute is by no means a simple, however, a rather risky undertaking, since the primary standard

of assessment is the application capable of evaluating positive and negative effects of the law. The evaluation is further complicated by the fact that professional (economic, financial) arguments are considerably intertwined with political concerns. However, I can hardly evade posing the question.

It is a mere fact that both the European Union and the member states are making remarkable efforts to settle the issue of take-over regulation. The real dilemma is obviously constituted by the problem of locating the ruling boundary the regulative transgression of which would incur disturbance in the operation of major registered companies with significant share in the economy of the respective country, and thereby, regulation is construed as more damaging than yielding. In this respect, the case of Hungarian law is peculiar in the sense that the recent one and a half or two years of the Budapest Stock Exchange would justify loosening stiff rules, instead of setting new barriers. What is seen as a problem is that both the intention and the meaning of the regulation of acquisition of control seem to have tarnished in the process of law-making, whereas rationality has been outstripped by an effort to comply with the pervasive and ominous standard of rigorous rules and "order", although the majority of the rules established are not unfamiliar to European practice. There are, however, severe risks entrapped in the mechanical import of technical procedures, particularly in an area in the intersection of economy and law. The following years to come will either prove of disprove the concerns exposed above.

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TAMÁS SÁRKÖZY*

Shareholders' Agreements

Abstract. The essay deals with the syndicate contract functioning as a preparation to partnership contract or a skeleton agreement. The syndicate contract, as an atypical-innominate contract, also evolved in the Hungarian legal practice concerning major companies. The essay distinguishes the syndicate contract from agreement in principle (in the Hungarian Civil Code). It discusses in details the problems of joining the syndicate contract at a later stage, the collisions of syndicate and partnership contracts and their consequences. In analyses the consequences of the breach of syndicate contract

Keywords: company law, syndicate agreement

1. Competition Law and Company Law Approach

In commercial law, shareholders' agreements are discussed from two different points of view: in a sense of competition law and in a sense of company law.

In a sense of competition law, the shareholders' agreement (syndicate agreement) is a *qualified cartel contract.* The essence of the cartel is that it is an agreement limiting (precluding) competition—with regard to prices, quantity of production, conditions of business deals, geographic area or other aspects. In a more narrow sense, the cartel is directed at influencing market behaviour, at the market itself. The shareholders' agreement is *stronger* than the market cartel: it is broadened to include matters of production and product development, e.g. specialisation, cooperation of production, cooperation of research and development etc.

In Hungarian competition law, the narrowly understood (market) cartel and the production-development or syndicate cartel *are not separately treated.* Arts. 11–20 of Act LVII of 1996 on the Prohibition of Unfair Market Conduct and Limiting Competition preclude as a general rule cartels in both the more narrow and the broader (syndicate) sense—proclaiming as generally illegal (with exceptions and the possibility of providing

* Tamás Sárközy, Professor of Law, University of Technical- and Economic Sciences, Budapest, H–1111, Budapest, Stoczek u. 2., Hungary.
Fax: (36 1) 463-1519

exemptions—relative prohibition of cartels) all such agreements concluded in a written form, orally, or by actual conduct. Consequently in Hungarian literature the competition law meaning of shareholders' agreements has faded, *we only talk of cartel agreements.*[1]

The company law interpretation of shareholders' agreements remains all the stronger. Precisely the multiparty and multisided, but at the same time—towards the outside world—cooperative-organisatory nature of the companies (organisational obligation as opposed to barter-based contracts: Steinbach), their characteristic as being based upon a long-term and generally significant joint ownership and a dominance of the community of interests of the parties and the companies' relative separation from their members is the reason behind the fact that the members in the case of a number of companies

— formed in perpetuity (or for a longer definite period of 10–15 years)
— with large funds
— and with legal personality
— conclude a shareholders' agreement alongside the company agreement.

The subject matter of the shareholders' agreement is thus the *formation and the operation* of the company.

The shareholders' agreement, as its name in common law areas implies, evolved in relation to *stock corporations* with large funds. Later, however, in German and French law it appeared also in relation to larger *limited liability companies* and is even exceptionally to be found among firms created in the form of *partnership or limited partnership.*

The shareholders' agreement thus became a *general institution* of the law of commercial companies. It must, however, be stressed that—in the lack of a statutory definition—the parties may conclude shareholders' agreements outside the realm of company law, e.g. it is not unknown for partners to complex investments to call their cooperation framework agreement a shareholders' agreement. But shareholders' agreements are found also in the law of non-profit organisations, e.g. among non-profit limited liability companies or associations. At the same time, in case of *the formation of stock corporations* by public share offering, the conclusion of a shareholders' agreement before the founders' meeting is not usual, only maybe later, and even then not among all shareholders but only *major shareholders.* For similar reasons, the shareholders' agreement—as concluded on a founders'

[1] Vörös, I.: *Az európai és a magyar versenyjog összehasonlító elemzése* (The Comparative Analysis of European and Hungarian Competition Law). Budapest, 1997.

meeting, alongside the articles of association—is also rare among co-operatives.

Following the general reform of Company Law new-regulation at the end of the 1980's, the instrument of the shareholders' agreement has also been reborn in Hungarian practice at the beginning of the 1990's. The spreading practice had been supported by scholarly literature.[2] At the same time a lot of interesting and open legal issues arise in the topic of the shareholders' agreement.

2. The Independence of the Shareholders' Agreement

The shareholders' agreement is directed towards the operation of the company and regulates the cooperation of the parties to the agreement with regard to the operation of the company. At the same time the shareholders' agreement and the company agreement are *two independent contracts*, usually not even concluded at the same time. The shareholders' agreement is generally already concluded before the company agreement, there is, however, nothing to prevent the shareholders' agreement from being concluded after the company agreement. (A special form of the shareholders' agreement, agreements as to the order of voting in the company's main organs are often concluded later.)

The parties to the shareholders' agreement and the company agreement are generally the same, but

— a person who is not a member of the company may be a party to the shareholders' agreement, either originally, even before the formation of the company, or he may "join" the shareholders' agreement through its modification later. The company may have members who were not originally parties to the shareholders' agreement. Anybody may cancel the shareholders' agreement while keeping his share in the company (he may leave the syndicate) or new members who do not join the shareholders' agreement may join the company.

— the shareholders' agreement may be in force only between a part of the company's shareholders.

— generally by selling stocks or shares and thus becoming a member of the company one does not automatically become a party to the share-

[2] For a book including an international overview of the topic, see Kolben, Gy.: *A szindikátusi szerződés* (The Shareholders' Agreement). Budapest, 1996.

holders' agreement. The succession as to membership does not mean a *change of parties* or *succession* regarding the shareholders' agreement; the party has to join that separately.

— in some instances (although rarely) it happens that the company as a legal person itself joins the shareholders' agreement (necessarily only after its conclusion, if the shareholders' agreement is concluded before the company agreement, but if it is concluded only afterwards, it may even be an original party.)

The *subject matter* of the shareholders' agreement and the company agreement also necessarily differ, it may be *mutually broader* or *narrower.* The company agreement regulates the cooperation of the members, but

— certain questions of cooperation are regulated only in the shareholders' agreement;

— issues regulated in the company agreement or by Company Law do not fall under the scope of the shareholders' agreement, although may be mentioned in both the company agreement and the shareholders' agreement;

— there is nothing to prevent the parties from regulating in the shareholders' agreement issues not touched upon in the company agreement or not falling under the scope of company law, e.g. issues of limitation of competition or matters of intellectual property law, the use of trademarks etc.

3. The Shareholders' Agreement as a special atypical Contract

The Hungarian civil law—as modern civil law systems generally—does not impose a limitation as to possible types of contract. The Part of the Civil Code on Specific Obligations lists the most common types of contract, but

— separate pieces of legislation may regulate other types of contract (this is how the concession contract, the funds management contract, the sponsorship contract etc. have been created),

— representatives of industry groups may create new types of contract through trade usages, *standard form contracts* (basically this is what happened in the case of the leasing or franchise contract, but

— anybody at any time may also *individually* create new contracts not fitting into a statutorily defined type of contract. The shareholders'

agreement is in this latest group, it is so specific that general terms as to it may hardly be created.[3]

Qualification as an atypical contract only means that the given contract does not belong to a type of contract regulated in the Civil Code (and consequently recognised by statute). However, an overwhelming majority of atypical contracts are at the same time *mixed* contracts, i.e. they are not typical contracts also because they had been created using the characteristics of several types of contract. Generally, also the Hungarian court practice developed in the direction to apply the rules of the type of contract that stands closest to the given atypical-mixed contract in cases when the contract fails to regulate a certain issue. This application, however, happens "adequately", often with the use of extensive interpretation, even analogy.

The shareholders' agreement is a *cooperative contract*; it is therefore a point of interest that the shareholders' agreement belongs to a "type" that is itself not named within the law and exists only in legal theory. The lower level of cooperative contracts are merely of a moral nature, qualified as *gentlemen's agreements*. The shareholders' agreement is, however, a business contract and may not be qualified simply as an *expression of best intentions*, the breach of which in Hungarian law may only result in a possibility of a tort claim of damages for expenses incurred in reliance if intentional misleading conduct is shown. The shareholders' agreement is a *contract* falling under the Civil Code; a conduct in opposition to its terms is a *breach of contract*.

The shareholders' agreement has certain aspects—especially if the shareholders' agreement is concluded before the conclusion of the company agreement and the shareholders' agreement is terminated with the formation of the company—which may qualify as a "consortium", as a partnership agreement and consequently may fall directly or by way of analogy under Arts. 568-578 of the Civil Code. The shareholders' agreement in other cases also stands close to the civil partnership as it is a contract with *no requirement of form*, although generally put down in writing, it may be concluded orally. As opposed to that, commercial companies (including partnerships) all over Europe share a mandatory requirement of written

[3] Company or commercial laws of West-European countries do not regulate the Shareholders' Agreement and it naturally does not appear in the current Hungarian Civil Code either. Of the ccmpany laws created in East-European countries in the 1990', one is known to include rules—of course, hardly more than a definition—of shareholders' agreements, that one being Albanian law.

form, stock corporations and limited liability companies even a qualified written form (e.g. a notarial document), moreover the law defines the mandatory substantive elements of the company agreement (articles of association).[4] Exceptionally in civil partnerships a mandatory requirement of written form may also be found, e.g. as to building communities; Art. 578/B (2) of the Civil Code.

A phenomenon similar to the more organised forms of the civil partnership is that the shareholders' agreement creates an *organisation independent* of the organisation of the company whose operation is the subject matter of the contract. Such is for example the *syndicate meeting* that is usually held immediately prior to the general meeting of the company, although generally may be called together at any time upon the request of any member. On syndicate meetings the members of the company often bring more important decisions as to the operation of the company than on general meetings, or the syndicate decisions may determine the decisions of the general meeting.

It may happen that the shareholders' agreement meets all the requirements of an agreement to agree or that the shareholders' agreement contains an agreement to conclude a company agreement as well. (The eventuality of a shareholders' agreement being solely an agreement to conclude a company agreement is rare in practice). According to Art. 208 of the Civil Code the shareholders' agreement qualifies as an agreement to form a company agreement if the parties to the shareholders' agreement oblige themselves to conclude a company agreement (form a given type of commercial company) in accordance with the terms of the shareholders' agreement at a determined, later date. The agreement to agree usually runs out with the conclusion of the final contract, whereas the shareholders' agreement generally remains in force.

The basic problem with the possible qualification of the shareholders' agreement as an agreement to agree in Hungary is that according to Art. 208 (1) of the Civil Code the agreement to agree must be concluded following the formal requirements established for the final contract which, on the other hand, according to Art. 10 of the Act on Business Associations (hereinafter referred to as Companies Act) would entail drawing up a notarial document or the signature of a lawyer. The parties to the shareholders' agreement tend, however, not to follow the qualified written form. In case of company

[4] About this issue, see Fischer, F.: *Die Gesellschaft bürgerlichen Rechts.* Hamburg, 1977. 271–280. and Ulmer, P.: Die *Gesellschaft bürgerlichen Rechts.* München, 1980. 5–8.

agreements the application of Art. 208 pars. (3)–(4) of the Civil Code is also hard to imagine. According to these rules, in case of a failure to conclude the final contract the court may create the contract—and establish its terms—at the request of any of the parties, moreover the court may exceptionally modify the terms agreed upon by the parties in the agreement to agree. Such an intervention by the court would, in case of multiparty contracts of a long duration, be in discrepancy with the principle of private autonomy. The rules of the company agreement would anyway be almost impossible to apply to an agreement to conclude a company agreement [Art. 208 (6) of the Civil Code]. Therefore I believe that *the rules pertaining to agreements to agree in the Civil Code, modelled on barter-based contracts, are not applicable* to the shareholders' agreement—even though its core subject matter is an agreement to conclude a later company agreement. Namely, as a result of its multiparty and multisided nature, the conclusion of the company agreement may not be regarded as a series of separate offers and their acceptance, the future partners must accept a unified draft contract and no mutual performances between the parties exist in the way as it does in contracts for the exchange of goods.[5]

The shareholders' agreement is definitely not to be confused with the instrument of *pre-incorporation company* existing from the signing of the company agreement to the judicial registration of the company (Arts. 14–15 of the Companies Act), although there is naturally nothing to prevent the parties from concluding a shareholders' agreement solely for this period. But even in this case the shareholders' agreement and the pre-incorporation company are different.

The basic difference is that the commercial company is a company registered by the state. In the majority of European laws the company gains a commercial name and legal existence, or, in the case of stock corporations and limited liability companies, legal personality constituted by inclusion in the register (either *ex tunc*, i.e. retrospectively to the conclusion of the company agreement as in the 1988 Hungarian Companies Act, or *ex nunc*, i.e. for the future, as it is laid down in our current 1997 Companies Act). Therefore the process of the formation of the company—as modelled especially by Fritz Rittner, Professor at Freiburg University—may be broken down into two phases.[6]

The first phase is the *internal bargaining process of the future company members* which may, in the given case, be regulated by the shareholders'

[5] See Müller, R.: *Gesellschaftsvertrag und Synnallegma*. Zürich, 1971. 16–21.
[6] See Rittner, F.: *Die werdende juristische Person*. Tübingen, 1972. 52–72.

agreement. The second phase, in which the future members play a mostly passive role, although it is initiated by them, is *obtaining State recognition.* Registration primarily means the state approval of the formation and operation of the commercial company which in the so-called system of normative requirements (in its historic origins crated to replace the general concession system) entails a *control of legality* and at the same time results in the inclusion of the company in the official register, providing publicity and thus the possibility of the control of publicity over the company to begin.[7]

The juridical registration procedure is a process, situations arising under which—e.g. whether the company may or may not operate and if it may, under what conditions—must be regulated by law. If state registration comes to pass, the law must regulate the *transition from the temporary State to the final state*, in a way which in the case of an already operating company expresses the *continuity* of the company's operations, but also the *qualitative leap* which obtaining legal personality, the official recognition of the company entails.[8] If, on the other hand, registration is denied with no further possibility of appeal, the preliminary formation operating in the hope of recognition must immediately be dissolved, but in a way so as to settle the internal (those between the members of the company) and external (e.g. contracts with third parties or employees) legal relationships arising between the conclusion of the company agreement and the refusal of registration.

The phase between the conclusion of the company agreement and the state judicial decision on recognition may theoretically be regulated by law according to two models.

a) The identity of the preliminary society and the final society may be denied and the "founding society", the "association of founders" may be regulated in both the internal and external legal relationships independently, following the analogous application of the loosest organisatory obligation, the *civil partnership.*[9] The internal and external relations of the unregistered company, the different questions of liability may adequately be dealt with on the basis of the rules of the Civil Code. This solution is especially advantageous in the case of an *ex*

[7] See Mummenhoff, W.: *Gründungsysteme und Rechtsfähigkeit.* Berlin, 1979. 7–13.

[8] See Büttner, P.: *Identität und Kontinuität bei der Gründung der juristischen Person.* Bielefeld, 1967. 111–128.

[9] See Fabricius, F.: Vorgesellschaften bei den A.G. und GmbH, ein Irrweg? In: *W. Kastner Festschrift.* Wien, 1972. 212–213.

tunc constitutive registration system, as in this case the registration process takes a longer time and therefore it is more correct if the decisions of the "preliminary" become the decisions of the company with the express decision of the highest organ of the registered company (this is why this solution was applied by the Companies Act of 1988).

b) If, however, the preliminary operates until registration according to the rules pertaining to the final company, a pre-incorporation company is created which, contrary to the civil partnership, is some kind of a legal subject.[10] The *Vorgesellschaft* had been created in relation to the limited liability company and the private stock corporation—these rules are harder to apply to the foundation of corporations by IPO, because of, if nothing else, the stricter imperative public law rules of the securities supervisory authority. In this case "continuity" dominates in the relationship between the "future" limited liability company or the future stock corporation and the final company; if the company is registered, the legal transactions of the pre-incorporation company automatically become—as succession is theoretically ruled out—the legal transactions of the final company (the limited legal existence melts into the full legal personality of the company).[11] If, on the other hand, the company is a "defective", "illegal" company and the court refuses registration after the exhaustion of possibilities of appeal, then the preliminary must be terminated basically according to the rules pertaining to the planned commercial company (although e.g. in Hungarian law, no formal termination takes place and the company is not dissolved either). Basically this German model had been transposed by the 1997 Companies Act, connecting this naturally with a maximum time limit of the registration process in the Law on the Process of Company Registration (Art. 44 of Act CXLV of 1997) and an *ex nunc* system of registration (Art. 16 of the Companies Act). The pre-incorporation company of a Hungarian limited liability company (LLC) or stock corporation (SC) is already an LLC p.r. or an SC p.r., i.e. a company pending registration. (Interestingly enough the new Hungarian Law on Cooperatives, Act CXLI of 2000 dropped, with regard to cooperatives, the institution of "pre-incorporation cooperative", introduced following the 1997 Companies Act, and returned to the civil partnership solution.)

[10] See Kiesslig, E.: *Vorgründung und Vorgesellschaften.* Berlin, 1999. 31–39.
[11] See John, U.: *Die organisierte Rechtsperson.* Köln, 1976. 307–311.

It must, however, be stressed that no matter whether the legal order accepts the first or the second solution as to the formation of the commercial company, the shareholders' agreement may *never*—not even with the civil partnership solution—*be equated* with the pre-incorporation company.

4. The Reasons Behind the Conclusion of a Shareholders' Agreement

Concluding a shareholders' agreement "before" or "alongside" a company agreement may be due to several reasons. The most typical are the following:

a) A typical purpose is to organise the cooperation of the future members in the possibly rather long period before the conclusion of the company agreement (or later, as the case may be, should e.g. a new member join) in order to enable a least problematic foundation of the company. In this case the shareholders' agreement, even if it is not an agreement to agree, is a *"preparatory" contract*. A typical element of this preparation is related to setting up the company's funds by the members with non-monetary contributions. The previous evaluation of contributions in kind—especially in the case of intellectual property—is a rather complicated question and may have consequences as to the future balance of power within the company, the involvement of an accountant or accountants is mandatory. (The parties should also regulate e.g. the procedure to be followed in case the court refuses to accept certain parts of the contributions in kind etc.)

b) In the majority of cases the shareholders' agreement is not terminated with the formation of the company but remains parallel in force during the period of the operation of the company. In this case the shareholders' agreement shows the characteristics of a *framework agreement*, including terms pertaining to the conduct of the members in relation to the organisation and the operation of the company during the whole period of the existence of the company—thus whether e.g. on the general shareholders' meeting votes are to be cast so as to appoint to the board of directors the candidate of each of the members, or so that the supervisory board should elect the candidate of the minority member as the chairman of the supervisory board etc. We remark that in several cases the shareholders' agreement remains in force for a shorter period after the termination of the company—e.g. members may oblige themselves to abide by the so called non-compete clauses, not to form companies with a similar sphere of

activity for a certain period of time with other partners after the termination of the company etc.

5. Collisions between the Company Agreement and the Shareholders' Agreement

If the shareholders' agreement and the company agreement are parallel in force, several interesting problems arise out of the independence of the two contracts.

a) The publicity of the content of the company agreement, the secrecy of the content of the shareholders' agreement

It is characteristic of the law of commercial companies that it places the interests of *business secrecy* important in the economic life to the background in preference for the *public interest of the publicity* of the operation of the commercial companies (*Publizitätskontroll*). The Law on the Procedure of Registration of Companies defines the sphere of data to be included in the register, documents to be submitted to the court, rules that companies' accounts should be made public etc. Moreover, anybody may at any time—without even rendering probable an interest recognised by law as to this—inspect the register free of charge. (See the 1st EU Company Law Directive on Publicity.)

An important purpose of the shareholders' agreement is to regulate those details of the cooperation between the members which the *parties do not intend to make public* and the publicity of which is *not prescribed in a mandatory manner* by the company law or the registration law. From these details the competitors may namely draw inferences, which would disadvantage the position of the company or its members in the market competition.

b) Choice of law

A large proportion of the members of companies in Hungary are *foreigners*. A significant number of Central-Eastern European countries suffer from a lack of capital and thus encourages foreign investment. These investments are mainly realised in the form of companies, even if the law of the State receiving investment provides the possibility of opening a direct appearance by the foreign company e.g. in the form of opening a branch subsidiary. Especially in the case of a foreign majority or ownership by a single foreigner the foreigner wishes to *transplant* as much of

his law as possible, conclude contracts in his own language, have dispute relating to the foundation and operation of the company settled in court procedures he is familiar with.

The company, however, has legal existence, the stock corporation and the limited liability company are legal persons, the stock corporation and the limited liability company are important actors in the economic life, therefore all countries insist on applying *their own company law* to companies which have their seat on national territory, to have the official version of the company agreement drawn up in the official language, as the registration process and the register itself are necessarily in that language. In company law therefore there is no general freedom of choice of law otherwise recognised among the principles of private international law—thus also the Hungarian Act on Private International Law (Art. 24 of Law-decree No.13 of 1978).

The shareholders' agreement, however, *falls under the general rules of collisions* on applicable law, therefore the foreigner may insist that his own law or perhaps some other foreign law be used as the supplementary legal system in deciding issues not regulated by the contract. There is nothing to prevent the parties in case of a limited liability company with two members, one of whom is Hungarian and the other German, to choose Swiss law as the law applicable to the contract as supplementary law, prepare the contract in several languages and proclaim for example the English version as official and provide for the resolution of company law disputes for a French language arbitration procedure by a Paris tribunal, for example.

c) Limiting the mandatory nature of company law

The legal regulation pertaining to the company agreement in case of a stock corporation is, as a general rule, mandatory in nature in the majority of he countries of the world, but mandatory regulation is rather widespread also in relation to the limited liability company. On the other hand, the shareholders' agreement as an atypical contract is regulated almost completely by non-mandatory rules—not taking into account a few exceptional provisions of the Part of the Civil Code on General Rules of Obligations, there is a possibility for *honouring the intention of the parties almost completely*. The parties therefore wish to make use of the shareholders' agreement in order to ease the strictness of the mandatory rules of company law. The question only is, to what extent does the law of the seat of the company accept the "intervention" of the shareholders' agreement into the company law, up to

what point does it honour solutions in the conflict between company law and general contract law to the disadvantage of company law.

The first question arises if some term in the shareholders' agreement conflicts a term in the company agreement. The view may be taken that

a) *the company agreement prevails*
b) the contract concluded *later* prevails
c) the term in the prevailing contract automatically invalidates or *modifies* the terms of the weaker contract.[12]

The prevailing—and in my opinion correct—view in Hungarian arbitration practice is that in case of a collision between the company agreement and the shareholders' agreement the content of each contract *must be independently ruled upon*, in other words the issue of collision need not be solved. From this it also follows that a breach of the "additional requirements" of the shareholders' agreement *may not have company law consequences*. If accordingly e.g. in a shareholders' agreement relating to a private stock corporation the majority Hungarian shareholder obliges himself to vote on a general shareholders' meeting on the candidate proposed by the minority foreign member during the election of the supervisory board and, to the contrary, with the help of his majority he turns down the persons suggested by the foreigner, the decision of the shareholders' meeting is valid in a company law sense and claims may "only" be put forward (e.g. for damages) according to the rules of civil law for breach of the shareholders' agreement. This is the reason why the parties try to ensure compliance with the contract by way of *security instruments*, e.g. penalty clauses.

The content of the shareholders' agreement may, however, in the given case lead to the *invalidity* of the company agreement. The "covering" or "fictitious" nature of the company (*Mantell-* or *Scheingesellschaft*) may often be established from the content of the shareholders' agreement, thus e.g. that the parties chose the corporate form primarily to avoid taxation. The problem is that following the 1st EU Company Law Directive the possibility of establishing the invalidity of the company agreement is limited, consequently even if a dispute over the shareholders' agreement leads to finding a fault in the company agreement, it is not possible to draw the legal consequences of invalidity regarding the company agreement.

[12] For this view see Juhász, J.: A szerződések ütközése a kft-n belül avagy felesleges duplicitás (The Collision of Contracts within the Limited Liability Company, or unnecessary Duplicity). *Magyar Jog*, 1991. No. 12. 730–732.

The question is more difficult when the terms of the shareholders' agreement are in contradiction to the rules of company law. The following cases may possibly arise from this aspect:

— the shareholders' agreement is in contradiction to the non-mandatory rules of company law;

— the shareholders' agreement expressly derogates the mandatory or imperative rules of the generally applicable parts of company law or of the part relating to the given type of company;

— the provisions of the shareholders' agreement are not in express contradiction with company law but contain possibilities not mentioned therein or aim at a specific application of the provisions of company law.

In the first case it would follow from the independent nature of the shareholders' agreement and the company agreement as legal transactions that it would only be possible to derogate the non-mandatory rules of company law in the company agreement. In this case Hungarian arbitration practice pierces the separation of the two contracts and generally makes it *possible for the parties to derogate* the non-mandatory rules of company law, i.e. those which allow for such deviation. In my opinion this practice is correct.

In the second case the arbitration practice regards the terms of the shareholders' agreement conflicting the imperative or mandatory rules of company law (or even, with the application of Art. 239 of the Civil Code, the whole of the shareholders' agreement) as being an illegal contract under Art. 200 of the Civil Code and consequently null and void. Thus e.g. the parties may not agree—regarding a limited liability company—even in a shareholders' agreement not to hold a single general shareholders' meeting a year and bringing decisions e.g. as to financial reports by way of casting votes by post.

The third case represents the hardest problem and depends partly on the interpretation of the nature of the regulation as mandatory or imperative. E.g. the Companies Act lists the types of preferential stock in Art. 183; the question remains whether one may introduce in the shareholders' agreement types of preferential stock not regulated in the Companies Act. Does this still form a part of the contractual autonomy of the parties or is the mandatory nature of the Companies Act provisions on preferential stock to be interpreted in a way that this creates a *numerus clausus* with regard to the types of preferential stock, providing for new types of preferential stock being invalid as a consequence?

In this question the arbitration and court practice is not unified neither internationally nor in Hungary. Some qualify as *invalid*, with a strict interpretation of Art. 9 (1) of Companies Act, all applications not mentioned in

the Companies Act, whereas others qualify the freedom of contract of the parties as the stronger interest and regard these rules of the shareholders' agreement (which usually find their way into the company agreement as well) as *valid.*[13] The practice generally classifies as valid those terms of the shareholders' agreement which aim at a particular application of the rules of company law in the company agreement. Such are e.g. the already mentioned shareholders' agreements containing limitations on the practice of voting rights—*voting agreement, Stimmbindungsvertrag.* The traditional legal view, thus e.g. also the Hungarian Supreme Court (Kúria) in the 1920s (see decision No. 3478/1925) considered voting agreements as conflicting the "morals of the good merchant", thus null and void as immoral. More recently, however, the American and Western European practice tends to recognise the validity of these agreements—accepted also by more recent Hungarian practice, as opposed to practice in the Czech Republic.[14]

[13] The issue is extensively dealt with in Balásházy, M.: Szindikátusi szerződés a társasági és a polgári jog határán (Shareholders' Agreement on the Borderline between Company Law and Civil Law). *Gazdaság és Jog,* 1993. No. 5.

[14] See e.g. Waldvogel, M.: Zur Zulässigkeit von Stimmbindungsverträgen in Tschechien. *WIRO,* 1997. No. 1. 13–16.

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LÁSZLÓ SÓLYOM*

The Rights of Future Generations, and Representing them in the Present

Abstract. The *Védegylet*, a civic organisation for environment protection presented 1990 a private draft for an Act on the Ombudsman of Future Generations. In this article the author of the Draft Law describes the background to the Law. After a short survey of the development of the idea of a guardian of future generations in international law the author discusses whether future generations can have "rights" and whether future interests can be anticipated. The article raises structural questions of the proposed ombudsman (who represent whom, before what institution) and points out the differences between the existing ombudsmen defending individual rights and the speaker of future generations, the latter being rather a representative of environmental interests and a mediator. Finally the author shows how the Hungarian Constitutional Court created favourable conditions for introducing the new institution.

Keywords: rights of future generations

When former students reunite to pay their tribute to the memory of their Master, they bear testimony to the fact that Gyula Eörsi's work lives on and is transmitted to future generations not only in the books he wrote but also in the memory of the members of the school of jurisprudence he once headed, their work and the personal affection that many of them still cherish. Once again, it is Professor Eörsi's spirit that is able, if only for a moment, to conjure up the scholarly community, which used to be His intellectual home as well as ours. The atmosphere was at once imbued with the strength of personal example, which counterbalanced the lack of a "director", with the cult of originality and performance. All this was supported by the practice of reading and commenting on every sketch and piece of work we did, a general tenor of detachment tinged with irony, and still some rare heart-to-heart conversations with the Boss about the role that he had chosen as his life mission.

* László Sólyom, Professor of Law, Budapest, H–1121 Budapest, Kútvölgyi út 103/b., Hungary.
E-mail: lasolyom@axelero.hu

Personally, I am particularly indebted to Gyula Eörsi. After my first publications he declared me a "private scholar", giving me dispensation from participating in the collective projects of the Institute. I could pursue whatever interest I came to have. (In those days we would have added that this was happening in *machtgeschützte Innerlichkeit*). On one exceptional occasion, he asked me—"a man of leisure", as he put it—to write an essay for the collection of papers on environmental law, which was imposed on the Institute as an obligatory exercise. Little did I, or anyone, know that this paper was to involve me in the movement for environmental protection and to be the source of instituting an unlimited access for everyone to the Constitutional Court. This *actio popularis* deeply influenced the entire style of the political transformation of 1989. I find it most appropriate to express my gratitude by publishing in this volume another offshoot of that felicitous imposition rather than a paper on a freely chosen topic.

1. The idea of a speaker for the environment and the future generations entered the public opinion in Hungary in connection with two events: directly on the occasion of debates on introducing the institution of the ombudsman in Hungary, and indirectly through international law. In conclusion to his book on the 'ombudsman' (of 1992), László Majtényi reflects upon arguments that came up around the change of regimes, formulating a demand for an ombudsman to represent each and every right and interest, from the disadvantaged, through hospitalised patients to prisoners and also the environment. Majtényi pointed out that an environmental ombudsman differs from other parliamentary commissioners who defend a concrete, and already acknowledged right. The role of the environmental ombudsman would focus on the safeguarding and representing general environmental interests, rather than defending individual rights. Consequently, he/she is a mediator. However these thoughts were not taken up. The problem that the right to a healthy environment lacks in an individual subject was left to the Constitutional Court to interpret, and to draw consequences from. The Constitutional Court also discussed the nature of the right to life. In both cases the verdicts took a line favourable to introduce a commissioner for future generations into the Hungarian legal system, even though the Constitutional Court itself was not concerned with this.

Important events in international law occurred in the meanwhile. At the 1992 Rio Conference, the representative of Malta made the case for a guardian of future generations, whose role would be to keep our sense of responsibility to the future generations alive. A number of scientific groups adopted the suggestion, producing a profusion of literature on the subject,

which brought all the related theoretical and practical problems to the fore. International law is better suited to incubate such plans and to solve its problems, as its distance from political life does not allow for the exploitation of these problems for everyday politics. But no official sign of any State's willingness to institutionalise the guardian has been given. The development of the law shows however a clear trend. The thought, that mankind as whole can be the subject of international law has gained ground. International law has brought about the concept of "the common concerns of mankind," as well as "the common heritage of mankind." Though the institution of a commissioner has not been accepted, the UNESCO issued a declaration on the responsibility of the present generation towards future generations in 1997. Guaranteeing the freedom of choice to those who come after us is the theme of this declaration, and it states the responsibilities of our generation in regards to the protection and handing over of a heritage in the fields not only of our environment in its traditional sense, but also that of biological diversity, the human gene, and cultural heritage.

In spite of these developments advance has been made largely in the theoretical fields. Apart from taking its own professional stance on the subject, international law has placed the idea of the guardian of future generations within the current theories of justice, and introduced it into debates on democracy, posing it as a question of participation, that is the future taking part in the decision making today. The question was raised, whether we should have to make concrete choices in the name of future generations (representing them), or whether we must make sure they will have the opportunity to make a choice once they are born. Would in not be better to save certain goods and to hand them down to the future generation instead of "representing" them? (As is commonly understood, whales and rain forests are such 'goods' today.)

2. How can the legal personality of future generations be recognised, taking their uncertain notion? It is evident to a student of private law that anyone or anything can be given legal personality; if these are not individuals or natural persons, than legal entities are legal subjects. The subjects of international law however could originally only be states. Steps away from this position have been taken in two directions: individuals can also be subjects of international law (see the example of the war criminals brought to trial in the Hague), and in the opposite instance, mankind—as a whole—can also be legal subject in international law, having respecting rights.

The question, which may help to elucidate the status of future generations as legal persons is, what kind of rights would they provided with? It is appropriate to look at the "rights" we believe future generations deserve as symbolic, and to think of the legal discussion dealing with them as metaphoric. What is present for us today of the future rights of those who are yet to be born, is the responsibility, the legal obligations we have towards them. International law assumes that future generations have "rights" in order to establish corresponding duties, for all rights are balanced by obligations. (We will see that according to the Hungarian Constitution the State may have responsibilities towards future generations, without giving them rights.) We are the ones who decide the rights of humankind in the future, based on our ideas, knowledge and needs. Respect for their autonomy requires that we make as few essential decisions for them as possible, passing on the freedom of choice instead.

The indefinable notion of future generations—especially in terms of time—shall warn us not to handle instead of the unborn generations. Lets hope there will always be future generations—but how far can we look ahead, and take responsibility for the future? What time limit can we claim, for our decisions to be proved correct and justifiable? Two points of conflict come up when we base our responsibilities and duties on social justice.

First we have to negotiate the clash of interests between present and future generations. What weight must we give the rights of the future generations, to place it over and above the poverty, and indeed life threatening circumstances (e.g. hunger in Africa) of generations alive today, belittling the later, and putting the future forward as the more important? The interests of the future generations cannot be brought up in itself, separated from the solidarity and responsibility for all of mankind in the present. We can find some amusing examples in the literature: if it has been discovered that a comet will hit the earth in two hundred years, a certain percentage of the global GDP must be set aside throughout those years, to avert the catastrophe, and everyone must accept this pledge. The inclusion of rights of the future generation in the legal system is justified through democracy. But who is to decide, what load should be born by whom in the name of the future?

The other controversial point is a clash of interests between future generations. A similar choice may come up between the fourth and fifth generations, or the fifth and the tenth. A beneficial decision for the next five generations may be lethal to the sixth. And why should all interests be global. Something beneficial to future Siberians and Alaskans can spell catastrophe in South-Asia. We may be able to bring sacrifices and even

force others to make sacrifices in order to save a species, but a virus it carries may wipe out future generations. For these reasons Rawls, a leading authority in social justice theory writes that we can only extend our guardianship to the next generation. One can put in the balance benefits to one's self, ones contemporaries and the future within the limits posed by this view. It is natural that we look after our own children—there is no need to go any further. Yet decisions made today, affect many generations to come—can a fair decision be taken without considering them?

"Goods" being conserved for future generations, rather than the anticipation of their rights and interests may partly solve the problems outlined above. This has a serious impact on the way the institution is built up.

3. Who represents whom, and before what court or authority? And how many ombudsmen shall we say are needed? The answer to the question put forward in the previous point—whether "goods" are to be saved or actions in the name of the future generations to be made—will define the way the institution of the ombudsman will be structured. If the speaker is a guardian of future generations in general, than the person would have to be knowledgeable in all fields, but essentially someone universally respected on moral grounds. (Yet is the moral authority of the person and universal respect enough? Will everybody bow to his/her position on a controversial subject such as abortion, or population explosion? Nothing affects the rights of the future generations and especially their right to life more than these both problems.) But if the protection of particular goods, i.e. certain objects such as the oceans or the whales is at stake, than an expert who can tell what is best for a whale is needed. In this case, we need as many speakers, as the number of protected goods. Who should be the speakers: a person or an institution, a State, a public authority or a NGO? Where should the platform be given for this speaker: should he/she make his/her case to the nation-states, international institutions, to both or neither, bringing the case instead before a court? (Though would the process then no longer be the representation of certain interests, but an enforcement of rights.) And as we proceed, one feels more and more lost in a maze of questions. Even the question of how an ombudsman would relate—in terms of prestige—to the organisations already at work has come up. After all, every organisation in the field will claim to be serving the interests of future generations. Nor can it be argued that people working on stopping a virus (even in a single country or region) will not influence the well being of generations in the future. Another factor to be reckoned with is the claims of established ombudsmen who may feel that a speaker of future generations will trespass on their field of

competence. And governments may see the new ombudsman as another attempt to limit their powers.

Following these structural questions, we can address the problems of the powers of the guardian of the future generations, and the nature of his/her activity.

The role of this ombudsman is different from that of all others. For this reason this office does not involve any competition with commissioners of civil rights and data protection. The later protect the constitutional rights of the individual: clearly defined rights in a legal process that is also clearly defined. It must be mentioned, that presently the only environmental ombudsman of the world, employed in Ontario Canada, has the responsibilities traditionally associated with the ombudsman, helping citizens fight for their environment related rights. A speaker for the future generations however, as I have said, will not be defending legal rights, but will have the office of representation. The term guardian, used in international law, makes its mark for this reason. Minors and those unable to take action in their own name have guardians. Future generations are not able to make a case for themselves, and therefore the speaker must do it in their name. On the one hand, the guardian helps to bring the issues touching on them to the legal recourse. On the other hand, the guardian influences the political decision making, as a representative, as well as by using public pressure. The fact must be stressed that the speaker for the future generations is not a decision maker. He/She seeks to orient the politics of decision makers. This may also be considered a weakness. But the symbolic "rights" of the future generations are quite different from the fundamental constitutional rights protected by other ombudsmen. The other ombudsmen are not authorities either; their recommendations take effect with a measure of the strength of the argument and the publicity given to it, and the personal prestige of the ombudsman. A smaller role is being proposed for the guardian of the next generations in the literature of international law: the right to speak out for the future generations—and of course full access to information. The Hungarian draft law for the setting up of the institution of a parliamentary ombudsman for future generations, which I prepared at the request of *Védegylet*, a civic organisation for the environment, goes to the limits of what is possible.[1] Half-way between the Canadian and the Hungarian conception lies the Israeli parliamentary ombudsman whose office was created after the publication of the Hungarian draft,

[1] The Draft Law on the Ombudsman of Future Generations can be found in www.vedegylet.hu in the 3. item of the menu: jövő nemzedékek képviselete.

and who is empowered to undertake preliminary norm control from the legal point of view of future generations.

4. Why am I convinced that the situation in Hungary is conducive to the establishment of this institution, in spite of all the questions we have left open, and all the apparent difficulties? Firstly the legal environment is suited for the introduction of such an ombudsman. Secondly I trust, that both public opinion and lawmaking bodies recognise our responsibilities to future generations. The story of data protection, and its commissioner gives some cause for circumspect optimism. It has taken twenty years to reach from the conception of integrated records, ready plans for registers on the population, and the general acceptance of the personal identification number to the declaration of the fundamental right of informational self-determination by the Constitutional Court in 1991, the establishing the office of the data commissioner, and the conscious everyday use of information rights. Our cause may run a similar course if we come to be aware of our responsibilities towards the generations of the future, and the attention of decision-makers is constantly drawn to the issue.

The present legal background is favourable, because the Constitutional Court has declared the state's duty to protect the condition of life for future generations. The Court also solved the question of how future generations can be a subject of law, a question that caused some difficulty in the international legal theory.[2] The Constitutional Court has dealt with this question in all of its sentences that had anything to do with life and death: abortion and death penalty. According to the judgement of the court, right to life, which is a basic individual right, stands balanced against the obligation of the State, to protect life. The duty of the State goes beyond its obligation not to violate the individual's right to life. It must also protect human life and its condition of existence in general. This latter duty is qualitatively different from aggregating the rights to life of individuals; it is human life in general, consequently human life as a value that is the subject of protection. Hence, the State's duty to protect human life extends to those lives, which are in their formation, just as it extends to the protection of living conditions of future generations. In 1998, the Constitutional Court put particular emphasis on the fact that not only individual rights must be brought under legal protection, but life and its

[2] For the relevant decisions and further explanation see Sólyom, L.—Brunner, G.: Constitutional Judiciary in a New Democracy. The Hungarian Constitutional Court. Arbor, A.: The University of Michigan Press, 2001.

natural conditions must be institutionally protected beyond this given circle, i.e. the protection of the right to life does not only apply to the rights of (now living) individuals. The Constitutional Court has therefore declared that these objective duties of the state *always* extend beyond insuring the rights of the individual. Every person has the right to the freedom of speech. The responsibility of the State is to create and sustain the conditions that enable the formation of and upkeep democratic public opinion. Therefore the State is for example limited to a few, well-defined cases as regards the penalisation of the expression of an opinion or is obliged to pass a Media Act. In other words, we have here a rather extensive and impersonal protection of rights through institutions. With a similar reasoning from the right to life follows that the State is responsible for the protection of the environment and the living conditions of future generations. Environmental rights are concentration of duties of the State, according to the Constitutional Court. When we consider this responsibility, we may speak of corresponding "rights" only in symbolic terms: as the Court put it, nature itself could be the beneficiary of this right. So is no need to use the language of "the rights of animals and plants." We might however add: there is a need to bring up the question of whether the future generations have rights or not, because it is valuable as strong propaganda.

5. The Hungarian legislative draft I have mentioned was published a year ago. Since the theoretical difficulties in connection with the future generations are avoidable in Hungary only practical objections were raised and discussed. The ombudsman of future generations will be modelled on the parliamentary ombudsmen who are already established. The question we may expect will come up is: why is a new institution needed when so many seem to be dealing with these problems already? According to the draft, the commissioner for the future generations would have the powers to conduct examinations in the private sector as well (similarly to the data protection commissioner), while the general ombudsman is only able to examine State institutions. For this reason, the field of work planned for our ombudsman would not be fully accessible to the general ombudsman. The numerous authorities that look after the rights of our descendants as one among their many duties would also not be able to replace the speaker for the future generations. These are government agencies, acting in the strict framework of their competences, duties and procedural rules. In contrast, the ombudsman for the future generations has a free hand in the selection of cases to be dealt with, which she/he believes to be most important in terms of representing the future generations, drawing not only the attention of

various authorities to the matters, and making his/her case with them, but also the attention of the general public, giving the sense of responsibility a chance to develop. An *actio popularis* completes the institution: any person can put in a motion for an investigation.

The draft act does not limit the powers of the parliamentary commissioner of the future generations to environmental protection. The tasks of the commissioner cannot however be defined without reference to the Environmental Protection Act and the Natural Conservation Act. These in turn refer to a number of areas from the cultural environment and protected historical buildings and monuments to education. The field of investigation and activity for the ombudsman is very wide. Apart from the right to a choice in matters related to nature, the UNESCO declaration of 1997 mentioned earlier lists cultural, political and economic choice among the opportunities for decision that must be saved for the future generations. In the preamble to draft act all these are included; freedom of choice, quality of life, free access to energy resources; these are areas to which the powers of the ombudsman are extended. While the commissioner is invested with the powers to investigate these legally definable fields, the office is never itself an authority. The powers of the parliamentary commissioner for the future generations are built on publicity, influence and pressure. He/she has the right to call for a public hearing, to give counsel on international obligations concerning the common heritage and the common concern of mankind, nature or environmental protection and resources, prior to entering them. Neither State, nor business secrets can hinder the commissioner's access to data related to the state of the environment.

As the cause of the *guardian* was not embraced by the States after 1992, the Hungarian political establishment rejected the proposal for the institution of an ombudsman for future generations. That the draft law made its way to Parliament and reached the stage of committee discussion was itself the result of political manoeuvring. However, government and opposition were of the same opinion: there were enough ombudsmen already. Yet if we come to think of the number of years it took the cause of data protection to get from official resistance to constitutional recognition and to the institution of the independent ombudsman for data protection, we have no reason to give up hope.

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LAJOS VÉKÁS*

The Foreseeability Doctrine in Contractual Damage Cases

Abstract. This study makes the proposal to introduce the contract remoteness test into the Hungarian civil law as a principal restriction on compensatory damages. The author sums up the development of the reasonable contemplation test in the English common law first formulated in Hadley v. Baxendale. He compares it with Art. 1150 of the Code civil, Art. 252 of the German BGB and Art. 74 of the Vienna Sales Convention, before making his proposal for the new Hungarian Civil Code.

Keywords: Hungarian civil law, contracts, contractual damages

One of the most remarkable aspects of the uniquely productive publishing work of Gyula Eörsi is the legal scientific work he did analyzing various aspects of liability for damages.[1] It is exactly for this reason that we chose a problem of tort liability as the focus of this publication dedicated to his memory. The choice of topic was also influenced by the fact that Eörsi's work in legal theory was most notably well received internationally when contributing to the framing of international sales law. Professor Eörsi belonged to the select group of experts who participated already in the development of The Hague Sales Convention[2] that was adopted as early as

* Lajos Vékás, Member of the Hungarian Academy of Sciences, Budapest, H–1053 Budapest, Egyetem tér 1–3., Hungary.
E-mail: vekas@ludens.elte.hu

[1] *Compensation for Illegal Behavior.* Budapest, 1958. Attempt at Drafting a Uniform System of Respons Under Civil Law. *Hungarian Academy of Sciences Társadalom-történeti Osztályának Közleményei* IX (1959) issue No. 2. Fundamental Problems of Legal Responsibility, Responsibility under Civil Law. Budapest, 1961; Problems of demarcation in the sphere of financial responsibility. Budapest, 1962; Handbook of Compensatory Liability in Civil Law. Budapest, 1966.

[2] Schlechtriem, P. (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG).* München, 2000[3], 28. Gives a rather witty parody of the proceedings and atmosphere

1966, and he was also an important participant in the work done within the framework of UNCITRAL. In addition to the general international respect he commanded it was probably for this latter reason that he was elected President of the Diplomatic Conference[3] held in spring of 1980, which adopted the Vienna Sales Convention that currently has more than 50 member states.[4]

Limiting Liability for damages in Hungarian Legal Theory and Practice[5]

1. The starting point for the regulation in the Ptk. (Civil Code, hitherto C.C.) [339 § paragraph (1)] regarding the amount of damages to be paid is the principle of full compensation, and accordingly no statutory exemption is provided within the general rules in the area of contractual damages. The possibility of partial judicial relief from liability for loss on the basis of equity [339. § paragraph (2)] is only available in the case of tort damages [318.§ paragraph (1)].[6] On the basis of judicial practice of more than forty years it can also be seen that judges did not exercise their freedom to grant partial relief allowed by law on the grounds of fairness in non-contractual damage cases either.[7] Instead, if they deemed it appropriate

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of the law-unification conferences Eörsi: Unifying the Law (A Play in one Act, With A Song). *Am. J. Comp. L.* 25, 1977. 658–662.

[3] *Eörsi* co-authored one of the first commentaries of CISG giving explanations of Articles 14–17 and 55: Bianca, M. C.—Bonell, J.: *Commentary on the International Sales Law* (The 1980 Vienna Sales Convention). Milan, 1987.

[4] For the list of member states see Magnus, U.: Wiener UN-Kaufrecht (CISG), in: *Staudingers Kommentar zum BGB*, Berlin 1999^2, page 27 at seq.; Mádl, F.—Vékás, L.: Nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga *(International Private Law and Law of International Economic Relations).* Budapest, 2000^5. 322. *et. seq.*

[5] For a comparative law outlining of the problem see Hellner, J.: The Limits of Contractual Damages in the Scandinavian Law of Sales. *Scand. Stud. Law,* 10 (1966) 37–79. (40. *et. seq.*).

[6] We mention that Swiss Contract-Law (OR) charges the judge with deciding the nature and size of the damage to be awarded, especially in tort cases (Art. 43, Art.99).

[7] Even the original intention of law makers suggested applying C.C. § 339. 2nd paragraph allowing mitigation of liability based on fairness only in "extraordinary cases". Cabinet Minister's Explanation for the quoted segment of the law". Indeed, legal practice used the fairness principle sparingly, which was also the recommended

given the circumstances of a particular case, judges would partially relieve the party causing the loss from liability based either on insufficient demonstration of proof, or by limiting the chain of causality. It is difficult to answer the question whether a similar reduction of damages can actually be observed in contractual liability cases. We may assume this to be a good probability, however, this could not actually be proven completely, let alone quantified, as we are limited by the abridged nature of the case reports.

It can be seen that although practice has (correctly) allowed for exceptions (from the principle of full compensation, nonetheless, court decisions on limiting liability for damages chose not to utilise the possibility of equity- offered by the C.C. *even* in tort cases. Most often they argue for a partial dismissal of claims for damages by pointing to a loose or distant causal relationship between injurious action and loss. At the same time, analysis of the judicial practice also shows that court practice did not draw such a clear distinction between contractual and tort liability in this regard as theintended.[8]

Reducing liability by way of *drawing the boundaries of causality*, primarily with the application of the so called *principle of adequate causality*, or by other means of limiting causality based on the cause being "too distant", "non-decisive" or "irrelevant" may in no way be disapproved. Most notably in German law, but also in Common Law, courts employ this method, and international scholarly literature also treats the problem as being an issue partially of causality and partially of distribution of risk. We should note, however, that in the world of contracts, (especially commercial contracts), the viewpoint of *distribution of risk* is dominant. Furthermore, the problem of causality is widely known to be a difficult

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position of the Supreme Court in its opinion coded PK 804/1. In the BH there were only two cases published in 1961 where the possibility of using § 339. 2nd paragraph presented itself. In one of these cases the Supreme Court brought a questionable decision to apply the fairness principle (BH 1961/issue 12, No. 3024), in the other case it correctly decided against such application (BH 1961/issue 6, No. 2910). The rule's application was triggered expressly by the injurious party's financial position in case coded LB Pf. III. 21027/1970 (this case is commented on by Petrik: *Law of Compensation*. Budapest, 1991. 33).

[8] The justification given by the Minister in an explanation attached to C.C. § 318. for the exclusion of the liability mitigating fairness principle from contractual cases is as follows: This differentiation "is mostly explained by the position that it would not be justified to provide relief of liabilities fixed in a contract, i.e. such liabilities that could be foreseen." In borderline cases, such as violation of a protected interest by breach of contract, however even the Minister's explanation thought it possible to allow the judge the use of fairness to mitigate liability.

one bearing a lot of uncertainty. As a result, decisions arguing a lack of causality are often disputable and not always detailed enough, and legal literature is also correct in challenging the erroneous theoretical foundation of the principal of adequate causality. It is correctly argued by Géza Marton that this particular way of mitigating compensatory damages transforms the fundamentally legal policy problem of liability into the more matter of fact question of causality. Consequently, Géza Marton ab ovo proposes the principle of "*adequate set-off*" instead of *adequate causality*. According to his correct views the practice of limiting liability for damages by way of limiting causality in cases of liability based on fault would be understandable, although, even here its foundation in theory is flawed. However, in the area of liability independent of fault the logic of *adequate causality* is even methodologically inappropriate, because this way of cutting the chain of causation at a standardized point applies the notion of *typified* fault even in a system of relief from liability independent of fault.[9]

2. In the case of Hungary the Vienna Sales Convention has been in effect since January 1, 1988.[10] Consequently, in matters of international sales Hungarian Law applies the rule (Article 74, 2nd sentence) of that Convention, which in the case of contractual damages limits compensatory damages to only those foreseeable by the injured party, thereby deviating from the principle of full compensation. Compensation amounts awarded as reparation for breach may not "surpass the loss that at the time of concluding the contract could or had to have been foreseen by the breaching party based on those facts and circumstances that had to be considered as the possible results of a breach".

In reference we mention here that in the case of a special problem involving the liability of a freight forwarder the C.C. itself operates on the principal of foreseeable damages. 500 §. paragraph (1) states that beyond the agreed penalty for late performance a freight forwarder is only responsible for a loss occurring as a result of late delivery if he agreed to the delivery date in knowledge of the other party's interest intimely performance.[11]

[9] Marton, G.: A polgári jogi felelősség *(Responsibilities Under Civil Law)*. Budapest. 1992, item No. 121, 222.

[10] Law-decree No. 20. of 1987; compare with Sándor, T.: A nemzetközi adásvétel *(International Sales)*. Budapest, 1990.; Mádl—Vékás: *International Private Law and Law of International Economic Relations. op. cit.* chapter 22 (322–349).

[11] It is worth mentioning, probably not as a coincidence, that in English common law the first court case to be built on the principle of foreseeability (Hadley v. Baxendale to be discussed below) has at its center the awarding of unrealized profit

3. As a preliminary remark we also point out that the availability of possible mitigation of tort liability and its dogmatic method seem to show a close connection with the method of relief from liability, and in fact can only be analyzed together. This is clearly shown in the practical application of the principal of adequate causality, and its previously mentioned well founded criticism in legal literature. The C.C. could only provide a special "emergency exit"-like method of mitigation of liability based on the court's discretionary application of the equity principle because it opened a rather wide and moreover flexible window for exculpation with the possibility that the party causing damages prove that he acted "as it can normally be expected under the given circumstances".

The Vienna Convention allows only for a more stringent and objective way of exculpation. According to the Convention a party can only be relieved of responsibility for partial non-compliance if it proves that said default resulted from an obstacle that it could not have circumvented, nor could it reasonably be expected that at the time of conclusion of contract the obstacle be foreseen, removed, or its consequences be averted.[12]

4. The theoretical need for full compensation of damages resulting from breach of contract had been a persistent problem in C.C.'s judicial practice, which is also reflected in legal literature. As early as 1971 Miklós Világhy saw the need for the correction of the principle of full compensation in the contractual domain and similar ideas have been raised by Attila Harmathy a few years later. In 1993 Tamás Tercsák wrote a comparative study dealing explicitly with the question of limiting liability for damages with the help of foreseeability.[13]

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occurring as a result of late performance of a transportation contract. Furthermore, leading even today's leading British handbooks discuss the topic with a focus on besides contracts of sale those of transportation. See for example McGregor, H.: *On Damages.* London, 1997[16], 182 *et. seq.*

[12] A translation of Article 79 paragraph (1) given by the author that is true to the original English text and therefore differs slightly from the official text published with Law-decree 20 of 1987.

[13] Világhy, M.: A Polgári Törvénykönyv felülvizsgálatának elvi kérdései II. (Theoretical Questions of the Revision of Hungarian Civil Code. (C.C.) II.), *Hungarian Law,* XVIII. 1971. 456; Harmathy, A.: Felelősség a közreműködőért *(Responsibility for intermediary third party).* Budapest, 1974. 243–251; Tercsák, T.: Előreláthatóság — mint a szerződésen belül okozott kár megtérítésének korlátja (Foreseeability as the Boundary of Compensation for Damages Caused within the Framework of a Contract). In: *Polgári jogi dolgozatok (On Civil Law),* (ed.: Harmathy, A.). Budapest, 1993. 231–254.

Világhy proposed the tightening of the rules governing the finding of liability in cases of defective performance and simultaneously proposed the need for an exception to the rule of full compensation. (We should mention that before the 1977 Novella has entered into force the C.C. awarded a claimant compensation *after* the expiration of the warranty period only in very limited cases [original 307. § paragraph (2)]: in order to be awarded compensation the entitled had to prove that the defaulting obligor acted fraudulently.) In limiting liability for damages he did not rule out the introduction of the foreseeability principle based on "the inspiration of English or French law and legal practice" as such a solution that "theoretically meets the criteria of the concept of contractual barter relationships". However, instead of introducing this principle "foreign to Hungarian legal thinking" by way of legislation, he rather suggested that "in legal regulation of the actual sum of damages a judicial practice would develop in the direction of the so called adequate causality principle and as a necessary consequence courts would award only that portion of contractual damage that the parties had to have considered at the time of breach given the particular nature of the terms of the contract." Although here is little difference with regard to their effect, the foreseeability principle and the principle of adequate causality differ significantly in terms of their theoretical foundation, as this was pointed out above when discussing ideas of Géza Marton. While the predictability principle allows the normative limiting of making a party liable for damages based on a decision of policy, the doctrine of adequate causality provides a tool for artificially breaking of the existing causality chain based on a judge's discretion. Világhy would solve the problem of how to flexibly limit the principle of full compensation in a way that would also provide a platform for a more organic development of law. He favored the use of the less unusual principle of adequate causality, deciding not to bother with the rather well founded theoretical criticism that were certainly known to him as well. Law No. 4 of 1978 essentially chose this same direction recommended by him. According to this law that is still in effect to this date the C.C. theoretically extended the defaulting obligor's liability over all damages even beyond the warranty period, and left their potential mitigation up to the judge. Even today the methodology of mitigation can be based (of course not overtly) on the principle of adequate causality. This is certainly a faulty solution in terms of its foundation in theory.

In his excellent monography on the subject of responsibility for the acts of intermediaries, Harmathy also deals with the issue of defining the limits of claims of contractual damages. In building a foundation for his

deductions he gives a short yet sophisticated comparative law study on the dogmatic tools used to limit the size of damage awards in French, English, and German law as well as in Hungarian draft codes and socialist law. He sums up his position by writing that "there is a need across the board for limiting liability over breach of contract. This is understandable because at the time of the conclusion of the contract the parties take into account a certain risk, a possibility of loss during the normal run of the process, and they agree on stipulations of the contract with these eventualities being taken into consideration." In his summary he explicitly argues for the condition of "foreseeability" to be inserted into the process of limiting liability for damages caused by contract violation, because this solution is "most sensitive to business considerations". For establishing the forseeable amount of damages Harmathy suggests we simultaneously take into account both objective and subjective criteria. "An objective characteristic exists in that those parts of damage are included which given the particular circumstances had to be taken into account based on prior knowledge or experience; a subjective one, in that we take into account also that part of the damage which although could not be expected based on experience, but the person in breach of the contract came to possess such facts at the time of contract talks and the fixing of the terms of the contract, that would have suggested the probability of the occurence of higher than usual damages."

Tercsák finds it desirable to limit liability for damages to foreseeable damages in the area of contractual liability law based both on the grounds of economic rationality and as a measure of prevention. He compares this solution with various other methods of limiting liability for damages used in some of the more important legal systems, for example schemes that define liability for compensation as a direct function of the degree of culpability, or the use of assorted causality theories, etc. As his ultimate conclusion he proclaims that in the area of compensation for contractual damages boundaries of liability can be drawn most accurately with the aid of the foreseeability method compared with all others.

5. In the following section we analyze the foreseeability doctrine. Our purpose is to contribute to the effort to reform the C.C. by providing an alternative solution to the problem of limiting liability in *damages* arising from breach of contract.[14] Providing such an alternative solution may be

[14] *Sándor* also recommends the solution of the Vienna Convention for the reform of the C.C.: Sándor: *International Sales. op. cit.* 276. footnote 9.

necessitated particularly by the fact that the reform of the C.C. is expected to bring about changes in matters of exculpation.[15] This is important, because if proof of lack of culpability is not sufficient grounds for relief (as it is suggested in the new Concept of C.C.), rather it is necessary to provide proof of objective circumstances (similarly to the provisions of the Vienna Convention), then a more robust, and more importantly, a more predictable foundation must be provided for the limitation of liability as well, in comparison with the current state of affairs. The foreseeability doctrine would provide an internationally common and successful dogmatic framework for this issue.

The Foreseeability Doctrine and its Related Institution in National Laws

1. The foreseeability doctrine was likely approved relatively easily as part of the Vienna Convention because it is known in the several highly regarded legal systems.[16]

a) In modern times it makes its first appearance in French Law,[17] from which it spread to most legal systems, fashioned after French codification. The *Code civil* itself expressly states (Article 1150.) the requirement of foreseeability in determining the amount of damages.

In French legal practice, however, this method of reducing compensation awards does not play a major role. This is in part due to substantive law reasons. As a matter of course the Code civil precludes the case of intentional breach of contract ("par son dol") from the scope of operation of the foreseeability principle. A further restriction in the application of the principle results from a unique distinction in French civil law between "*obligation de résultat*" and "*obligation de moyens*". Moreover, it is superfluous to refer to the necessity of foreseeability due to the special legal

[15] Compare with Vékás, L.: Javaslat a szerződések általános szabályainak és a szerződéstípusok szabályainak korszerűsítésére (Vitaindító tézisek az új Ptk. Koncepciójához, II. Rész). Polgári jogi kodifikáció III. évf. [*Recommendation for the updating of the general rules of contracts and rules governing various contract types.* (Debate opening theses for the new concept of the C.C., part 2). *Codification of Civil Law*], vol. 3. 2001. issue 4–5.

[16] Hellner: *The Limits of Contractual Damages... op. cit.* 47., with footnote's 3 and 4.

[17] Dupin, A. M. J. J. (ed.)*: Oeuvres de* Pothier, *contenant les traités du droit français.* Paris, 1824. l. k.: Traité des obligations, Nr. 159. *et. seq.* For the roots of the principle in Roman law see Zimmermann, R.: *The Law of Obligations (Roman Foundations of the Civil Traditions).* Cape Town, 1990. 829. *et. seq.*

exemptions given both in the general rules of contracts (Article 1153.) and in contracts of sale (1630. and following Articles, Article 1644.).[18] In addition to these reasons we should also consider the procedural matter that a claim based on the foreseeability doctrine (being a legal objection presuming deliberations of fact) may not be raised before the Cour de cassation.19 Finally, the less frequent use of the foreseeability rule can most likely be attributed to the fact that beyond the scope of *damnum emergens* and *lucrum cessans* the Code civil (Article 1151.) limits compensatory damages to the immediate and direct ("*immédiate et directe*") consequences of the breach of contract .

b) A significantly more important role is played by the foreseeability doctrine in English common law.

In English judicature this principle was first applied in Hadley v. Baxendale[20] by the Court of Exchequer. At the heart of this often quoted case was the dispute between a mill owner and a carrier. A part of the steam mill that had been off site for a necessary repair was delivered back to the mill only four days past the time of delivery that the carrier had agreed to and the miller sued the carrier for lost revenues. It is an interesting example of the unpredictable interactions that the history of law can produce that in this case the plaintiff's attorneys and one of the judges referred to French Law[21] based on an American textbook.[22] The

[18] Mazeaud, H.—Mazeaud, L.—Mazeaud, J.—Chabas, F.: *Traité théorique et pratique de la responsabilité civil délictuelle et contractuelle.* 3/1. Vol. Paris, 1978[6], Nr. 2190 (compare with Nr. 2378 and 2390 as well); Ghestin, J.—Desché. B.: *Traité des contrats — La vente.* Paris, 1990, Nr. 853. *et. seq.*

[19] Viney: *La responsabilité: effets.* Paris, 1988, Nr. 324.

[20] (1854) 9 Exch 341 156 Engl. Rep. 145(1854); for more recent analyses of the case see.: Danzig: Hadley v. Baxendale: A Study in the Industrialization of the Law. *Journal Legal Studies.* 4 (1975) 249–284.; Faust: Hadley v. Baxendale — an Understandable Miscarriage of Justice. *J. Legal Hist.* 15 (1994) 41–72.; also compare with Zimmermann: *The Law of Obligations... op. cit.* 830.

[21] Hadley v. Baxendale, (1854) 9 Exch 341, 345 *et. seq.* According to the transcript Judge Parke said the following during the trial: "I wish the sensible rule was established, that damages must be confined to what the parties reasonably anticipated. My attention has been drawn to the subject by reading Mr. Sedgwick' work." Hadley v. Baxendale, 23 L.J.R. [N.S.] Exch 179, 181 (1854). (Eörsi was known to enjoy "playing around" with English cases.) *Pothier*'s views were incidentally fondly adopted by English decisions of the 19th century, in fact according to *König* (Zimmermann: *The Law of Obligations... op. cit.* 336., 830.) the concept of foreseeability can be traced back to *Dumoulin* in French private law (Molinaeus. C.: *Tractatus de eo quod interest: 1546*): König: Voraussehbarkeit des Schadens als Grenze vertraglicher Haftung — zu

decision that was handed down in the case was written by Lord Alderson of the four judges produced an important procedural innovation not relevant to our subject, but it also contained a legal argument that was likely flawed considering the particulars of the case which led to an unjust resolution.[23] Nonetheless, to this day it is regarded as the leading precedent in English Law ("the most celebrated case in the field of contract damages"[24] spelling out the the clause of forseeability, the "contemplation rule" (or "contemplation doctrine"). The holding of this famous judgment is that in a case of breach of contract, in addition to "general damages" (i.e. actual losses), such additional damages may be claimed on the basis of unrealized profit "as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as a probable result of the breach of it".[25] Dicta to the judgment emphasizes that if the party in breach could be made liable for that part of the damage which he did not have to foresee at the time of breach, then it would not be in the injured party's interest to come to an agreement with the other party regarding the probable damages resulting from a possible breach. By the same token, the party later to be in breachcould not effectively protect himself from larger consequential damages by the appropriate limiting of his liability with suitable contract terms.[26] The foreseeability doctrine became a general principle of English judicial practice after 1854 and this remained unchanged after the 1893 Sale of Goods Act and even after its 1979 reform (Section 54).[27]

Art 82, 86, 87 EKG, in: *Das Haager einheitliche Kaufgesetz und das deutsche Schuldrecht.* (Hrsg.: Leser/von Marschall), Karlsruhe, 1973. 75–130. (76. *et. seq.*).

[22] Sedgwick, Th.: *A Treatise on the Measure of Damages.* New York, 1847, 64. *et. seq.*

[23] Danzig: Hadley v. Baxendale: A Study in the Industrialization of the Law. *op. cit.* 260.; Faust: *Die Vorhersehbarkeit des Schadens* gemäß Art. 74. Satz 2 UN-Kaufrecht. Tübingen, 1996. 80. *et. seq.*

[24] McGregor: *On Damages. op. cit.* 157.

[25] Bradley, J.: (1854) 9 Exch 341, 354; in English literature foreseeability is also known as *„test of remoteness".*

[26] *Ibid.* 355, the following English court cases contributed significantly to solidifying or advancing the foreseeability doctrine: Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd. (1949) 2. K.B. 528.; Monarch Steamship Co. Ltd. v. Karlshamus Olejfabriker (A/B) (1949) 196., 224. The best guide to the development and sub-problems of the principal in English law are given by Ogus, A.: *The Law of Damages.* London, 1973. 71–79; McGregor: *On Damages. op. cit.* 157–184. (items 247–281).

[27] Ogus: *ibid.*; McGregor: *ibid.*; Guest, A. G.: *Benjamin's: Sale of Goods.* London, 1997[5], §§ 16-040 (856), 17-001 (894), 17-045 (929); also compare with Faust: *Die Vorhersehbarkeit des Schadens... op. cit.* 82. *et. seq.*

c) United States judicial practice also applies the contemplation rule as a classic common law principle.[28] UCC § 2–715 (2) (a) spells out in detail the rule of contemplation with regard to consequential damages in the buyer's assets: "Consequential damages resulting from the seller's breach include any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reasonably to know and which could not reasonably be prevented by cover or otherwise".[29] It is important to point out that UCC [§ 2–715 (2) (b)] does not apply the contemplation rule for damage to the buyer's person or property "resulting from any breach of warranty".

2. Although the BGB chose a slightly different path when limiting liability for damages the English "contemplation rule" managed to find its way into German jurisprudence as well.[30] Incidentally, the solution found in BGB is also interesting as well as instructive.[31] Besides limiting claims of unrealized profit to the amount that could be expected with good probability (252. §), the German code allows for the reduction of damages within the context of the claimant's responsibility to prevent damages

[28] Howard v. Stillwell and Bierce Manufacturing Co., 139 U.S. 199, 208 (1891); Primrose v. Western Union Telegraph Co., 154 U.S. 1, 29(1894) etc. According to *König* American judicial practice had applied the foreseeability principle even prior to Hadley v. Baxendale: Sedgwick: *A Treatise on the Measure of Damages. op. cit.* 80. *et. seq.*

[29] The UCC gives no particular rule for damages suffered by the seller due to the buyer's violation of contract terms. This one-sided feature is duly criticized in the literature White, J.—Summers, R. S.: *Uniform Commercial Code,* vol. 1, St. Paul-Minn, 1995[4], 412. *et. seq.* However, the literature also correctly points out that the buyer's potential late payment is a possible cause of loss liability that can generally be estimated with good accuracy ahead of time. Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 78. *et. seq.* Huber, P.: *Leistungstöhrungsrecht.* vol. 2. Tübingen, 1999, 264. 3. footnote.; compare with Schwenzer, I.: *Freizeichnung des Verkäufers von der Sachmängelhaftung im amerikanischen und deutschen Recht.* Frankfurt/M. 1979. 38. *et seq.*

[30] Rabel, E.: *Das Recht des Warenkaufs.* Vol. 1. Berlin, 1936. (reprint: 1964), 491. *et seq.*; von Caemmerer, E.: Das Problem des Kausalzusammenhangs im Privatrecht. In: *Gesammelte Schriften* (vol. I.). Tübingen, 1968. 395. *et. seq.*

[31] The BGB's damage liability laws were founded on *Mommsen*'s study: Zur Lehre von dem Interesse. Braunschweig, 1855. Mommsen believed firmly in the principal of full compensation: *op. cit.* 168. *et. seq.* and the BGB's drafts also kept this principle almost uniformly, compare with Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 340. *et. seq.*

from occurring. According to 254. § paragraph (2) the obligor in breach is not required to compensate for damage that the injured entitled failed to prevent or mitigateby actions of gross negligence. It is considered to be the injured's negligence if, preferably at the time of contracting, he failed to bring to the other party's (the future breaching party's) attention such extraordinary risk of unusually large loss that was neither known nor could have been expected to be known to his partner.[32]

The solution offered by the BGB reaches similar goals to that of the contemplation rule by following a different dogmatic path. In this case risk is considered extraordinary if the level of damage significantly surpasses that which could be expected in a similar business scenario. For example if the result of a late bank transfer is the loss of a patent claim then the resulting damage can be considered unusually high. Naturally, the entitled can only be made responsible for negligence if he himself could have been aware of the nature and size of the damage. The entitled is not under obligation of disclosure if his contractual partner himself knew or had to know the extraordinary risk.[33] The disclosure of the possibility of extraordinary risk by the obligee can result in the obligor deciding to (in the first three cases, possibly simultaneously):

— pay extra attention to specific performance of the contract
— attempt to limit his risk by stipulations limiting or excluding liability
— raise the price due to increased risk
— decline to enter into contract due to impending large risk.

Grossly negligent failure to disclose facts leads to a division of the loss between the breaching and injured parties. When distributing the burden of loss both the cause leading to the loss and the parties' negligence must be weighed.[34]

The possibility of liability reduction offered by the first sentence of the BGB [254. § paragraph (2)] (which incidentally is also open in tort cases) is very rarely applied in practice.[35] In tort cases even the rule of the BGB can prevent only the further growth of existing damages such as the one that would result from late payment of a compensation award.[36] The

[32] Lange, H.: *Schadenersatzrecht.* Tübingen, 1990[2], 574.; Huber: *Leistungstöhrungsrecht... op. cit.* 263. *et. seq.*

[33] Lange: *ibid.*

[34] BGB Handkommentar. Baden-Baden, 2001. Schulze, R.: ad § 254, Rn. 10.

[35] König: *Voraussehbarkeit des Schadens als Grenze vertraglicher Haftung... op. cit.* 96.; Tercsák: Foreseeability as the boundary of compensation for damages caused within the framework of a contract. *op. cit.* 237.

[36] See for example BGH 23.2. 1960, VersR 1960, 526.

infrequent use of this rule in practice is undoubtedly related to the attitude of the BGB in granting relief from liability (besides being also related to other issues like the limited nature of the concept of lost profit and other restrictions governed by separate laws such as the HGB):as a matter of course, non-negligent breach leads to no liability for damages.

3. In comparing the foreseeability doctrine and the solution provided by the BGB the following may be stated.[37] Primarily, it is immediately clear that both solutions summarized above effectively surpass either the method of *judicial cutting of the chain of causation* or *discretionary reduction of liability based on fairness* in the sense that instead of leaving the key to resolution in the hands of the judge they both hand it over to the parties, and that is a significant plus in contract law.

Almost undoubtedly, the foreseeability doctrine appears to give a more solid and specific point of reference to the contracting party in its effort to size up the risk of entering a contract in advance and make decisions accordingly. At the same time both solutions reflect a market-oriented attitude and treats the parties as sovereign and equal participants of a pecuniary transaction. One side is motivated to disclose risk, the other to evaluate it and base its business decision on that.

The foreseeability doctrine is perhaps a bit more effective in that the obligor can always take into account the increased risk when determining counterperformance. In the case of the BGB this is not always possible because the contracting party is obliged to give notice of a higher risk not necessarily at the time of entering into contract but only when he becomes aware of the risk. Also, the claimant's right to full compensation stays valid if no negligence is involved in his failure to give notice or if his negligence had no effect on the prevention of loss. Conversely, the BGB may be more effective in the actual prevention of loss. While the foreseeability doctrine does not provide cover for risk of loss that increases after the conclusion of contract the BGB makes even that possible as the obligee is required to give notice of higher risk throughout the entire length of the contractual relationship. Moreover the BGB is also a bit more fair in contrast with the foreseeability doctrine in that in the case of increased

[37] Compare with Huber: *Leistungstörungsrecht. op. cit.* 267. *et. seq.*; Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 339. *et. seq.*; On Limits of the application of the foreseeability principle, see Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op.cit.* Especially 77. *et. seq.*

risk not foreseen by either party responsibility for the risk rests with the party in breach.[38]

However, as far as the effectiveness of either the foreseeability doctrine or the BGB rule is concerned, a hindrance is presented by the fact that (especially in the world of business) contracting parties are reluctant to shed light on their business strategies (often speculations).

Finally, as we pointed out before, in a legal climate where a breaching party has to compensate for losses only in case of negligence, the importance of more subtle dogmatic ways of mitigation of liability is significantly reduced in comparison to a more stringent doctrine of liability. It is also clear that the most accurate (although by far the least harmonious with liberal market philosophy) tool of defining risk is the capping of liability by law. This solution is rather common in the area of freight forwarding and transportation contracts.[39]

The Foreseeability Doctrine in International Conventional Sales Law and in Model Laws

1. The foreseeability doctrine—based on *Rabel*[40]—was an almost unchallengeable part of even the earliest drafts (1935, 1939, 1963)[41] intended to uniformly regulate international sales law, so it was almost natural that it became part of the Hague Sales Convention[42] (Articles 82 and 86)[43] and from here a direct path led to Article 74 of the Vienna Sales Convention.[44] There are only subtle differences in wording between the latter and the above mentioned rule of the Hague Sales Convention and according to the

[38] Same as Faust: *Die Vorhersehbarkeit des Schadens... op. cit.* 344.

[39] Compare with Huber: *Leistungstörungsrecht. op. cit.* 267. *et. seq.*

[40] Rabel: *Das Recht des Warenkaufs. op. cit.* 495–511.

[41] See Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 47., footnote No. 3.

[42] July 1st, 1964; compare with Mádl—Vékás: *International Private Law and Law of International Economic Relations.* 320. *et. seq.*

[43] Compare with Dölle, H.—Weitnauer, W.: *Einheitskaufrecht.* München 1976, 531. *et. seq.*, 537. *et. seq.*, directly to the Hague Sales Convention: 543. *et. seq.*

[44] Compare with Knapp, Ch. L.: in: Bianca-Bonell: *Commentary on the International Sales Law. op. cit.* 540. *et. seq.;* Stoll, H.: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG).* 698. *et. seq.*, 714. *et. seq.*; Sándor: *International Sales.* 275. *et. seq.*

working documents of the Vienna Agreement there was no intention or impetus for significant changes.

As opposed to the negligence based contract liability law found in the Code civil and the BGB, Article 79 of the Vienna Sales Convention, as was pointed to earlier, mandates a higher *standard of reason* in granting liability relief. The introduction of the foreseeability doctrine into the rules of the Convention is essentially the supplementation of this more stringent system of relief. When liability for compensation is not linked to *negligence* of the party in breach then the entire risk for damages inherent in contract violation rests with the party in breach, although only to the extent that was possible to predict at the time of entering the contract. Commentaries all emphasize the close connection of the concepts of *non-negligence based liability* and *liability limited to foreseeable damages.* These two principles provide the fundamental pillars of the liability system of the Vienna Convention. The basic idea behind this system of liability is that a contract performs its function of interest protection if the consequences of a possible breach do not the*subjective culpability of* the party in breach, butthe risk he takes on is limited to that which he could clearly judge and *knowingly take on* at the time of entering into contract.[45] It is important to repeat: the foreseeability doctrine is given a primary role particularly in cases where there is a system of relief less forgiving than the requirement of non-negligence. Finally, it is also worth noting that contributing to the internal balance of the system of damage liability found in the Vienna Convention is another rule according to which awards of compensation are not limited to cases of "fundamental breachof contract" (Article 25).

2. As we briefly showed earlier the foreseeability doctrine was fully developed in English and American judicial practice. It is important to observe however that there are differences between the *contemplation rule* found in English common law and the *foreseeability doctrine* found in the ienna Convention, just as Article 74 of the Vienna Convention deviates from Article 1150 of the Code civil.

a) Of these differences we need to emphasise the notion that, at least as a starting reference, common law treats as the upper limit of awardable compensation those damages that could be contemplated by both parties.[46] 46 In contrast, the Vienna Convention, similarly to Article 1150 of the

[45] Same view by *Rabel* as well: *Das Recht des Warenkaufs. op. cit.* 495.

[46] The Hadley v. Baxendale decision states this point explicitly: "contemplation of both parties": (1854) 9 Exch 341, 354.

Code civil,[47] limits liability to only those damages that could be predicted by the party i.b.[48] It is to be noted that more recent English decisions, although still always referring to *Hadley v. Baxendale,* essentially focus on examining foreseeability only on the side of the party i.b.[49] Despite some uncertainty a similar tendency can be observed in American judicial practice as well[50] and the UCC specifically provides this very rule, which we even quoted earlier.

Even as a general attitude common law tends not to subject to compensation damages that could not be forecast with good probability at the time of contracting. This exclusion applies not only in the case of tort damages, but also in judging contractual damages.[51] The Vienna Convention is clear: it is sufficient enough reason if the breaching party could calculate the damage as the "possible consequence" of his breach. The "possible" nature of the resulting damage is not a strict prerequisite requirement. We can support the position that the "possible" nature of the occurrence of damage is to be judged on a case by case basis and it cannot be fixed in a general manner as with the use of a predetermined percentage.[52]

b) According to actively held belief the foreseeability doctrine of the Vienna Convention is to be applied in cases of negligence and even in cases of intentional breach of contract. In this regard the Vienna Convention deliberately diverges from the "source rule" of Article 1150 of the Code civil which, as we pointed to before, excludes the use of the foreseeability doctrine in the case of intentional breach of contract. We should mention, however, that an opinion exists according to which the principles and general spirit of the Vienna Convention suggest we consider not using the

[47] Mazeaud, H.—Mazeaud, L.—Mazeaud, J.—Chabas, F.: Traité théorique et pratique de la responsabilité civil délictuelle et contractuelle. No.'s 2381–2382.; Viney: *La responsabilité: effets. op. cit.* 323.

[48] Stoll, in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG) op. cit.*; Magnus: Wiener UN-Kaufrecht (CISG), in: *Staudingers Kommentar zum BGB.* Art. 74, Rn. 31.

[49] Most explicitly in the Czarnikow Ltd. v. Koufos (The Heron II) case: [1966] 2 Q.B. 695, 730 (C.A.)

[50] Redgrave v. Boston Symphony Orchestra, Inc.: 602 F. Supp. 1189, 1212 (D. Mass. 1985), 855 F. 2d 888 (1st Cir. 1988), 488 U. S. 1043 (1989).

[51] See for example the decision of the House of Lords in The Heron II case: [1969] 1 A.L. 350; similarly to Restatement of Contracts 2d, § 351.

[52] Same way Faust: *Die Vorhersehbarkeit des Schadens.* 33. *et. seq.* 331.

liability limiting tool of the foreseeability doctrine in cases of intentional breach.[53]

3. According to the Vienna Convention foreseeability is an express and exclusive requirement related only to the contracting party's possible damage and its size. Consequently, this requirement does not link the act of breach itself or its possibility with the causal relationship, because such an expansion of foreseeability would influence not only the size of the damage to be compensated but also the basis of liability. Furthermore, this would introduce into the required conditions of liability a new element of culpability not known in the Vienna Convention.[54]

In the case of defective performanceof the contract it is particularly important to limit the requirement of foreseeability to the damage itself, because in these cases the application of the foreseeability doctrine is not very appropriate and indeed often impossible.[55] Damage caused by a hidden fault is obviously not something the obligor could be aware of at the time of entering the contract or even during its execution, though he must carry the responsibility for it regardless.[56] Most likely this is the reason why, as we mentioned before, the UCC treats this kind of damage case differently.[57]

In the context of defective performanceof the contract with regard to the so called consequential damages, it is not possible to mitigate liability of the party i.b. on the basis that he did not foresee the damages or that it was under no obligation to predict them as these damages had to be taken

[53] Enderlein, F.—Maskow, D.—Strohbach, H.: *Internationales Kaufrecht.* Berlin, 1991, Art. 74., Anm. 8. Later we mention the European Principles (Article 9. 503.) which also does not limit responsibility to only those damages that were not foreseeable in cases of intentional or grossly negligent behavior resulting in damage.

[54] For the uniform opinions in legal literature see Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG)* 715. with footnote No. 152.

[55] Compare with Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 75.; Dölle—Weitnauer: *Einheitskaufrecht. op. cit.* 546. *et. seq.*

[56] Consequently the decision reached in LG Duisburg v. 16. 7. 1976 is erroneous brought (still) under the Hague Sales Law. Compare Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG).* 716. with in footnote No. 153. It should be mentioned however that even *von Caemmerer* would make the seller liable for faulty performance (given that he is not operating an established business) only if he ought to have recognized the problem ahead of time. von Caemmerer: *Probleme des Haager einheitlichen Kaufrechts.* AcP 1978. 121–149. (149.)

[57] UCC § 2-715(2)(b), compare with Schwenzer: *Freizeichnung des Verkäufers von der Sachmängelhaftung im amerikanischen und deutschen Recht. op. cit..*

into account by the party i.b. under all circumstances. Consequently, in these cases liability for compensation can generally only be mitigated based on a circumstance where the injured party is at fault for the damage, for example as in the case of improper use of a product conflicting with guidelines established by the maker.[58] We note here that the obligeeis of course obliged even under the foreseeability doctrine to prevent or damagesdamage.[59]

At the same time we can observe in legal literature a clear tendency to expand the interpretation of the foreseeability doctrine to include possibly all damages in all breach of contract cases. According to this view the foreseeability doctrine should be interpreted in a way that the party i.b. is to be liable for even those damages that a logically reasoning person in his position ought to have calculated with. This interpretation would also give the judge deliberation power over the issue of logical distribution of damages or risk of damage between the contracting parties.[60] This interpretation in and of itself is acceptable because it can be deducted from the expression „ought to have foreseen". However, even this way of interpreting Article 74 of the Vienna Convention gives no particular help in evaluating the scope of the effects of defective performance. Therefore, with regard to this problem,[61] that opinion appears more convincing which challenges the „omnipotent" nature of the foreseeability doctrine. Instead of the „normative" concept of the foreseeability doctrine recommended by *Stoll* it is indeed more realistic in the case of d.p. to disregard the foreseeability doctrine which is a frequently inadequate requirement in this area. Instead, if the particular case calls for it, it is better to limit the liability of the breaching party for reasons of the injured party itself being at fault.

[58] *Magnus*: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB. Art. 74, Rn. 46–47. Magnus nevertheless sees a role for the foreseeability doctrine in determining the degree of likeliness of an existing damage: *ibid.* 46.

[59] Same Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 78.

[60] This view is foremost represented in Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 716. with footnote No. 154.; Schlechtriem: *Internationales UN-Kaufrecht.* Tübingen, 1996, 169. *et. seq.*, 171. *et. seq.*; *Magnus*: Wiener UN-Kaufrecht (CISG), in: *Staudingers Kommentar zum BGB.* Art. 74, Rn. 35.

[61] Faust: *Die Vorhersehbarkeit des Schadens... op. cit.* 34. *et. seq.*, 273. *et. seq.*, 331. *et. seq.*

We note here that in charging the injurious party only those mitigating circumstances are allowed that were actually known to him, but not those that he ought to have known.[62]

4. Taking into account that the foreseeability standard of the Vienna Convention fixes the distribution of risk between the contracting parties to the time of contracting it is commonly held that the breaching party is not liable for damages that become apparent after the time of contracting (even if the time of appearance is prior to the breach).[63] This view may present legitimate questions with regard to effective prevention of loss as was pointed out in comparing the solutions found in the BGB and the Vienna Convention. Perhaps this recognition is the root of those more recent American decisions that are beginning to treat as foreseeable damages those damages that become apparent from post-contracting disclosure of imminent risk of damage.[64]

As far as the discernability of damage itself is concerned we should underline the following based on commentary found in the literature:[65] on the one hand, it is not sufficient proof of existing liability for damages of

[62] Same way Faust: *ibid.* 269., 307. *et. seq.*

[63] Knapp: in: Bianca-Bonell: *Commentary on the International Sales Law. op. cit.* 542.; *Magnus*: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB. Art. 74, Rn. 38.; Stoll: in: Mádl-Vékás: *International Private Law and Law of International Economic Relations.* 717.

[64] See Faust: *Die Vorhersehbarkeit des Schadens* decisions analyzed on 114. *et. seq.*; compare with Eisenberg: The Principle of Hadley v. Baxendale. Cal. L. R. 1992, 563–613. Eisenberg summarizes his opinion as follows (599. *et. seq.*): „Finally, reasonable foreseeability should be determined as of the time of breach, so the in deciding whether to breach the seller must sweep into its calculus all the costs that it should reasonably foresee will be incurred by the buyer as a result of breach. Application of the foreseeability standard at the time of breach, rather than at the time the contact is made, gives precedence to the rate of efficient breach over the rate of precaution. However, it is inescapable in this context that one of these rates must dominate the other. It is preferable to give precedence to efficient breach, because in practice the rate of precaution is likely to depend on contractual allocations of loss and precontract judgments based on probability, rather than on in formation communicated at the time of contracting. Moreover, contracting parties should not be encouraged to make decisions on breach that fail to sweep into their calculus all costs that are reasonably foreseeable at the time the decision is made."

[65] Knapp, in: Bianca-Bonell: *Commentary on the International Sales Law. op. cit.* 541.; Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG).* 717.; Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 238. *et. seq.*

the party i.b. that he was aware of the *nature* of the impending damage (as in the possibility of lost profit) at the time of contracting. On the other hand, it is not an additional requirement of finding of liability that the party i.b. know the actual monetary valueof the damage at the time of contracting.[66] Liability is defined by the scope of the knowledge the party i.b. possessed or ought to have possessed about the nature and potential magnitude of the damage at the time of contracting. This is how the purpose of the norm can be achieved which is the pre-contracting ability to assess and plan for risk to be assumed. For example, if the breaching seller was aware at the time of contracting that the buyer was getting the contractual goods for resale, but the buyer did not disclose the actual amount of profit he expected to gain by his personal speculation, then the seller is responsible for lost profit only to the extent that general market conditions would imply, but he does not have to pay for any additional lost profit even if it could actually be proven by the buyer to have been achievable based on his speculation in the particular case. Of this speculative profit the seller did not know or had to have known at the time of contracting.[67]

5. The foreseeability doctrine has considerably different significance in various kinds of breaches and damages. This was pointed out on several occasions earlier, it seems practical, however, to summarize.

a) In the case of non-performance delayed performance turning into impossibility of performance the party i.b. must always consider as a possible loss the price of the goods on open market and administrative costs/overhead. This is so even when the market price of goods under contract is significantly higher at the time of covering purchase than it was at the time of contracting. According to common understanding the usual fluctuation of market prices is part of the risk of doing business and the would-be violator assumes the resulting liability by entering intocontract.[68] The same conclusion can be drawn from the interpretation of Article 74 as well. Damages resulting from the fluctuation of market prices must be categorized as those

[66] Same view by *Rabel* as well: *Das Recht des Warenkaufs. op. cit.* 509.

[67] *Stoll's example*: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG).* 717.

[68] The situation isn't as straightforward in the case of loss the entitled suffers as a result of late payment and subsequent foreign currency exchange where the transaction is completed at a conversion rate that had changed in an unfavorable direction when viewed from the entitled's perspective. Compare with Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 21. *et. seq.*

consequences of breach that had to be foreseen at the time of contracting. Naturally, in this case as well (as usual[69]) the injured is expected to mitigatedamages just the same in accordance with Article 77.[70]

There is a similar situation when the obligeehas to take out a loan in order to balance the consequences of the breach. Interest on such a loan is to be paid by the party i.b. and related expenses incurred as the result of any appropriate action taken to prevent or mitigate damages (such as freight forwarding, warehousing, inspection, etc.) must also be covered. The solution is the same with regard to other costs and related expenses resulting from the repairing of the damage.

We can say generally that the necessary cost and expense of averting the breach itself (as a form of damage) is the responsibility of the breaching party and the foreseeability doctrine has no bearing on this matter. This appears to be the correct view, although Articles 75 and 76 of the Vienna Convention contain a reference to Article 74 when regulating elimination of loss in covering sales and purchases as well as short sales. This legislative solutioncould theoretically mean that the foreseeability doctrine (as in the second sentence of Article 74) is in effect in this case as well. However, based on consensus on this matter the application of the foreseeability doctrine is correctly ruled out. Grammatical analysis in and of itself points in this direction: both Articles 75 and 76 talk about "other damages" established by Article 74 to be compensated, in this way automatically ruling out the foreseeability doctrine going into effect with regard to these damages. This view is further supported by arguments based on legislative history,[71] and on the system and the purposes of the Convention.[72]

We have already pointed out that the foreseeability doctrine cannot be adequately utilized in the case of so called consequentialdamages that is in the case of reparations for defectiveperformance by way of compensation.

b) As it is already clear from the preceding discussion, the true target of influence for the foreseeability doctrine is the issue of compensation for consequential damages and above all for unrealized profit in cases of

[69] Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 297. *et. seq.*

[70] *Magnus*: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB. *op. cit.* Art. 74., Rn. 40–41.

[71] Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 718., footnote No. 166.

[72] Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 26. *et. seq.*, 329.

breach of contract.[73] These damages are namely often connected to circumstances that are not known to the breaching party and could not have been known without the disclosure of theobligee. Consequently, in order for the affected contracting party to be able to measure the risk and the cost of its coverage and based on these have the ability to make an informed decision about whether to contract at all, or about counter-performance and possible limiting of liability, he must be informed about the risks related to unrealized profit and consequential damages at the time of contracting. Or if such notice cannot be given because even the other party has no information on consequential damages that may result from a possible breach, or perhaps the party in possession of such information has overriding interests that run counter to sharing details of his trade secrets, for example, in order to protect his market position or business strategy then the breaching party is exempted, based on the foreseeability doctrine, from liability for compensation of those damages that he did not know or had to have known at the time of contracting.

According to common understanding the party i.b. is only liable to compensate the obligeefor expected but unrealized profit from planned resale if the intent of resale was know to him at the time of contracting. If the buyer is a merchantand the subject of the contract is commercial goods then the obligor must, even without any pertinent additional notice, calculate with resale and its resulting benefits that in the case of breach manifest themselves as unrealized profit.[74] Similarly, if the buyer of real estate is a firm engaged in the business of trading or leasing real estate, the seller must calculate with profit from resale as unrealized profit if the contract is breached. Also similar is the case when at the time of contracting it is known to a transportation outfit that the raw materials they are contracted to deliver are intended for processing in the client's plant and there is an intent of eventual sale of the finished product.

In the same category we find the example of such cases where the breach forces the obligee's plant to temporarily suspend operation which causes a realistically expected profit not to materialize.[75] On the contrary,

[73] The same conclusions were reached by *Hellner*'s comparative law analyses as well: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 78.

[74] Rabel: *Das Recht des Warenkaufs. op. cit.* 509. A similarly principled court decision is quoted from the application of the Vienna Convention Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 718., with footnotes No. 168–169.

[75] Same way *Magnus*: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB. *op. cit.* Art. 74, Rn. 40.

there are opinions in the literature that hold the party i.b. responsible for such a loss only if explicit prior notice was given of the danger of a possible temporary shutdown of operations. The rationale behind this train of thought is that in the absence of such warning the breaching party can assume that theo., being a professional practitioner of his trade or business, is himself prepared for just such an eventuality, possessing tools to avert loss, for example by stockpiling surplus inventory of spare parts, etc.[76]

c) Similarly to unrealized profit, the foreseeability doctrine provides a guideline for those cases as well where the entitled suffers a loss due to the circumstance whereby the breach of his contracting partner prevents *him* from performing another contract with a third party, and he therefore becomes liable for compensation or other reparation (for example, obligations under a warranty) to the third party. If o.is a business person, obligor must without any express warning consider this consequence and therefore must be responsible for this kind of loss.[77] However, if the o.has taken on commitments toward the third party outside of or surpassing what is legally sanctioned (special guarantee or higher than industry-standard penalty for non-performance, etc.) he may transfer liability for the consequences of such commitments to the party i.b. only if he informed the would-be breaching party of the possibility of such damages occurring at the time of contracting or if the contracting party had to have independently known of these extra commitments.[78]

d) The literature generally shows an even stricter standard when providing guidelines for the transfer of liability where harm to the entitled's *goodwill* is at stake as the consequence of breach (as in defective performance where the damage may take the form of loss of clientele. Even such an opinion exists that the o.may only enforce claims of such damages against the breaching party if at the time of contracting he gave express notice of

[76] Schlechtriem: *Internationales UN-Kaufrecht. op. cit.* 171. It is interesting to observe that the judges reached a similar position in Hadley v. Baxendale as well. The loss at issue is seen even more firmly, as a matter of general principle, by *von Caemmerer* as the liability of the entitled: von Caemmerer: *Probleme des Haager einheitlichen Kaufrechts. op. cit.* 147.

[77] A similar court decision from the practical application of the Vienna Convention: Magnus: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB, Art. 74, Rn. 45.; Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 719., footnote No. 172.

[78] Same way Stoll: *ibid.* 719. with footnote No. 173.

such possible damage.[79] A case adjudicated based on the Hague Sales Convention by the German Bundesgerichtshof found loss of goodwill and foreseeability of loss of business on the grounds of a trade usagefound in the particular business sector involved.[80]

e) We should mention here that with the evolution of product liability laws a significant portion of consequential damages resulting from defective.perf.is governed by separate rules.[81, 82]

6. It is difficult to arrive at a conclusive position on the allocation of burden of proof linked to issues of foreseeability.

a) There are various conflicting positions in English legal practice.[83] Nevertheless, according to a majority or perhaps even prevailing attitude the burden of proof rests with the adversely effected party.[84] It is his responsibility to prove that the loss at hand could be or at least ought to have been foreseen by the breaching party. A similar attitude is reflected in American decisions as well.[85]

[79] Same Magnus: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB, Art. 74, Rn. 50.; Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 719. (for differing views see: same place footnote No. 175.).

[80] BGH 24.10.1979, quoted by Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 21. with footnote No. 94.

[81] In Hungarian Law the rules of Law No. 10 of 1993, which need to be fully integrated into the Code during the reform process of the C.C..

[82] This view was held even at the beginning stages of European product liability law Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 79.

[83] McGregor: *On Damages. op. cit.* 83. (item No. 138.).

[84] Lord Summer in S. S. Singleton Abbey v. S. S. Paludinas, [1927] A.C. 16, 25-26; further cases found with McGregor: *On Damages. op. cit.* footnote No. 2.; same way Lord Merriman P. in The Guildford case, [1956] P. 364, 370. Contrary view: if the party causing the damage wants not to be compelled to compensate for damages he should argue that the given damage could not be foreseen: Lord Haldane and Lord Dunedin in The Metagama case, [1927] 29 Ll.L. Rep. 253, 254, 256 (Lord Dunedin's opinion dissenting judgment). In his commentary McGregor also holds the view that the injured is charged with the burden of proof. He adds that although all referenced cases are about tort damages, he sees no reason not to accept the same rule as a general one to be applied in all cases, including those of contractual damage.

[85] Redgrave v. Boston Symphony Orchestra, Inc.: 602 F. Supp. 1189, 1212 (D. Mass. 1985), 855 F. 2d 888 (1st Cir. 1988), 488 U. S. 1043 (1989); Larsen v. A.C. Carpenter, Inc., 620 F. Supp. 1084, 1132 (E.D.N.Y. 1985), 800 F. 2d 1128 (2d Cir. 1986); Lassen v. First Bank Eden Prairie, 514 N. W. 2d 831, 838 (Minn. Ct. App. 1994).

However, in French literature the opposite can be observed. Majority opinion puts the burden of proof on the party i.b., that is in order to be granted relief it is the breaching party whois asked to prove that the given loss could not be foreseen or that he ought not have been expected to foresee it.[86] However, we should note that possibly among the reasons for this thinking are considerations of procedural law.[87]

In short, we can say that there is no consensus among those legal systems that serve as a foundation for the Vienna Convention in the matter of allocating burden of proof of foreseeability. Considering, however, the larger practical scope of the English and American cases it is more prevalent that the adversely affected party is actually charged with the task of proving foreseeability.

b) Wiews reflected in literature dealing with Article 74 of the Vienna Convention are also remarkably split when it comes to the issue of allocating proof.

Some simply reasonfrom the position that the foreseeability rule is a norm that is specific to the general rule of full compensation (1st and 2nd sentence of Article 74) and, consequently, burden of proof rests with the breaching party causing the damage. This view incorporates the understanding that preconditions of liability for damages (breach of contract, chain of causation, damage and its size) must be proven by the injured party, while the lack of foreseeability as grounds for partial relief must be shown by the injurious party.[88] *Magnus* corrects this view in that he suggests the injured party must prove that the breaching party knew the relevant circumstances, especially those contributing to elevated levels of risk, or at least had to have known them.[89]

[86] Lalou, H.—Azard, P.: *Traité pratique de la responsabilité civile.* Paris, 1962[6], item No. 495.; le Tourneau, Ph.: *La responsabilité civile.* Paris, 1982[3], item No. 246. Chartier as a general rule also places the burden of proof with the injurious party, but in the case of the problem that actually occurs most commonly, that of consequential damages, he holds the opposite view; according to him the assumption can be effectively challenged that the given damage was not foreseeable: Chartier, Y.: *La réparation du préjudice dans la responsabilité civile.* Paris, 1983.

[87] Compare with Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 190. footnote No. 739.

[88] Enderlein—Maskow—Strohbach: *Internationales Kaufrecht. op. cit.* Art. 74, item No. 10.

[89] Magnus: Wiener UN-Kaufrecht (CISG), in: Staudingers Kommentar zum BGB. *op. cit.* Art. 74, Rn. 62.

The contrasting position considers the foreseeability doctrine itself to be part of the foundation of liability and therefore puts the related burden of proof on the injured party. According to the authors referred to earlier this solution is supported by the central thesis of the foreseeability doctrine: at the time of entering into contract the future breaching party had to know the resulting risk. So a position that would stipulate that the breaching party calculated with (or at least ought to have calculated with) *all of the proven damage* at the time the contract was concludedwould be at odds with this correct legal policy foundation at the heart of foreseeability. To the contrary, the party i.b. mayonly be held responsible for covering those risks of damage that he was proven by the injured party to have taken on as contractual obligations. This view therefore does not consider the foreseeability doctrine to be a rule of exception, rather it is understood to be part of the general rules of conditions of liability, in a sense equating foreseeability with the concepts themselves of breach, damage and the link of causality between the two.[90] We consider this latter position to be correct, especially considering that the achievement of the purpose of the foreseeability doctrine necessitates this solution because in order for the future breaching party to be able to make well founded and calculated decisions about taking on risk at the time of contracting, the future injured party must provide facts that create the condition for him to be in an appropriately informed state. Essentially, the future injured party has to be charged with providing the conditions, by way of adequate dissemination of information, for his contractual partner to be able to make decisions in the matter of taking on risk and calculating pricing accordingly, based on the largest possible degree of familiarity with the probability of risk of damage.7. Article 74 of the Vienna Convention is yet to produce signs of significant application in judicial practice. Even commentaries use cases connected to the Hague Convention on Sales for illustration. Nevertheless, we see a fundamentally well formed doctrine in foreseeability, reflected in the fact that this principle's essence is echoed by recent model laws.

UNIDROIT Principles of International Commercial Contracts (1994)[91] determines the breaching party's liability for damages independently offault

[90] Stoll: in: Schlechtriem (Hrsg.): *Kommentar zum einheitlichen UN-Kaufrecht (CISG). op. cit.* 721.; Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 324. *et. seq.*, 333., certain irrelevant restrictions: 325., 326. *et. seq.*

[91] Among others the text is published in Eu. J. Law Reform, Issue No. 1998/99.: 345–363.

and excuses him from liability only on the basis of an impediment beyond his control such asvis maior.[92] Article 7.4.4 states: „The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of contract as being likely to result from its non-performance".[93] The meaning of this rule coincides with that of the norm found in Article 74 of the Vienna Convention, and it differs only in its phrasing slightly. Such a difference exists between „could reasonably have foreseen" versus „ought to have foreseen" and „as being likely to result from" instead of „as a possible consequence". We should remark that in the system of UNIDROIT Principles the concept of „non-performance" universally applies to all forms of contract.[94]

I believe that in comparing the norm of the UNIDROIT Principles with Article 74 of the Vienna Convention the former leaves less of a doubt that the foreseeability doctrine belongs to the definition of damage as a precondition of liability of the party i.b. (Articles 7.4.2 and 7.4.3), therefore the burden of its proof rests with the injured party.

b) The Principles of European Contract Law (1997) also finds liability of the non-performing party independently of fault[95] and the foreseeability doctrine is used here to supplement this principle (Article 9.503).[96] This solution differs from the norms established in the UNIDROIT Principles

[92] Article 7.17., Force Majeure: Non-performance by a party is excused if that party proves that the non-performance was due to on impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences

[93] The non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of contract as being likely to result from its non-performance.

[94] Article 7.1.1.: Non-performance is failure by a party to perform any of its obligations under the contract, including defective performance or late performance.

[95] Article 8.108.: A party's non-performance is excused if he proves that it is due to an impediment beyond his control and that he could not reasonably have been expected to take the impediment into account at the time the conclusion of the contract, or to have avoided or overcome the impediment or its consequences.

[96] The rule matches the norm found in the above mentioned UNIDROIT principles almost word for word. The only deviation is found in the case of damage caused by intentional or grossly negligent non-performance which is excluded from the sphere of application of the foreseeability clause: „The non-performing party is liable only for loss which he foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of his non-performance, unless the non-performance was international or grossly negligent."

in two ways. The European Principles [article 9.501 paragraph (2) b)], as a matter of course, orders compensation of only that future loss „which is reasonably likely to occur". At the same time, showing similarities with Article 1150 of the Code civil, it does not limit liability for damages via the foreseeability doctrine in cases of intentional or grossly negligent non-performance. This latter solution, in our opinion, is not in satisfactory harmony with a system of liability independent of fault and is also at odds with the foreseeability doctrine which builds on considerations of distribution of risk along the principles of a free market, not to mention the complexity of burden of proof.[97]

Conclusion and proposal de lege ferenda

1. Particularly In a system of strict contractual liability that is independent of fault, the inclusion of an appropriate mechanism for limiting compensation is an absolute necessity. Among the known dogmatic resolutions leading to distribution of loss the foreseeability principle appears to be the most appropriate one to fulfill this role.

The foreseeability doctrine can be considered a proven tool of law in the distribution of market related or other contractual risk among contracting parties. It incites the o.to appropriately inform the obliged at the time of the conclusion of contract of the expected consequential damages resulting in the eventuality of breach, especially regarding the valueof the lucrum cessans and of the possible consequentialdamages. Knowing the risk of these damages is a condition of the obliged making an informed decision about whether to conclude the contract and under what conditions of counter-performance, possible limitation of liability, etc. Risk of damage that is unusually high because it significantly surpasses that which could be calculated as the normal consequence of the given contract can be known by the obligor only based on disclosure by theo.

b) By the same token, the foreseeability doctrine is a rather flexible tool in the hands of the judge in the distribution of loss caused by non-performance among the parties, above all loss of expected profit and consequential damages. The foreseeability doctrine defines the conditions of distribution of loss more precisely than a statutory enpowermentto

[97] The same view is held on the system of responsibility under European Contract Law principles—based on well-founded reasoning—Faust: *Die Vorhersehbarkeit des Schadens. op. cit.* 314. *et. seq.*, 333.

reduction of damages based on the equity principle [for example C.C. 339. § paragraph (2)]. Moreover, particularly considering conclusions arrived at previously, it is a better fit for the attitude of contract law, market considerations, and business rationale.

2. A separate examination is required whether the foreseeability doctrine could be applied similarly in the case of tort damages. Naturally, in these cases issues mentioned under paragraph 1) have no relevance. Based on his analysis of German legal literature Tercsák finds the application of the foreseeability principle in limiting liability for damages in tort cases „rather confusing".[98] It is of note, however, that judicial practice of common law applies the foreseeability doctrine even in tort cases rather effectively and a rule of the BGB [254. § paragraph (2)] that shares a common purpose with the foreseeability doctrine is itself not limited to contractual matters. In his study written for the Concept of the New (Hungarian) Civil Code Lábady suggests the introduction of the foreseeability doctrine in adjudicating matters of unrealized profit even in tort cases.[99]

3. Considering the above it appears advisable that, with the ongoing reform of the Hungarian Civil Code, the system of liability for contractual damages (besides the relief power being converted from a discretionary to a more objective one) be amended, above all, by the foreseeability doctrine that provides a foundation for limiting liability for damages. The norm found in the second sentence of Article 74 of the Vienna Convention could serve as a guide for this purpose in the new (Hungarian) Civil Code.

a) The foreseeability doctrine would theoretically apply to all cases of damage caused by non-performance, i.e. it could be structured accordingly, without relevant limitations. Both the experience built by foreign legal practice and views reflected in the literature seem to point uniformly to the understanding that the foreseeability doctrine will play a significant practical role primarily in the adjudication of matters of unrealized profit and consequential damages.

b) We ought to also consider, modeled after the UCC, that we exclude from the domain of the foreseeability doctrine those cases where the o.wishes that the party in breach should repair the defect in the performance itself

[98] Tercsák: *(Foreseeability as the boundary of compensation...) op. cit.* 251. *et. seq.*

[99] Lábady: Felelősség a szerződésen kívül okozott károkért; a biztosítási szerződés. *Polágir jogi kodifikáció* III. [Liability for tort damages, the insurance contract. *Civil Law Codification* III] (2001) issue No. 4–5.

in the form of damages (and not as a warranty claim). This is so because, as we pointed out earlier, the foreseeability doctrine is not a good fit for this kind of damage. It is to be noted that this would turn out to be a rather limited problem if the new Civil Code, as it is suggested by the Concept, would allow the making of claims of these damages" at issue only during the period of implied warranty and not throughout the general limitation period.

c) From the perspective of foreseeability the concept of relevant time is generally the time of conclusion of contract, or more precisely, the time when the obligor (the possible non-performer) makes a legal declarationt relevant from the perspective of the coming into existence ofthe contract. This is the time, namely, when the obliged can make contract forming decisions that are informed by knowledge of risk that correlates to his possible future liability. The relevant legal statement is typically the declaration of acceptance when the contract is actually concluded, but it could also be a declaration of offer.

Moreover, it is also to be considered based on recent American judicial practice that the non-performing party be positively held liable for damages that become known up to the time of a grossly negligent or intentional-breach.

d) In the new Civil Code the uncertainty caused by the language of Article 74 of the Vienna Convention must be remedied so that it is clear that burden of proof related to the foreseeability doctrine rests on the injured party.

e) Finally, we should calculate with the possibility that the norms established by rules of particular types of contractcreate an exception from the general rules of liability and reparation of damages resulting from breach of contract. In our case this would mean an exception to the rule of foreseeability.[100] Such a solution can be found in the effective Code as well among the rules of specific kinds of deposit (Civil Code § 467–468, § 471), freight transportation (§ 500 and following), donations (§ 581).

[100] Same way Hellner: The Limits of Contractual Damages in the Scandinavian Law of Sales. *op. cit.* 79.

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EMÍLIA WEISS*

Remarks on Certain Aspects of the Codification of Family Law

(made in connection with the incorporation of family law into the new Civil Code)

Abstract. In 1998 the government of the Hungarian Republic decided that a new Civil Code is to be drafted. In 2000 the Main Committee of Codification issued guidelines for the new Civil Code, determining, among others, that the new Code is to be cast into separate books, after the model of the Dutch Civil Code, and that one of these separate books is to be devoted entirely to family law, i.e. a branch of law which has been enunciated in a separate Act since 1952. The present study examines some of the topical questions raised by a reform of family law in general, and the relevance of the above considerations to such an undertaking, in particular. The author makes a few proposals concerning the determination of independent principles for the family law materials which are to be included in the Civil Code, raises and discusses a number of questions in the area of marital property law which are in need of regulation or re-regulation, and discusses a few questions of child-parent relationships and of a reform in children's rights as related to some of the requirements enunciated in the U.N. Convention of Children's Rights.

Keywords: family law, matrimonial property, children's right

From the beginnings of the travaux préparatoires of the first Hungarian Civil Code, Gyula Eörsi was an influential personality who left his distinctive mark on both the process, which began in 1953, and the final outcome, which was enacted in 1959 and became virtually the first legislative enactment on civil law to be made in Hungary. Obviously, the value of his contribution to its codification is not lessened by the fact that nearly 40 years after the Code had entered into force the changes in socio-economic relations which determined its substance at the time of its adoption and, in particular, the profound transformations that had taken place over the past ten years, gave rise, in 1998, to a need for elaborating a new Civil Code.

Clearly, the new Code is not intended to decry the merits of the old one of 1959, which was drafted with the effective involvement of Gyula Eörsi,

* Emília Weiss, Professor of Law, Eötvös Loránd University, Budapest, H–1053 Budapest, Egyetem tér 1–3., Hungary.
Fax: (36 1) 266 4091

accomplishments which are still adequate to serve the needs of present-day socio-economic relations. It is intended not only to replace the rules that, in terms of either approach or substance, no longer serve, or serve inadequately, the said pattern of relations, or to be better adapted to the law of the European Union, but also to extend its scope of coverage, incorporating fields of law which did not come under the aegis of the Civil Code of 1959.

This concept led, firstly, to a statement of policy, according to which the Civil Code should follow the so-called monist principle by embracing the traditional commercial law, also called "private commercial" law, and, secondly, with the ruling of the Main Committee of Codification dated 1 June 2000, to the decision, inter alia, that family law should likewise be part of the Civil Code, even if as a separate book. This was in contrast to the family-law legislation and legal practice as well as the view advocated or at least prevalent even in jurisprudence over the past 50 years since the adoption of the Family Act in 1952, which have treated family law as an independent branch of law.[1]

At the present stage of codification it will be noted, if only for the sake of completeness, that the two studies commissioned by the Ministry of Justice similarly stated the case for a separate codification of family law rather than for its coverage by the Civil Code.[2] What the Main Committee of Codification recognized was only the fact that family relations or family-law relations differed from other civil-law relations in several aspects and that this point should be taken into account in the course of codification.

Hence, in the new situation, it became the concern of codification to revise, on the one hand, the rules of family law—not necessarily those laid down in the Family Act only—in a context responsive to the need to bring those rules into closer harmony with the rules of the Civil Code where the specific features of family relations do not warrant deviation and, on the other, to consider, where appropriate, the peculiarities of familial relations and the principles which control them but diverge from civil-law requirements, which are basically tailored to economic conditions. Again, and this point is likewise worth making, the integration of family law into

[1] See *A Kodifikációs Főbizottság 2000. Június 1-i határozatai* (1 June 2000 Decisions of the Main Committee on Codification), *Polgári jogi kodifikáció* (Codification of Civil Law), No. 2 of Vol. II, 4.

[2] Körös, A.: A Ptk. és a családjog kapcsolata—a gyakorló jogász szemével (The Link between the Civil Code and Family Law, through the Eyes of a Legal Practitioner). *Polgári jogi kodifikáció,* No. 1 of Vol. I, 3–9, and Weiss, E.: Az új Polgári Törvénykönyv és a családjogi viszonyok szabályozása (The New Civil Code and Regulation of Family Law Relations). *Polgári jogi kodifikáció,* No. 2 of Vol. II, 4–13.

the Civil Code should prompt traditional civil law to take greater account, in some questions, of the interests of involved in the protection of the family than has been the case so far.

There are two more aspects to which it is justified to call attention in connection with the integration of family law into the Civil Code.

First, while in revising the material of civil law, looking as it does to economic life, the legislator will have to keep in mind approximation to the law of the European Union, and legislation on family law will have to be more responsive to the family-law provisions of the European Convention on Human Rights, to the judicial practice followed in matters of family law by the Court of Human Rights at Strasbourg in pursuance of these provisions, and, among other international conventions, particularly to the United Nations Convention of 1989 on the Rights of the Child, for the added reason that members states are required to submit periodic reports on the application of this convention to the international forum of the Committee on the Rights of the Child.

Second, while civil law or, more accurately, the law of property and the law of obligations as two principal areas thereof, should be open to economic policy and economic life in the first place, family law should be open to family policy and social policy, including children's rights, which equally affect family relations, and social rights.

Moreover, the "private-law concept of the person", formed by Tamás Lábady as one to be retained in the codification of civil law, namely the "autonomous, sober-minded and risk-taking businessman who is bold enough to venture and has a sense of responsibility",[3] will not be, nor should necessarily be, a match for the concept of the person in family law relations. True, this concept of the person is not necessarily one either of all civil-law relations or of civil-law property relations, especially if it is remembered that parties to civil-law relations may be infants incapable of action and even unborn children with retrospective effect in the case of live birth.

We have chosen the following three topics to be discussed in the course of the codification of family law, notably the basic principles of family law, certain issues of matrimonial property law and matters concerning parental rights and duties and, related to them, the rights of children.

Basic Principles of Family Law

[3] Lábady, T.: Alkotmányjogi hatások a készülő Ptk. szabályaira (Effects of Constitutional Law on the Rules of the Civil Code under Preparation). *Polgári jogi kodifikáció*, No. 2 of Vol. II, 15–16.

The approach to the ongoing codification will recognize, where warranted, the raison d`être of formulating independent principles for the separate books of the Civil Code, including the book on family law. This calls for a review and a revision of the current principles of the Family Act and perhaps also justifies the proposal for reformulating them. At the same time, the codification is seeking to eliminate overlaps in, while giving more consolidated treatment of, the general principles of the Civil Code.[4] No doubt, this may also be true of the basic principles embodied in the preambular provisions of the book on family law.

Some of the preambular provisions or, one might say, basic principles of our Family Act currently in force were taken directly from the Constitution, some others, were borrowed a little later from the Civil Code and were enunciated as basic principles also of the Family Act and, finally, the scope of its preambular provisions has recently been extended to include the requirement of the United Nations Convention on the Rights of the Child to give absolute primacy to the interests of children.

In the view of jurisprudence, moreover, the scope of the general principles of family law is not a closed one: some legal scholars consider it to be now wider, now narrower. Thus, for instance, there was a view, still represented during the 1960s and even in the early 1970s, which enumerated voluntary marriage, the freedom of marriage and the freedom to choose one's marital partner among the basic principles of family law.[5] This may undoubtedly have been explained by the fact that these precepts had also been enunciated in Art. 16 of the Universal Declaration of Human Rights, in Art. 23 of the International Covenant on Civil and Political Rights, and in Art. 12 of the European Convention on Human Rights. Still, in the context of our present-day conditions, we hold that application of these requirements can be ensured without formulating them as preambular principles of family law. Besides, among the constitutional principles, the principle of the separation of State and Church was likewise articulated in family law as a separate principle for a long time. This may likewise be dispensed with as such today.[6]

[4] See Vékás, L.: in: *Az új Polgári Törvénykönyv koncepciója* (The Concept of the New Civil Code), 2001, kézirat (Manuscript), 12.

[5] For these views, with authors and sources indicated, see in: *A családjogi törvény magyarázata* (Commentaries on the Family Act). Budapest, 1988. Vol. I, 22–23.

[6] See *A családjogi törvény magyarázata. op. cit.*, 1. c., in the preceding note.

Later, in the early 1980s, the question was raised whether the principle of equity should be accepted as a separate basic principle of family law.[7] This idea can be supposed to have emerged from a perhaps stronger than adequate endeavor of the legislators at the time of drafting the Civil Code to block the way to a judicial practice which admits considerations of equity, and the legislators continued judging such practice of "eroding" the law to be pernicious in later times. It was in opposition to that "retrenchment" that the need was expressed for a wider scope to be left for equity in judicial practice in consideration of the specific features of family relations.[8] I believe that the requirement, formulated with effect even for the future, that both legislation and judicial practice concerning matters of family law should take into account the peculiarities of family relations will, in questions where appropriate, allow considerations of equity and that there is no need to formulate such a basic principle expressly among the family-law principles of the Civil Code now in the making.

As regards now the basic principles of the Family Act currently in force, the integration of the family-law rules into the new Civil Code will naturally eliminate the need for the basic principles taken from the Civil Code to be enunciated as separate basic principles of family law. At the same time, it stands to reason that those preambular principles of the Civil Code which do not figure as such in our current Family Act—particularly good faith and fairness, which will in all certainty be retained by the new Civil Code as determinant principles underlying the exercise of rights in family law—will become general principles governing the exercise of rights in family law, as well.[9]

It was as a result of the family law's being enunciated as a separate Act that the Amendments of 1986 to the Family Act took over from the

[7] Csíky, O.: Családjogunk fejlődésének újabb tendenciái (New Tendencies in the Development of our Family Law), *Jogtudományi Közlöny*, 1980. 560.

[8] Earlier Eörsi argued that the mere gap-filling role of equity itself was acceptable but within rather narrow limits even in judicial practice concerning family law. As he wrote, care should be observed in invoking equity also in family law because it may exert a sapping and eroding effect even there (Eörsi, Gy.: Megjegyzések a Legfelsőbb Bíróság Polgári Kollégiumának iránymutató döntéseire, 1965–1966 február (Comments on the Authoritative Decisions of the Civil Division of the Supreme Court, February 1965–1966), *Állam-és Jogtudomány*, 1966. 260.

[9] In the absence of a separate provision of law, *Kőrös* presents, rightly in all certainty, this principle as being already one such, in: *A családjog kézikönyve* (Manual of Family Law). Budapest, 2000, Vol. I.19.

Civil Code and incorporated the principle of the exercise of rights according to their designation—although reference to the related prohibition of the abuse of rights was only made in the ministerial exposé de motifs added to this statutory provision—and the principle of harmony between social and individual interests; the latter, however, was abolished in 1991 as a basic principle of the Civil Code.

Of course, it becomes unnecessary to formulate these two requirements as separate basic principles of family law, but two of the pertinent topics may nevertheless deserve mention.

First, as concerns the civil-law rules which prohibit any abuse of rights, neither legal practice nor jurisprudence is unanimous about the question whether the sanction set forth in Art. 5 (3) of the Civil Code—namely substitution of declarations at law or, more accurately, of declarations of consent for court judgements—is also applicable in family relations or this rule may not apply to the substitution of declarations at family law.[10] In my view, which I have set out on several occasions, the substitution of declarations at law for court judgements should not be recognized in the domain of family-law relations.[11] With respect to several types of declaration at family law, the Family Act allows, without reference to an abuse of rights or even the intention to ascertain whether such abuse is the case, guardianship authorities to substitute their own declarations for declarations of consent thereof. In respect of consent by the blood parent to the adoption of his/her child, a question which has carried the greatest weight in past practice, it will obviously remain the appropriate solution to enumerate in the Code itself the certainly exceptional cases in which the consent of blood parents to adoption will not be required, again on grounds other than abuse of rights in the first place.

Second, I would see merit in the idea of postulating harmony between family and individual interests rather than between social and individual interests, and this not merely on the plane of a requirement for the exercise of rights as presently prescribed for the accommodation of social and individual interests, but also at the level of legislation.

As concerns the constitutional principles of family law, most of them are to be upheld in the future.

[10] For a presentation of divergent views, see Kőrös: A Ptk. és a családjog kapcsolata — a gyakorló jogász szemével. *Polgári jogi kodifikáció. op. cit.* 6.

[11] Thus, as early as in: *A családjogi törvény magyarázata* (Commentaries on the Family Act), 1988. Vol. I, 33, and then: *Az új Polgári Törvénykönyv és a családjogi viszonyok szabályozása* (The New Civil Code and Regulation of Family Relations), 8.

The constitutional principles to be upheld include that of the protection of marriage and the family (which conforms to Art. 15 of the Constitution), the equality of spouses in marriage and family life (which conforms to Art. 66 (1) of the Constitution spelling out the equality of men and women in several other respects and the application of related rules in the field of family law), the protection of the child and primary consideration for the interests of minors (which conform, on the one hand, to Art. 67 (1) of the Constitution and, on the other, to the broader definition of these principles in the Preamble to and Art. 3 of the United Nations Convention on the Rights of the Child with respect to family relations.)

The time is long gone when increased responsibility for the child and promotion of the education of youth—which are formulated by way of basic principles, as it were, in Art. 1 of the Family Act—were enumerated by jurisprudence among the general principles as ones which deserve special mention along with other requirements of family law, even though they undoubtedly imply duties which fall, at least partly, within the domain of family law.

Giving a separate formulation to the constitutional principles of family law in the preamble to the book of the Civil Code on family law is justified, apart from the importance of these principles, by the fact that, as against the opposite view embraced by jurisprudence, acceptance was gained, with regard to the general principles of the Civil Code, by the approach that the principles and the positive rules of the Constitution should exercise their hold over private-law relations and their subjects through the medium of civil-law norms rather than by direct means.[12] At the same time, the requirement as formulated in the concept of the Civil Code concerning the basic principles of civil law that those principles should not henceforth reappear in the rules of civil law cannot stand the test in the realm of family law. Both the requirement of the protection of the family and the principle of equality of spouses, and, in particular, the protection of the interests of the child are, where appropriate, repeatedly invoked in the current rules of the Family Act, and these norms must be adhered to in the future.

Moreover, certain constitutional principles and precepts that are formulated in general terms may call for further exposition and interpretation. We will mention but two examples at this point.

[12] Vékás, L.: in: *Az új Polgári Törvénykönyv koncepciója. op. cit.* 4; for the opposite view, see Lábady, T.: *Alkotmányjogi hatások a Ptk. szabályaira* (Effects of Constitutional Law on the Rules of the Civil Code). 13 *et seq.*

While, in respect of the principle of the protection of marriage and the family, what called for explanation earlier was the question of how the principle of the protection of marriage could be reconciled with the rather liberal rules of divorce law, today it is the principle of the protection of the family that calls for an answer to the question whether this principle should be limited to the traditional family based on blood relations or founded by adoption or should be extended to actual family relations. To the family lawyer, it has always been unambiguously clear that the family protected and contemplated by family law is not identical with the notion of the small or nuclear family as elaborated by sociology. With the present-day pattern of family relations kept in mind, however, family relations increasingly mean actual family relations such as that between step-parent and step-child or foster parent and foster child. What is more, it is not exceptional today for the family lawyer to have to deal with confrontations between biological and birth parents. At any rate, it can be stated that the notion of family life protected by Art. 8 of the European Convention on Human Rights has increasingly been given an expansive interpretation by the European Court of Human Rights at Strasbourg.

With regard to the principle of equality of spouses it should be noted that such equality is expressly extended by Art. 5 of Additional Protocol 7 to the European Convention on Human Rights to the period subsequent to the dissolution of marriage in respect of both the spouses and their children. There is no doubt, however, that to ensure the equality of spouses in that phase of family life is no easy task either for the legislator or for the courts and the custodianship authorities who have to decide and then to enforce the decisions in these questions.

The protection of the interests of children presents a manifold challenge, and, obviously enough, only a part of those interests falls within the purview of family law. Yet, in regard to them, one may question whether there is a case for having some of the related principles and rules, which are explicitly treated as matters for family law in the United Nations Convention on the Rights of the Child as well as in the Hungarian Act on the Protection of Children, written into our family law as provisions or, where relevant, even as basis principles thereof. We will make but two special points on this score.

One of the most important principles similarly relevant to regulation by family law concerns the requirement—absent from the current Family Act, but formulated in the Preamble to the aforesaid Convention—that the child should grow up in a family environment, and in a way spelled out in Art. 7 of the Convention, that is to say, that such environment should, where

possible, be his/her parental family, that the child should not be separated from his parents whenever possible or, more specifically, should only be separated when so required by his paramount interest (Art. 9, para. (1), of the Convention). The Hungarian Act on the Protection of Children extends this principle, and rightly so, to separation from other relatives, all the more so since Art. 8 of the Convention makes it a duty of the States parties to respect the right of the child to maintain his family relations.

In this respect the Act on the Protection of Children recognizes wide-ranging rights for children who have been removed from their family environment an committed to professional or long-time care in a social establishment.

Among its rules relative to the right of parental custody even the current Family Act contains the right of children with power of discernment, as defined in Art. 12 of the United Nations convention on the Rights of the Child, to freely express their opinion in matters affecting them and to be heard in judicial or administrative proceedings in which they are involved.

Certain additional rights, those designed to ensure the protection of children and safeguard their interests, could be given wider scope than they have today, if not by the provisions of family law which embody basic principles, by other family-law rules of the new legislation. Again, to give but one example, though Art. 8, paras. (1) and (2), of the Act on Protection of Children recognizes the right of the child to file complaints with the forums specified by law in matters of concern to him and the right as stated in Art. 7 of the Civil Code to take proceedings, where his fundamental rights are violated, before the court or other organs specified by law, there still is no forum which the child might, in cases presumably not so frequent, look to for help and support in such matters.

Some Questions of Matrimonial Property Law

1. Matrimonial property law is the part of family law which was hardly, if at all, adjusted to the changed pattern of socio-economic conditions, albeit adjustment would already have been warranted in many respects, and which therefore calls that the need should be addressed with the greatest momentum both for substantive change and for more detailed regulation than is the case at present.

The rules of the Family Act of 1952 on matrimonial property law were framed in an era which sought to promote a speedy withering away of private property, which may explain why these rules were enunciated in

such sparing terms. It must be admitted that in respect of the personal property that remained, the legislator rightly sought to devise a matrimonial property regime which made due allowances for the equality of spouses, the differences in earnings between men and women, and the duties of the wife in the household and the upbringing of children.

Rather soon, practice came to show that the rules on matrimonial property, set out in as little space as five articles, were inadequate to meet the needs even under conditions of shrinking private or personal property playing an ever smaller role in economic life, and that the Family Act had left numerous matters unsettled. The gap was first filled by judicial practice partly in the form of directives, partly in the form of individual judgements, and then some of the relevant rules were supplemented by the 1974 and 1986 Amendments to the Family Act. By 1986, however, new times had begun to breathe in the patterns of economic conditions and property relations, but the Family Act was slow to respond to them. True, the Amendments of 1986 adjusted standards by recognizing again the possibility of concluding matrimonial property contracts, which had been abolished in 1952, but the relevant provisions were even more laconic and incomplete even in comparison with the pre-existing rules of the Family Act.

In addition, Directive No. 10 of the Supreme Court on matrimonial property law matters was repealed in the meantime on the ground, admittedly most questionable, that what had not been legislatively covered among the points raised in the Directive had meanwhile been similarly recognized and followed in practice.

The past ten years have seen further significant changes in property relations and in the direct or indirect participation of private persons, whether married or not, in economic life. In view of these changes, the rules of matrimonial property law call for much more flexible treatment —more differentiated where necessary, but more elaborate, in any case—in respect of inter se relations of spouses, relations between spouses and third persons, particularly of relations between persons participating in economic activities. Yet the need is invariably for legislative regulation which takes account of the interest in the protection of the family, of the fact that the family life-style influences the property relations of spouses and is normally shaped by their common will, and, naturally, of the interests of children.

Moreover, mention should be made of the fact that even though it is the family-law rules on matrimonial property that come closest to matters dealt with in civil-law and have stood in need of application of the underlying civil-law rules in the past, these rules are treated by nearly all legal systems in a way different from other civil-law relations, in response

to the distinctive features of everyday family relations and of the jointly shaped patterns of family living. This holds primarily for the rules on matrimonial property matters affecting the internal (inter se) relations of spouses as well as their external property relations with third persons, though to a lesser extent.

The rules of matrimonial property law are typically rules which were laid down in legislative enactments by all countries of Europe during the 19th century or in the first third of the 20th century, enactments in which significant substantive and conceptual changes have since been pressed for either by the changing patterns of family relations, particularly the recognition of the equality of spouses, the growing predominance of dual income families, the increasing participation of women in economic life, or by shifts in the make-up of assets owned in the Western part of Europe as elsewhere.

The trend of change, even if accomplished in different ways by the various systems of law, is towards laying down rules of matrimonial property law which, at least with the statutory matrimonial property regime prevailing, will ensure that both spouses share in the increase of their property achieved during marriage, even though by the activity of one of the spouses, and that their shares are equal, apart from a few exceptions as observed in the different legal systems. This requirement has consistently been satisfied by the Hungarian matrimonial property law in force.

However, unlike the rules of Hungarian matrimonial property law, most foreign laws leave more scope for spouses to replace the statutory matrimonial property regime by another, contractually stipulated regime, an optional one, the detailed rules of which are similarly established by law. In the course of recodifying the family law there may be some ground for elaborating rules to govern such optional regimes of matrimonial property law in Hungarian law, too.

Equal sharing by both spouses in property acquired during marriage or married life can, in principle, be ensured by either of two property regimes. One is the regime of the community of property, which is embraced in Hungarian law. Under this regime, any property acquired by the spouses during married life except for assets of separate property specified by law, is held in joint ownership from the moment of acquisition, and this community of property is indivisible. The other is similar to the community of jointly acquired property regime of earlier Hungarian law, which, retaining proprietary independence and responsibility during marriage, recognizes a share for the spouses, at the end of marriage, in the increment of property taking place in the other spouse's property during the continuance of marriage.

While the marriage subsists, the spouses live under a separation of property regime, though subject to certain exceptions, but the property acquired during marriage will, at the end of marriage, be due to the spouses in equal shares, again subject to certain exceptions, regardless of the extent to which the property was acquired in common or separately.

There is no doubt that this kind of matrimonial property is flawed just as the conjugal community of property regime under Hungarian law is, and that the failing of either regime can be remedied by statutory regulations only to a certain extent. Still, even if the current unrealistic restrictions on the disposal of common property should be modified by a new rule, what seems to be more realistic is a regime of community of jointly acquired property in respect of, e. g., property contributed by one of the spouses to his/her economic undertaking or to such undertaking with a person other than his/her spouse. Such an arrangement requires, on the one hand, much greater freedom of disposal, within the sphere of his/her undertaking, for the spouse engaged in economic activities and, on the other, allows scope for risk involved in the economic undertaking to be borne solely by the property of the spouse engaged in economic activities. Today, in point of fact, such an arrangement can only be made by stipulating the separation of property regime, which places at a much greater disadvantage the spouse not participating in economic activities and, indeed, at one which is presumably against the desire of most spouses.

If this regime is adopted as an optional one of matrimonial property—or even if the right is recognized for the spouses to stipulate this regime in respect of their property assets such as serve a specific purpose, with the rest of their property remaining under the control of the statutory matrimonial property law—, there will emerge other issues that will, or may, call for regulation both in the inter se relations of the spouses and in respect of protection of creditors. A few examples will suffice. There will doubtless have to be a group of property assets—depending on the purpose for which it is intended, primarily a dwelling used jointly by the spouses—in respect of which it will be necessary to retain the right of joint disposal. Similarly, the right of separate disposal must not entail avoiding payment of expenditures on the common life and the upbringing of children, or of the property acquired by way of gift or inheritance may not invariably be regarded as an increment of property subject to distribution. Besides, more attention will have to be devoted to whether movements of assets as between spouses are purported to take away the coverage of debts.

It is not advisable to rule out, as an option, the regime of separating all assets of property. In such a case, the creation of conditions for joint

occupancy and defrayal of the expenses of a common household and the rearing of children may nevertheless be considered as matters that must be excluded from a full separation of property and may be in need of appropriate regulation.

Of course, in respect of goods jointly purchased from the earnings or incomes of both spouses, the marital partners may, even during marriage, have common property even under both matrimonial property regimes we have described in this paper.

With the optional matrimonial property regimes recognized and duly regulated, it would be necessary for the community of property regime, commonly accustomed and accepted as it is, to be maintained as a statutory matrimonial property regime in the future.

The current rules of this regime, however, call for various degrees of adjustment, modification or, where appropriate, interpretation.[13] It is all the more justified to keep this in view since, in Hungarian practice, marriage settlements cannot be assumed to gain currency in the future and consequently the statutory matrimonial property regime can likewise be assumed to remain in operation in the majority of marriages.

2. The statutory matrimonial property regime of the Family Act is a community property regime which, but for the statutorily defined exceptions, creates a community of property acquired by the spouses either in common or separately throughout their matrimonial life. As against the terminology used by the Family Act, this community of property means not only joint ownership, but also a community of other components, notably of assets and liabilities, or of rights pertaining to the spouses and, with appropriate exceptions, obligations imposed on them, and the common property, again without the current Family Act spelling it out, is due to the spouses in equal shares, at least at the time the community property is divided.

Legal systems which adopt, as a general rule, the community of property, i.e. the community of property acquired jointly during marriage, tend—one might say, as a matter of fact—to enumerate those items of property that do not form part of the community property of spouses; that is to say, they constitute their separate property—or liabilities—, but are not uniform in incorporating in, or omitting from, this structure of regulation the presumption that the property of spouses is jointly owned. While the Hungarian Family

[13] For proposals partly differing from, partly wider in scope than, those presented below, see the study by Kőrös: A házassági vagyonjog korszerűsítésének elvi kérdései (Conceptual Questions of Streamlining the Matrimonial Property Law). *Polgári jogi kodifikáció*, No. 2 of Vol. III. 5–7.

Act does not declare such a presumption, judicial practice persists in applying it and perhaps gives it, as often as not, greater emphasis than warranted. There is an opinion that the presumption of common property should be legislatively spelled out.[14]

This notwithstanding, there are, admittedly, drawbacks, even if left unmentioned, to the statutory confirmation of this presumption and, in particular, to giving it too much emphasis. A legal declaration to the effect that forming part of separate property is any asset which, whether acquired prior to or during marriage, is not clearly shown—by e. g., a premarital entry in the real estate register or a certificate of inheritance issued during marriage—to have the status of separate property cannot be claimed to be a confidence-building mark of a marriage at all. Such declarations at law, merely embodying the existence of separate property at the time of entering marriage and written into matrimonial property contracts, are not exceptional even today, nor can they be prohibited, but, in a society where conclusion of marriage settlements is far from common, they somehow imply that the intending spouses face up, ab initio, to the possibility of dissolving the marriage into which they are about to enter.

The scope of separate property as defined by the Family Act in force is more or less in conformity with regulations valid in other countries. In addition to acquisitions under any title before marriage, separate property chiefly includes, among the items acquired during marriage, assets acquired by way of donation or succession and serving exclusively for personal use, by one of the spouses. In our conviction, the matters and problems which judicial practice is seized of in connection with the statutorily defined items of separate property—and one might add that related questions do emerge in respect of all such assets—are to be settled by practice as before and call for no modification to the relevant provisions of the Act, regardless of whether we endorse the current practice or would find the opposite to be appropriate.[15]

However, what was omitted from the Family Act and is in need of legislative coverage is this: while the scope of separate property was defined satisfactorily in the main, the Act is almost completely silent on the separate liabilities or debts of one of the spouses or, more accurately, the

[14] See, e.g., Kőrös: A házassági vagyonjog korszerűsítésének elvi kérdései. *Polgári jogi kodifikáció. op. cit.* 8.

[15] For instance, we have repeatedly stated that what we would deem appropriate is the opposite of the current practice, which, endorsed also by authors of commentary literature, regards property acquired under a succession contract as constituting common property.

only point covered concerns the question whether the spouse withholding his/her consent to transactions effected without his/her consent is or is not liable, and to what extent, for debts so incurred.

This matter cannot be solved by merely stating let alone presuming that a debt incurred before marital life is a separate debt and that a debt incurred during marriage is a common debt encumbering the common property of the spouses.

Without claiming to be comprehensive, the following list of questions would call for regulation. The obligation of maintenance originating from a legal title prior to marriage or during marital life and imposed on one of the spouses could not normally be classified as a separate debt. Damage which one of the spouses has caused, even during marital life, to a third person by a criminal offence or otherwise willfully or perhaps through gross negligence would reasonably have to be classified as forming part of separate liabilities, while other cases of damage would not. As for the costs of the maintenance of separate property, it would be justified to make regulation dependent on whether or not an asset of separate property is also used to meet the needs of the common life. Obviously enough, its consignment to separate debts is unwarranted in the former case, but is warranted in the latter.

The question whether—in addition to an express enumeration of the items of separate property and statutory classification of all other assets as belonging to the community property of spouses—there is ground for a separate provision that the two sources of property form a community, may be at issue. One such item of property treated with emphasis in the Family Act is the proceeds of separate property or, more accurately, the net income derived therefrom. Other items include royalties pertaining to inventors, innovators, authors and other persons creating intellectual products and falling due during marital life. Whereas some foreign laws contain rules consigning the proceeds of separate property to common property, there are no foreign laws which treat royalties separately.

Two points are worthy of consideration here. First, the fact that the explanatory comment added by the Ministry to the 1986 Amendments to the Family Act refers to the possibility and justifiability of making settlements on royalties diverging from the law as a reason in support of the fairness of matrimonial property contracts, which have recently been reintroduced by legislation. Secondly, it is far from unambiguously clear whether by framing that rule, the legislator has widened or narrowed the scope of common property, because the rule in question also implies that the particular intellectual creation itself (invention, innovation, etc.)

remains the author's own property, which the other spouse has neither any right to dispose of nor any matrimonial property claim to a share in, if its proceeds are realized in a form other than royalty. Such a conclusion was reached by, e. g., the Supreme Court in its ruling which upheld the position of the Hungarian Bureau for the Protection of Authors' Rights in a case involving an author's estate with unsold figurines.

Some experts attack the in-force regulation in another respect, judging it inequitable that an author's proceeds from earlier work created before marriage should, if the royalty has fallen due during marital life, belong to common property, at least as a general rule. Such a rule is found to be inequitable especially in cases where an intellectual product was created during a previous marriage of the author, when the former spouse might have contributed, even if indirectly, to enabling the author to "safely engage in creative work".[16] Still, it is more than contrary to the actual facts of life to allot, by operation of law at any time after dissolution of the marriage, to the former spouse a share of royalties for work done during the existence of the marriage with him or her.

3. A matrimonial property law which is to deal with three parts of property—the common property of spouses and the smaller or larger separate property owned by the spouses—should devote greater attention than do the current rules of the Family Act, to the intermingling or merger of these sub-divisions of property, to questions of investments or other outlays from the separate property of one spouse which increase the property of the other spouse or the common property, or, conversely, investments or other outlays from the common property which increase the separate property of either spouse, and to whether or not such investments or outlays are to be reimbursed.

This set of questions was not yet covered at all by the Family Act of 1952. Some guidance for regulations was provided by Directives No. 5 and No. 10 of the Supreme Court, which came to be incorporated—though in part only and certainly not at the proper places, among other rules - in the subsequent Amendments to the Family Act.

It is only in an extended sense of the term that one may speak of a merger of sub-divisions of property in respect of separate property lived

[16] See Tóthné Fábián, E.: *A házassági vagyonjog egyes elemeinek áttekintése* (A Review of Certain Aspects of Matrimonial Property Law). In: Veres, J.: *Emlékkönyv* (Memorial Volume), Szeged, 410; and this view shared or the in-force rule of the Family Act is at least held rigid by Kőrös: A házassági vagyonjog korszerűsítésének elvi kérdései. *Polgári jogi kodifikáció. op. cit.* 10.

off during marital life—and we might add—regardless of whether the spouses were compelled to do so by temporary difficulties in meeting the expenses of the common household or the separate property was used up through the common will presumably of both spouses to secure a higher level of living, thereby affording extra opportunities for children or raising funds for an occasional spending of larger sums of money as a result of an acquisition of sizable non-communal property.

The provision of the Family Act which in such cases does not, in general, recognize any claim for reimbursement to separate property is certainly right, but exceptional cases are likewise acceptable in which reimbursement in respect of lived-off separate property may be admissible. To take one example, the spouses secure for any reason their common life by using up the separate property of one of them, while leaving the separate property of the other spouse intact, thus creating a situation which, without a recognition of claims for reimbursement, would unbalance the financial standing of the spouses, and result in unreasonably great disproportions in their property holdings.[17]

The intermingling or merging of common and separate property in cases where investments or other disbursements undertaken in one sub-division and financed from another sub-division result in a significant increment value of the other sub-division should naturally receive different treatment. Strictly and practically speaking, it is only in cases of this kind that one is justified in speaking of an intermingling of sub-divisions of property.

Such intermingling or merger of sub-divisions in the property of spouses can be said to be an everyday occurrence. The spouses may jointly own a house built on a building plot which forms part of the property held by one of them separately or may use their common property to enlarge a dwelling which one of them had at the time of marriage or inherited during marriage, or, conversely, they may draw on a sizable inheritance conferred on one of them to invest in an asset of common property, to enlarge it or to increase its value. Mere defrayal of the costs of management and maintenance of property in one sub-division out of funds in the other sub-division would not be deemed, at least in general, to be an instance of intermingling property even in cases like this.

Moreover, for purposes of treatment under family law, outlays resulting in enhancement of value should likewise be distinguished according to

[17] See *A családjogi törvény magyarázata* (Commentaries on the Family Act, 1988, Vol, I, 373; and Kőrös: *A családjog kézikönyve. op. cit.* 193.

whether the increased value is still existent at the time of the distribution of the property or has been used up during the common conduct of life or may subsequently have become depreciated for reasons beyond the control of the spouses. The latter cases should be disregarded in respect of claims for reimbursement.

As regards incremental property which preserves its value and is to be reimbursed to different sub-divisions in the course of the distribution of assets, present-day judicial practice is far from uniform and consistent in establishing when the intermingling or blending of sub-divisions affecting, as it often does, immovable property creates a claim for a share in property, with account taken of the increase in value, or a claim "only" for refund in money. Judicial practice has, recently in any case, recognized claims for sharing in property in a wider scope than do Art. 137 (3) of the Civil Code and Opinion No. 7 of the Civil Division of the Supreme Court, recognizing claims of ownership in respect of internal alterations and the provision of modern facilities which do not affect the structure of a building, provided that they have created new and enduring value. There is, however, no answer to the question about a rationale for such a practice, and the best one gets in justification, without that policy being questioned in principle, is that the effective rules of the Family Act confer no power on the courts to adopt such a practice.[18] Yet it may be questionable whether this matter should be one of those in which continuance of a practice deviating from the provisions of the Civil Code appears to be justified, once the family law has been integrated into the Civil Code. Supposing but not suggesting that it is, there would be a need for a statutory regulation to this effect, with a statement of its justification.

For that matter, a distinction between claims of ownership and claims for refund in money is of relevance particularly to dwellings used by the spouses, where the question of whether the dwelling is in joint ownership or is separate property held by one spouse has relevance in deciding how the spouse/s may live in the family home after divorce.

Among the provisions of the Family Act which govern claims for reimbursement, the rule under which no such claim in respect of investment from common in separate property or, conversely, from separate in common property is admissible "where the expenditure was incurred with intent to abdicate claims" does not work nor is it necessarily applied by the courts, though for a different reason. Such intent is certainly motivated by trust in

[18] See Körös: A házassági vagyonjog korszerűsítésének elvi kérdései. *Polgári jogi kodifikáció. op. cit.* 14.

the continued existence of the marriage, while reimbursement of the value of investment will take place upon dissolution of the marriage or, probably less frequently, upon termination of the marriage in the event of the death of one of the spouses.

Numerous matters relating to claims for reimbursement and not covered by the Family Act are adequately settled by judicial practice which relies partly on the repealed Directives of the Supreme Court, but some of the arrangements adopted would nonetheless require legislative coverage, albeit without an unduly casuistic regulation.

4. The integration of family law regulation into the Civil Code requires that special attention should be paid to the specificity of the relationship between spouses and the function of conjugal community property. This, in turn, requires, that regulations different from the relevant rules on civil-law community property should be introduced for the use and management of conjugal community assets, the defrayal of the costs of maintenance and, in particular, the disposal of common property.

Such a different regulation has been adopted by the Family Act, but some of the relevant provisions are in need of rethinking and revision, mostly in the wake of the changes that have taken place in economic conditions since their introduction. This holds for the rules on the management and, to an even greater extent, of disposal of, common property.

With regard, first, to property management, the present-day patterns of daily relations and economic conditions require exceptions to be allowed to the general desiderate of joint management in respect of assets of common property necessary for the exercise of a profession or occupation, apart from the fact that, as against the current provisions of the Family Act, management extends not only to assets of property, but also to such other items as are in need of management. It stands to reason that the said assets of common property should be subject to exclusive management by the spouse who is assisted by them in pursuing his/her profession or occupation.

Finding the appropriate way to regulate disposal of common property is a more sophisticated and complex issue, to achieve which the legislator had to accommodate two conflicting interests in the past and will have to do the same in the future.

What common property should require, in any event during marital life, is, if only in general, joint disposal by the spouses and hence, especially in case of wrongful non-exercise thereof, protection of the rightful, reasonable interests of the spouse who is not involved in joint disposal. Still, on the other hand, legal regulation should also keep in view the

principle of security of transactions, considering that the right of disposal is, as a matter of fact, exercised externally, towards third persons. The requirement of joint disposal of common property, as would be dictated by the interest of spouses, would clearly be too much for the security of transactions to bear. A third person establishing a business relationship with one spouse cannot evidently be expected to pry into the marital status of his/her partner or, if the partner is married, into whether the other spouse has consented to the deal to be made with him. The rules of the Family Act, although stating the requirement for common property to be jointly disposed of, give priority to the interest of the security of onerous transactions, at least in general, by establishing the presumption of consent by the other spouse to a rather broad range of transactions with third persons.

Nevertheless, this area would certainly need more differentiated and more realistic regulation than is the case at present. The question of the joint disposal of common property arises differently and raises other problems in respect of movable and real property, and emerges, again differently, in respect of the property brought by one spouse into a business undertaking and of the property used to meet the needs of daily life of the spouses. And this list could be extended by the different ways in which the consequences of wrongful disregard of joint disposal ensue especially in inter se relations of the spouses and in external relations with third persons.

As for real property, if it forms part of common property and is registered as standing in the names of both spouses, joint disposal of it is an absolute requirement—real property may obviously not be either alienated or encumbered with consent not subject to formal requisites or based chiefly on presumptions—and a "mere" promise of the spouse effecting a transaction to obtain the consent of his/her spouse to the transaction will not authorize the third party to the transaction to use pressure to procure the consent of the other spouse. If, however, the real property which forms part of common property is, for any reason, registered as standing in the sole name of one spouse, the principle of public authoritativeness of real estate recording certainly must take precedence over the requirement of a joint disposal of common property. It is nonetheless justified to allow an exception to this rule in respect of dwellings used in common by the spouses, even if such an exception runs counter to the principle of public authoritativeness of real estate recording.

With regard to movable property (including rights, entitlements, claims, etc.), subjecting joint disposal thereof to practically no restriction

is certainly an undue or excessive requirement. It is acceptable in respect of assets used for the common life of spouses, but is unacceptable in respect of assets necessary for pursuing an occupation or profession and of those contributed to a business undertaking run by one spouse. It is unrealistic, furthermore, to require joint disposal even years after termination of the matrimonial relationship or, in the spelling of the law, for the period between the termination of matrimonial life and the division of the common property. A new enactment should replace these unrealistic rules with more life-like ones.

In the legislative process, however, what calls for a change is not only the excessive, unrealistic requirement of joint disposal, but also the protection of a spouse wronged in his/her intra-marital relation by the other spouse's act of unilateral disposal, and even the protection of that spouse against a third person acquiring property from him/her in bad faith, in the knowledge of the lack of consent on the part of the other spouse. The appropriate solution would be, again, to recognize claims for damages in the internal relations of spouses—claims that had once been recognized by, but were later omitted from, the Family Act—, just as it would also be appropriate to replace the current unrealistic rule governing cases in which one spouse is unlawfully deprived of common property by the other spouse after the matrimonial relationship is terminated but before the common property is divided. It would similarly be acceptable to recognize either claims for damages against mala fide third persons in external relations or the right to sue for cancellation of transactions concluded by the other spouse with such third persons. Today these matters are not legislatively covered at all.

5. And, finally, there are a few more matters relating to marriage settlements to be mentioned in the sphere of matrimonial property law.

In addition to the rules on formal requirements for marriage settlements, the Family Act is practically confined to providing that in such a contract husband and wife, or even in a premarital agreement the intending spouses may depart from the provisions of the Act in assigning certain assets to common or separate property. This provision is supplemented by the Decree of the Minister of Justice on the Enforcement of the Family Act, stating that contracts of sale, exchange, donation and loan made by spouses with each other during the existence of the matrimonial relationship must also be deemed to be marriage settlements as defined by the Act.

However, a marriage settlement may be of a content different from that determined by the Hungarian Family Act and, indeed, these differences boil down to either of two basic kinds. One is that which, as mentioned

earlier, is not covered by Hungarian law at all, namely the stipulation of an "optional" matrimonial property regime instead of the statutory regime; the other consists in the laying down of stipulations on certain details which depart from the relevant rules either of the statutory or of the optional regime. Such stipulations may also cover matters other than the specification of the assets of common or separate property which deviate from the provisions of the existing law. They may, inter alia, relate to the management or freer disposal of common property and make different arrangements in respect of assets used for business purposes or for the pursuit of an occupation in general, or of proceeds from separate property.

The current rules of the Family Act, at least if interpreted literally, leave little or no room for making similar stipulations, which are, beyond question, responsive to the needs of daily life. It would be absolutely necessary for further progress to be made in this respect. Of course, not even a future legislation will be able, nor could it be concerned, to determine fully the substantive details of the marriage settlement.

As regards the content of such a contract, however, it would be necessary to determine the restrictions that would be needed and justified. Thus, on the one hand, it should be spelled out that the freedom of contract may not prejudice fundamental interests of family protection and may not result in, among others, evasion of payment of expenses incurred in connection with the common conduct of life, or non-contribution to the sustenance of children, or in an unilateral exercise of the right of disposal in respect of the occupancy of a dwelling used by the spouses. On the other hand, and with adjustments for present-day economic conditions, such restrictions may also have a major role to play in ruling out the possibility of the freedom of contract being instrumental in practically defrauding the creditors of one of the spouses.

A further question which bears on the content of the marriage settlement may be that of whether such settlement should be allowed to contain a stipulation for the event of death, one which is, in this context, virtually a testamentary disposition or even qualifies as a joint testament of spouses, or of whether the freedom of contract should not be allowed so wide a scope in terms of content. While acquiescing in the fact that stipulations of a matrimonial property contract, in so far as they determine the list of items assigned to common and separate property in departure from the law, are bound to have a bearing on what remains in the property held by the spouses in cases where the marriage terminates as a result of death. I would not subscribe to the admissibility of incorporating testamentary dispositions in marriage settlements even if the Civil Code now in the

making were intended to allow again a narrow scope for joint wills to be made by spouses.[19]

Yet another question emerges as to the extent to which the general rules of contract law, laid down in the book of the Civil Code on the law of obligations, will or will not be applicable to marriage settlements fundamentally differing in function from contracts controlled by the law of obligations, particularly those tailored for commercial transactions. In all certainty, they will be applicable to a lesser extent in respect of the internal (inter se) relations of spouses, although defects of will existing at the time of contracting, for instance, may also be taken into consideration in this context, and they will be taken into consideration to an even greater extent if they bear upon the interests of third persons, creditors in particular. This question will call for closer scrutiny, especially once marriage settlements come into more general use.[20]

Parental Rights and Duties–Certain Matters concerning Children's Rights

1. Questions of the parent—child relationship as well as questions of a confirmation and protection of children's rights have gained prominence in both legislation and legal practice in the sphere of family law across the world today.

Even though the traditional elements of the right of parental custody have seemingly remained unchanged, the principles governing exercise of the right of parental custody and some of the problems related thereto have undergone significant changes over the past few decades.

It would be justified for the basic principles guiding the legal regulation of the parent—child relationship to be included among the introductory provisions of the chapter of the new law on the right of parental custody , even if most of these principles are by no means new to Hungarian family law. The case may be argued for formulating such principles also in view of the requirements set forth in the United Nations convention on the Rights of the Child, notably

[19] For an opposite view, see Kőrös: A házassági vagyonjog korszerűsítésének elvi kérdései. *Polgári jogi kodifikáció. op. cit.* 16.

[20] An additional question within the domain of matrimonial property law can be that of creating a harmony between matrimonial property law and company law, or at least between the rules of matrimonial property law and the property relations of some forms of company. We will not be concerned with this matter in the present paper.

(a) the principle of the exercise of parental rights in the best interest of the child;

(b) the requirement to involve children who are capable of making a decision, i.e. competent to formulate, and decide in, questions affecting them, and to take their opinion into account where possible;

(c) the right and duty of parents to exercise parental rights and perform parental duties in common; in this respect, however, the rights and duties of parents living apart from their child are in need of separate regulation;

(d) the provision to the effect that interference, whether by legislation or by administrative authorities, with the exercise of parental rights is admissible only in exceptional cases in the interest of the child; and

(e) the recognition of the right of the child to maintain his family relations, including his actual family relations,

In connection with the implementation of principles it should nevertheless be mentioned that the rights and duties of parental custody, particularly the duties of care and rearing, are seen and felt by a considerable majority of parents to be duties or responsibilities which are crucially different from legally prescribed rules and that parents generally find it natural, even without legal regulation, to exercise these rights and responsibilities in the interest of the child. The requirement that parental custody should be exercised in the interest of the child is nonetheless so fundamental, such a basic principle of family law that it is to be spelled out in this context even if it can be supposed to belong to the category of exceptional instances in which it will have to be enforced by legal means or, if disregarded, may even entail legal sanctions.

Still, the approach which considers minors to be a priori "unprotected" by reason of their age or of their place in the family and consequently finds that the parent—child relationship calls for increased control by the State and increased administrative intervention is certainly in need of reappraisal. Such rethinking must also be reflected in the revision of the rules as regards parental rights to property management and the right of parents to legal representation.

For that matter, the requirement of respect for the exercise of parental rights—and the exceptional nature of interference with the exercise thereof—follows from Art. 8 of the European Convention on Human Rights, Art. 5 of the United Nations Convention on the Rights of the Child, and Art. 67 (2) of the Constitution of the Republic of Hungary, which, gives it separate expression save with respect to the choice of the type of education which parents wish to ensure for their children.

Where there is cause for intervention because of an improper exercise of parental rights and responsibilities, the relevant powers are vested in the guardianship authorities in the first place and in the courts in more exceptional cases.

The right to parental custody to be exercised by parents in common was slow in replacing paternal authority, generally accepted as it was for a long time not only in Hungarian law, and the rules which, likewise characteristic not only of Hungarian law, drew a sharp demarcation line between rights of parental custody according as they were to be exercised over children born in or out of wedlock.

However, the right of custody to be jointly exercised by parents living together, whether spouses or cohabitants without a formal marriage bond, has come to be definitively accepted by current Hungarian law and, more or less generally, by the laws of other countries, it being understood, of course, that the modalities of joint exercise are determined by the parents themselves, and practice shows that in the majority of cases, which can be said to be typical, joint exercise of this right is a reality, that parents living together share, whenever possible, in the everyday care and rearing of children as well as in the adoption of major decisions affecting their children, and that joint exercise is motivated neither by the relevant provisions of law nor by the requirements prescribed in international conventions, but is rather a life style which parents have adopted regardless of those requirements and which they increasingly look upon as natural.

The question of how parents are to enjoy equality and exercise their rights in common after the termination of their matrimonial relationship or the dissolution of their marriage poses itself in a different way and is much more difficult to solve. From this perspective, it is inevitable for the joint exercise of rights to be prejudiced to some extent, but legislation is bound by international conventions to search means which are likely to reduce such prejudice and thereby to enable both the parents living apart from their child and the child living apart from one of his parents to maintain a parent—child relationship that is satisfactory by any measure even if altered by the change in their respective situations.

It is common knowledge that voluntary observance of the law is not typical of all such situations. In order for this requirement to be fulfilled in ways other than by recourse to legal means, a rather high degree of cooperation would have to be practiced with respect to their child by persons who are often highly estranged as spouses or cohabitants. This, however, cannot release the legislator from his duty to settle the rights of parents who live separately, on the one hand, and the law enforcement

authorities from theirs to facilitate, wherever possible, the enjoyment of these rights on the other. We will have more to say about this issue later.

As regards the right of children, as also embodied in Art. 8 of the United Nations Convention on the Rights of the Child, to maintain family relations, wider than those of the parental family, pertinent rules can be found in the current Family Act and more of them in the Act on the Protection of Children, but further progress in this direction would certainly be salutary.

2. Among the substantive elements of the right of parental custody, a revision may be called for by exercise of the parents' right to manage property and of parents' right and responsibility to act as legal representatives.

While the rules which empower the guardianship authority to take over regular control over property administration if the parents fail in their duty to manage the child's property are to be retained, the parental right to manage the child's property in other cases should be adjusted to real-life situations more closely and with greater confidence placed in parents. Much broader than warranted are the powers of guardianship authorities today, as a result of which they have a say, ex officio by operation of law, in the parents's exercise of the right to property management and practically withhold that right from parents who otherwise take due care of the interests of their children. Besides, these rules are of relevance particularly to widowed parents who are to continue rearing their child on their own, cases in which property inherited from the deceased parent is, as often as not, placed under close control by the guardianship authority without any reason and, where legal practice is treating the child as a person having interests a priori contrary to those of his parents. In other cases it depends on the parent or some other close relative wishing to give the child a gift to decide whether to give or not to give a child under 18 a gift of considerable value which is to come under close custody by the guardianship authority.

Moreover, Art. 84 and 85 of the Family Act are no less unrealistic and at least as ignorant of the decision-making autonomy of the persons concerned in these aspects of the parent—child relationship. Nevertheless, enforcement or non-enforcement of these unrealistic provisions may, in these cases, be free from administrative intervention, and although these rules are, in a large majority of cases, most likely to have very limited or no application, it would be necessary for a new legislation to replace them with such rules as are more responsive to real needs.

The rules on legal representation as formulated in the Family Act should be harmonized, on the one hand, with the provisions on the parental

administration of property, which are to be made more flexible, and, on the other hand, with the provisions of the Civil Code on legal representation. As for the latter, the current rules of the Civil Code, the Family Act and the Guardianship Decree fall a mile short of overlapping in certain respects.

In addition, attention should be drawn to the fact that in the field of family law the parents' right to, and duty of, legal representation includes not only representation in traditional declarations at civil law but also procedure of legal representation required by declarations at family law or consent thereto, as well as—in an area still further removed from civil law—acts of giving consent to medical treatment. Revision is called for especially with respect to the exclusion of the parent as a legal representative from declarations which concern the establishment of the child's family status.

Several rules, otherwise adequate in terms of substance, which govern exercise of the right of parental custody require re-casting at the level of laws as opposed to their present state of being part of the Guardianship Decree.

3. The rights and duties of parents living apart from their child should be given more attention than they are accorded by the current regulation. Cases in which one of the parents came to be living separate because of the termination of the matrimonial or extramarital relationship, including cases of acknowledged paternity where the acknowledging father has never lived together with his child, but attaches importance to building an effective father—child relationship, and in which a parent came to be living apart from his/her child because of the need for the child to be removed from the parental family are to be governed by different rules. For that matter, the latter cases are regulated by the Act on the Protection of Children, even if not satisfactorily in all respects.

The significant rise in the number of families affected by divorce or termination of married or unmarried common life and of children of such families as well as the fact that, under present-day socio-economic conditions, both parents increasingly participate in rearing and caring for their children while the couple are together, has lead to an increased need in separating parents to strengthen the rights they will retain in respect of their children and, in a number of cases which is by no means negligible, probably also to a similar need in children for the maintenance of satisfactory contacts with the parent who comes to live separately. At the same time, for the parent living separately to be capable of exercising his/her rights and responsibilities retained in respect of children after the termination of the matrimonial relationship, both parents are required to cooperate properly in one way or

another and to accept the fact that both of them continue being the parents of their children.

Most of the rights recognized for, as also the increased responsibility resting on, the parent who lives separately in respect of his/her child are embodied in the parental right of joint custody retained, or adjudged, despite the dissolution of marriage or the termination of married life, and their actual substance is for the parents to forge.

Joint exercise of parental custody after divorce or the termination of married life nevertheless represents a higher degree of cooperation which it is not justified to make compulsory, because this right may only be recognized for parents willing to undertake and practice such cooperation in the interest of the child. However, a lower degree of cooperation, particularly provision for the child, opportunities to maintain satisfactory contacts with his parent who lives separately, is a matter not of commitment, but of legal duty. A kind of cooperation wider in scope than this is prescribed by those rules of the Family Act which accord to the parent who lives separately a right of joint decision-making on essential matters that are expressly enumerated in the Act as affecting the life of the child, so in the case of a dispute on matters in need of joint decision the parents can have recourse to a court.

The institution of joint custody was introduced by the Family Act as amended in 1995 on the model of foreign legislation and in pursuance of the principles and provisions of the Convention on the Rights of the Child. The rules of the Family Act recognizing this right in seeking a settlement in divorce actions or actions involving custody take due account of the child's interests as well as of the parents' willingness to cooperate, but those which settle this matter in cases where the community of living is broken up without a settlement having been reached are in need of revision. The general provision that, unless the parents agree otherwise, the rights of parental custody must be exercised jointly even if the parents no longer live together is unrealistic and needs to be revised.

As against the arrangement adopted by some foreign laws, we must be aware that recognition of joint custody after the community of living has been broken up or after divorce is more of an exceptional solution in Hungary today, while it should be spelled out by the new legislation in clear terms that a verdict of joint custody must not amount to a placement of the child which is divided between the two parents and alternating, e. g., weekly, fortnightly or monthly. Such arrangements are not accepted by the European systems of law which regulate this institution, whereas the practice doubtless prevailing and by far not exceptional in America cannot serve as an example for us to follow.

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The foremost right of the parent who lives separately is to maintain regular contact with his/her child, a right which is today formulated by Art. 9 (3) of the United Nations Convention on the Rights of the Child even as a right of the child in respect of his parent who lives separately. The rules governing this fundamental right of parents and children are currently laid down partly in the Family Act, partly in the Government Decree on Guardianship. A new enactment should consolidate the relevant regulations at the statutory level, while eliminating minor deficiencies of substance in the existing provisions.

Furthermore, statutory provisions should take greater account of the links that exist between the rules for the placement of the child and the right to contact with the non-custodial parent.

This notwithstanding, as regards matters of contact with the non-custodial parent, mention should be made of the fact that questions more difficult than that of regulating the settlement of the issue of contact-keeping are often raised by the enforcement, by court order or the guardianship authority's decision, of the execution of sanctions against the parent who impedes the orderly exercise of the right of contact. Compulsory recourse to mediation might make some progress in this field, but such an obligation should naturally be imposed by law.

4. The rules on termination and suspension of the right of parental custody need revision to a smaller extent, but future codification should devote greater attention to ensuring that, for cases in which a child is temporarily or permanently removed from the parental family either because of the suspension or termination of the right of parental custody or for some other reason, there should be a legal rule which expressly provides that the child should be placed, where possible, with hi/her relatives and that, again where possible, brothers and sisters should not be not separated. Observance of this requirement is in keeping with the provision of Art. 8 of the United Nations Convention on the rights of the Child which seeks to guarantee for the child the right to maintain his family relations.

Finally, let us raise the question whether, given the present-day pattern of familial relations, there is a need for regulations that are more responsive to the desiderata of family-law aims and to actual parent-child relationships, to cover relations between step-parents and step-children or, where such relations are lasting, even between foster parents and foster children.

Certainly, the questions discussed here must seem randomly selected from the perspective even of the process of codification which is going on at present. We have attempted to address—raise and answer—besides the basic family-law principles of the new Civil Code, some of the matters

covered by two main areas of family law, namely those dealing with marriage and relatives. Naturally, we do not claim that there are no other matters, either in these two parts or in the third part of family law on guardianship that do not call for debate or rethinking in the context of codification.

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Manuscripts and editorial correspondence should be addressed to

ACTA JURIDICA HUNGARICA
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ZOLTÁN PÉTERI*

Foreword

The 16th International Congress of Comparative Law takes place at a time that can be characterized as transitory in several respects. Modern societies and their institutions are transformed at a quick pace by the ongoing tendencies of globalization: our familiar concepts gain new meanings.

These changes also affect the world of law. It is not only the formation of the positive law of particular countries that is influenced: our view of law is thoroughly reshaped. It means more than outdating for good the narrow, normativist view of law, namely understanding law simply as a sum of legal rules. As a consequence of this change of perspective, the wider social, economic, political and cultural relations of law are also involved in legal studies and in jurisprudence. Moreover, these changes mean more than just including value-relations of law as a social phenomenon in the framework of a renewed view of law. It seems that the ongoing transformation today also affects an attitude that has characterised and dominated law and jurisprudence since the era of modern codification. It is manifested mainly in the fact that convictions concerning law as having a "national" character, the primacy, the supremacy or even the exclusiveness of domestic law are shaken or undergo a change. There is a growing interest in "otherness", in foreign institutions and forms of procedure, a growing aspiration to understand them. Patience and recipience towards them based on mutual respect plays an ever more significant role.

It hardly requires much explanation that in this process of transformation comparative law plays a particularly important and even unavoidable role. This role, being many times emphasized by the outstanding representatives of international comparatistics, brings us closer to mutual understanding and reconciliation. In this spirit, comparative law becomes an instrument of developing and accepting the "common law" of mankind. Perhaps, we are not wrong if we believe that nowadays we witness a return to the classical

* Full member of the International Academy of Comparative Law.
E-mail: peteri@jog.mta.hu

idea of the "ius commune" but in a new, modified sense. In respect to the idea of the nature of law as being "common", we talk about something more than the manifestation of the universal idea of law in national legislatures in several ways (in the sense of the slogan: "ius unum—lex multiplex"): the aspiration directed to the realization of the universal idea of law seems to come to fruition. In a not too far future, in the framework of a process of unification and harmonization of law unfolding on an international scale, it can result in the cessation of many differences that we see today.

Even in the present, altered situation, the international exchange of ideas and experiences that has been made possible by other congresses of comparative law (organized by the International Academy of Comparative Law for many decades) can make a useful contribution to the realization of the unified world law. The unification of law has been the declared purpose of the international comparative law movement since the first International Congress of Comparative Law held in 1900. Our experiences support the claim that the exchange of ideas taking place in the framework of the congresses of comparative law has already contributed to the formation of the common future of the community of lawyers and the whole mankind. Thus, it is not an accident that the interest in these and similar programmes is ever growing, just like the number of meetings organized in the name of comparative law and the experts taking part in them.

Since the very establishment of the International Academy of Comparative Law Hungarian jurisprudence has represented itself and has played an active role in its activities. In this respect, it is not only the example of Professor Elemér Balogh, one of the founders of the International Academy and its first General Secretary that can be a guideline for us, latter successors, but those more recent experiences related to Hungarian contributions to the International Congresses of Comparative Law in the past decades. Hungarian participation has been continuous since 1958, and, since the 6th Congress held in Uppsala in 1962, it is manifested in the publication of Hungarian national reports in independent volumes.

Carrying on this tradition, the Hungarian national reports addressed to the 16th International Congress of International Law are compiled in a special issue of the periodical titled Acta Juridica in order to make them accessible to a wider public. These national reports indicate our unchanged commitment to the idea and practice of comparative law but, hopefully, also the freshness of thinking and the ability of renewal that is to characterize our response to the challenges of the tendencies of globalization in our world.

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I. A. The Status of Indigenous and Minority People

PÉTER KOVÁCS*

The Legal Status of Minorities in Hungary

Abstract. The Article gives a general overview of the Hungarian constitutional and legal framework for the participation of national minorities in the decision-making. The relatively low number of people belonging to national minorities in Hungary as well as the scattered patterns of their settlement and some aspects of the Hungarian legal traditions underlie the choice of the so called personal autonomy approach. The minorities can establish *via* a special electing mechanism local and national self-governments enjoying consultative and truly public law type rule-making and administrative competences. Having given the proper interpretation of the relevant article of the Constitution, the Constitutional Court also contributed to the birth of the Act on the Rights of Minorities. The basic reason behind the creation of a very complicated, multilevel institutional complex is that in this way, educational and cultural needs of minorities of different scale can be represented in a relatively coherent manner. This does not exclude at all the possibility of bringing modifications to the legal text in the light of a decade's experience.

Keywords: Hungary, minority, self-government, participation in decision making

Hungary's position viz. the linguistic minorities is based in the consideration that instead of classic nation-state concept,[1] the subsidiarity principle[2]

* Professor, PhD, dr habil, Miskolc University Faculty of Law, H–3515 Miskolc–Egyetemváros, Hungary and Péter Pázmány Catholic University Faculty of Law, H–1088 Budapest, Szentkirályi u. 28–30., Hungary.
E-mail: profpeterkovacs@hotmail.com

[1] In the last years of our century, the institution of the nation-state, its advantages and disadvantages are subject to numerous scientific studies and colloquies. This is not by chance, because at the end our century we see things differently than before when it seemed so evident for thinkers and politicians to import western examples in order to get nearer to modernity. However certain phenomena perceived without doubt in the XIXth century as the deposit of evolution, have been questioned since then. It has become clear that the nation-state has had drawbacks and even victims and it costs a lot today to mitigate damages and to promote small languages and cultures. The nation-state has a particular but apparently inherent temptation to uniformity and to cultural and linguistic hegemony. That's why a good number of countries make efforts to reshape the internal administrative structure according to the principles of decentralization and subsidiarity. Hungary is one of these countries.

[2] We know well, that subsidiarity has a double meaning. It has become evident since the Maastricht Treaty that there are certain inherent limits of sovereignty-transfer to

should be applied. In this way, minorities can decide in the matters important for their identity.

In addition to provisions linking international and national law,[3] or providing safeguards expressed in the European terminology of human rights[4] or in particular providing discrimination[5] the Constitution enshrines the fundamental principles of effective participation by minorities in public life:

§ 68 (1) The national and linguistic minorities in the Republic of Hungary shall share in the people's power, being constituent elements of the state.

(2) The Republic of Hungary shall accord protection to the national and linguistic minorities, ensuring their collective participation in public life, the cultivation of their culture, the use of their mother tongue, education in their mother tongue and the right to use names in their own language.

(3) The laws of the Republic of Hungary shall guarantee the representation of the national and ethnic minorities living in the national territory.

(4) National and ethnic minorities may set up local and national self-governing bodies.

(5) *The enactment of the law on national and ethnic minorities shall require a two thirds majority of votes of members of parliament present.*

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the supranational level, i.e. when the efficacity of the activity is threatened e.g. when the organization which has acquired the given competencies is unable to use them or when the bureaucratic way keeps down the required activity. But subsidiarity means also a constitutional and administrative doctrine in expansion which is ready to grant a greater place to local self-government if advantages of fiscality or efficacity justify it. Without doubt, the state has survived this slimming diet and citizens have realized that as a result of the decentralization, a lot of things have become cheeper and simpler.

[3] Article 7: "The legal system of the Republic of Hungary shall accept the generally recognised rules of international law and shall ensure harmony between obligations under international law and the municipal law."

[4] Article 8 (1): "The Republic of Hungary shall recognise fundamental human rights as inviolable and inalienable and it shall be a prime duty of the state to respect and protect those rights.

(2) In the Republic of Hungary, the rules relating to fundamental rights and duties shall be determined by law, which neverteless cannot restrict the substance of any fundamental right."

[Note: Human rights are set out in Chapter XII—articles 54-70/K.]

[5] Article 70/A (1): "The Republic of Hungary shall guarantee for everyone in its territory all human and civil rights without distinction of any kind such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status."

The Constitution laid particular stress on the institution of the ombudsman for minorities.[6] Quite plainly, the Constitution can regulate no more than the truly fundamental principles and the specific conditions are established by separate legislation, notably on the rights of minorities. This law' passed in 1993 associates the concept of individual rights with a collective approach, expressed generally as the manifestation of the concept of the "personal autonomy".

In fact the solution prescribed by Hungarian law only partially corresponds to this idea of "personal autonomy": institutions securing it are indeed provided for in the letter of the law, alongside and as it were above the normal institutions of local self-government, the individual rights of persons belonging to minorities and the collective rights pertaining to these minorities. It is the essential ingredient in a coherent complex of instruments. Logically, self-government, present at various levels of socitey, tends to be linked with collective rights. At the same time, as it will be explained below, it embodies the applied principle of *subsidiarity*. Even so, in theory, self-government is also conceivable in the framework of the organisation of public administration and not necessarily in the human rights framework. Nor indeed is it alien to human rights — the Hungarian law find landmarks in European practice, like the ombudsmen and Lapp assemblies of the Scandinavian countries or certain Slovenian institutions. At the same time, Hungarian law is consistent with the undertakings made in international law: the *European Charter for Regional or Minority Languages*, the *Framework-convention for the Protection of National Minorities in Europe* and bilateral treaties—which are furthermore based on the individual as well as the collective approach to the protection of minorities, and establish bilateral supervision machinery[7] are the frame of reference, supplementing the other stipulations of international law.

[6] Article 32/B (2): "The parliamentary ombudsman for the rights of national and ethnic minorities shall have the duty to examine or have examined any irregularities brought to his attention in connection with the rights of national and ethnic minorities and to initiate general or individual measures to remedy them."

[Note: He is elected by the parliament. cf. article 19 (3) of the Constitution.]

[7] Hungary-Ukraine: Treaty on good-neighbourly relations and foundation of co-operation (6. 12. 1991), Declaration on principles of co-operation in the protection of the rights of national minorities (31. 5. 1991) and Protocol thereto (31. 5. 1991). Hungary-Slovenia: Treaty on good neighbourly relations (1. 12. 1992) and Convention on the special rights of the Slovenian minority living in Hungary and of the Hungarian minority living in Slovenia (6. 11. 1992); Hungary-Croatia: Convention on the rights of the Croatian minority living in Hungary and of the Hungarian minority living in Croatia (5. 4. 1995); Hungary-Slovakia: Treaty on the good neighbourly relations and the co-operation (19. 3.

Self-government in terms of "personal autonomy" thus find its technical justification in the geographical and numerical patterns of minorities in Hungary.[8] Its legal justification is inferred from the aforementioned stipulations of the Constitution and to some extent from the law on local authorities;[9] its political justification stems from the will of the minorities concerned—which conducted the negotiations as a united front: the government had as its associate and talking-partner and *ad hoc* representative body made up of delegations of the interest[10]—and the meeting of minds between the government and the parliament. (This is also expressed the virtual unanimity with which the law was passed.) The long drafting procedure, in which the commencement and the first draft date back to 1989–1990[11] also testifies to the fact that the minorities regarded the proposals founded on traditional freedom of association[12] as inadequate.

1995); Hungary–Rumania: Treaty on understanding, good neighbourly relations and co-operation (16. 9. 1996)

[8] Hungary and her minorities:

a) results of the census of 1980, 1990 according to the reply to the question about "nationality": Germans:11,310 (1980); 30,824 (1990); Slovaks: 9,101 (1980); 10,459 (1990); Croatians, Slovenians or Serbians: 18,431 (1980); Croatians:13,570 (1990); Serbians 2,905 (1990); Slovenians or other:1,930 (1990); Rumanians: 8,874 (1980); 10,740 (1990); Gipsies (Roma): 142,683 (1990).

b) results of the census of 1980,1990 according to the reply to the question about "mother tongue": Germans: 31,231 (1980); 37,511(1990); Slovaks: 16,054 (1980); 12,745 (1990); Croatians, Slovenians or Serbians: 27,052 (1980); Croatians: 17,757 (1990); Serbians: 2,593 (1990); Slovenians or other: 2,627 (1990); Rumanians: 10,141 (1980); 8,730(1990); Gipsies (Roma): 48,072 (1990).

c) governmental approximation following certain empirical researches in 506 localities, according to the Hooz-method: Germans: min. 95,000; Slovaks: min. 50,000; Croatians, Slovenians et Serbians: min. 38,000; Rumanians: min. 10,000; Gipsies: 400–600,000 (global estimation, without empirical researches).

d) estimations of organizations of minorities: Croatians: 80-90,000; Serbians: 5,000; Slovenians: 5,000; Rumanians: 25,000; Germans: 200–220,000; Slovaks: 110,000; Poles: 10,000; Bulgarians: 3,000; Greeks: 2,500–3,000; Armenians: 1,500; Ukrainians: 451; Ruthenians (Ruthéno-ukrainiens): 1,000; Gipsies (Roma): 600-800,000 ou 1,000,000.

[9] Law n° LXV (1990) on local authorities and law n° LXIV on the election of local representatives for local authorities and of mayors.

[10] This body was working under the title of "round table of minorities".

[11] It was elaborated by the Secretariat for Minorities, directed by the deputy minister Csaba Tabajdi. The basic approach was elaborated by Mr.Gáspár Bíró.

[12] Such a proposal was drafted by the Ministry of Justice as an eventual alternative to the home rule principle, proposed by the Secretariat for Minorities (see footnote n°10).

Under the terms of the law, a national or ethnic minority is a community (*Volksgruppe*) in a numerical minority by comparision with the other inhabitants of the state, which has resided in the territory of the Republic of Hungary for at least a century, and whose members—who are Hungarian citizens—differ from other population components in language, culture and tradition. According to this definition, evidently inspired by Mr Capotorti, the following communities are assumed to be traditionally settled in Hungary: Germans, Armenians, Bulgarians, Croates, Greeks, Poles, Romanians, Ruthenians, Serbs, Slovaks, Slovenes, Gypsies. Minorities as communities are entitled to establish their own forms of social organisation and autonomy at local and national level. The Parliament has elected an ombudsman to supervise and further the effective exercise of the rights of national or ethnic minorities.

Minorities as communities are entitled to establish their own forms of social organization and autonomy at local and national level. The Parliament has elected an ombudsman to supervise and further the effective exercise of the rights of national or ethnic minorities. The ombudsman's missions was important: mainly certain members of the Roma community asked for his fact finding and good offices in conflict-settlement.

The law recognises the creation and operation of minorities' self-government in the sense of cultural autonomy, as the most important requirement for minorities to assert their rights. It thus enables minorities in the municipalities, the towns and the districts of the capital to establish their own municipal councils or to bring into being, whether directly or indirectly, self-government bodies with a local or a national remit.[13] Where the minority is unable to form a local minority council, its interest are represented by a local ombudsman (speaker).

Why was such an intricate and highly complex arrangement chosen? The four "manifestations" of the autonomy, namely municipal self-government,

[13] A municipal council may declare itself a minority council if 50%+1 of its representatives have been elected as candidates in respect of a national or ethnic minority. Where at least 30% of the members of a local assembly have been elected as candidates is respect of the same minority, these may form a local minority council consisting of at least 3 members. (If the population is below 1300, this body is constituted by 3 delegates. There are 5 in a municipality with a population of over 1300. In towns, there are 7 and 9 in towns which are county capitals and in districts of the national capital.) It is also possible to elect local self-government bodies directly by special local initiative. Elections of this kind were held on 11 December 1994 in conjunction with the municipal elections and were also held additionally at the end of 1995 by the decision of the government.

local self-government, the institution of the local ombudsman and the national self-government, differ in purpose.

Municipal self-government ("municipal minority council" in the law) is in fact an other title of a local self-government in the European sense of the word. This can be practised in municipalities, where most of the electorate belongs to a minority. The geographical distribution of minorities is however such that some would be incapable of forming a local self-government body since generally speaking this would presuppose that the bulk of the local electorate belongs to a national minority present only in some municipalities even in the case of the more numerous minorities. *Local minority self-government* ("local minority council" in the law), however, caters for situations where the linguistic minority constitutes a minority even in the locality; apparently this type of institution could become far more widespread. The law contains generally identical competences, regulated in the same paragraphs for both hypotheses.[14]

[14] § 26: (1) Municipal minority councils and local minority councils may, in matters affecting the situation of minorities, refer to the head of appropriate administration in order to: a) request information; b) submit proposals; c) request the application of certain measures; d) object to any practice or decision relating to the operation of institutions and violating minority rights, with a view to the modification or withdrawal of the decision in question.

(2) The head of the administration, in the cases defined in (1) above, must make a substantive reply to the appeal within 30 days.

(3) If the head of the administration appealed to does not have competence or authority with respect to the subjects of the appeal, he shall refer the appeal within 3 days to a competent body.

§ 27: Within their own sphere of competence and within the limits of the provisions made by the municipal council, the local minority council shall determine: a) its organisational and operational structure and its rules of procedure; b) its budget and final accounts and the use of resources allocated by the local council; c) the use of separate resources allocated to it from the resources of the municipal council in accordance with the provisions of the present law; d) the name, emblems and honours of minority council and the regulations on their conferment; e) the local holidays of the minorities it represents; f) in accordance with the regulations pertaining thereto, the list of its protected monuments, commemorative sites and the local rules for their protection.

(2) On the initiative of the minority council, the representative body forming the municipal council shall determine the resources and assets which it is required to provide for the use of the minority council, itemising the movable and immovable assets and the financial resources, so that the minority council may discharge the functions defined by law.

The *local ombudsman*[15] (speaker) is a special institution which operates when, despite the rules advocating positive discrimination, it has not been possible to elect even a local minority council.

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(3) Within its sphere of competence, the minority council may found and operate as far as its resources permit institutions in the following areas in particular: a) local public education; b) local press and electronic media; c) maintenance of traditions; d) culture.

(4) Within the framework and limits assigned to it, the minority council may: a) found and operate enterprises or other economic concerns; b) organise competitions; c) establish scholarships.

(5) If a decision by the municipal council is required in order to enable the minority council to exercise its rights, the representative body shall place on the agenda of its next meeting the minority council's request for the necessary decision. Where the decision is in the remit of another self-government body, the latter shall take a decision within 30 days following the submission of the request.

§ 28: The mayor's office, appointed by the municipal council, is required to render assistance in the proceedings of the local minority councils in accordance with its rules of procedure.

§ 29: (1) For the purpose of enacting local by-laws on local public education, local media, maintenance of traditions and local culture and use of the language associated with the minority population's status as a minority, the representative body of the municipal council shall obtain the consent of the local minority council representing the minority population.

(2) The consent of the local minority council is required for the appointment of heads of minority educational institutions and for decisions concerning the training of members of minorities. In the absence of a minority council, an opinion shall be given by the ombudsman for the minority or, in his absence, by the local association of the minority.

(3) Whichever authority holds the right of approval and the right of inspection shall notify its decision within 30 days after receiving the request or being apprised of its content. Thereafter, these rights shall be forfeited.

§ 30: (1) Municipal and local minority councils may maintain relations with any other minority organisation or association and conclude co-operation agreements with them.

(2) Minority organisations, institutions and associations may enter state competitions conducted in the fields of culture, education and science on equal terms with minority self-government bodies.

§ 46: (1) Municipal councils and local minority self-government bodies shall assist in assessing needs in respect of minority education and its organisation. (...)

§ 47: Local minority self-government bodies may not take over from another body the control of educational establishments unless the standard of education hitherto achieved can be maintained. The extent of state support to these establishments cannot be reduced after the transfer of responsibility.

[15] § 40: (...) the local minority ombudsman is authorised: a) inasmuch as he is not a member of the local council's representative body, to be present in an advisory

National self-government[16] (the "national minority council" in the law) is an elected body whose electors are persons working in the lower self-

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capacity at its meetings and those of all its committees, including closed sessions, dealing with questions concerning a minority; b) to propose to the mayor and to the committee chairman during council or committee meetings that a debate be held on any issue affecting the situation of minorities which comes within the remit of the council or committee; c) to initiate a review by the representative body of any decision by its committee concerning the situation of minorities; d) during meetings of the representative body or of its committee, to request information from the mayor, the clerk or the committee chairman on local government business of concern to minorities; e) to request from the mayor or the clerk such information and administrative co-operation as is necessary for the discharge of his duties; f) to request action by the mayor, the clerk or any official holding the appropriate responsibilities in matters affecting the minority as such; g) to propose that the representative body, in matters affecting a minority, turn to a state authority (...)

(2) Pursuant to the initiatives provided for in sub-section 1, paragraph (b), the mayor or the committee chairman shall submit the ombudsman's proposal to the next session of the representative body or the committee, which shall decide whether to place the issue on the agenda and what preparatory steps will be taken for its discussion.

(3) If the ombudsman requests information from the mayor, the clerk or the committee, a substantive reply must be furnished either during the session or in writing within 15 days thereafter.

(4) On the ombudsman's request, his statement shall be included in the minutes of the session or—if submitted in writing—appended thereto.

(5) Discussion of the issue which affects the situation of minorities and has been placed on the agenda following an initiative as provided in sub-section 1, paragraph (b) and in accordance with the provisions of sub-section 2, cannot be postponed or removed from the agenda except at the ombudsman's request.

(6) Before issuing any decree determining the rights and obligations of a minority, or before taking measures which generally influence the situation of minorities, the municipal council shall consult the ombudsman.

[16] § 37: The national minority councils, under the arrangements and within the limits established by law, shall decide independently on: a) seat, organisation and operation; b) budget, final account and property inventory; c) elements constituting its entire property; d) names and emblems; e) national holidays of the minorities which they represent; f) honours and conditions and rules for their conferment; g) principles and procedures for use of radio and television frequencies at their disposal; i) release press statements; j) foundation of institutions, their organisation and rules of procedure, upkeep and operation; k) foundation and operation of theatres; l) foundation and upkeep of museum or public collections constituted by collectors throughout the country; m) constitution of libraries for minorities; n) establishment and operation of an arts or science institute or a publishing company; o) maintenance of secondary and higher education establishments under national authority; p) provision and operation of a legal aid service; (....) r) discharge of other duties assigned to them by law.

government bodies. Certain minorities may unable to avail themselves of other forms of self-government than this national-level one, far want of a sound local basis. In this case, the election is vested in the hand of special caucus, composed of electoral representatives designated for this purpose by the scattered communities.

The powers vested in the different forms of self-government are fairly similar and essentially concern the fulfilment of minorities' educational, cultural and traditional needs. This is where the two classic expressions of autonomy are apparent: either true self-government or a co-decisional competence, implying a *de facto* veto right. In other areas, the right to consult the local or state governmental administration and the right to present them with initiatives (right of petition) are secured. The quality of the right of initiative is enhanced by the obligation of reply which is imposed on the body adressed.

Despite the complexity of the provisions, there is no duplication at local level because the three modialities described above are alternative institutions whose actuation essentially depends on two factors: firstly the specifics of the geographical distribution of linguistic minorities and secondly their political activism.

It was therefore expedient for the law to offer an array of instruments presenting a certain logical coherence and applying to the various minorities concerned while taking account of wide numerical differences. Subsidiarity, i.e. the devolution of powers, chiefly concerning matters of identity, education, schooling, culture and including the relevant budget, (alimented essentially

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§ 38: (1) The national council a) expresses its opinion on draft laws affecting the minorities it represents as such, including decrees by the general assemblies of counties and the capital; b) may request information from administrative bodies on matters concerning groups of minorities they represent, submit proposals to them, and call for measures to be taken in matters within their competence; c) co-operates with the relevant state bodies in the professional supervision of primary, secondary and higher education for the minorities it represents. (...)

(3) For the purposes of legislation on the maintenance of historical settlements, the consent of the national minority council—and the local minority self-government bodies in the case of legislation concerning them—is mandatory.

If there is no local minority council, it is the spokesperson, or failing that, the local minority association, which gives its consent.

(4) With the exception of higher education, the national council has the right of approval as regards preparation of the general syllabus for the education of minorities.

§ 39: Within its sphere of activity, the national council may organise competitions or establish scholarships.

from the Fund for National or Ethnic Minorities but the Parliament[17] also contribute to special programs) at every level where self-government operates. Electoral legitimacy bolsters the responsibility of the representatives of minorities and at the same time, confers the of choosing between the various forms of organisation upon those directly concerned. In this way, it is also hoped to guard against government patronage (clientelism).

The combined municipal and minority elections in 1994 and the minority elections in 1995 yielded the following results:

The minorities and the self-government bodies						
	Local minority		Minority		Local minority	
	self-gov't		village		self-gov't	
			(renamed as municipal			
	Directly	Indirectly	minority self-gov't)			
	elected	elected	Election		Election	
	11Dec 1994	11Dec 1994	11Dec 1994		19Nov 1995	Total
Bulgarian	2				2	4
Roma	415		1		61	477
Greek	2				4	6
Croat	35	1	15		6	57
Polish	2				5	7
German	98	7	19		38	162
Armenian	9				7	16
Romanian	9		1		1	11
Ruthenian	1					1
Serb	19					19
Slovak	28	4	6		13	51
Slovene	2		3		1	6
Total	622	12	45		138	817

[17] The Parliament authorized the Committee for Human and Minority Rights and Religious Affairs to pass the decision about the budgetary contribution to special programs.

What are the experiences of the seven year existence of this instrumental complex? The appreciation is globally positive. The following problems emerged during the practice: the very complicated way of the elections was criticized, but the greatest problem is the modesty of budget and the difficulty how to secure properly the control of the State Audit Office concerning the use of the state-subsidies. There is another (but for the time being only theoretical) problem: how to treat the eventual bad financial exercise in order to avoid "bankruptcy". The harmonization of the co-decisional competences should also be improved. It is interesting to see the two different main profils of the activities: the self-governments of the gipsy (Rom) community want to deal much more or essentially with social problems, establishment of special schools of special curricula, axed on the effective social rehabilitation, equality of chances etc. The government prepared a medium-term plan aiming to improve the Romas' position in the labour market with educational programs as well as with certain initiatives to help them to establish small agricultural and industrial enterprises. At the same time, the classic linguistic minorities (Germans, Slovaks, Croatians, Romanians, Serbes etc.) are concentrating on linguistic educational and cultural matters, institutions etc.

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I. B. 1. The Structure of Legal Systems

BÉLA POKOL*

The Structure of Legal System

(The Concept of Multi-Layered Legal System)

Abstract. In the study the legal system is conteptualized as a meaning system which contains the text layer, the layer of the legal dogmatics, the layer of judicial precedents and in some modern legal system the layer of the constitutional tights is added to these. The study outlines the connections among these layers of law comparing the continental legal systems rooted in the Roman law to the common law systems. With this concept of law the study analyses the history of legal theory and makes a typology of the tightening concepts of law which emphasize only one layer of the law. For example, for the French ecole de l'exégèse in the 19. century the law was only the text, for the German Bergiffs-jurisprudenz the law was the layer of the legal doctrines, or for the legal realists the law was the judge made law; and newly for Ronald Dworkin and his followers the law is identified as the layer of the constitutional rights first of all.

Keywords: legal system, legal theory, legal dogmatics, constitutionalization

If one decides to make a comparative analysis of the various modern legal systems, one will inevitably encounter the following phenomenon; namely, that the very same component which one finds in the legal systems of different countries is of varying importance; in certain countries it plays a major role, while in others it is much less important. Such a comparative study which examines components of several different countries will reach a far more comprehensive result than research which only focuses on a single legal system. Therefore, an attempt to create an overall legal concept will be more precise if it is based on a comparative study of the various legal systems of the present, and further compared with the opposing influential legal theories of the last centuries. The result of such a comparison will show that these legal theories restrict the actually existing multi-layered legal systems. This can be easily integrated into an overall theory of law, which is the aim of this brief study.

* Professor, Eötvös Loránd University, Budapest, H–1053 Budapest, Egyetem tér 1–3, Hungary.
Fax: (36 1) 266-5198; E-mail: pokolbela@axelero.hu

1. Restricting legal theories and multi-layered legal concepts

If one examines the development of the legal theories of the past two-hundred years, one observes the formulation of certain opposing legal concepts which identified law with phenomena that determined the rulings of court. Montesquieu's surprising statement, which declared that the judge is the mere mouthpiece of law, appeared in numerous tendencies of legal theory in the last two-hundred years. First, it was the French "école de l'exégèse" in the first half of the 19th century; later on it appeared in German legal theories by Julius Bergbohm and, some time later, by Hans Kelsen. Subsequently it made its appearance in the theories of the Soviets.

The legal concept which identified law with the text of the past decisions made by state bodies was opposed by the leading German legal concept of the 19th century, namely the pandectist jurisprudence, known under several designations, such as "Begriffsjurisprudenz" or "jurisdiction built on legal-doctrines", according to the terminology of its critics. This concept defined law as a "touched up", refined system of legal-terms. Its main representatives, Georg Puchta and Bernhard Windscheid, for instance, saw the determination of the judicial decisions through the hierarchical order of the legal terms, and when the first draft of the German BGB (civil code) was completed with the participation of Windschied in 1884, the practicing judges of the time labeled it a "monstrosity of jurists."[1] It is impossible to deal with everyday cases, with all their tiny divergences, if legislation is based upon an abstract system of legal terms—this was the opinion of the practicing judges.

This clarity of legal notions and the identification of law with the clear-cut system of legal terms appeared in the United States in the 1870's, almost contemporaneously with Windscheid's works, through the participation of Christopher Columbus Langdell, the dean of the Faculty of Law of Harvard University.[2] It remained the leading tendency of the American legal practice and influenced works on legal science for the next several decades. An opposing tendency emerged which defined law as the collection of all judicial decisions. In Germany, it was supported by the members of the so-

[1] Finkentscher, W.: *Methoden des Rechts.* (Band I.: Romanischer Rechtskreis; Band II. Anglo-amerikanischer Rechtskreis; Band III. Mitteleuropäischer Rechtskreis) Tübingen, 1975; Larenz, K.: *Methodenlehre der Rechtswissenschaft.* 4. Auflage. Berlin—New York, 1979.

[2] Duxbury, N.: The Theory and History of American Law and Politics. *Oxford Journal of Legal Studies.* 1991/4. 589–597.; Grey, Th. C.: Modern American Legal Thought. *Stanford Law Review.* 1996.

called School of Free Law, while in the United States its representatives were the exponents of the trend of "legal realism".

From time to time, although a few influential jurists appeared who endeavored to include the multiple layers of law in their legal concepts, although the authority of the ruling tendency always oppressed these random attempts. The authors of multi-layer legal concepts therefore abandoned their ideas, and they too adopted the mainstream direction. The German Carl Friedrich von Savigny can be mentioned, for instance, who, in his earlier works wrote about legal institutions and legal dogmatics which analyze them and formulate general rules. Later on, however, influenced by Georg Puchta himself, he also shifted his attention towards a legal concept built on legal terms in spite of being one of the main supporters of the idea of a school of legal history. Another example is Francois Gény who, at the end of the 19th century in France, opposed textual positivism propagated by the "école de l'exégèse", and emphasized the importance of the multiple components of law. In 1921 in the United States, Benjamin Cardozo emphasized the role of the multi-layered legal components in his book "The Nature of the Juridical Process".[3] Later on, however, he adopted the views of the legal realists, who emphasized the central role of the rulings of the court.

Thus, these theories define law as a "textual layer", "legal dogmatic layer", and "a layer of judge-made law", though it must be said that these theories only recognized one of the three layers as law at a time, and sometimes the coming into existence of one of these theories was in reaction to another.

Another layer of the law was emphasized by an emerging legal theory in the United States in the 1960's, which can be identified with the name of Ronald Dworkin.[4] This theory found the essence of law in the fundamental constitutional rights and basic constitutional principles. Dworkin's thesis was set out in his book "Taking Rights Seriously", though his legal theories are more clearly expressed if we paraphrase the title as "only basic rights should be taken seriously!". In the United States from the 1960's the extension of the judicial process based directly on the constitution led to the relegation of simple laws to the background while, in parallel, the doctrinal conceptual system of certain legal branches also lost its importance. These developments, which began in the United States, have emerged in several other countries in the past years, while in the U.S. they fell into the background.[5] The

[3] Cardozo, B. N.: *The Nature of Juridical Process.* New Haven, 1921.

[4] Dworkin, R.: *Taking Rights Seriously.* Cambridge, Mass. and London, 1977.

[5] Posner, R. A.: *The Problems of Jurisprudence.* Ann Arbor, 1990; Grey: Modern American Legal Thought. *op. cit.*

textual layer, the doctrinal layer, the layer of judge-made law and, above all, the layer of fundamental constitutional rights—these notions summarize the most influential legal theories of the last two-hundred years. How is one to create an overall theory, a multi-layered legal concept out of these opposing legal concepts?

2. The layers of the law

If one examines the development of the modern legal systems, a striking feature of its progressive tendency is that the rules of law tended to take the form of decisions of the sovereign power, and that judicial decisions had to be made according to the texts of the state power. Based on the medieval continental European jurisdictions, which already possessed collections of customary laws, the legal practice that can be always amended by the central state power was rapidly accomplished with the influence of the absolutist rulers of the 1600's.[6] Later on, with the sovereign power's growing democratisation and the development of parliamentarism, it was only the place of making the final decisions that shifted from the royal authority to the parliaments. With this progress, law became the collection of the decisions of the sovereign power, but it primarily became a collection of legislated texts in countries with a democratic political system. In England and in countries influenced by England's common law system, however, it was attenuated by allowing the high courts to create judge-made law.

With the adoption of a multi-party system and within the sphere of mass-media based on freedom of speech, the parliament became the culminating point of the society's political common will; so the law that appeared in legislative texts more or less depended on the will and majority opinions of society. The court decisions that depend on legislation fulfill society's self-governing nature: society itself decides when the judges apply these fixed laws in each individual case and dispute. Because law fundamentally appears in legislative texts and is a result of a democratic decision of the state power, it tends to express the empirical common will of society.

When textual positivism identifies law with legislative texts, it emphasizes an important aspect, but it also commits two fundamental mistakes. One of these concerns the following: in the complex and intricate social context, thousands and thousands of legal regulations have to be perpetually created

[6] Caenegem, R. C.: Das Recht im Mittelalter. In: *Entstehung und Wandel rechtlicher Traditionen* (hrsg.: Fikentscher, W. A.). München, 1980. 606–667.

if they are to be consistent. If this is not done properly, they may end up canceling each other's effects through contradictory content. It might be well imagined what sort of legal chaos would result on the level of judicial case-law. It is only a carefully prearranged system of legal concepts that can provide harmony amongst the many thousands of legal regulations. Furthermore, it is the unified application of these concepts in many legal rules that can maintain this intellectual systemic quality and consistency in a heightened form. Thus without a legal dogmatic layer, the layer of legal texts cannot function. Overlooking this fact is one of the errors of textual positivism.

The other source of error is the failure to take into account the openness of the legal regulations. It is very typical of code-like laws to use overall, rather general notions and regulations, which renders divergence possible in its application. This could result in several different judicial decisions in a country in similar or even identical cases, which would easily create legal chaos. Thus without a Supreme Courts' use of concretizing precedents, the imprecise legal regulations could not properly function.[7]

Textual positivism, a concept of law built on legal dogmatics and the concept of judge-made law can be integrated into a multi-layer legal concept, if their striving for absoluteness is set aside. The textual layer of law, that can function as a consistent intellectual organization due to its prearranged doctrinal conceptual system, is connected to a democratic political common will, and among the existence of many thousands of legal provisions, it keeps the functioning of law in consistent order. The openness of the regulations that the texts of laws, that are formed from a legal-dogmatic point of view, contain, are counterbalanced by the jurisdiction of the Supreme Courts. It is a jurisdiction built on precedent, and together with the doctrinally formed texts of laws, it renders a unified law for each country.

The importance and function of the aforementioned three layers of law can be easily observed in continental European legal systems, as well as those built on the common-law system, though in different proportions. It can be stated, that the more abstract the codified law gets in a legal system, the more inevitable it becomes to concretize the doctrinal categories, and to shape the judicial processes accordingly. Furthermore, the loose regulations that the codes contain have to be concretized and updated with the current judicial precedents. In contrast, the more specific and concrete the legislative provisions, the less necessary it becomes to have a doctrinal layer or a

[7] For the growing role of the precedents in the contemporary legal systems see *Interpreting Precedents. A Comparative Study* (ed.: MacCormick, N.—Summers, R. S.). Dartmouth, 1997.

concretizing body of judicial precedents. Accordingly, judicial precedent would instead function as a method of independent regulation, and not as a concretizing legal layer. The English legal system can be characterized as such a system, while the legislation of the United States started to shift in the last century towards that of the continental European countries' codified legal system and, compared to the English system, a stronger legal-dogmatic categorical system was established in certain fields of law.[8] However, among the continental European countries' legal systems, a visible difference can be observed concerning the importance of each of the three legal-layers; while in the German legal system and in the other continental legal systems influenced by it, the doctrinal layer is of high importance, it is much less so in the French legal system.

There is a divergence amongst the continental legal systems with regard to the development of the layer of judicial precedent. Although its significance seems to be increasing everywhere in the course of the last few decades, it is mostly in the Scandinavian countries and Germany where it is of marked importance, while in the southern-European countries and France it is still not so highly emphasized.[9] Among the post-socialist countries, it is in Hungary and Poland that a visible development can be observed concerning the importance of the aforementioned layer of judicial precedents.[10] Besides the mere textual layer of official regulations, the layers of doctrine and judicial precedent are also an essential part of the legal systems of these countries. In Hungary, the empirical statistics which analyze the rulings of the courts prove that the position taken by the Courts is based on the texts of law, as well as on the interpretations of certain doctrinal notions, together with the precedents of the Supreme Court which provide solutions for some of the legal dilemmas which were left unsolved by the former legal regulations.[11] The cooperation of these three layers of law is not recent; it can be observed in the legal history of the past centuries and, in some countries

[8] Dawson, J. P.: *The Oracles of the Law.* Ann Arbor: 1968.

[9] See Alexy, R.—Dreier, R.: Precedent in the Federal Republic of Germany. In: *Interpreting Precedents. A Comparative Study. op. cit.* 17–64.; La Torre, M.—Taruffo, M.: Precedent in Italy. In: *Interpreting Statutes. A Comparative Study. op. cit.* 141–188; Peczenik, A.—Bergholz, G.: Precedent in Sweden. In: *Interpreting Precedents. A Comparative Study. op. cit.* 293–314.

[10] Wróblevski, J.: Statutory Interpretation in Poland. In: *Interpreting Statutes. A Comparative Study* (ed.: MacCormick, N.—Summers, R. S.). Dartmouth, 1991. 257–310.

[11] See Pokol, B.: Statutory Interpretation and the Precedent in Hungary. *East European Quarterly.* 2000. No. 3. 162–177.; Pokol, B.: Rechtauslegung und höchstrichterlichen Prajudizien in Hungary. *Zeitshcrift für öffentliches Recht.* 2000 Heft 3.

where a Constitutional Court was established, it was even accompanied by a layer of constitutional rights. If we do not accept Ronald Dworkin's overemphasizing attitude on this field, and we attempt to integrate fundamental rights into an extensive legal concept, as a recently established legal layer, the following connections have to be emphasized.

As a starting point it has to be stressed that this recent legal layer may have a different impact on the three already existing layers within the legal systems of various countries. Wherever the new legal layer comes into being with the establishment of a Constitutional Court, it inevitably influences the creation of the textual layer. A judicial decision which is declared unconstitutional loses its validity—this is the sole influence of the layer of fundamental rights. Its other important influence is due to the procedure of considering the essential normative basis of the previous constitutional decisions before issuing new judicial decisions.

A third influence can be observed if the fundamental constitutional rights and their concretizing constitutional restrictions are included in each legal branch's doctrinal activity, and the doctrinal system of legal terms of the criminal law, family law, labour law, etc. is (also) altered according to the legal layer of fundamental rights. If this is accomplished, the new legal layer, besides its effect on the textual layer, will have an influence on the doctrinal layer as well.

Finally, a third influence is that of fundamental rights on certain court rulings; either through its inclusion in the analysis of judicial decisions—together with other evaluations, or through their exclusion—or relegating the relevant judicial decision itself to the background, and issuing a ruling based on fundamental constitutional rights. If the latter occurs—as it did in the United States during the period of the activist Warren Court in the 1960's and 1970's, then fundamental rights push all other legal layers into the background. In most legal systems which have constitutional courts, the layer of fundamental rights only influences the layer of the legal text, and jurists also form their "de lege ferenda" suggestions that consider fundamental rights according to the legislation and not with the aim of influencing the judicial decisions.

In this restricted solution the traditional cooperation of the three legal layers remains, and the fundamental constitutional rights only slightly modify its final outcome. Aspects of righteousness, and influences that have a short-term pacifying effect on the empirical common will, improve the functioning of the legal system.

If the aforementioned ideal arrangement is established, the layer of legal texts, together with the layer of legal dogmatics and that of judicial

precedents and fundamental constitutional rights together provide a unified legal system. This is the goal of the concept of a multi-layered legal system. Besides defining the ideal concept of law, it also points out the shortcomings of other legal concepts that strive for the absoluteness of one of the legal layers.

3. The implications of the concept of the multi-layered legal system

The broadening of the concept of law and the recognition of other legal layers engenders the necessity of reconsidering several legal phenomena. In the following, we shall examine a few of these.

(The definition of law) One of the first aims of the necessary reconsideration has to be to redefine what law itself means. In other words, if we include the doctrinal system as an inevitable part of the law then, accordingly, it has to be expressed within the definition of law itself.

There is another aspect in which law differs from non-legal norms. Namely, it produces an intellectual system, and after a certain stage of development this emphasizes the notions and categories that are used by legal norms from other notions of everyday-thinking. The only way to eliminate the (possible) inconsistencies that might occur among the many thousands of legal norms is to deliberately create specific legal terms, expressions and classifications, and then systematically use these when dealing with any legal norm in question. Contrary to this, other non-legal, social norms rely on notions that are used in everyday-life, and the solutions based on these notions do not constitute a unified intellectual system.

Taking all this into consideration, the definition of law can be given as the following: law is a system of norms and their terms that express regulations and prohibitions which, failing all else, is sustained by coercion of the state.

(Legal dogmatics as a barrier of legislation) The prearranged system of legal terms that the legal norms are based on also has an influence on the modifiable nature of certain legal norms. Namely, the modified norm has to fit the already existing unified intellectual system and, for instance, a new legal norm can not use a classification that would clash with the classifications used by the already existing legal norms. For example, in the criminal law of most of the modern legal systems, the intentional character is separated from negligence when judging culpability—or rather these concepts are divided into different degrees. If a new legal rule contained a new classification of guilt, regardless of the already existing ones, the numerous restrictions of the criminal code would simply collapse. To replace a legal norm with a new one is only possible if it is doctrinally verified.

The emphasis of this connection sheds a different light on the ability to modify legislation and the role of legal dogmatics which ensures the law's intellectual unity.

Often it is sufficient to include well-trained lawyers in the parliamentary apparatus and legislative committees in the ministries in order to verify the consequences of certain amendments. But if a more significant amendment or a new enactment of the legislature is at stake, the consideration of the doctrinal questions should be done by a specialized legal experts in the relevant field. This is especially so in the case of codified laws.

Inasmuch as the politicians in parliaments often amend and interfere with laws which rely on a prearranged notional system, or rather establish new codes, and this does not affect the fundamentals of the legal-dogmatics, we have to hypothetically assume that there has to be a transformational-mediator sphere in existence between the legislation and the legal dogmatic sphere, that somehow connects legislators following a political logic and the legal dogmatic sphere itself. In order to verify this hypothesis, the following things have to be taken into consideration: the methods of codification, the political intentions of the parties, or rather the professional organizations of legislation. As a result, *the outlines of a legal-political sphere* can be detected which, in some form or another, is present in every modern democracy, particularly in the case of the continental European countries.

On the one hand, this legal-political sphere exists as a part of the legal subsystem that is directed towards politics, and on the other hand, some institutions can be found as part of the political subsystem that are involved with issues of legislation. Ideally, these two elements of the legal-political organization adopt parts of the "de lege ferenda"-type restrictions in a two-step transformational process, and in the course of a selected borrowing the political side gradually tables bills which were originally formed as part of a doctrinal activity, according to the logic of politics (for instance the method of aspiring to maximize the number of votes).

The part of legal-politics that is established as a part of the legal subsystem, typically consists of bodies and assemblies of the various legal professions. The conferences, programs, membership-meetings and publications of these bodies mostly emphasize proposals about amendments that react to the recent social problems, and that were previously outlined and supervised from a doctrinal point of view and already published in some of the legal periodicals. Thus, a part of the numerous "de lege ferenda"-type propositions that the legal experts of universities and the members of the high courts etc. outlined only from a juridical point of view, become the object of a certain filtering process. As a result, those propositions will come to the

foreground that are the reactions on the current social problems. At the same time, non-topical propositions that concern academic-scientific issues only excite attention in scientific circles and are the subject-matter of the legal periodicals, without having any influence on the functioning legal sphere.

The other part of the legal-political sphere that is founded as part of politics, consists of the legal experts of the parties, the legal groups of the parliamentary party-factions, and of the groups of the jurists who are the members of the so-called "background-institutions" of the political parties, such as the political foundations and party-schools. Though the aspirations of the parties are mostly determined by the maximization of the votes (and due to this they try to include motions in the party's program that are likely to enhance the number of votes), the adequacy of the programs inquires aspirations that are more or less workable. On account of the latter reason, the legal experts of the parties can only choose from propositions concerning amendments that are adaptable from a legal-dogmatic point of view. Although it becomes very important method to start looking for such motions among the lot that would fit the interest of a certain party the best, or rather to look out for those that would be against their interest the most. The jurists of the parties mostly concentrate on those "de lege ferenda"-type regulative propositions that were already emphasized on the assemblies and conferences of the associations of the lawyers, and the social consequences of which were already stressed in relation to certain propositions. Thus with a double transformation—despite the pushing of the pure legal-dogmatic point of view into the background and emphasizing the logic of politics—those regulatory models will appear in legislation, that do not violate the intellectual coherence of law. The legal experts of parliamentary committees are continually on the watch for motions concerning amendments that would violate the established legal-dogmatic system.

It is only this legal-politic sphere that mediates between law and politics, that can assure the proper operation of legislation, and the intellectual systematic character of law.

(The expansion of the circle of legal sources) The inclusion of more legal layers into the concept of law requires the expansion of the circle of legal sources. As the multi-layer legal concept can be best observed in the legal systems of the continental European countries, let us look at their legal sources.

It is the state bodies that are in charge of the textual layer of law, and the sources of the textual layer are those forms of decision making, that contain the textual layer of law. The most characteristic of these are the forms of decision making in the case of parliamentary acts, the forms of decision

making of the governmental orders, the orders of the ministers, or rather the locally prevailing forms of decision making of the local authorities.

The first outcome of these forms of decision making is a series of open legal norms, that can only be accurately interpreted according to the legal-dogmatic categories that the norms contain. The reduction of the occurring disparate possibilities and the establishing of a more unified interpretation can be achieved with the consensus of the legal profession. The employment of the accepted legal opinion in legal case-decisions, and—due to juridic decisions that refer to these—also the legal-dogmatic works that express legal consensus, all contain characteristics of legal source. This is typical of Germany, for instance, where in the case of legal dilemmas that have to be decided by the Supreme Court, the judges often refer to works of certain jurists.[12] It is characteristic of numerous countries that when a decision has to be made about a legal dilemma, it is the commentaries of the law that they refer to, and not directly to the law as it applies to the case. According to this—although on a comparatively small scale—, some systematizing legal-dogmatic works may also serve as a kind of a legal source in certain legal systems.

The legal textual layer's regulations—even if it is amplified with the legal-dogmatic interpretations—still remain open, and the layer of the concretizing judicial precedents that supplements it and creates a further legal source, has to be perpetually observed by lawyers, if they want to know what they should expect in their cases. These judge-made laws, that gained considerable importance in the legal systems of the continental European countries, were mostly created by the Supreme Courts of the countries in question, and the forms of decision making of these judicial forums function as a legal source.

Finally, wherever a constitutional court is in existence, its concretizing decisions concerning fundamental constitutional rights and basic principles also serve as a legal source. These constitutional decisions have to be separated from the concretizing precedents that concern basic legal decisions, because the fundamental rights that these are based on are not systematized dogmatically, they are usually more abstract and compared to certain legal restrictions their openness is greater, or the fundamental rights contradict each other in some cases, respectively. This is one of the various reasons why, based on these, in the continental countries it is the constitutional court that decides in these cases, and their influence is reduced to

[12] Alexy, R.—Dreier, R.: Statutory Interpretation in the Federal Republic of Germany. *Interpreting Statutes. A Comparative Study.* (1991) *op. cit.*

legislation, furthermore, they do not directly affect the judicial decisions. Naturally, there are great differences between the degree of influence that they have on a countries' legislation , and apart from most of the countries where the impact of fundamental rights and the decisions of the constitutional court (that serve as the interpretations of them) is restricted to the role of controlling legislation, in Germany they also influence certain judicial decisions. In theory the judge, based upon the constitutional court decisions and the constitutional basic rights, could simply set aside the given judicial provisions that should be applied under those circumstances and directly refer to these in a constitutional case, as it was achieved in "the rights revolution" in the United States in the 1960's.[13] (However, this did not become customary in Europe. In other respects, if this is not established, then it can result in the falling of the other legal layers to the background, and furthermore, in the course of the re-politicization of the law it can lead to the corrosion of the predictable judicial decisions—as it could be seen as one of the consequences of the " rights revolution" in the United States.[14] The existence of these degrees show that the constitutional court-decisions would only be of full value as a legal source if they had direct influence on certain judicial decisions, though this only appears as an exception in the continental legal systems. In most places their impact is narrowed down to the control of legislation, therefore their function as a kind of a legal source is limited.

(Broadening the methods of statutory interpretation) Having included numerous other legal layers into the theory of law and the legal system, and the discovery of the determined relations between them, influences the ways of legal interpretation as well. Let us look at a few connections visible on this field.

The recognition of the importance of the textual layer of law brings forth the recognition of the primary importance of grammatical interpretation. It is the parliament, as the chosen representative of society's political common will, that is in charge of the proper interpretation and usage of the textual layer of jurisdiction, therefore to take the grammatical meaning of the text seriously is identical with taking the empirical common will seriously. The several ways of interpretations that rely on the other legal

[13] See Epp, Ch. R.: *The Rights Revolution.* Chicago and London, 1998.

[14] For the politization of the law in the United States; see Scheingold, S.: The Struggle to Politicize Legal Practice: A Case Study of Left-Activist Lawyering in Seattle. In: *Cause Lawyering. Political Commitments and Professional Responsibilities* (ed.: Austin, S.—Scheingold, S.). New York, 1998. 118–150.

layers can only advance as far as it does not contradict the clear grammatical meaning of the legal text.

The legal-dogmatic layer and the emphasis on the intellectually systematic character of law in the course of the functioning of legislation impels the employment of those ways of legal interpretation, that, beyond the grammatical meaning of the textual layer, help the judge in decision making in a given case. One of the possibilities is the interpretation based on the use of legal-logical maxims, that, starting from the text's perceivable meaning, but not encroaching it or using judicial autocracy, manages to control the judicial procedure. The so-called "argumentum a minore ad maius" (to reach more from the less by inference), and the "argumentum a maiore ad minus" (to reach the less from more), their collective designation is "argumentum a fortiori", or the "argumentum a contrario" (induction from opposites) etc. can control jurisdiction with the extrapolation of the text's perceivable meaning. In order to remedy a situation when a legal gap occurs, the judicial decision that relies upon analogies shall also end up leaning on the legal-dogmatic layer, as it constructs the verdict directly from the legal principles (this process is called legal analogy), or it transfers a legal provision that was created in a similar case, so to base the current regulation on the former example (the method of statutory analogy). As to the doctrinal interpretation, it implements the embedding of the notions found in the textual layer, therefore it binds the textual and the legal-dogmatic layer together, in relation to the current case.

The interpretation based upon precedents connects the textual legal layer with the layer of judicial precedents, and it specifies the open regulations, and therefore assures the nationwide unity of jurisdiction. Thus, this is of primary importance in the concept of the multi-layer legal system.

From the multi-layer legal system's point of view it can be qualified as dangerous, when in relation to a current case, the verdict relies on an interpretation that is based on such constitutional court decisions that concretize fundamental constitutional rights and basic principles. The American legal practice that carried this into effect is a proper example to show how this process "re-politicizes" law, and how it instigates to push the other legal layers—besides the layer of the fundamental rights—into the background.[15] The German legal practice is also liable to experience

[15] See MacCann, M.—Silverstein, H.: Rethinking Law's "Allurements": A Relational Analysis of Social Movement Lawyers in the United States. In: *Cause Lawyering. Political Commitments and Professional Responsibilities* (ed.: Austin, S.—Scheingold, S.). New York, 1998. 261–292; Scheingold S.: The Struggle to Politicize Legal Practice. *op. cit.*

such a shift, and the only reason why it has not yet shown such negative sings is because—despite having accepted the fundamental rights as directly prevailing through the German constitution—in practice they are rarely included into the current judicial procedures.

In Central Europe it was in Poland where, for only a few years, the Constitutional Court's legal interpretations were obligatory, that is, the judges were bound to take it into account. But the judicial opposition to the functioning of a re-politicized Constitutional Court led to its exclusion from the new constitution of 1997.[16] The Hungarian constitutional court—even on an international scale—has a very great competence, and it has a right to eliminate laws, though the Constitutional Court decisions do not directly influence judicial decisions. In fact there are some lawyers and smaller groups of legal experts who—based on the American pattern achieved by "the rights revolution"—support the introduction of the Constitutional Court's direct influence on judicial decisions, but this has not been put into practice yet.

Thus in order to conclude, the concept of the multi-layered legal system supports the idea of a law on a larger scale, accepting the parallel operation of several methods of legal interpretation at the same time, therefore it is against legal concepts that place a single legal layer into the center.

[16] Poplawska, E.: Constitutionalization of the Legal Order. *Polish Contemporary Law Quaerterly Review*. 1988. N° 1–4. 115–133.

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I. B. 1. The Structure of Legal Systems

CSABA VARGA*

Structure in Legal Systems:

Artificiality, Relativity, and Interdependency of Structuring Elements in a Practical (Hermeneutical) Context

Abstract. Does the legal system have a structure (according to sources and branches of law, general and special parts of codes, principles, rules and exceptions in regulation, etc.), or structuring is taken into it from the outside? And providing that it is taken, whoever is taking it? For neither principles, nor rules are given in themselves, separated from each other in a way classified in terms of the law's taxonomic systemicity as bearing their own separate meaning. All this can be but the result of a constitutive act. Based upon legal doctrines, it is judicial practice that builds different propositions into either principles or rules. Or, it is not logic itself that labels anything as a structuring element identified as either principle or rule but we, who ponder the mode of how to construct a sequence of distinction, deduction and justification conclusive enough to convince those controlling the issue we propose in the procedural hierarchy. Therefore the structuring features in law are construed and construing, constructed and constructing at the same time, for they do not and cannot exist in and by themselves at all.

Keywords: structure, division, legal system, principles and rules, legal doctrine, judicial practice, legal construct(ion)

The unquestionable hegemony of the idea of the positivity of law lasted until the third third of the 19th century on the European continent, all along the age of the exegetic application of statutory instruments, until the dawn of the movements of free law. Although re-codification was not effected in the second half of the 20th century—now disregarding the different direction of development taken by the socialist law—and the classical civil codes became gradually reduced, from their classical function of defining the law, to the increasingly passive role of being used as mere systemic *locus*-providers and *locus*-indicators of the direction and conceptuality taken by the judicial

* Scientific Adviser, Institute for Legal Studies of the Hungarian Academy of Sciences, Budapest, H–1014 Budapest, Országház u. 30.; Professor and Director of the Institute for Legal Philosophy at the Pázmány Péter Catholic University, Budapest, H–1428 Budapest 8, P. O. Box 6.
E-mail: varga@jak.ppke.hu

law development,[1] the legal doctrine has nevertheless successfully cut down the disintegration caused by the free law movement and maintained a positivistic domination for yet another century on the European continent. Though legal positivism was not shattered by the brief rebirth of natural law which took place after the Second World War (as a post-war German reaction to warmongering), finally, the way of posing questions in legal sociology in Europe (from the 1910s on, launched by *Eugen Ehrlich*), the American "realist" pragmatism (from the 1930s on, inspired mainly by *Roscoe Pound*), the transformation of the new English linguistic and logical analysis of law (from the 1960s on, initiated by *H. L. A. Hart*) into an American-type reconstruction of legal discourses (effective from the 1970s, represented by *Ronald Dworkin*), and, at last—as a stroke of grace—in Europe itself, the stabilisation of the so-called anti-formalist stand (formulated by *Michel Villey* and *Chaïm Perelman*) in the debate on law and logic and its progress into a reconstructive inquiry of legal processes, on the one hand, and the foundation of a continental theory of argumentation, cultivated almost as a substitute to legal dogmatics (mainly introduced by *Robert Alexy* and *Aulis Aarnio*), on the other—well, all these challenged the validity of unconditional adherence to legal positivism—even if exclusively in theoretical explanation—, moreover, made it outdated by the 1980s.[2] In brief, what had seemed, just a few decades ago, to be a demand (guided by wishful thinking) of the "decline" of legal positivism, is now rather anticipated by several visions—instead of a stigma of decay—as the image of a positive escape forwards, resulting from having been transcended as transformed into something new, in a way, however, accompanied by a reassuring continuity.[3]

Nevertheless, the theoretical dominance of legal positivism in its era had offered two possibilities: notably, the acceptance of the actual definition of

[1] Cf., from the author, *Codification as a Socio-historical Phenomenon.* Budapest, 1991, ch. V, para. 5, especially at 121.

[2] For an overview, cf., from the author, *Theory of the Judicial Process* The Establishment of Facts, Budapest, 1995, ch. I.

[3] For the decline, see, e.g., Villey, M.: 'Essor et décadence du volontarisme juridique' *Archives de Philosophie du Droit* 3: Le rôle de la volonté dans le Droit. Paris, 1958. As to continuity, it is characteristic that—only to take just one telling example—the editor of *Transformation de la culture juridique québécoise* dir. Bjarne Melkevik, Québec, 1998, Avant-propos, 7, had to leave his working hypothesis behind as unfounded. Albeit the sub-topic of the debate in question was heralded as „Est-ce la fin de l'hégémonie positiviste?", it does not feature any longer in the printed collection of the proceedings, as the workshop has proven just the antithesis, namely, „l'hégémonie positiviste ne touche nullement à sa fin au Québec, pas plus qu'en d'autres lieux".

the law by positive law in practical legal processes and the explanation of any kind of eventual difference as only an exceptional deviance, on the one hand, and taking the formal and official positivation of the law also as a theoretically descriptive conceptual criterion of legal phenomena, on the other. While the cutting back of the latter took place relatively soon as applied to the notion of juridicity itself,[4] moreover, the former was also cut back in a conclusive way (as mainly replaced by explanation within the framework of the processes of an overall autopoietic system),[5] paradoxically all this has not affected in nearly any respect the range of problems raised by "The Structure of Legal Systems".

In the field of continental civil law, it seemed to be a self-evident fact, not questioned by anybody until the recent decades, that the structure of legal systems consists partly of their visible *external division* (according to *branches* of the law and, inside any of them, according to its *formal sources*)—that is, their division into individual branches of the law, including the relevant provisions of the Constitution, the appropriate code(s) and law(s), the eventual decrees and orders designed to ensure their implementation, as well as the judicial guiding principles, decisions for the uniformity of jurisprudence, and the individual judgements—, and partly of the *internal (logical) self-division* of any legal (normative) regulation resulting from the axiomatic ideal of modern legislation, that is, the fact that regulation is mostly effected by

[4] As a programme and a realisation, cf., from the author, 'Quelques questions méthodologiques de la formation des concepts en sciences juridiques' [1970] *Archives de Philosophie du Droit* XVIII (Paris: Sirey 1973), para. 4, in particular at 223 et seq. [reprinted in his *Law and Philosophy* Selected Papers in Legal Theory (Budapest: Eötvös Lóránd University Project on "Comparative Legal Cultures" 1994), 7–33 {Philosophiae Iuris}].

[5] Cf., as a philosophy of language reconstruction, from the author, *Theory of the Judicial Process...* [1987], passim, and 'The Context of the Judicial Application of Norms' [1988] in *Prescriptive Formality and Normative Rationality in Modern Legal Systems* Festschrift for Robert S. Summers, ed. Werner Krawietz—Neil MacCormick—Georg Henrik von Wright, Berlin, 1994, 495–512. [reprinted as 'The Nature of the Judicial Application of Norms (Science- and Language-philosophical Considerations)' in his *Law and Philosophy*, 295–314], and, as a restatement characteristic of the critical legal studies, Conklin, W. A.: *The Phenomenology of Modern Legal Discourse* The Judicial Production and the Discourse of Suffering. Aldershot, 1998. xii + 258., respectively. It is to be noted that essays on the turn of the 19th and 20th centuries in Central Europe already explored such arguments for theoretical explanation. Cf., above all, Wurzel, K. G.: *Das juristische Denken,* Wien, 1904 [trans. Ernest Bruncken as 'Methods of Juridical Thinking' in *Science of Legal Method,* Boston, 1917 (reprint: New York, 1969), 286–428. (The Modern Legal Philosophy Series IX)].

general rules and particular dispositions in the *general,* as well as the *particular parts* of the law-code in question, on the one hand, and by established *principles*, main *rules* (disposing of the particular area of regulation), rules (breaking them further down in concretisation), *exceptions* (allowing concessions from these), as well as sub-exceptions (making additional concessions available with regard to their last specification), on the other. All this encountered no problems for a long time, because it was made visible exactly this way; however, also because a number of legal theories (including, of course, that of MARXISM) were trying to find (simplifyingly, viewing law as the reflection of something else, external to and outside of it, hence having to conform in features, structure, etc. to what it is a reflection of) a kind of correspondence between law and the spheres of (social) reality regulated by it, which is not merely instrumental and/or functional, but also epistemologically interpretable;[6] as well as because these theories took far too seriously the suggestion of all the positive law's staff on the exclusivity of established juristic methods in legal processes. This was the shift in codification from the casuistry to the axiomatic ideal, the transition from the *creative precedential induction* (method of comparing, assimilating and distinguishing those precedents, taking the individual cases for a starting point), to the *reproductive* and *mechanical, deductive rule-application* (starting out from the mass of provisions at various degrees of generality of the code, construed as constituents of one logical system, following the axiomatic ideal).[7]

What the DWORKINian theoretical challenge has made unambiguous is that there are principles in every system which are, as to their nature, not only different from the rules but, in fact, control the very policy of the

[6] Cf., e.g., Samu, M.: *A szocialista jogrendszer tagozódásának alapja* [The basis of divisions structuring the socialist legal system]. Budapest, 1964. 268., and, as its ontological criticism, from the present author, *The Place of Law in Lukács' World Concept,* Budapest, 1985 [reprint 1998], ch. 5, para. 3, especially at 123 et seq.

[7] Cf., from the author, *Lectures on the Paradigms of Legal Thinking,* Budapest, 1999, ch. 2, para. 1, 9 et seq. [Philosophiae Iuris]. See, also from the author, as the first critical formulation of its primitive idea, with his proposition to transcend it, 'A magatartási szabály és az objektív igazság kérdése' [Rule of behaviour and the question of objective truth, 1964] in *Útkeresés* Kísérletek — kéziratban [The Search for a Path: Early Essays in Manuscript]. Budapest, 2001, 4–18. [Jogfilozófiák] and, as applied to the paradigm of basis and superstructure in *Marx*ism, 'Autonomy and Instrumentality of Law in a Superstructural Perspective' [1985] *Acta Juridica Hungarica* 40 (1999) 3–4, 213–235.

applicability of rules and, thereby, also their actual practice.[8] Well, it is not by mere chance that, based upon this, it was in the United States of America, the flagship of politicised aspirations and expectations, that the practice known as constitutionalisation (subjecting any issue at will to get reduced to—for being inferred directly from—basic rights or constitutional values)[9] had evolved. In parallel with this, as a result of the compromise between the needs in changing life and the technical availabilities offered by the law's codification, after the Second World War the German style of legal dogmatics had, as its own construction developed from the practice based on general clauses, already definitely nourished a conception of law, defining it as a texture made up of principles and rules.[10]

However, as it can be told about the facts that they never get to the court by themselves, labelled and prepared for a syllogistic inference from the complex of facts and norms[11] (but only as the result of a *creative*—both *normative*[12] and *constructive*[13]—act of the judicial forum taking a decision),[14]

[8] Since the classical *topos* by Ronald M. Dworkin's 'The Model of Rules' *University of Chicago Law Review* 35 (1967), 14 et seq., his entire oeuvre seems to substantiate the underlying idea mostly in a constitutional context.

[9] For a dissent in a similarly politicised mirror, see Bork, R. H.: *Slouching towards Gomorrah* Modern Liberalism and American Decline. New York, 1997. xiv + 382. Also cf., from the present author, 'Önmagát felemelő ember? Korunk racionalizmusának dilemmái' [Man elevating himself? Dilemmas of rationalism in our age] in *Sodródó emberiség* Tanulmányok Várkonyi Nándor: Az ötödik ember című művéről [Human species drifting: On Várkonyi's The Fifth Man] Katalin Mezey ed. Budapest, 2000, 61–93, in particular at 71–76.

[10] Cf., above all, Alexy, R.: *Theorie der Grundrechte.* Baden-Baden, 1985, and, as built into a coherent theory, Pokol, B.: *The Concept of Law* The Multi-layered Legal System, Budapest, 2001, particularly ch. VIII, 90–106. For the overall debate, cf., e.g., Carl E. Schneider 'State-interest Analysis in Fourteenth Amendment »Privacy Law«: An Essay on the Constitutionalization of Social Issues' *Law and Contemporary Problems* 1988/1, 79–121; Epp, Ch. R.: *The Rights Revolution,* Chicago—London, 1988; Koch, H.: 'Constitutionalization of Legal Order', Copenhagen, 1998. [a paper presented at the XVth World Congress of Comparative Law, Bristol]; Poplawska, E.: 'Constitutionalization of the Legal Order' *Polish Contemporary Law* 1998/1–4, 115–133.

[11] "For court purposes, what the court thinks about the facts is all that matters. For actual events [...] happened in the past. They do not walk into the court." Jerome Frank *Courts on Trial* Myth and Reality in American Justice, Princeton, 1949, 15.

[12] See, e.g., most expressedly from Joachim Israel, 'Is a Non-normative Social Science Possible?' *Acta Sociologica* 15 (1972) 1, 69–87 and 'Stipulations and Construction in the Social Sciences' in *The Context of Social Psychology* A Critical Assessment, ed. J. Israel—H. Tajfel, London—New York, 1972, 123–211.

similarly, neither the principles nor the rules are given in themselves, separated as such from each other in a way classified according to the law's taxonomic systemicity as bearing their own, separate meaning. As is known, all this can only be the result of a creative act. Based upon the *doctrinal study of law*, which classifies the law's notions by transforming them into a legal system, it is the *judicial forum*, exercising its authority while undertaking its exclusive responsibility to decide, that builds different propositions into (or, properly speaking, uses them in its reasoning openly or implicitly as) either principles or rules, respectively. And, in parallel with this, it is their *posterior analytical reconstruction* that will also label them, interpreting the immense mass of normative regulations and reasonings used as just a raw material, as principles or rules.

Does the legal system itself have a structure, or is any structure taken into (or given to) it from the outside? And if it is taken, whoever is taking it? I think it would be absurd to give any kind of negative answer: how would it be possible to transplant any structure into something thought to be unstructured by itself? Or, for the sake of any reasonable answer, we have to hypothesise the legal system as being *structured* in itself. However, the questions "what is it?" and "what does it consist of?", "how is it divided and into what?" and "what is the meaning of this all and of any of its structured components?", as well as "what is the significance of its being structured?"—well, all these depend already upon the sense given (or, more precisely, attributed) to law.

Formerly, in a somewhat similar context, I had already presented the figure of three partially intersecting circles. This was intended to prove, as against the normativist message of legal positivism (claiming that by means of norms alone one can bring about a medium of own existence, capable of effective operation in social practice), that the criteria for the law set when it has been made positive do not necessarily imply more than sheer manifestations of an intention that existed at the time of positivation. Therefore, the concern of what the law has been intended to be (i.e., to signify and represent) by its drafter(s) when it has been promulgated (e.g., in legislation) is not necessarily identical with the one of what and how the law is being formed into—when re-asserted, adapted, or ceased practically to exist—in either its official "application" (e.g., in judicial practice) or its

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[13] See, e.g., most forcefully, Hans Kelsen *Reine Rechtslehre* Einleitung in die rechtswissenschaftliche Problematik, Leipzig—Wien, 1934.

[14] Cf., from the author, *Theory of the Judicial Process*, passim.

actual community practice respecting the unofficial and spontaneous, popular ways of customary proceeding as legal.[15]

Well, we can apply again the aforementioned figure (implying the practice of hermeneutical communities, giving and exchanging meanings) as reflected to the issue of the internal structuring of the legal system itself, by placing the intersecting circles into a circle partly closed. [Figure] The reason for this is that the legislator may influence the decision to be taken by the legal and/or the social community on what is what amongst the possible structuring components of the legal system and also on what kind of one-sided or symmetrical connection is being implied by each of these in what type of horizontal or vertical context. However, we also have to bear in mind that, according to the nature of things, any creature of the legislator can exclusively become productive in the hands and through the understandings of its addressees as clients—as operated by its professional official administrator and/or the practice of non-professionals—by their standardising pattern which, as conventionalisingly re-asserted, may become organised as and integrated into social tradition. There is one considerable difference from the instance invoked above, relating to the theoretical understanding of facts, notwithstanding. Namely, the entirety of processes and interactions in question is mediated through and within the bounds of a *legal doctrine*, that is, by the conceptual sets and contexts of its prevailing *dogmatics*, constantly refined by both practitioners and prudents of the law, i.e., by a dogmatics that albeit mostly lacks officially established and formal qualities, yet exerts, by means of professional socialisation, a practically exclusive impact upon how the law, as explored and solidified in its internal system, is actually understood and practised. And no need to say that the more the legal processes (legislation and administration of justice) are practised and controlled by the *legal profession*, the more the *doctrinal* representation and mediation of the law prevails.

In consequence, it is not logic itself that labels anything as a structuring element identified either as a principle or as a rule, but we, who ponder, as the only possibility, always based upon the more or less successful comprehension of such a doctrine, projected through its re-consideration and reconstructive re-interpretation onto our given question, the mode of how to construct a sequence *of distinguishing, deduction* and *justification*,

[15] Cf., from the author, 'Anthropological Jurisprudence? Leopold Pospíšil and the Comparative Study of Legal Cultures' [1985] in *Law in East and West* ed. Institute of Comparative Law of the Waseda University, Tokyo, 1988, especially at 271–272 [reprinted in his *Law and Philosophy*, 437–457].

which seems to be utilisable and conclusive enough to convince those who control the issue we propose, in the procedural hierarchy. In doing so, we start from a practically optional formulation of normative language and reasoning (or from any expressions or even fragments of these), and within the boundaries of the internal 'rules of the [legal] game' (of how to proceed in identification, argumentation and induction/deduction, etc.) as established and re-confirmed by the legal profession in practice.

Of course, in practice all this appears as dynamism, and not as chaos; as openness to new issues, but by no means unforeseeability lacking any perspective. This assumes creative and constructive co-operation with normative force on behalf of all actors and, at the same time, also a community game processualised in formal sequences, as controlled in multiple ways many times; in which although equal chances are granted to everyone in principle, and anyone may innovate or deviate from earlier rules, yet anybody doing so not only has to give motives and justification for this, but also to derive this as inevitably resulting (even if not perceived and not practised by anybody so far) from the normative order which is continuously claimed to have remained untouched as a whole, and thereby again re-established and re-asserted (that is, re-conventionalised) in its overall arrangement.[16]

In a final conclusion, notwithstanding, in the long run and in their practical continuity, both the structuralisation of the legal system and the considerable stability of the way it is made up can be taken as granted. As opposed to the obvious architectural analogy in this case, our edifice is not built into one single construction by assembling components originating from different sources and made up of different elements—in architecture: bricks, mortar and plaster. On the contrary, we build and live the lawyer's

[16] All this recalls the obvious parallel with the challenge of *Euclid*'s geometry by *Bolyai* and *Lobachevsky*. "From an external point of view [...] the creation of »another new world« is manifest in the choice between equally eligible incidentalities and the presentation of the selected variant as perfect and logically necessary. [...] This concerns conceptualisation, namely the fact that conceptual systems, be they as perfect as possible from an internal point of view or had they the most convincing explanatory force when describing the external world, can merely be regarded as mental experiments. They are nothing but games, which we make use of *faute de mieux*." Varga *Lectures*, 38.

It is to be noted, however, that legal systems achieving a mature and balanced state are characterised exactly by the conscious institutionalisation of the ability of challenging the system from within the system (as an own judicial solution on account of gaps in the law unfillable otherwise, pursuant to, e.g., overruling precedents in England or § 1 (2) of the Swiss *Zivilgesetzbuch*), however, due to the self-disciplining force of the system, this does not proliferate in practice, being resorted to as a corrective measure only in the last resort.

profession using the only one material at our disposal, notably, language, in which words are selected to refer to concepts so that the suitable series of intellectual (logical) operations can be performed.[17] Well, the question of which word stands in the place of what (the role it will be used in and what it will refer to in the given hermeneutical situation) depends, in addition to the language use socialised and conventionalised,[18] in a direct sense exclusively on those who perform the intellectual (logical) operation in question. And the person concerned is involved as a hermeneutical actor in the given circles of communication, on the one hand, and, at the same time, is also an actor of some sociological situation, on the other, who, in average cases, will act in the way he is expected to, not exceeding the justifiable boundaries of his professional socialisation(s).

It can be established, therefore, that in our human world one acts amongst and as confronted with a huge number of various *donnés* crystallised in conventionalised (and continuously re-conventionalising) tradition, that is, *donnés* that never stand by themselves as they are never freed from their humanly given meaning. Time after time *construits* are being generated out of these, for and to the benefit of man performing an action, which are going to be transmitted to his fellows and to the posterity, only to become a tradition which, in its turn, will be further handed down again merely in its quality as a *donné*.[19] Well, if we inquire, in an ontological sense, about the continuity and practicality of these and the safety of their meaningful transmission, we can confirm that, throughout the historical process of conventionalisations, a kind of "tendential unity"[20] can always be safely recognised—both in the sense of the actuality of their functional correspondence to the overall social practice and of the reliability of their materialisation through speech acts.

All in all, my report has intended to present, as a basis, the elementary component of the idea underlying the questions set forth above, namely, the apparent paradox traceable in it, according to which structuring features in law are, in their massive incidence, construed/constructed and construing/constructing at the same time, for they do not and cannot exist in and by themselves at all.

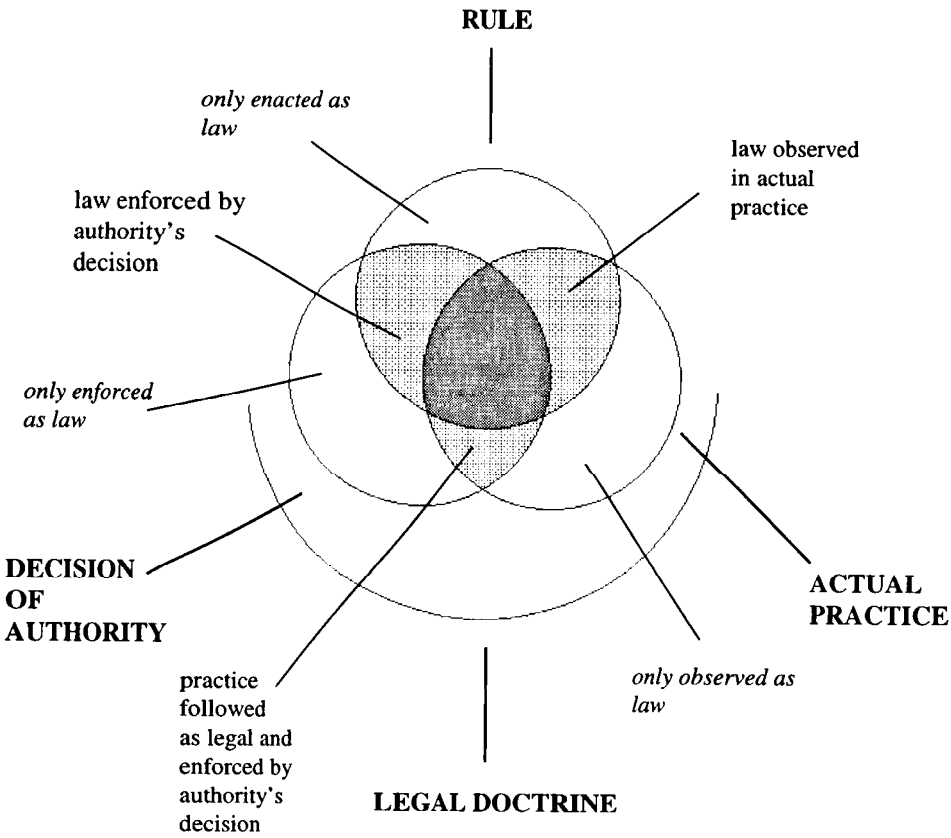
[17] For the stand of logic and conceptuality in human thinking, cf., from the author, 'Az ellentmondás természete' [The nature of contradiction, 1989] in his *Útkeresés*, 138–139.

[18] Cf., e.g., Ost, F. : 'Le code et le dictionnaire: Acceptabilité linguistique et validité juridique' *Sociologie et sociétés* XVIII (avril 1986) 1, 59–75.

[19] For the expression of *François Gény,* cf. Varga *Lectures*, 4.

[20] For the expression of *Georg Lukács*, cf. Varga *The Place of Law*, *ibidem.*

[Figure]


RULE
only enacted as law
law observed in actual practice
law enforced by authority's decision
only enforced as law
DECISION OF AUTHORITY
ACTUAL PRACTICE
practice followed as legal and enforced by authority's decision
only observed as law
LEGAL DOCTRINE

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I. C. Teaching of Comparative Law and Comparative Law Teaching

ZOLTÁN PÉTERI*

Teaching of Comparative Law and Comparative Law Teaching

Abstract. In the author's view a dividing line can be drawn between, on the one hand, teaching comparative law as an independent discipline with its own history, methods, goals and functions, and the whole "curriculum" of legal studies based on a comparative attitude and carried out with the comparative method, on the other. The differences between the traditions and present-day practice of universities and law faculties in the Civil Law and the Common Law countries in this field may be interpreted as characteristic for the "style" of the entire legal systems belonging to one of these two big legal families.

Keywords: comparative law, legal education

Legal education has played an important role in the life of peoples for centuries as—according to an apt remark—it informs us about something substantial in regard to legal systems and the societies in which they operate. Legal education "provides a window on the legal system. Here one sees the expression of basic attitudes about the law: what law is, what lawyers do, how the system operates or how it should operate. Through legal education the legal culture is transferred from generation to generation. Legal education allows us to glimpse the future of the society."[1] Thus, the topic that is on the agenda of the Congress of 2002 in Brisbane on the basis of the decision of the International Academy of Comparative Law deservedly commands the interest of the comparatists as the issue of the development or the comprehensive reform of legal education is on the agenda in not one or two countries but all over the world. This is true even if there are substantial differences in understanding the objectives and the methods of legal

* Scientific Adviser, Institute for Legal Sciences of the Hungarian Academy of Sciences; Professor, Pázmány Péter Catholic University, Budapest, H–1088 Budapest, Szentkirályi u. 28–30. Hungary.
E-mail: peteri@jog.mta.hu

[1] Merryman, John Henry: Legal Education There and Here: A Comparison. Stanford Law Review, Vol. 27., No. 3. (1975) 859.

education as well as in respect to organizing and financing it, and not only between particular countries but the traditions and present practices of whole legal families. So we can hardly speak about a uniform system or a universal paradigm of legal education.

The ongoing tendencies of globalization today set new and new challenges for the development of law and jurisprudence, and comparative law either in national or in international framework cannot be reserved from those challenges. While on the first International Congress of Comparative Law (Paris, 1900) ideas concerning the establishment of a future world law were presented as mere hopes, nowadays—after many earlier failures and disappointments—new and new substantial efforts have been devoted to the unification or, at least, the harmonization of law. In a growing number of countries, the activity of comparative lawyers provides the basis and the starting point for a legislation enacting legal rules that promote the accordance of domestic law with other legal systems or with a more general, widely accepted model. On the field of comparative jurisprudence, we witness a growing number of efforts that aim at clarifying the theoretical basis for the international unification and harmonization of law. As a consequence of this, comparative law shows signs of transformation: according to a summarizing evaluation, it is on the way to becoming basically "international" as opposed to remaining "national". Comparative method that earlier served basically the development and the reform of the domestic legal system, and was applied in the traditional framework of domestic law, now adopts itself to the needs of the new tendencies aiming at the "globalization" of the law with a more comprehensive objective. Even legal thinking—mirroring these efforts—is directed towards the establishment of a universal jurisprudence that centres around a comparative approach and that encourages its representatives to apply new methods, to raise new questions, to assert new points of criticism preparing us to the formulation of a new paradigm of comparative jurisprudence. Thus, it is fully justified to include a topic in the programme of the 16th International Congress of Comparative Law that makes us conscious about the new challenges originating from the objective of the international unification and harmonization of law also in the field of legal education. Legal education situated in a human society going through continuous and profound changes cannot remain intact from the effects of these new challenges. Thus, if we repeatedly raise the issue of what, why, and how we teach it is to be taken as an "evergreen" question even if the efforts of reform—mainly in countries inclined to respecting their traditions—rarely meet the "official" concepts of governments.

Inquiries in this field fit into the framework of comprehensive initiatives that can be witnessed all over the world even with the aim of bringing the

teaching of comparative law to a new, higher level. The recognition that the knowledge of foreign laws plays an indispensable role in solving the problems raised by the ongoing globalization process has taken root both among the representatives of jurisprudence and legal practice. By now, not only the narrow, positivist-normativist view of law and the approach to solving legal problems on this basis that indisputably dominated the 19th century has been outdated for good, but also the "national" character of law and jurisprudence. Consequently, legal education can hardly limit itself to the teaching of domestic law (statutes, legal practice, jurisprudence) as issues raised on an international scale and situated in the framework of globalization require a supranational approach on an international level. Thus, the requirement that lawyers of the future are to be provided an education adapted to the needs of the modern world seems wholly justified. Of course, apart from raising repeatedly the issues of teaching comparative law, it involves in general the issues of law teaching and, possibly, a new approach to it as well.

The changes of the world set an increased challenge to the teachers of comparative law just and now, us age-old traditions of teaching the law will, by all probabilities, suit to the new demands. We have to find and use the methods mainly by ourselves on a relatively new, hardly more than a hundred years old field of research. The achievements of the international movement that unfolded in under the slogan of "droit comparé" or "comparative law" cannot overshadow the fact that—partly owing to the terminology regarded by many as misleading or, at least, unclear—we have to face several questions still to be clarified here. Here, the "common denominator" could be the fact that the comparative law movement gradually expanding to the whole world includes all of those who take the comparative analysis of law and the application of the comparative method to legal phenomena as their task. The "communis opinio doctorum" that—at least in its broad outline—can provide the guideline for a legal education that preserves the valuable achievements of the past but takes into account the needs of the new world can be established only with their contribution. It can be hardly contested that putting down this topic in the agenda was a useful initiative even in respect to promoting the international exchange of ideas and experiences.

2. Right for the sake of the success of this endeavour and to avoid the "dialogue of the deaf", it seems necessary to formulate some preliminary observations in regard to our topic. During the preliminary work following the earlier traditions and preceding the implementation of the general and the national reports to be submitted to the Congress, it became clear that the terminological vagueness concerning the concept of comparative law

(droit comparé), recognized and rightly criticised by many distinguished comparatists,[2] manifested itself even in the I.C. topic of the International Congress of Comparative Law. For the topic—as it was pointed out by the general reporter of the topic in his notice addressed to the national reporters—includes not one but two topics, although it is hard to draw a clear dividing line between them. The dividing line is seen by the general reporter as follows: the first topic deals with the actual teaching of comparative law in universities and in comparative law institutes, while the second deals with the impact of current global development on the teaching of comparative law.[3]

One can hardly agree with drawing the dividing line this way. As this dividing line—as it stands out clearly from the French title (l'enseignement du droit comparé et l'enseignement comparatif du droit) as opposed to the rather aphoristic English one (Teaching of Comparative Law and Comparative Law Teaching)—is supposed to indicate the indisputable difference between teaching in the universities a study or a discipline having become independent under the name of "comparative law" or "droit comparé" on the one hand, and the transformation or the reform of the whole legal education in the spirit of comparativism, on the other. So one aspect of the topic centres around the (partly taxonomic, partly educational-political) issue whether there is anything like an independent discipline called comparative law (droit comparé) and whether it can be taught anyway, while the other aspect concentrates our attention to the question of how one could make legal education in the universities "comparative" in its character, how one could turn its "national" attitude into a "supra-national" one.

It can hardly be disputed that different understandings make it hard or even impossible for the general report to achieve the rightly expected synthesis of the national reports. For if we examine the topic only from a "technical" aspect, i.e. from the aspect of the methods applied in teaching comparative law considered as an independent discipline—as it is suggested by the general reporter—it necessarily pushes into the background—in our view—more important issue concerning the ways we could renew the whole legal education in a comparative, supra-national spirit based upon the recognized needs of our time. This aspiration—as it is indicated in the distinction between "Teaching of Comparative Law" and "Comparative Law Teaching"—concerns the "substantial" aspect of the problem well beyond the methodological one. Thus, it presupposes the rethinking of the basic issue of the whole legal

[2] As to the concept, it was characterized as "strange" (Gutteridge), "unfortunate" (David) or "misleading".

[3] Moens, G. A.: Note to National Reporters on Comparative Law Teaching. 1–2.

education, of the considerations concerning the objectives of the whole "curriculum" of the law faculties well beyond the mere "technical" issues of education—in fact, mainly as opposed to them. If we remain faithful to our starting point which takes the issue of raising and answering the questions of "what?", "why?", and "how?" as a permanently current task, we can hardly reach any other conclusion but an examination of this topic of the Congress that expands to these substantial issues.

Yet, the difference in understanding the topic between the general reporter and ourselves raises—in our view—no inextricable difficulty. For according to the information gained from the general reporter, the questionnaire prepared by him and containing points preferred by him merely provides guidelines for national reporters. This allows us to follow the interpretation that we find adequate in formulating the national report. So we sum up our views not only concerning the methodological issues of the teaching of comparative law (droit comparé) considered as an independent discipline but also in respect to its renewal in comparative spirit—touching upon the basic objectives of legal education.

II.

3. The application of the comparative method in the 19th century—as it is well known—yielded remarkable results in many fields of scientific study. Although in this respect the study of law showed signs of backwardness not only compared to natural sciences but the study of language as well, the application of the comparative method proved to be a useful analytic tool; and not only in supporting the legal practice but also in the study of law as well. As a consequence of this, the opinion that comparative law (droit comparé) is not only the application of the comparative method on the world of law but also an integrated system of knowledge that can legitimately claim to be ranked as an independent discipline named the science of comparative law was put forward.[4] It is also well known that listing the arguments supporting or refuting the claims concerning the nature of comparative law as being a method or a discipline became a favoured topic in the relevant literature.[5] Although by this time these disputes have

[4] This claim is best expressed by the German term "vergleichende Rechtslehre".

[5] These disputes intensified especially in connection with the appearance and spreading of socialist law and jurisprudence, and often led to the denial of the comparability of legal systems belonging to contrasting social formations.

lost their earlier, often passionate or even personal intonation, the question whether the application of the comparative method as a kind of "panacea" on legal phenomena can bring new scientific findings unattainable by other methods remained current. Thus, the question is whether the comparative activity is characterised by specific criteria that, based upon the peculiarities of the subject and the method, may qualify it as an independent kind of knowledge, viz. an independent discipline. And, if the answer goes in the positive, where one could find the place of this "comparative jurisprudence" in the system of the legal sciences.

Answers to the questions formulated above were given in the 19th century in the English- and the German-speaking world within the framework of the comparative and historical inquiries into ancient law. The primary objective of these inquiries—as it is well known—was to reveal the so called objective laws of development taken as valid (also) in the world of law, or rather—following the pattern of the Darwinian theory of evolution—to extend the scope of these laws of development to social phenomena. Based upon the inquiries into the so called primitive human communities including "ancient law", Henry Maine could formulate his theory that interpreted the development of society as a progress from "status" to "contracts".[6] It can be taken as a result of the impregnatory effect of the points raised by him that a "comparative" as well as "historical" jurisprudence emerged. First in Germany and later all over Europe, those results also led to the establishment of another discipline—both comparative and historical—under the name of legal ethnology.[7] So Maine's works created a new and lasting link between law, history and anthropology.[8] As a result of his works, the comparative method became a distinguished tool for legal studies. Even Maine himself considered that his inquiries radically turned away from the schools that dominated jurisprudence at the time. Maine saw the difference, or even the conflict between analytically and dogmatically oriented comparative law and his new comparative and historical jurisprudence manifested in the fact that whereas the inquiries of the latter concern the historical process or—using a more current term—the dynamics of law, the so-called comparative law analyzes the law given at a certain point of time, namely the static of law. Of course, that excluded the point taken also by Maine

[6] Sumner, M. H.: *Ancient Law: Its Connection with the Early History of Society and Its Relation to Modern Ideas*. London, 1861, 170–175.

[7] Post, A. H.: *Grundriss der ethnologischen Jurisprudenz*. Oldenburg-Leipzig, 1894–1895.

[8] Pollock, F.: *Oxford Lectures and Other Discourses*. London, 1890, 159.

and his followers as the supreme criterion of scientific quality: the search for the objective laws of development. Thus, comparative law as an application of the comparative method to the legal phenomena of a given period could play only a secondary, supporting role compared to the real science of law, to a jurisprudence historical and comparative in character. This way, in a sense, Maine transcended the standpoint of analytical-dogmatical jurisprudence concerning comparative law. While comparative law—as opposed to the properly so called jurisprudence—could mean only a method for the analytical-dogmatical conception, for Maine, this contraposition manifested itself in the opposition on the one hand of comparative law not worthy of being regarded as an independent discipline and the "real", historical and comparative jurisprudence centring around the idea of development, on the other. This way, Maine opened a way to recognize comparative law as a science.

Undoubtedly, it was F. Pollock, Maine's disciple and successor in his scientific efforts who played the decisive role in synthesizing science and comparative law. Already in his inauguration lecture in Oxford, he took an oath continuing the work of his predecessor by pointing out that the theory of development is nothing but historical method applied to the facts of nature and the historical method is the theory of development applied to human societies and institutions.[9] Connecting comparative and historical research is not only natural and desirable but necessary as well in the field of jurisprudence. The task is not to confront the "static" point of view of comparative law with the "dynamic" approach but to apply in the world of law the two methods—namely the historical and the comparative—jointly, in a mutually complementary way. Jurisprudence itself must be both historical and comparative.[10] Thus, comparative law plays not a "secondary" or "supporting" role: both historical and comparative jurisprudence has an independent place in the system of legal sciences.

4. As opposed to this conception, an alternative way of establishing the scientific nature of comparative law was formulated on the first International Congress of Comparative Law (Paris, 1900). The new approach put forward on the Congress (by E. Lambert) claimed scientific independence for

[9] Pollock, F.: English Opportunities in Historical and Comparative Jurisprudence. Oxford Inaugural Lecture, 1883. In: *Oxford Lectures and Other Discourses.* London, 1890. 45.

[10] Pollock, F.: The History of Comparative Jurisprudence. *Journal of the Society of Comparative Legislation.* New Series, vol. V., 1903. 914.

comparative law from the aspect of positive law or the disciplines of positive law that are more receptive to the needs of legal practice. Instead of searching for the objective laws of development of society and law, this approach put a practical objective in the centre: the promotion of the convergence of national legal systems by way of revealing the common basis (fonds commun) of legal institutions and legal concepts. The concept was underlined by Lambert with a historical analogy: just like before when, in an earlier phase of the development of European law, the integration of French and German local customs resulted in a "droit commun coutumier" and the "Deutsches Privatrecht" which could provide the basis for codification as a kind of "common law", we, in a new phase of development based on the particular codified legal systems[11] might or rather must establish a "common legislative law" (droit commun législatif) The function of comparative law (droit comparé) lies in the promotion of this process: comparing the positive law of nations that are on the same level of civilization might reveal the common features of the measures chosen in particular legal systems on the one hand, and the removable differences originating from the contingencies of historical development and not from the political or moral "attitude" of the given nation on the other. This is exactly the long-term objective of comparative law (droit comparé).

Lambert's new conception concerning the nature and the objectives of comparative law that was put forward on the Congress of Paris did not give up entirely the results of the earlier, historical-comparative research. By the term "droit comparé" he exerted a dual classification. He distinguished comparative law based on historical and ethnological research and serving exclusively scientific and speculative objectives, searching for the universal laws of the life and providing an independent branch of social sciences on the one hand, and another positive branch of legal sciences on the other concentrating its inquiries on the common elements of legislation in particular states or rather the civilised nations taken as a "common legislative law". This line of argumentation formulated in his report addressed to the Congress was later rectified by Lambert: he distinguished two independent disciplines that are relative to each other only in the application of the comparative method within the framework of the science named "droit comparé". One forms a part of legal sociology under the name "comparative history" (histoire comparative) and searches for the causal relations and

[11] Lambert, É.: Rapport général au Congrès International de Droit Comparé tenu à Paris du 31 juillet au 4 août 1900. In: *Procès-verbaux des Séances et Documents.* Tome premier. 32.

regularities of legal phenomena, while the other discipline, under the name "comparative legislation", deals with the common elements of legal ideas and institutions, and, as a tool of lawmaking and the application of law, serves practical action.[12]

Today, one can definitely point out that the historical way of modern comparative law was determined by the latter meaning both in respect to the theoretical issues and the practical tasks. This latter meaning can provide the starting point in determining the place of comparative law as an independent discipline in legal education.

III.

5. The place and the role of comparative law in legal education is determined by two points. On the one hand, it functions as an invaluable tool of extending the general legal culture and the lawyer's erudition. On the other, it mediates a kind of knowledge indispensable for practicing any legal profession. The joint and co-ordinate assertion of the two points—as it is well known—takes place in differing ways in different countries and even in different universities. The reasons for these differences are often connected to basic conceptional differences concerning the objectives of legal education.

The priority of one conception that appears in many universities of Europe as a continuation of the common tradition of universities dating back to the middle ages is not to train "technicians of law" in the narrow sense of the term: on the contrary it seeks to provide a comprehensive general education that includes legal culture.[13] It mediates a kind of universal knowledge beyond "professional" skills. It strives to educate lawyers who are able to recognize problems raised by the practice of their profession in their depth and social context, who are able to be aware of their responsibility and, by asserting a scale of values acquired and strengthened during their studies, to serve the cause of social progress. This might explain why certain subjects appearing in the curriculum do not have an obvious, immediate practical value, and prove their merit only in the long run (legal history, theory of law, philosophy of law, etc.). One can add to this list some social sciences

[12] Lambert, É.: *La fonction du droit civil comparé.* Paris, 914.

[13] David R.: Le droit comparé—enseignement du culture générale. Rapport presenté à la Conférence Commune du Comité International de Droit Comparé at the l'International Bar Association (juillet 1950). In: *Rechtsvergleichung.* Hrsg.: von K. Zweigert und H.–J. Puttfarken. Darmstadt, 1978. 206.

(economics, sociology, political science) the teaching of with seems to be necessary to understand the social environment of law. In a sense, this paradigm of education—that is characteristic mainly for the universities of the countries of the "civil law"—can be depicted as "non-professional" or "non-technical" for it is in many respects "philosophical" or, at least, "abstract" in nature. It concentrates not on the solution of "concrete" legal issues that are of primary importance for the legal practice, and not on the functioning of legal institutions, but on the clarification of the theoretical issues of law, on the establishment of the theory or the science of positive law. Of course, this does not exclude that one can put an emphasis on the social role of law as an instrument of human coexistence: it takes it as a starting point that this role can be better fulfilled with keeping an eye on universal contexts. Such an attitude—also naturally—presupposes an understanding of the nature of law that goes beyond the traditional positivist view of law, namely understanding law as a sum of rules and procedures. Clearly, this conception of legal education takes law as a science that has had established subjects, systems of terms, categorizations for centuries which, for that reason,—even if time to time requires additions or modifications—can be an independent subject of a legal education that is based upon these traditions.

The other conception that can be witnessed both in the world movement of comparative law and legal education—especially as a manifestation of the paradigm dominating in the United States—puts the primary emphasis on the needs of legal practice. It takes the lawyer—in the spirit of "social engineering"—as a person whose direct and everyday task is to solve the problems raised by the life of the society and who has at his disposal the professional and technical skills necessary to it. Thus, in a sense, the lawyer as an expert plays a key role in the formation of society, in arranging and attaining the necessary reforms. Legal education is also in the service of this cause: its objective is to prepare the young generation of lawyers from the very outset for their future social role, striving to train lawyers who are ready to work as lawyers right after their graduation. This conception pays less attention to the theoretical and the methodological issues of law, it rather puts the emphasis of education on teaching thoroughly the positive law, the actual operation of legal institutions, the role of law in the formation of society. Its function is to study the legal system in action, to evolve a critical view on it, and, moreover, to prepare the necessary reforms—in the form of proposals aimed at improving the system. For this reason, its material can be taken as much less established or "settled", it is much more open to modifications necessitated by social changes. Using an apt

expression, one could say that the emphasis is on how we teach rather than on what we teach.[14] Instead of the issue of subject, the issue of method comes to the front: how we can develop in the student the ability to distinguish the relevant from the irrelevant, to handle the massive amount of facts before him, to argue in defence of his standpoint, to consider "pro" and "contra" arguments, etc. Education is primarily directed to the development of these skills, contrary to the educational practice dominating the universities of the countries of "civil law" that provides knowledge, mediating a determined material of knowledge.

6. The striking differences of the two conceptions are manifested even in the ways the tasks of legal education are understood and the questions of educational methods adapted to them are answered. The forms of legal education that serve rather practical objectives open the way to comparative law courses that are connected to the subject of particular positive branches or disciplines of law and that study them in a comparative way, by applying the comparative method. They deal with comparative law teaching instead of the teaching of comparative law. As opposed to this, for the conception that sees the function of legal education in mediating a comprehensive legal culture, it seems indispensable to provide a form of legal education (as well) that—being basically theoretical in character—is to clarify the nature, the objective and the method of comparative law. In this respect, it amounts to teaching of comparative law as an independent discipline. This would mean—as it was repeatedly put forward on various national and international fora—to initiate a so called introductory or basic course in legal education.[15]

The justification of such an introductory course is provided by the consideration that without it even the above mentioned other conception, namely discussing the material of positive law with a comparative method and view cannot lead to the desired outcome: to discernment relevant to the practice. Without proper theoretical and methodological foundations, students cannot gain a knowledge that allows for or, at least, facilitates the understanding of the substantial issues—concerning the objectives and the social functions of the given legal institution—behind the terminology

[14] Merryman: *op. cit.* 866.

[15] Schmidlin. B.: Der Beitrag der Rechtsvergleichung zum akademischen Unterricht. Eine Stellungnahme zu den Empfehlungen der vierten Europäischen Konferenz der Juristischen Fakultäten. Zeitschrift für Rechtsvergleichung. 18. Jahrgang. Heft 4. 1977. 241.

applied in particular legal systems. In such circumstances, one can hardly hope for the understanding of similarities and differences of institutional and technical measures applied in particular legal systems or in legal families, for the proper interpretation of their social role and function, and for the clarification of their practical consequences (for example, in respect to the various possibilities of the reception and the integration of laws). It hardly requires justification that this point is significant in regard to the tendencies of globalization today.

By now, it has become clear that even law cannot be taught in a "static" way in a world that generates fast changes. The particular legal institutions cannot be elucidated in their present form of appearance. The emphasis is placed right on the "dynamics", namely the historical transformation and variability of institutions. However, the historical point of view and approach involves taking into account the past experiences beyond the present and the future, and the way of future development can be marked on the basis of the lessons of the past. In the formation of the future, past plays a role, and it is to be taken into consideration by legal education.

If we add to this the insight originating from practical experiences that textbooks of the subjects of positive law are rather lengthy even without references to foreign legal measures, and the fact that the limited time for education is a serious obstacle to referring to foreign law and the points of comparative law in teaching domestic law, the claim that it is necessary to "teach comparative law" in the form of an independent introductory course that goes beyond "comparative law teaching" appears to be legitimate. The justification of such a course—beyond the reference to the necessity of a more comprehensive legal culture as a scholarly argument—is reinforced from the aspect of the practice as well.[16] This leads us to the conclusion that in respect to the spreading of comparative law in university education, we cannot be content with applying the comparative method in the course of particular subjects of positive law. In addition to this and as an establishment of this, we think it is necessary to have a course dealing with the theoretical, methodological, historical issues of comparative law. It follows in a logical way from the independence of comparative law as a discipline.

Such an introductory course—according to an apt definition—is addressed to students who think it is necessary to integrate their knowledge on law into a cultural panorama expanding well beyond their own nation. It

[16] Schlesinger, R. B.: The Role of the "Basic Course" in the Teaching of Foreign and Comparative Law. *American Journal of Comparative Law*. Vol. 19. Number 4. Fall 1971. 616.

mediates a kind of knowledge that, apart from extending their legal culture, provides a more comprehensive foundation to the promotion of their career as lawyers. Accordingly, the course in question may consist of two parts.[17] It introduces the world of comparative law to the students, makes them to understand the nature of comparative law, its objectives and functions, methods and history on the one hand, and gives a general overview of the main cultures or families of law on the other. Of course, within this general framework one can come up with a wide variety of measures concerning the ways of education, so it leaves open the opportunity of asserting the historical traditions of the given country and university or the paradigm dominating the education (or another one deviating from that), or even of attaining certain practical objectives. But all this belongs to the technical-methodological issues of education only indirectly connected to our line of argument.

IV.

7. In Hungary, teaching of law including comparative law has old historical traditions.[18] The European university—as it is well known—is an invention of the middle ages. According to the dominating paradigm of science of the time, it provided the framework for teaching the entirety of the sciences, namely theology, humanities, law and medicine. Lacking any domestic university, the Hungarian students initially attended foreign universities, especially in Padova, Bologna, Pavia and Paris. Later they preferred the Central European universities established in the 14th century (Prague, 1348, Cracow, 1364, Vienna, 1365) but the first initiatives to establish universities in Hungary soon manifested themselves. Although we have only fragments of information on the first attempts to establish universities in Hungary in the middle ages (Pécs, 1367, Buda, 1395, Pozsony, 1467), it seems legitimate to claim on the basis of research in this field that these attempts included legal education following the Bologna model. However, as a consequence of the often stormy turns of Hungarian history of the time, these early initiatives proved rather short-lived.

[17] Hazard, J. N.: Ten Years of International Teaching of Comparative Law. The Strasbourg Experiment. *American Journal of Comparative Law*. Vol. 19. Number 2. Spring 1971. 253.

[18] Török J.—Legeza L.: *Pázmány Péter Katolikus Egyetem* (Catholic University Pázmány Péter), Budapest, 1999. 7.

The same does not apply to the university established in Nagyszombat in the North of Hungary (1635) by Péter Pázmány, archbishop of Esztergom. We have detailed and exact information on it. The university that was originally named Studiorum Universitas had only a faculty of humanities in the beginning (1636), and later a further faculty for teaching theology (1638). The faculty of law was organized later (in 1667). On this faculty, besides the domestic customary law, canon law and Roman law were taught which one can interpret as a sign of an effort to create a kind of legal education transcending the framework of domestic law and to assert a more universal view of law if not an early manifestation of the idea of comparative law. Shortly after the foundation of the medical faculty (1769), the university moved to the capital, to the Castle of Buda (1777) by order of empress and queen Maria Theresa. Teaching began in 1780 there. The new order of university was settled by the educational regulation (Ratio Educationis) that was in force all over the Habsburg Empire in all types of schools. The regulation strove to assert the ideas of enlightened absolutism even in legal education. In regard to legal education, it was based on the German natural law theory of the time, especially the theory of Christian Wolff mediated by the distinguished professor from Nagyszombat: Karl Anton Martini. These conditions—just like in other European universities—were not favourable to the spreading of the idea of comparative law for the acceptance of the idea of universal natural law put the emphasis on unity—and not diversity—in legal education.

The first steps towards modern comparative law were taken in the first quarter of the 19th century in the so called "reform era" when the interest in foreign laws and the claim to know and possibly take over foreign legal measures manifested itself. Although there were differences in respect to the search for the ways and the methods of social progress (in the sense that the camp of reformers was divided between the revolutionary French and the more moderate, traditionalist English way of development), in the eyes of the representatives—especially the lawyers—of both standpoints, comparative law was a tool of "modernizing" the Hungarian society and its legal system burdened with the remains of the feudal era. It appeared to them that the way of transcending the Hungarian legal system of their age based on customary law and burdened with feudal remnants must lead towards modernization through knowing and comparing foreign laws and drawing lessons from it. In this respect, the results of the French codification that became known very early on provided a mobilizing force. It can hardly be seen as an accident that the French model gradually came to be dominant in the reform movement.

These efforts took root in university education as well. Among the youth of the universities—and especially law students—there was a growing sense of dissatisfaction concerning traditional legal education, and the emotions of the revolution maturing in the entire Hungarian society had a decisive impact on the transformation of university life.[19] It was a generally accepted requirement that university education including legal education should serve basically practical objectives, and, in this respect, the model to be followed (in regard to codification as well) were provided by the developed Western countries, especially France. Of course, it also paved the way to a better understanding of foreign laws and to comparative law in the modern sense of the term. However, the organizational and educational reforms necessitated by these tendencies did not take place in the reform era. Although the government of the revolution that broke out parallel to the revolutionary movements unfolding all over Europe in 1848 took the first steps in this direction, the events leading into an armed conflict had set back for a long time the cause of the reform of university education including legal curriculum. The conditions of the reform were not given until the compromise of 1867 with Austria. However, one can evaluate it as the survival of the efforts of the reform era that on the University of Pest teaching of comparative law was introduced in 1850.

The idea of comparative law, apart from university education, commanded attention to the theoretical aspects of the issue. In this respect, the Hungarian Academy of Sciences founded in the reform era played an initiative role. A lecture given on a session of the department of philosophy and social sciences of the Academy characterized comparative law as one of the most important branches of the science of law which is to study "the legal life of the universal mankind". According to the lecturer (Gusztáv Wenzel, professor at the Faculty of Law in the University of Pest), such an inquiry, besides pointing to the universal, common features of the development of law, should involve revealing the specific legal measures of the particular nations in order to get to the main principles of law and to promote the unification of "institutions and legal principles differing so much" as manifestations of the idea of law by way of comparing them.[20] Perhaps, we might not be wrong in claiming that these ideas already involved an insight that later came to be generally accepted: it sees a difference between historical inquiries directed to the revelation of the universal laws of

[19] Horváth P.: *Frank Ignác*. Budapest, 1993. 107.

[20] Wenzel G.: Az összehasonlító jogtudományról (Comparative jurisprudence). *Magyar Académiai Értesítő*. 1850. 292.

development forming one main branch of comparative law, and the activity committed to the needs of the practice and directed to the unification of law as the other. A quarter of a century later (1875), in another lecture also given in the Academy, Wenzel already put forward several ideas that are part of the paradigm of comparative law even today. Thus, he emphasized the importance of the distinction between the legal and the non-legal features to be taken into consideration by comparatists claiming that this distinction was to be asserted in comparing whole legal systems as well as their parts. He also pointed out that new scholarly results cannot be brought by comparison unless it takes place between the legal systems of nations comparable in respect to their cultural level.[21]

Among the results on this field, attempts to clarifying the comparability of the Hungarian law with Western legal system deserves special attention. The Hungarian legal system interwoven with feudal elements had several features—i.e. the lack of a written constitution, the delay in civil law codification, the recognition of customary law as a source of law and the role of courts in the developing the law—that resulted in differences not only in respect to the European way of the development of law but compared to other parts of the Austro-Hungarian Monarchy as well. On the basis of these differences, the view that Hungarian law in its entirety and in regard to its historical traditions shows striking analogies to English law was put forward. Some thought that, to a certain extent, Hungarian law is independent of the Continental way of the development of law based upon the traditions of Roman law.[22] On the basis of supposing such a "resemblance"—that is otherwise hardly justifiable and was criticized even in Hungarian jurisprudence—, one could reach the conclusion that the Hungarian legal system—just like the English one—belongs to the "self-lighted" (sui generis) legal systems that cannot fit into the framework of the comprehensive Roman-Germanic tradition.

In the 20th century in Hungary—already adapting the results of the Congress of Paris that was a landmark in the modern comparative law movement—, there were attempts to define the nature of the science of comparative law using both natural law and positivism as starting points. As a consequence of these attempts, the point of view that understands the science of comparative

[21] Wenzel G.: Az összehasonlító jogtudomány és a magyar magánjog (Comparative jurisprudence and the Hungarian Private law). *Értekezések a társadalmi tudományok köréből.* IV. Köt. II. sz. Budapest, 1876. 24.

[22] Grosschmid B.: *Werbőczy és az angol jog* (Werbőczy and the English Law). Budapest, 1928.

law as a branch of the science of positive law became dominant.[23] There were successful initiatives to apply the comparative method to whole legal systems as well as branches of law and legal institutions.

8. At the outset, the so called socialist jurisprudence faced several difficulties in regard to raising the idea of comparative law, and later in respect to making it accepted. As it is well known, the problem lied in the fact that socialist jurisprudence emphasized the qualitatively new character of the socialist type of law which cast doubt on the possibility of comparing the two conflicting types of law. Coupled with the distrust concerning any political ambition associated with the slogan of droit comparé, it had excluded all sorts of attempts of rapprochement for a long time. This situation had changed rather slowly but finally there evolved—both among the "Western" and the "Eastern" representatives of comparative law—an almost unanimous agreement concerning the possibility of comparing the law of countries of different social formations.[24] In this respect, Hungarian comparatists played a significant and internationally recognized role.

In Hungarian jurisprudence, raising and answering the theoretical issues of the so called socialist comparative law mainly fell on the representatives of the theory of state and law—as a general, fundamental discipline. Professor Imre Szabó whose name is associated with most of the initiatives in this respect, originally joined the dominant, majority opinion in socialist jurisprudence, and understood the comparative activity as one of the methods of revealing the phenomena of state and law.[25] Later, he gradually changed his position finally arriving at the conclusion that results gained from the application of the comparative method add up to a general theory of comparative law.[26] On Szabó's initiative, a scientific conference jointly organized by the Hungarian Academy of sciences and the three legal faculties took place in December 1963 where the idea of the necessity of applying the comparative method in socialist jurisprudence and legal education was

[23] Pauler T.: *Észjogi elõtan* (Introduction to the law of reason). Budapest, 1873. 36., Somló B.: *Juristische Grundlehre*. Leipzig, 1917. 2., Moór Gy.: *Bevezetés a jogfilozófiába* (Introduction to the philosophy of law). Budapest, 1923. 46.

[24] Zweigert, K.—Puttfarken, H.-J.: Zur Vergleichbarkeit analoger Rechtsinstitute in verschiedenen Gesellschaftordnungen. In: *Rechtsvergleichung*. 395.

[25] Szabó I.: Az összehasonlító jogtudomány. In: *A jogösszehasonlítás szocialista elmélete* (Comparative jurisprucdence. In: *The socialist theory of legal comparison*). Budapest, 1975, 31.

[26] Szabó I.: Az összehasonlító jog elméleti kérdései (Theoretical questions of comparative law). *Ibid.* 105.

put forward for the first time.[27] This concept primarily concerned the legal systems of socialist countries, and manifested itself in the claim that socialist law is to be studied both on the level of "generality" (namely in respect to all socialist countries) and concretized on the particular legal systems. The positive law of the individual countries was understood as "particular" within the "general". On the conference, it was also emphasized that such a "pan-socialist" approach did not release the jurists from the obligation to study carefully the domestic law.

These results gradually led to the spreading of the ideas of comparative law in legal education. As a consequence of the fundamental turn in the history of the country after 1945, the opportunities of getting informed concerning foreign laws were in the beginning rather limited—and basically limited to the soviet law and its development (this was indicated by the introduction of the new courses of Soviet law in the legal faculties). However, the "melting" in jurisprudence soon resulted in a turn even in university education. Although comparative law as an independent discipline did not become part of the compulsory curriculum of the university, however, there was a significant progress in this respect during the years to come. Thus, on the one hand, there appeared and optional courses discussing particular legal institutions of some branches of positive law from a comparative point of view and with the comparative method. This was undoubtedly an important step towards the teaching of comparative law. On the other hand—especially in the form of optional courses in the framework of the departments of legal theory—the teaching of the so called comparative law as an independent discipline took place in the form of an course. The subject-matter of this introductory course was primarily provided by the products of the international comparative law literature that fit into this function and were at hand, but the experiences stemming from the international educational fora of comparative law were also made use. Accordingly, the programme of the basic course on comparative law is still adapted to the settled and internationally wide-spread educational paradigm on this field in the sense that the course, besides the theoretical, methodological and historical issues, includes the presentation of the main legal families. The main form of teaching is giving lectures by the teacher but the students themselves regularly hold lectures, and—in narrow circle, with the participation of students showing increased interest in comparative law—seminar-like professional discussions also take place. It is worthy of

[27] A magyar állam- és jogtudományok és a társadalmi gyakorlat (Hungarian legal science and social practice). *Állam- és Jogtudomány,* Vol. VII. No. 1. (1964) 9.

mentioning that the growing interest in the issues of comparative law and foreign legal systems is manifested in the fact that the students often take advantage of the educational opportunities provided by foreign universities, and many of them attends the postgraduate courses of the International Faculty of Comparative Law in Strasbourg. Of course, it presupposes certain language skills on the part of the students which—partly as a consequence of the favourable political developments of the recent years—is manifested in the achieved results.

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IV. A. 1. International Criminal Court

IMRE A. WIENER*—KATALIN LIGETI**

Hungarian Report on the International Criminal Court

Abstract. In the study the legal system is conteptualized as a meaning system which contains the text layer, the layer of the legal dogmatics, the layer of judicial precedents and in some modern legal system the layer of the constitutional tights is added to these. The study outlines the is identified as the layer of the constitutional rights first of all. Contains the text layer, the layer of the legal dogmatics, the layer of judicial precedents and in some modern legal system the layer of the constitutional tights is added to these. The study outlines the is identified as the layer of the constitutional rights first of all.

Keywords: legal system, legal theory, legal dogmatics, constitutionalization

The Rome Diplomatic Conference on the Establishment of an International Criminal Court ended on 17 July 1998 with the adoption of the Statute of the International Criminal Court (ICC Statute). The next day the treaty was opened for signature at Il Campidoglio in Rome. The purpose of the ICC Statute is to create a permanent international criminal court that will effectively investigate and prosecute the most serious violations of international human rights law: genocide, crimes against humanity, and war crimes.

The treaty containing the ICC Statute will enter into force 60 days after the sixtieth instrument of ratification is deposited at the United Nations. As of 12 February 2001, 139 States have signed and 29 States have ratified or acceded to the treaty.[1]

* Imre A. Wiener, Professor of Law, Eötvös Loránd University, Budapest, H–1053 Budapest, Egyetem tér 1–3, Hungary.
E-mail: Wieneraidp@mail.matav.hu

** Katalin Ligeti, Research Fellow, Institute for Legal Studies of the Hungarian Academy of Sciences, Budapest, H–1014 Budapest, Országház u. 30.
E-mail: ligetik@jog.mta.hu

[1] Progress report on the ratification and national implementing legislation of the statute for the establishment of an International Criminal Court. 7th Edition. 19 February 2001.

1. New tendencies in international criminal law[2]

1.1. Ad hoc *international criminal tribunals*

The United Nations Security Council Resolutions 827 (1993) and 955 (1994) established *ad hoc* international tribunals. Security Council Resolution 827 established an international tribunal for the prosecution of persons responsible for serious violations of international humanitarian law committed in the territory of the former Yugoslavia since 1991. Security Council Resolution 955 established an international tribunal for the prosecution of persons responsible for acts of genocide or other serious violations of international humanitarian law committed in 1994 in the territory of Rwanda and as far as Rwandan citizens are concerned, responsible for such violations committed in the territory of neighbouring States.

According to the Statute of the international tribunal on Yugoslavia (ICTY) the tribunal and national courts have concurrent jurisdiction to prosecute persons for serious violations of international humanitarian law committed in the territory of the former Yugoslavia since 1 January 1991. The international tribunal has primacy over national courts. At any stage of the procedure, the international tribunal may formally request national courts to defer to the competence of the international tribunal in accordance with the ICTY Statute and the Rules of Procedure and Evidence of the ICTY. (Art.9.)

The Prosecutor initiates investigations ex-officio or on the basis of information obtained from any source, particularly from Governments, United Nations organs, intergovernmental and non-governmental organisations. The Prosecutor assesses the information received or obtained and decide whether there is sufficient basis to proceed. (Art.18.)

1.2. The Lockerbie case

Besides establishing *ad hoc* international criminal tribunals the Security Council also interfered with international criminal jurisdiction by its decision in a concrete case. The UN International Court of Justice has confirmed such interference.

[2] This chapter intends to illustrate the changing international climate in which the Statute was adopted and which serves as a frame for the current ratification procedure For past events *see* Bassiouni, M. Ch.: Historical Survey: 1919–1998. In: *The Statute of the International Criminal Court, A Documentary History*, Complied by Bassiouni, M. Ch.: Transnational Publishers, Inc, Ardsley, New York, 1998.

In the Lockerbie case the Security Council demanded in its Resolutions 748 (1992) and 883 (1993) that Libya submit the two accused Libyan nationals for trial before a Scottish court. For the failure to comply with the resolutions the Security Council also imposed economic sanctions on Libya.

As a response Libya begun proceedings before the International Court of Justice against both the US and the UK by arguing that they had failed to meet their obligations under the 1971 Montreal Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation. Libya claimed its willingness to prosecute those accused of the bombing and by this she would have fulfilled her own obligations under the Montreal Convention.

In a provisional order of 14 April 1992 the International Court of Justice decided that the Security Council Resolution based on Article 103 of the UN Charter prevails over the obligations of the Parties under any other international agreement including those under the Montreal Convention.

Accordingly the Security Council in its Resolution 1192 (1998) of 27 August 1998 called all states to co-operate to ensure the presence of the two before a Scottish Court in the Netherlands and suspended the measures imposing economic sanctions on Libya. The help of the Secretary-General of the United Nations was decisive for the transfer of the accused. On 5 April 1999 the two accused were first surrendered to a United Nations official at the Tripoli airport in Libya and later on the same day to the Scottish authorities in the Netherlands.

1.3. Crimes under international humanitarian law

In the *Nicaragua case* the International Court of Justice observed that the laying of mines in the waters of another State without any warning or notification is not only an unlawful act but also a breach of the principles of humanitarian law underlying the Hague Convention No. VIII. of 1907. The Court considered that the rules stated in Article 3 of the four Geneva Conventions of 12 August 1949, which is common to the four Conventions, applying to armed conflicts of a non-international character should be applied. This obligation derives from the general principles of humanitarian law to which the Conventions merely give specific expression.[3]

[3] Summaries of Judgments, Advisory Opinions and Orders of the International Court of Justice. United Nations New York, 1992. 79. Case concerning the military and paramilitary activities in and against Nicaragua (Nicaragua v. United States of America) (Merits) Judgment of 22 December 1986 166.

In the *Pinochet case* Law Lords emphasised that the immunity of the Head of State would simply be incompatible with the provisions of the Torture Convention which clearly indicates the official or governmental character of torture as a constituent element of the crime. Under customary international law there can be no immunity for crimes of international law. The exercise of extraterritorial jurisdiction over certain grave offences is permitted on the basis of the universality principle. However, if one accepts the prohibition of torture as a *ius cogens* norm such immunity can not co-exist with that norm. Since *ius cogens* norms enjoy the highest status within international law they prevail over and invalidate other rules of international law.

John Hopkins commented on the above cases as follows: "The cases show remarkable and, as it appears, unprecedented willingness to rely upon provisions of international law, both conventional and customary, in domestic proceedings. The relationship between international and municipal law will be viewed very differently henceforth. In particular, the apparently ready acceptance by the majorities of the notion of *ius cogens* and of the provisions of the Torture Convention (and of certain other treaties) as instances of the *ius cogens* is perhaps surprising."[4]

1.4. The opinion of the Hungarian Constitutional Court

The Hungarian Constitutional Court made the following elaboration in relation to crimes under international humanitarian law:

The first sentence of Art. 7 (1) of the Constitution, according to which the legal system of the Republic of Hungary accepts the generally recognised rules of international law, states that these "generally recognised rules" are part of Hungarian law, even without separate (further) transformation. An act of general transformation—one without a definition or enumeration of the rules—was performed by the Constitution itself. According to it, the generally recognised rules of international law are not part of the Constitution but are "assumed obligations". The fact that the assumption and transformation are contained in the Constitution does not affect the hierarchical relationship of the Constitution, international and domestic law. This general internalisation of assumed obligations absolutely does not preclude certain "generally recognised rules" from being defined by specific international agreements (as well), and that regarding those a separate act of

[4] Hopkins, J.: Case and Comment—Former head of foreign state—extradition—immunity. *The Cambridge Law Journal,* Volume 58 Part 3 November 1999. 465.

transformation takes place. The United Nations Charter and the Geneva Conventions, for instance, may contain such rules.

Articles 7 (1) of the Constitution also means that by the Constitution's command, the Republic of Hungary participates in the community of nations: this participation, therefore, is a constitutional command for domestic law. It follows therefrom that the Constitution and domestic law must be interpreted in a manner whereby the generally recognised international rules are truly given effect.

The second sentence of Art. 7 (1)—the harmonisation of the obligations assumed under international law and domestic law—applies to every "assumed" international obligation, including the generally recognised rules. In addition, harmony must be achieved for the whole of domestic law, the Constitution included. Thus, Art. 7 (1) of the Constitution requires the harmony of the Constitution and the obligations derived from international law—assumed directly under the Constitution or undertaken in treaties—as well as domestic law: is ensuring their harmonisation, attention must be paid to their particular characteristics.

Historically, the distinction has been applied with respect of war crimes and crimes against humanity committed during the Second World War. But the development of international law has continuously separated the sphere of "international humanitarian law" from the war context and made the prosecution and punishment of these crimes independent of the requirements and conditions of the domestic criminal law system, also with regard to statutory limitations, inasmuch as two conventions on the non-applicability of statutory limitations for war crimes against humanity have been concluded.

The rules on the punishment of war crimes and crimes against humanity—since these crimes threaten the foundations of humanity and international coexistence—constitute peremptory norms of general international law (*ius cogens*). Those States which refuse to assume these obligations cannot participate in the community of nations.

The norms on war crimes and crimes against humanity are undoubtedly part of customary international law: they are general principles recognised by the community of nations in the parlance of the Hungarian Constitution, they belong to "the generally recognised rules of international law". The Hungarian legal system accepts these rules, according to the first clause of Art. 7 (1) of the Constitution, therefore they fall, without separate transformation or adoption, within those "assumed obligations under international

law" whose harmony with domestic law is required by the second clause of the aforementioned Article of the Constitution.[5]

1.5. The universality principle

According to Feller the universality principle reflects the special quality of the class of offences known as *delicta iuris gentium*, crimes under international law. These crimes threaten to undermine the very foundations of the enlightened international community as a whole, and it is this quality that gives each one of the members of that community the right to extend the incidence of its criminal law to them, even though they are committed outside the state's boundaries and the offender has no special connection with the state. One essential prerequisite for the application of the municipal criminal law of a certain state in a particular case is that the offender be in its territory. The link between the offender and the *lex loci deprehensionis* is the injury which the offence causes to the foundations and security of the entire international community. This is what endows every state with the power to establish by law the incidence of its own municipal criminal law on *delicta iuris gentium* if the offender is actually in custody in its territory.

The universality principle must necessarily be of a general nature, i.e., the personal status of the offender cannot affect the incidence of the municipal criminal law by virtue of that principle. The offender may be the national of another state, he may be domiciled elsewhere, stateless or with no permanent domicile, nevertheless, in each of these cases he will fall within the scope of that law, provided that two basic conditions are satisfied, namely, he is within the territory of the state that seeks to apply its municipal law and the offence is one of those embraced by the universality principle.

There is no point here in demanding, as a prerequisite of its applicability, the double criminality of the conduct in question, too. The principle holds good even when the conduct does not constitute an offence in the place where it occurred, that is also the position when the offence is committed in a place over which no state has sovereignty.[6]

[5] Detailed in: *Constitutional Judiciary in a New Democracy.* The Hungarian Constitutional Court László Sólyom and Georg Brunner with a Foreword by Justice Stephen G. Breyer (The University of Michigan Press 2000), 273–283.

[6] Feller, S. Z.: Theories and Jurisdiction in: *A Treatise on International Criminal Law,* Volume II Jurisdiction and Cooperation (Charles C Thomas Publisher Springfield Illinois USA, 1973), 32–34.

By virtue of the universality principle, some legal systems (e.g. in Hungary) provide that proceedings are to be initiated only in cases of this kind by the head of prosecutions himself. The reason for this is that in addition to all the other considerations to be taken into account in weighing the initiation of proceedings in the case of extraterritorial offences, special legal problems arise when the offence is an international crime.

It is necessary to pay attention to the Belgian Congo case, which is pending right now and which may also substantially affect the interpretation of the *universality principle*.

An international arrest warrant was issued on 11 April 2000 by a Belgian investigation judge against the Minister for Foreign Affairs in office of the Democratic Republic of the Congo. The warrant also sought his provisional detention as long as a request for extradition to Belgium for alleged crimes constituting serious violations of international humanitarian law are pending. Under the very terms of the arrest warrant, the investigating judge claims jurisdiction in respect of offences purportedly committed on the territory of the Democratic Republic of the Congo by a national of that State *without* an allegation that the victims were of Belgian nationality or that these acts constituted violations of the security or dignity of the Kingdom or Belgium.

Congo pointed out in her reply that such universal jurisdiction is conditional on the perpetrators' presence on the territory of the prosecuting State, and these are exceptional heads of jurisdiction, which derive their compliance with international law solely from the treaties which provide for them and which are not part of general international law.

In her declaration, the Belgian Judge Van den Wyngaert emphasised the importance of the case for the development of modern international criminal law. According to Van den Wyngaert international community undoubtedly agrees in principle with the proposition that the core crimes of international criminal law (war crimes, genocide and crimes against humanity) should not remain unpunished. How this should be realised in practice is still the subject of much discussion and debate. Ideally, such crimes should be prosecuted before international criminal courts. However, not all cases will be justifiable before such courts and in the meanwhile national criminal prosecution before domestic courts is the only means to enforce international criminal law. States have not only a moral but also a legal obligation under international law to ensure that they are able to prosecute international core crimes domestically.

Judge Van den Wyngaert draws the attention to the growing support for the idea that traditional limitations on criminal prosecution (territorial

jurisdiction, immunities) cannot be applied to international core crimes. This idea is gaining support, not only in legal doctrine but also in national courts' decisions such as the judgement of the House of Lords in the *Pinochet case*.

In contrast to the above opinion the International Court of Justice rejected the request of the Kingdom of Belgium that the case be removed from the List and found that the circumstances, as they presented themselves in the Court, were not such as to require the exercise of its power under Article 41 of the Statute to indicate provisional measures.[7]

The arrest warrant issued by the Belgian investigating judge is based on the universality principle and not on the priciple of forum deprehensionis. This is an important novelty of the case.

2. The jurisdiction of the ICC

One should examine the truth of the opinion according to which the Statute of the ICC is a step backwards from the position that had been taken for the courts of the former Yugoslavia and Rwanda, and the concept of complementarity provides a major and unnecessary restriction on the jurisdiction of the court. Once it had been accepted that these core crimes were damaging to the international community and could be tried by an international court, the pride of national sovereignty should not have been allowed to obstruct the effectiveness of that court.[8]

The Preamble and Art. 1 of the Statute laid down that ICC's jurisdiction shall be complementary to the national criminal jurisdictions. The jurisdiction of the ICC under Article 5[9] extends, to three well-established international crimes: genocide, war crimes, and crimes against humanity. They conform to existing international criminal law and fall within the meaning of *ius*

[7] Case Concerning the Arrest Warrant of 11 April 2000 (International Court of Justice, 8 December 2000, General List No. 121).

[8] Elliott, C.: A Permanent International Criminal Court: 'A Giant Step Towards Universal Human Rights' or 'Dead on Arrival'? *The Journal of Criminal Law*, 2000. 401. Quotations in the title are taken from the comment of Kofi Annan, Secretary-General of the UN, The Times, Monday 20 July 1998. And from the comment of the American Senator Jesse Helms before the Rome conference (quoted by the Lawyers Committee for Human Rights at www.lchr.org/lchr/icc/rome/senate.htm).

[9] The jurisdiction of the Court shall be limited to the most serious crimes of concern to the international community as a whole. The Court has jurisdiction in accordance with this Statute with respect to the following crimes:

(a) The crimes of genocide, (b) Crimes against humanity, (c) War crimes, (d) The crime of aggression.

cogens which is binding upon all states and which contains norms that carry obligations from which a state may not derogate. The Statute also lists the crime of aggression, which has yet to be defined and is therefore not subject to the ICC's jurisdiction.[10] Furthermore, the Court has jurisdiction also over crimes against the administration of justice and may impose sanctions (Article 70, 71).

Bassiouni states that "the ICC is a treaty-based institution which is binding only on its states parties. It is not a supra-national body, but an international body similar to other existing ones. The ICC is not a substitute for national criminal jurisdiction and does not supplant national criminal justice systems, but rather is "complementary" to them. The ICC does no more than what each and every state in the international community can do under existing international law.[11] It is the expression of collective action by states parties to a treaty that established an institution to carry out collective justice for certain international crimes. The ICC is, therefore, an extension of national criminal jurisdiction as established by a treaty whose ratification under national parliamentary authority makes it part of national law. Consequently, the ICC neither infringes upon national sovereignty nor overrides national legal systems capable of and willing to carry out their international legal obligations.[12]

The Court can exercise jurisdiction over crimes that have been committed on the territory of a state party or by one of its nationals[13]. In addition, the ICC may exercise its jurisdiction when a state which is not a state party consents to the Court's jurisdiction and the crime has been committed on that state's territory or the accused is one of its nationals.

Jurisdiction of the ICC is based on the principle of territorial criminal jurisdiction, and not on a theory of universality of criminal jurisdiction. While the reach of the Court's jurisdiction is universal, it does not represent the theory of universality, except for "referrals" from the Security Council, which are not linked to the territoriality of any state, whether they are Parties or non-States-Parties. It is clearly established in international law that whenever a crime is committed on the territory of a given state, it can prosecute the perpetrator even when that person is a non-national. Accordingly, every state has the right, in accordance with its constitutional norms, to transfer

[10] Bassiouni, M. Ch.: Explanatory Note on the ICC Statute, in*:* *Revue Internationale de Droit Pénal* 71eme année, 1er et 2eme trimestres, 1–39.

[11] Compare with conclusions of this chapter.

[12] Bassiouni: *op. cit.* point 6.

[13] Bassiouni: *ibid.* point 15.

jurisdiction to another state which has jurisdiction over an individual accused of committing a crime, or to an international adjudicating body.[14]

On the basis of the above Bassiouni argues that since the ICC is not a foreign legal system (such as that of a sovereign state), after ratification of the treaty, it becomes an extension of a state's national criminal jurisdiction. This is not to be confused with the idea that the ICC is an extension of national criminal justice systems. The ICC is neither part of national criminal justice systems nor an extension thereof. It is an extension of national criminal jurisdiction established by treaty and implemented by national legislation. The closest analogy is that of transfer of criminal proceedings. Thus, an individual is "surrendered" to the ICC and not extradited.[15] A consequence of that concept is that states parties could not invoke, in opposition to surrender, their domestic laws that prohibit extradition of nationals, or other defences.[16]

In order to evaluate Bassiouni's opinion it is necessary to know Article 12, 13 and 17 of the ICC Statute. The Court may exercise its jurisdiction if one or more State Parties have accepted the jurisdiction of the Court or a State which is not a Party to the Statute accept the exercise of jurisdiction by the Court (Art. 12). The Court may exercise its jurisdiction if: crimes appear to have been committed is referred to the Prosecutor by a State, or by the Security Council acting under Chapter VII of the Charter of the United Nations, or the Prosecutor has initiated an investigation. (Art. 13.) The Court shall determine that a case is admissible if the State is unwilling or unable genuinely to carry out the investigation or prosecution. In order to determine unwillingness, the Court shall consider that the national decision was made for the purpose of shielding the person concerned from criminal responsibility for crimes within the jurisdiction of the Court or there has been an unjustified delay in the proceedings, the proceedings were not conducted independently or impartially (Art. 17).

Bassiouni acknowledges that it is up to the Court to determine that a state is unwilling to genuinely investigate or prosecute, the proceedings are not conducted independently or impartially, national judicial system is totally or substantially collapsed.[17]

[14] Bassiouni: *ibid.* point 16.

[15] Article 102: For the purposes of this Statute: (a) "surrender" means the delivering up of a person by a State to the Court, pursuant to this Statute. (b) "extradition" means the delivering up of a person by on a State to another as provided by treaty, convention or national legislation.

[16] Bassiouni: *op. cit.* point 94.

[17] Bassiouni: *ibid.* point 58.

A conviction or acquittal by a national jurisdiction will not bar subsequent prosecution by the ICC if: (a) the purposes of the state proceedings were to "shield the person concerned form criminal responsibility" or the domestic proceedings were not conducted independently or impartially.[18]

According to Art. 13 the Court may not only then exercise its jurisdiction if a States Party or a non-State Party initiates proceedings at the public prosecutor. The Security Council enjoys the same right, too. Next to those exists the public prosecutor's independent right to initiate proceedings. Although the public prosecutor's right of initiative is dependent on the support of one of the councils of the Court, it nevertheless removes the initiating of the procedure from the exercise of national jurisdiction.

The Security Council besides its independent right of initiative may exercise further influence on the functioning of the Court according to the terms of Art. 16. The activity of the Security Council interferes with national jurisdiction as it happened in the Lockerbie case, when with its Resolutions 748/1992 and 883/1993 interfered into a concrete cases and ordered economic sanctions against Libya.

The Statute itself declares in Art. 17 when does the jurisdiction of the ICC overrides national jurisdiction. The principles of the primacy of national legal systems and the ICC's "complementarity" are evident in other provisions of the Statute. Article 15(4) requires the authorisation of the Pre-Trial Chamber before the Prosecutor commences an investigation *proprio motu* as opposed to when it is referred by a state party or the Security Council /Article 15/.[19] Contrary to Bassiouni's opinion, Art. 15 does not restrict the Court, it restricts only the prosecutor.

Furthermore Art. 27 fundamentally restricts the exercise of national jurisdiction by prohibiting any immunities provided for in the national law in the course of the Court's proceedings.

On the basis of the above one may conclude that it is the sovereignty of those states which did not ratify the convention that "obstruct the effectiveness of that court". On the other hand, for the states parties the ICC represent a restriction of their national jurisdiction. Moreover, the ICC does less than "what each and every state in the international community can do under existing international law",[20] since according to international law states may prosecute hard core crimes on the basis of the universality principle regardless who committed those crimes and where. It is unclear,

[18] Bassiouni: *ibid.* point 63.
[19] Bassiouni: *ibid.* point 9.
[20] See: *supra* note 12.

however, whether this is obligatory for the ICC upon prosecution initiated by the Security Council. This would be only then the case, if the Security Council is not bound by the complementary principle.

Answers to the questionnaire

3.1. Hungary has not yet ratified the ICC Statute. The ratification procedure is currently under preparation.

3.2. There is no objection in Hungary against establishing the ICC. Nevertheless the ICC represents a brand new type of institution, therefore its implementation into the domestic law requires thorough preparation. One possible way of ratifying the Statute would be, if the Hungarian Parliament first ratified it with a special law and provided for the necessary modification of several Hungarian laws only then when the 60 ratifications are deposited and the Statute enters into force. There is so far no decision in Hungary about the method of ratification.

3.3. Since the ICC interferes also with the exclusionary domestic jurisdiction based on the territoriality principle, the chapter of the Hungarian Constitution dealing with the court system needs to be modified accordingly.

At present the Hungarian Constitution provides as follows:
Article 45.

(1) In the Republic of Hungary justice is administered by the Supreme Court of the Republic of Hungary, the Court of the Capital, the county ourts and the local courts.
(2) Special courts for specific groups of cases may be established by law.

Article 47.

The Supreme Court of the Republic of Hungary determines the guidelines for the operation and administration of justice in all courts. The guidelines and principles established by the Supreme Court are of binding nature for all courts.

3.4. Upon ratification the responsibility of the head of state as set out at present in Art. 31/A and 32 of the Hungarian Constitution requires modification. The Hungarian Constitution does not contain further provisions in respect of the responsibility of other leading politicians.

The responsibility of the head of state is regulated as follows:

Article 31/A.

(1) The person of the President of the Republic is inviolable; protection from criminal prosecution shall be granted by a separate law.
(2) Should the President of the Republic violate the Constitution or any other law while in office, a motion supported by one-fifth of the Members of Parliament may propose that impeachment proceedings be initiated against the President of the Republic.
(3) A majority of two-thirds of the votes of the Members of Parliament is required to initiate impeachment proceedings. Voting shall be held by secret ballot.
(4) From passage of this resolution by the Parliament until the conclusion of the impeachment proceedings, the President of the Republic may not attend to any of the duties of his office.
(5) The Constitutional Court shall have jurisdiction in such cases.
(6) Should the Constitutional Court determine that the law was violated, it shall have the authority to remove the President of the Republic from office.

Article 32.

(1) If impeachment proceedings are initiated against the President of the Republic on the basis of an indictable offence committed in connection with official activities while in office, then the Constitutional Court shall also apply the basic provisions of criminal prosecution in its proceedings. The prosecution shall be represented by a Special Prosecutor elected from among the Members of Parliament.
(2) In other cases, criminal proceedings against the President of the Republic may only be initiated subsequent to the end of his term of office.
(3) Should the Constitutional Court find the President of the Republic guilty of an intentional criminal offence, it may remove the President of the Republic from office and simultaneously apply any punishment and measures prescribed for such offence in the Penal Code.

3.5. Further immunities are not contained in the Constitution, but in special laws. Immunity means in those cases not the exemption from criminal responsibility. It contains special procedural rules for waiver of immunity. Such waiver is a prerequisite of commencing criminal proceedings.

The following special laws need to be modified:
— Act No. 1972/V on the Public Prosecution Office
— Act No. 1989/XXXII on the Constitutional court
— Act No. 1993/LIX on the Legal Status of Members of Parliament
— Act No. 1993/CX on National Defence
— Act No. 1977/LXVI on the Structure and Functioning of the Courts
— Act No. 1989/XXXVIII on the Hungarian Court of Auditors
— Act No. 1978/IV on the Hungarian Criminal Code
— Act No. 1996/XXXVIII on International Cooperation in Criminal Matters

3.6. Once the ICC is implemented into domestic law, it would be a contradiction within the national legal system, if different rules applied to proceedings before the ICC and proceedings before a domestic court.

3.7. Upon ratification of the ICC Art. 102 of the Statute becomes part of Hungarian law. Art. 102 distinguishes between extradition and surrender. The Hungarian Constitution does not prohibit the extradition of own nationals. Surrender is, however, a new institution also within the Hungarian legal system. It was first introduced by the ICTY Statute that Hungary ratified. Nevertheless no surrender of Hungarian nationals has taken place so far on the basis of that provision.

3.8. Hungarian law contains provisions on lifetime imprisonment and Hungarian courts may decide that the sentenced person can be on conditional release only after a period of 30 years. Consequently, the ratification of the ICC Statute would not pose any problems in that respect.

The part 10 of Statute the Enforcement. According to Art. 103 a sentence of imprisonment shall be served in a State designated by the Court from a list of States which have indicated to the Court their willingness to accept sentenced persons. Rule 199: Unless provided otherwise in the Rules, the functions of the Court under Part 10 shall be exercised by the Presidency. Rule 200/2: The Presidency shall not include a State on the list provided for in article 103, paragraph (1), if it does not agree with the conditions that such a State attaches to its acceptance. The Presidency may request any additional information from that State prior taking a decision. The Rules 200–225 regulate the enforcement.[21]

[21] In: Revue Internationale de Droit Pénal, 71eme année, 1er et 2eme trimestres 2000 203–215.

3.9. According to section 3.3. of the present report, the proceedings of the prosecutor of the ICC may only serve as the preparation for the functioning of the previously accepted jurisdiction.

3.10. Both Art. 29 of the ICC Statute and Art. 33(2)b of the Hungarian Criminal Code prohibit any statutory limitation in connection with the crimes that fall under the jurisdiction of the ICC. It is rather unlikely that the perpetrator of such crimes may receive pardon. Should this be the case, however, in our view Art. 17(1)a of the Statute could then be applicable according to which it could be classified as if "the State is unwilling to carry out the investigation or the prosecution."

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IV. A. 2. Constitution, International Treaties and Contracts

LÁSZLÓ BODNÁR*

Constitution, International Treaties, and Contracts

Abstract. Hungarian statutes and regulations contain a "without prejudice to international treaty obligations" clause as to the scope of their provisions. In such cases the international treaty—or maybe an existing *mutual practice* in its absence—shall be enforced based on the express provision of the domestic act. This process might prove to be quite lengthy, since the Minister of Justice is authorized to pronounce on the existence of such mutual practices. In the second half of the 1990's the Hungarian legislative branch (the Parliament) passed a statute on taxation which entered into force even though it violated the bilateral treaties concluded by Hungary to avoid double taxation.

Keywords: constitution, status of treaties, promulgation

I. General issues concerning the relationship between international law (including international treaties) and the Hungarian legal system

In order to understand the specific the problems dealt with in the outline of the report, first of all one must define the status of international treaties in the Hungarian legal system. The question has been settled by the comprehensive revision of the Constitution of the Republic of Hungary entering into force on October 23, 1989. Art. 7 (1) of the Constitution[1]—corresponding to the previous doctrine and practice followed in the absence of constitutional provisions—provides that *no international treaty shall be applied directly by Hungarian authorities issuing legally relevant decisions.* According to the above mentioned constitutional provision, the ensurance of the agreement between the accepted international legal obligations and domestic statutes is

* Professor, University of Szeged, Law School, H–6701 Szeged, Rákóczi tér 1., Hungary.
Fax: (36 62) 544-490; E-mail: drbodnar@juris.u-szeged.hu

[1] Art. 7 (1) of the Constitution (statute No. 20 of 1949 with several modifications) in its present form provides: "The legal system of Hungary accepts the generally recognized rules of international law, and furthermore, it shall ensure the agreement between the accepted international obligations and domestic statutes."

in fact the *transformation* of an international treaty into the Hungarian law, i.e. the promulgation of a treaty in the Official Journal (*Magyar Közlöny*) as a Hungarian legislative act in the form of an instrument of domestic law (regulation, statute).[2]

Thus the Hungarian judiciary and other organs applying the law regard not the international treaty ifself but the internal legislative act as the source of law.

However the regulation having the force of statute (tvr.) No 27 of 1982 on the conclusion of international treaties also provides for the mere publication of an international treaty in the official journal without actually transforming it.[3] While the internal legal status of an international treaty already transformed is clearly defined by the legislative act of promulgation, that of an international treaty merely published cannot be ascertained. In the present state of Hungarian law the priority of international treaties is not recognized.

The provisions outlined above present several difficulties, especially for the judiciary. A judge, for instance, finds no guidance in the relevant legal materials as to the relationship between an international treaty promulgated by a statute, and another domestic statute on the same subject. It is unclear whether the principle *lex posterior derogat legi priori* is applicable. The situation is even more complicated if such a collision exists between a regulation of the Cabinet, and a previous or subsequent statute, i. e. in cases where reference might be made to the principle *lex superior derogat legi inferiori.*

Some German courts—with regard to the provisions of the *Grundgesetz* also establishing a dualistic/transformational system—have on several occasions deemed an international treaty *lex specialis* in order to secure its priority

[2] E.g. statute No. 100 of 1999 on the promulgation of the European Social Charter; regulation of the Cabinet No. 148 of 1998 (IX. 18.) on the promulgation of the Agreement between the Government of the Republic of Hungary and the Government of the Russian Federation concerning the cooperation in cultural, scientific and educational matters; however, the Exchange of Letters between the Government of the Republic of Hungary and the Commission of the European Communities on (The Rapporteur's remark: the promulgation of a legal instrument is the final phase of its adoption (in this regard, see: Creifelds, C.: Rechtswörterbuch. Munich, 1978 (5th ed.) 224 and 890). Since the adoption of an international treaty is complete by signiture, ratification or accession, its promulgation seems superfluous and meaningless.)

[3] Art. 13 of the regulation having the force of a statute (tvr.) No. 27 of 1982 provides: "(1) International treaties ratified by Parliament shall be promulgated by statute. (2) International treaties conferring rights and duties on natural and legal persons in a direct and general manner shall be promulgated by statute, regulation having the force of a statute, regulation of the Council of Ministers or regulation of a Minister. (3) International treaties not referred to in paras. (1) and (2) shall be published. The Council of Ministers or the Presidium of the People's Republic of Hungary may decide otherwise."

over the domestic legislation by invoking the principle *lex specialis derogat legi universale.*[4] However the Hungarian judiciary has not developed a similar approach so far inducing the Hungarian judge to enforce the domestic act.

On the other hand it must be emphasized that a number of important Hungarian statutes and regulations contain a *"without prejudice to international treaty obligations"*[5] clause as to the scope of their provisions. In such cases the international treaty—or maybe an existing *mutual practice* in its absence—shall be enforced based on the express provision of the domestic act. This process might prove to be quite lengthy, since the Minister of Justice is authorized to pronounce on the existence of such mutual practices.

At this point the national rapporteur would like to propose a general but very important concluding remark. In the post-1989 era the parties to a law-suit invoke the provisions of an international treaty with increasing frequency and success. In the second half of the 1990's the Hungarian legislative branch (the Parliament) passed a statute on taxation which entered into force even though it violated the bilateral treaties concluded by Hungary to avoid double taxation.[6] The growing number of references to these international treaties compelled the internal revenue service (APEH—Bureau of Taxation and Financial Control) to issue an instrument of interpretation to construe the domestic statute in a way conforming to the international obligations emanating from these treaties. (The question remains whether such interpretation of a statute by an administrative or executive organ is authentic or even constitutional.[7]) It must be noted however that without this kind of interpretation or modification the success of an action

[4] FG Bremen 18. 2. 1970. (II. 114/68) EFG 1970, FG Baden-Württemberg 3. 9. 1970 (VI. 58/69) EFG 1970, FG Baden–Württemberg 29. 11. 1968 (III./II.74/67) EFG 1969, FG Münster 28. 2. 1965 (II.a.417/65) EFG 1965. In: *Fontes Iuris Gentium.* Series A. Sectio II. Tomus 6. 1966–1970. 6–7. Nr. 107, 120, 73, 11.

[5] For such provisions, see *inter alia* Art. 37 (1) of statute No. 100 of 1995 on customs duties, Art. 1 of statute No. 95 of 1995 on foreign exchange, Art. 1 of statute No. 112 of 1996 on credit banks and financial services.

[6] The Agreement of July 18, 1977 between the Republic of Hungary and the Federal Republic of Germany on the avoidance of double taxation of income, profit and assets, promulgated by the regulation having the force of a statute No. 27 of 1979, provides that a State shall not exercise its right of taxation based on the seat of the enterprise if the income has already been taxed by the other State.

[7] Cf. APEH (Bureau of Taxation and Financial Control) guidelines 1995/62 on the interpretation of the agreement between Hungary and Germany on the avoidance of double taxation.

brought before a court by disadvantaged individuals or companies would have been rather unsure.

As far as the enforcement of foreign law in the area covered by *private international law* is concerned the relevant provisions are much better and safer. The Code on Private International Law[8]—internationally acknowledged for its quality drafting—is applied by the judiciary without reservations.

Admittedly the judicial practice on the enforcement and enforceability of the treaties concluded under public international law is somewhat ambiguous and equivocal. But the effect of the decisions taken by international organizations[9] and of the rulings of international judicial organs is even more obscure since in this area legislative act or judicial practice is totally lacking.[10]

II. Practical Examples

1. From 1990 onwards the Constitutional Court many times had to face the interpretation of Art. 7 (1) of the Constitution in attempting to define the relationship between international law (including international treaties) and the domestic legal system.[11]

The most controversial decision so far concerned the constitutionality of statute No 90 of 1993 (the so-called "act of delivering justice"). The statute adopted by Parliament provided for criminal proceedings against persons who took part in the crimes committed against participants of the revolution of 1956 despite the fact that according to the Criminal Code in force at the commission of the act, the limitation period prescribed for these crimes has already expired.

In consequence the Constitutional Court held that no criminal proceedings might be initiated under Hungarian domestic law, but if the acts in question constitute a crime under international law and the relevant rules of international law so provide, an action might be based on these provisions.[12] Both

[8] See regulation having the force of a statute No 13 of 1979. The regulation having the force of a statute existed as a source of internal law until 1990. The Presidium of the People's Republic was authorized to issue such instruments being in effect equal to the statutes of the Parliament.

[9] Cf. UN Security Council Resolutions 757 (1992), 760 (1992) and 820 (1993).

[10] Cf. Case concerning the Gabčikovo-Nagymaros project.

[11] Cf. Constitutional Court decisions 30/1990 (XII. 15.), 16/1993 (III. 12.), 53/1993 (X. 13.), 36/1996 (IX. 4.), 4/1997 (I. 22.), 30/1998 (VI. 25.).

[12] In its decision 53/1993 (X. 13.) the Constitutional Court held that notwithstanding the expiry of the limitation period for a crime set by domestic law, if "the act committed

the Constitutional Court and the proceeding courts of justice declared such charges admissible basicaly by invoking common Art. 3 of the four Geneva Conventions[13] of 1949. In the opinion of the national rapporteur, from the viewpoint of international and constitutional law the main difficulty was created by Hungary's failure to transform the Geneva Conventions into internal law, publishing only the titles thereof in the official journal and completely omitting their texts.[14] Accordingly the Geneva Conventions could not become

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is considered a war crime or a crime against humanity under international law and the rules of international law prohibit the existence of such a limitation period, Hungary is bound by international law to exclude limitation in these cases."

[13] Common Art. 3 of the Geneva Conventions of 1949 provides that:

"In the case of armed conflict not of an international character occurring in the territory of one of the High Contracting Parties, each Party to the conflict shall be bound to apply, as a minimum, the following provisions:

(1) Persons taking no active part in the hostilities, including members of armed forces who have laid down their arms and those placed *hors de combat* by sickness, wounds, detention, or any other cause, shall in all circumstances be treated humanely, without any adverse distinction founded on race, colour, religion or faith, sex, birth or wealth, or any other similar criteria.

To this end, the following acts are and shall remain prohibited at any time and in any place whatsoever with respect to the above-mentioned persons:

(a) violence to life and person, in particular murder of all kinds, mutilation, cruel treatment and torture;

(b) taking of hostages;

(c) outrages upon personal dignity, in paricular, humiliating and degrading treatment;

(d) the passing of sentences and the carrying out of executions without previous judgement pronounced by a regularly constituted court, affording all the judicial guarantees which are recognized as indispensable by civilized peoples.

(2) The wounded, sick and shipwrecked shall be collected and cared for.

An impartial humanitarian body, such as the International Committee of the Red Cross, may offer its services to the Parties to the conflict.

The Parties to the conflict should further endeavour to bring into force, by means of special agreements, all or part of the other provisions of the present Convention.

The application of the preceding provisions shall not affect the legal status of the Parties to the conflict."

[14] The exact words of the regulation having the force of a statute No. 32 of 1954 are as follows:

"Regulation having the force of a statute of the Presidium of the People's Republic No. 32 of 1954 on the legal effect of the International Conventions for the Protection of Victims of War done at Geneva on August 12, 1949. (The instrument ratification of the People's Republic of Hungary have been deposited at Bern, on August 3, 1954.)

part of the Hungarian law. The relevant decision of the Constitutional Court is based on the assumption that the Geneva Conventions belong to the generally recognized rules of international law, and thus became part of the Hungarian legal system by virtue of Art. 7 (1) of the Constitution providing for the *"general transformation"*[15] of such norms.

The provisions of the Constitution referred to above were interpreted in 1998 by the Constitutional Court in a more detailed and precise manner. The Court reinforced that an international treaty may become part of the Hungarian law only by an act of transformation. In addition the Court held that it had no jurisdiction to rule on the constitutionality of an international treaty itself but reserved the right to do so as regards the transformed version of the international treaty, i.e. the domestic act performing the transformation.[16] Following the same line of reasoning the Constitutional Court declared unconstitutional an instrument publishing the executive provisions of a protocol of the Association Council relating to Art. 62 of the Association Agreement concluded between the Republic of Hungary and the European Communities and their Member States (the so-called European Agreement), without having to pronounce on the treaty itself.[17]

Art. 1 The Presidium of the People's Republic hereby incorporates the following Conventions for the Protection of the Victims of War done at Geneva, on August 12, 1949 into its regulations having the force of a statute:

1. Convention for the Amelioration of the Condition of the Wounded and Sick in Armed Forces in the Field;
2. Convention for the Amelioration of the Condition of Wounded, Sick and Shipwrecked Members of Armed Forces at Sea;
3. Convention relative to the Treatment of Prisoners of War;
4. Convention relative to the Protection of Civilian Persons in Time of War.

Art. 2 (1) The Conventions enumerated in Art. 1 shall be effective as regards the People's Republic of Hungary from February 3, 1955.

(2) The competent ministers shall be responsible for the execution of the Conventions.

Art. 3 The Minister of Foreign Affairs shall be responsible for the communication of the official translation of the Conventions to the public before the Conventions shall take effect."

[15] The transformation of customary rules is inconceivable. The concept of "general transformation" have been invented by the dualistic doctrine and practice in order to provide for the internal application of universal customary rules, and their recognition as a part of the national legal system. In this regard, see Müller, J. P.—Wildhaber, L.: *Praxis des Völkerrechts*. Bern, 1977. 134.

[16] Cf. Constitutional Court decisions 4/1997 (I. 22.) and 30/1998 (VI. 25.).

[17] The Constitutional Court in its decision 30/1998 (VI. 25.) has reinforced its stance taken in decision 4/1997 (I. 22.): "According to decision 4/1997 (I. 22.) the Constitutional Court after finding unconstitutional a provision of an international treaty, shall declare

2. For the analysis of Art. 7 (1) of the Constitution, it also might be of interest to take a look at the domestic legal effect of judgement No 92 of the International Court of Justice (ICJ) dated September 25, 1997 in the case concerning the Gabčikovo-Nagymaros project inolving Hungary and Slovakia. In 1992 the Republic of Hungary terminated a bilateral treaty[18] stipulating for carrying out a joint project originally concluded in 1977 between Hungary and Czechoslovakia. In doing so, Hungary—by an act of domestic legislation—abrogated the regulation having the force of a statute No of 1978 that transformed the bilateral treaty into domestic law.[19] The ICJ held however that Hungary could not lawfully terminate the treaty and it is still in force. Nevertheless the statute No 40 of 1992 abrogating the regulations having the force of a statute No 16 of 1978 and No 6 of 1984 (the second act promulgated the 1983 protocol of Prague modifying the original treaty) continues to be operational as far as the domestic law of Hungary is concerned.[20]

3. The national rapporteur finally would like to note the difficulties that were presented by the application of the Security Council resolutions of 1992-1993 imposing embargo on the Federal Republic of Yugoslavia.[21] In compliance with the resolutions, the Hungarian legislature amended the Criminal Code and provided for a new criminal offence. However the definition of this crime inserted in the Code was too general and vague for the courts to apply it in an exact manner, since it did not contain the enumeration of the acts falling under the scope of the resolution.[22] Though the resolution itself usually was not available for the judges, they wouldn't have been allowed to apply it in a way contrary to the Criminal Code (a statute) anyway because it was *in part promulgated by an inferior source of domestic law (regulation).*[23] The situation was further complicated by

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unconstitutional the internal legal instrument promulgating the treaty. The declaration does not affect the international obligations of the Republic of Hungary." (Reasoning of decision 30/1998 (VI. 25.) Part VI. Section 2.)

[18] Promulgated by regulation having the force of a statute No. 17 of 1978.

[19] See statute No. 40 of 1992.

[20] The statute No. 40 of 1992 was still effective on November 1, 2001.

[21] See Security Council Resolutions referred to *infra* 11.

[22] Art. 261/A of the Criminal Code provides: "Whoever violates the economic, commercial or financial restrictions imposed under international obligations of the Republic of Hungary, shall commit a crime, if such act is sanctioned by separate statute."

[23] On this problem, see Kovács, P.: Nemzetközi szervezetek szankciós típusú határozatai magyarországi érvényesíthetőségének alkotmányjogi gyakorlata és problémái. (Constitutional Practices and Problems of Applying in Hungary the Resolutions

the legislature's failure to provide guidance in distinguishing the resemblant cases of *"smuggling"* and *"violation of embargo"*.

In spite of the aforementioned constitutional problems as a matter of fact there are encouraging attempts to define the status of international treaties in the legal system of Hungary, to facilitate their application by the judiciary, and in general to honor their provisions. These attempts—even in short term—might contribute to the disappearance of a tradition of neglecting the international treaties in the domestic administration of justice that characterized the judicial practice between 1950 and 1990. For these ends the modification of the Constitution is indispensable in order to secure the application of international treaties and clarify their priority over domestic law. The remarks and proposals of the Hungarian scholars of international law are intended to support this process.[24]

III. Treatment of individuals and entrepreneurs

First of all one must point out that the law of Hungary recognizes the right of entrepreneurship and contains provisions on the protection of the rights of individuals.

1. The fundamental rights of individuals are dealt with in a separate chapter of the Constitution[25] and in other statutes laying down detailed rules for each fundamental right.[26]

The protection of fundamental rights is also fostered by Hungary's becoming a party to the European Convention for the Protection of Human

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of International Organizations Imposing Sanctions) In: *EU-csatlakozás és alkotmányozás*. (Publication No. 2. of the Department of International Law, University of Szeged), Szeged, 2001.

[24] See particularly the critiques by Bodnár, L.: The Relationship of International Law and Domestic Law in our Constitution—de lege ferenda. *Acta Jur. et Pol.* Szeged, Tom. XLIX., Fasc. 8., Szeged, 1996.; Bragyova, A.: A magyar jogrendszer és a nemzetközi jog kapcsolatának alkotmányos rendezése. (Constitutional Regulation of the Relationship between International Law and the Hungarian Legal Order.) In: *Nemzetközi jog az új alkotmányban* (ed. András Bragyova), Budapest 1997.; Vörös, I.: Az Európai Megállapodás magyar bírósági alkalmazása. (Implementation of the European Agreement by Hungarian Courts.) In: *Collega* (Journal of the Loránd Eötvös University), 1997/3–4.

[25] For the enumeration of fundamental rights, see Chapter XII of the Constitution (Art. 54–70/K) entitled "Fundamental Rights and Duties".

[26] See *inter alia* staute No. 2 of 1989 on the right of association, statute No. 3 of 1989 on the right of assembly, statute No. 7 of 1989 on strike.

Rights and Fundamental Freedoms (the 1950 Convention of Rome and its Protocols), the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights adopted in 1966 under the auspices of the UN. In addition Hungary took the necessary measures to enable other States as well as individuals claiming to be victims of violations of any of the rights set forth in the Convention or in the Covenants to access the Europen Court of Human Rights or to submit a communication to the Human Rights Committee by becoming a party to the relevant optional protocols, as well.

2. The law of Hungary (e.g. statute No 144 of 1997 on incorporated companies, statute No 145 of 1997 on the company register, the publicity of company related informations and judicial proceedings concerning companies or statute No 24 of 1988 on foreign investments in Hungary) recognizes the right of entrepreneurship and promotes both individual and corporate enterprise.

Accordingly there are tens of thousands of companies incorporated at the Hungarian registry courts. A significant percentage of these companies incorporated in Hungary is exclusively or in part owned by foreigners.

The protection and promotion of foreign investments is facilitated by nearly 50 bilateral treaties.

After abandoning the completely planned economy of the socialist era and abolishing State monopoly in international commerce, from 1990 on—subject to some limitations on quantity and compulsory licenses—both internal and external trade can be pursued by anyone. From July 2001 as a result of our membership in the OECD and the progress made in the negotiations concerning our accession to the EU, all restrictions on capital movements and current transactions and transfers have been lifted as regards individuals and companies allowing curbs only for the purposes of the oppression of money laundering.[27]

3. Litigation concerning companies incorporated in Hungary may usually be initiated before the regular courts of Hungary. Even if the conctractual relationship involves international elements (e.g. damage suffered either at home or abroad during an international conveyance), in most cases the jurisdiction of a Hungarian regular court or court of arbitration can be

[27] On the liberalization of capital movements and current transactions and transfers, see Cabinet regulation 88/2001. (VI. 25.).

established according to the provisions of the Code of Private International Law or the Code of Civil Procedure.

If the case involving Hungarian citizens or legal persons is judged by a foreign tribunal, the protection of their interests and the assertion of their rights is facilitated by international agreements. The Republic of Hungary concluded some 60 bilateral treaties on judicial assistance in civil and commercial matters. The content of such agreements is of course not uniform, e.g. the treaty of 1965 between Hungary and Austria only provides for judicial assistance in civil matters and the recognition of official documents, however the treaties of 1980 between Hungary and France and of 1981 between Hungary and Finland deal with judicial assistance in civil, family and criminal matters as well.

The Republic of Hungary is also a party to many multilateral treaties on judicial assistance and on other topics with economic implications protecting and binding the Hungarian entrepreneurs and the Hungarian State, as well. Some provisions of international treaties have been incorporated into Hungarian statutes without modifications, e.g. Art. 8 of the Agreement on the Implementation of Art. VII of the General Agreement on Tariffs and Trade is reproduced in our 1995 statute on customs duties.[28]

The ban on all kinds of discrimination is strictly enforced as regards individual rights and the freedom of entrepreneurship. Discriminative practices have been used frequently by employers but firm State action has been taken in return. It is illegal for an employer to determine conditions for the filling of a vacancy based on gender or age. Exceptionally such discrimination is allowed only if the characteristics of the job itself so require. It is also illegal to publish job advertisments of discriminative nature.

The real problems are of course presented not by the open and obvious discrimination but by the so-called latent discrimination especially directed against gypsies. In such cases the employer will not hire e.g. a gypsy or a pregnant woman but gives other reasons for refusing the application.

Further work has to be done—not only in Hungary—concerning the discrimination based on sexual orientation and the rights of homosexuals and other persons with a not exclusively heterosexual attitude. These days in Hungary a huge debate is going on about a decision of the public guardianship authority allowing a well-known transvestite to adopt a baby. (Should a homosexual or a transvestite be allowed to adopt and raise a child?)

[28] Cf. statute No. 100 of 1995, Art. 21–33.

IV. Foreign investments in Hungary, investments of Hungarian nationals abroad

In the past ten years, since the beginning of the transformation of Hungary into a market economy a multi-speed process could be observed in this field. A separate statute was adopted on the foreign investments in Hungary in order to facilitate the influx of capital.[29]

The single most important barrier is the prohibition of the acquisition of agricultural lands by foreigners. This situation is not expected to change until several years after Hungary's accession to the EU. Otherwise the capital moving into Hungary (first of all green field investments) was given preferential treatment, especially between 1990 and 1995. In the same time a number of treaties on the protection of foreign investments were concluded between Hungary and other States.[30]

The liberalisation of the investments of Hungarian nationals in third countries was not completed until the aforementioned liberalisation of capital movements and current transactions and transfers. Accordingly investments of Hungarian natural or legal persons in third countries might be limited only in areas requiring special protection and only by invoking the internationally accepted causes of restriction (public order, national security, protection of cultural heritage etc.) besides being subject to the provisions of the host State.

[29] Cf. statute No. 24 of 1988 on foreign investments in Hungary

[30] E.g. with the Federal Republic of Germany, Canada, Kuwait, Spain, Israel, Australia, Italy, Austria, Sweden, France, United Kingdom etc.

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IV. C. 3. Rights of Embryo and Foetus in Private Law

GÁBOR JOBBÁGYI*

Rights of Embryo and Foetus in Private Law

Abstract. The paper gives an overview of the Hungarian legal regulation of the legal status of the foetus. In this respect, it reveals the historical roots of the legal protection of the foetus in Hungary. It analyses in details the theoretical standpoints of Hungarian authors of civil and criminal law. It describes the unconstitutional legal practice of the period of communist dictatorship (1950-1990) that lead to the unparalleled destruction of 4,5 million embryos. It analyses in details the unconstitutional practice. The analysis also includes the treatment of he prevailing "Embryonic Life Protection Act". Finally, the essay determines, in accordance with Hungarian legal practice and jurisprudence, the legal status of the foetus and comes forward with proposals addressed to future legislation.

Keywords: legal status of the foetus, decisions of the constitutional Court, "Embryonic Life protection Act"

1. Foundations of the Legal History and in Law under Hungarian Law

As far back as the Middle Ages, the status of embryo and foetus had some roots deeply entrenched in Roman law, which had been received into Hungarian law.

In 1517 Werbőczy's *Tripartitum*, practically having the force of law, spelled out what held sway for three centuries: "Here we must realize that some of the offspring are called 'conceived', others 'born', and yet others 'posthumous'. Those conceived are ones who have been procreated in the mother's uterus by the sexual union of husband and wife, but are unborn. Given their nature, they enjoy equal rights with the offspring born and living, from the date of conception as evidenced by delivery".

Embryo and foetus exist and have rights under medieval Hungarian law. While the rights of foetus are primarily rights to succeed, foetus is *full-fledged* in this field, that is to say that foetus, if born alive, must be regarded as having been living at the time of accrual of the inheritance.

* Professor and Director of Institute, Pázmány Péter Catholic University, Budapest, H–1088 Budapest, Szentkirályi u. 28–30., Hungary.
E-mail: jobbagyigabor@yahoo.co.uk

In addition, Hungarian law had never made any reference to the possibility of legal abortion down to the 20th century. King Coloman I's penal code of the 11th century referred to "women destroying embryo or foetus", who were required to "expiate before their archdeacon". This led the Council of Buda, held in 1279, to rely on the threat of excommunication against women procuring abortion. Pursuant to municipal laws, the courts passed severe criminal sentences for procured abortion during the 16th and 17th centuries. Sentences were severe especially in cases where "the foetus already had soul", a fact which occurred on the 40th day following conception, because that date caused such women to be sentenced for "filicide". Data testifying to death sentences passed on women for aborticide are available from 1576, 1582, 1612 and 1655.

The first Penal Code of the Hungarian State (Act V of 1878) contained uniform strict regulations under the hallmark of disestablishment of the Church. Articles 285 and 286 prescribed separate penalties for women procuring abortion (imprisonment for a term of 2 to 3 years) and for illegal aborters (imprisonment for a term of 2 to 15 years).

During the 19th and 20th centuries, private-law practice, which was developing along the lines of customary law, granted foetus *conditional capacity to rights*, meaning that *legal capacity was subject to live-birth*. In other words, a foetus born alive was to be regarded as capable of rights from the date of conception. In one of its judgements delivered in 1892 the Supreme Court (*Curia*) held that "even foetus has rights, which, in case of birth, the court shall proceed *ex officio* to have preserved and enforced".

Up to the first part of the 20th century there was no legal practice to change the legally absolute protection of foetus and there was no jurist to support the legalization of abortion.

In 1933 a judgement of the *Curia* spelled out that abortion performed for the purpose of protecting a mother's life and health was not punishable. This, in the absence of legislative authorization, served to introduce medically indicated abortion into medical practice under circumstances that made it virtually impossible to know when such indication was justified. Given that in 1945 thousands of Hungarian women were raped by Soviet troops occupying the country, a decree of the Minister of Health cleared the way to abortion for a period of a few months.

In summing up developments during the period extending to 1950 it can be stated that the criminal legislation of Hungary accorded absolute protection to foetus, while Hungarian private law recognized conditional capacity to rights.

The period of 1950 to 1990 saw radical changes in "socialist" legislation concerning the status of foetus and the legalization of abortion.

The distinctive features of that era were the following:

— the status and the rights of foetus were not covered by a single provision of law or court decision, and the subject-matter was theoretically treated in brief by only a few writers;

— the Penal Code retained the ban on abortion, while government decrees and departmental orders devised a system for the authorization of abortion that was the world's most liberal as compared to contemporary legal practice;

— abortion as the only method of birth control was practised on a mass scale before the spread of contraception;

— there was no explanatory work and, in the absence of the right of association, there existed no "pro life" organizations, with no possibility for protest against the existing legal practice even within the frameworks of the churches.

All these features combined to result in the world's highest ratio of legal abortions in Hungary by comparison with the number of inhabitants (about 10 million) between 1956 and 1990, with a total of some 4,5 million legal abortions performed.

In more years than one, the number of abortions exceeded by far that of live-births (in 1969, for instance, there were 206,815 abortions against 154,319 live-births). This caused Hungary to become a country with the worst demographic pattern, the number of inhabitants decreasing by some 500,000 between 1981 and 2001.

The period 1950–1990 witnessed the following changes in the legal system:

— the years of 1953 to 1956 were a period of "abortionist terror", with legal abortion practically non-existent and with sentences of imprisonment for a term of 8 to 10 years often meted out for illegal abortions, while the social bases for the upbringing of children were lacking;

— the period 1956–1973 was that of the most liberal system for authorization of abortion in the contemporary world. If an expectant woman appeared before the "abortion committee" prior to the 12th week of pregnancy and said, without giving any cause or reason, that she wanted to receive abortive treatment, the permission had to be granted;

— during the period of 1973 to 1988 there was introduced a model of indications of a rather wide scale: in case of 6 indications the abortion committees had to grant, while in case of 4 indications it might grant, permission for abortive treatment. The annual number of abortions fell by 100,000 under the impact of that legislation;

— the scale of indications for abortion was further narrowed in 1988.

After the collapse of the communist party state (1989–1990) the Constitutional Court was established in Hungary, and there came into being organizations for the protection of life. The *Pacem in Utero* association immediately applied to the Constitutional Court to have the party-state rules on abortion declared unconstitutional.

In its Decision No. 64/1991. (XII. 17.) the Constitutional Court declared the whole body of relevant party-state legislative enactment's to be unconstitutional and annulled the subordinate provisions of law. It held that this domain was to be governed by legislative acts only, because it involved fundamental constitutional rights, such as the foetus's rights to life and legal capacity as well as the right of free disposal of one's own self.

Several of the Court's decisions contained findings of paramount importance:

— Foetus can be regarded as a *person* from the date of conception, subject, however, to an act of legislation. There is no bar to the law-maker recognizing "man as man from the date of conception".

— Any authorization of abortion with no reason assigned is unconstitutional. The grounds for authorization are to be stated by law, it being understood that both complete ban and fully legalized abortion are contrary to the Constitution.

— The law-maker may provide that foetus is a human being, in which case nothing but indications of emergency are legal. Should the law-maker decide that foetus is not a human being, the State's constitutional responsibility for the protection of foetal life is nonetheless incurred. The Court held that "protection of foetal life is a state responsibility from the date of conception".

Constitutional Judge Tamás Lábady, in his dissenting opinion appended to the decision, maintained that "foetus is a person, viz. a subject at law, and has, from the date of conception, a subjective right to be born".

Act LXXIX of 1992 on the Protection of Foetal Life was adopted in the wake of the above-mentioned decisions of the Constitutional Court. It has failed to spell out that foetus is a "person" and to invest it with legal capacity and with rights. Although protecting foetus in principle, this Act can practically be considered to be an "act on abortion". It presents some positive as well as negative features with regard to the protection of foetal life, namely

— it states that "foetal life beginning with conception shall enjoy respect and protection"; it introduces a "pregnancy allowance" due form three months of embryonic life; makes it a duty of the State to do explanatory work and to provide information prior to termination of pregnancy;

— it introduces a system of indications for abortion, including a broadly termed "crisis indication", up to 12 weeks of pregnancy. Medical indications are likewise formulated in a rather wide sense. It is silent on the protection of embryo formed by way of artificial fertilization.

The status of embryo formed by way of artificial fertilization as well as the related procedures are regulated by Articles 165–187 of Act CLIV of 1997 on Public Health, which distinguishes *embryo* and *foetus*. Considered as embryo is a viable human embryo from the date of conception to 12 weeks of pregnancy, while defined as a human being is a foetus from 12 weeks of pregnancy. The Act affords little legal protection for embryo and deems artificial fertilization, embryo donation and research on embryo to be a basically medico-technical issue. While gratuitousness is held to be the general rule during the related procedures, the Act consistently uses property-law terms (embryo "donation", "deposit" of embryo, "disposal" of embryo, etc.).

The aforesaid two enactment's are silent about the starting date of human life. The date of conception is determined by Art. 9 of the Civil Code: "the three hundredth day preceding the date of birth shall be considered the day of conception, but it shall be open to proof that conception took place at an earlier or a later date".

It is likewise provided by the Civil Code that a curator must be appointed before the birth of the child, if such appointment is necessary for safeguarding the interests of the child (Art. 10). It was pursuant to this Article that in the "Dávod Abortion Case", which found an extremely great echo, the Town Court of Baja, by its Judgement No. 8.P. 20.367/1998/7, prohibited the performance of abortion on a girl mother aged 13. The Court based its judgement on the foetus's constitutional right to life. This notwithstanding, the abortion was performed subsequently.

2. Foetus as a "Person" in Hungarian Law, and Rights of Embryo and Foetus

With regard to recognition of foetus as a "person" and to "rights of embryo and foetus", distinction can be made in Hungarian law between *views of legal theory and civil law* and the *approach of positive law*.

2.1. Recognition of foetus as a "person" and of the related rights of embryo and foetus has always been a majority or dominant opinion in the history of the science of Hungarian private law.

István Werbőczy's *Tripartitum* (1517), which was of decisive importance in Hungarian private law for three centuries, declared an embryo conceived

to have *equal rights* with a foetus born.[1] Based on it, Emericus Kelemen's first textbook of note on private law (1804) divides "persons" into three groups: persons conceived (*conceptas*), persons born (*natas*) and persons born after their fathers' death (*posthumas*). It states that "favourable opinion" regards them as being of full standing. Kelemen points that the expectant mother enjoys benefits in the interest of foetus (*"Quin favore foetus"*).[2]

Hungarian legal folkways in this field are interesting. According to traditions, "abortion in a sin form the outset, but once the foetus has quickened it is a murder, because thenceforth the foetus has soul". Another tradition has it that "aborting women go to hell", "fall victim to the devil", and "have to eat the aborted foetus in the hereafter".[3]

Károly Szladits, a determinant figure of Hungarian jurisprudence in the 20th century, asserts that "in case of live-birth a foetus is similarly personable, its legal capacity is not limited to certain rights or modes of acquisition, but is *general yet conditional* for it (foetus) has to be born alive". He even names some rights pertaining to foetus, such as family rights, rights of inheritance, rights to damages, maintenance, gift, and mortgage registered in its favour, and the right to make certain contracts through its representative.[4]

Andor Sárffy, too, accepts the foetus's capacity to rights: "Once we accept the tenet that legal capacity is possible without disposing capacity, concerns are allayed that one who cannot exercise his rights cannot have legal capacity either".[5] Bálint Kolosváry argues that the principle *"Nasciturus pro iam nato habetur, si de commodis eius agitur"* (One to be born is to be regarded as born if one's benefits are involved) certainly prevails in Hungarian law.[6] According to criminal jurist Ferenc Finkey, the object

[1] *Werbõcy István Hármaskönyve* (István Werbõczy's *Tripartitum*), Révai 1897, Part II, Title 62, §§ 2–4.

[2] Kelemen, E.: *Institutiones Juris Privati Hungarici*, Pest, 1804, 178–180.

[3] Tárkány-Szücs, E.: *Magyar jogi népszokások* (Hungarian Legal Folkways), Budapest, 1981, 113–125.

[4] Szladits, K.: *A magyar magánjog vázlata* (An Outline of Hungarian Private Law), Budapest, 1937, 74.

[5] Sárffy, A.: *A jövõbeli ember jogképessége* (Legal Capacity of Man Yet Unborn), in: *Szladits Károly emlékkönyv* (Essays Presented to Károly Szladits), Budapest, 1938, 47–55.

[6] Kolosváry, B.: *Magánjog* (Private Law), 1930, 78.

in law of the crime of procured abortion is constituted by "the right of foetus to life".[7]

The most definite stance in 1946 was represented by István Szászy, a jurist of European fame, claiming that "even a foetus and even a human yet to be conceived are persons and consequently have legal capacity, because in our law both are vested with rights, and with rights not only prospective but also present, while legal obligations devolve on them, and, to be sure, one either entitled or legally bound can only be a legally capable person".[8]

After 1945 the communist system of law unconstitutionally introduced an extremely liberal machinery for the authorization of abortion, which it was impossible to protest against openly. Still, the traditional views appeared in the pertinent literature and none of the jurists supported the abortion policy of the party state, which allowed 4,5 million abortions. In 1965 Károly Törő posited that "legal capacity pertains to man, not from birth and not from the development of human consciousness, but from the date of conception... Man is endowed with personal rights in certain respects form the time legal capacity is acquired. Most important of such rights is the right to life, the *sine qua non* for the acquisition and exercise of any other right".[9] In 1986 he added that "even before birth, from the date of conception, our legal system ensures the protection of interests of the child to be born. Although the foetus is not yet a person, it carries the real possibility of a legally capable person being born".[10] Also, in the debate of 1990 over the rules on abortion, he said "this regulation is unsatisfactory... It should be recognized that foetus is a human being capable of independent legal protection". Barna Lenkovics contended that it was untenable that protected animals were afforded a greater protection of the law than "foetal man" was, even though his right to life emanated form several rules of the Civil Code.[11]

This opinion is shared by Gábor Jobbágyi, the present writer, whose views, set forth in several professional articles and two books, can be summed up as follows: foetus exists in law, as it flows form many articles of the Civil Code and the Penal Code; "foetal man" is a human being form

[7] Finkey, F.: *A magyar büntetõjog tankönyve* (Textbook of Hungarian Criminal Law), Budapest, 1914, 594.

[8] Szászy, I.: *Magyar Magánjog, Általános Rész* (Hungarian Private Law, General Part), Budapest, 1948, 5–8.

[9] Törő, K.: *Az orvosi polgári viszony* (The Medico-Civil Relationship), Budapest, 1965, 153–157.

[10] Törő K.: *Orvosi jogviszony* (Medico-Legal Relations), Budapest, 1986, 269–274.

[11] Törő K.: A meg nem született magzat jogi védelme (Legal Protection of Unborn Foetus), *Magyar Tudomány*, 1990/7, 845–848.

a medico-moral point of view and is entitled to medico-moral protection; legally, foetus is *a human person in a proces of formation*, and its condition as a subject at law is already independent of that of its mother and father form the date of conception, a reason why foetus cannot be "disposed of"; the legal capacity of foetus is general, equal and temporary; foetus is vested with personal and property rights; its *personal rights* include the right to life (subject to restrictions in very exceptional cases only), the right to dignity and the right to health; its property rights include capacity to inheritance, "capacity to claims" (e.g. claim for damages), and capacity to be a beneficiary (e.g. sale, donation, insurance); in legal relations, foetus is represented by its legal representative(parent, curator).[12]

Three renowned jurists acting as constitutional judges appended dissenting opinions to Decision No. 64/1991. (XII. 17.) AB.h. of the Constitutional Court.

— Tamás Lábady argues that "foetus is biologically a human, not a thing, not an object, but a genetically completed person, an individual, and individual human life is a unique process from conception to biological death. Foetus is therefore a person, or a subject at law, who has a right to be born form the moment of conception".

— János Zlinszky contests the possibility of foetus's full legal capacity, but he claims that foetal life as a *value* is to be protected by all means. "Foetal life is human life to be protected by law", with "disposal" of it as a subjective right pertaining neither to the mother nor to the father.

It is important to stress that the above-mentioned Decision of the Constitutional Court contains a crucial fining, the Court holding that foetus's full legal personality, or its condition as a person is in conformity with the Constitution, but it cannot be established except by the law-maker. That Act LXXIX of 1992 did not grant foetus the status of "person" is a different matter.

At the same time, Hungarian law contains provisions vesting embryo and foetus with rights:

— the Civil Code recognizes the capacity to inheritance for en embryo conceived (Art. 646);

— where it is necessary for safeguarding the rights of foetus, particularly if there is a conflict of interests between the child and its legal representative, a curator shall be appointed for foetus (Art. 10 of the Civil Code);

— foetus may be a beneficiary under a contract of life insurance (Art. 560 of the Civil Code);

[12] Jobbágyi, G.: *A méhmagzat életjoga* (The Right of Embryo and Foetus to Life), Budapest, 1997, 207–214.

— the prohibition of "abortion" in criminal law is placed by the Penal Code among "offences against life, bodily integrity and health", "foetal life" being one of the values to be protected (Art. 169);

— the Preamble to Act LXXIX of 1992 on the Protection of Foetal Life provides that "beginning with conception, embryonic and foetal life deserves respect and protection";

— pursuant to Art. 20 (4) of Act CLIV of 1997 on Public Health, a patient may not refuse life-sustaining or life-saving intervention if she is expectant and is likely to have a normal pregnancy;

— Art. 9 of Act LXXIX of 1992 contains a provision expressly aimed at protection of embryo and foetus, ordaining that a staff member of the Family Welfare Service must inform a mother asking for abortion in a crisis situation "in the interest of keeping the embryo or foetus", in particular about

— state and other support, material and in kind, available in case of accepting the child;

— conception, development of embryo and foetus, hazards of abortion and its effect on eventual later pregnancy;

— the possibilities of and conditions for adoption.

3. Foetus and Mother: Rights in Conflict

The Hungarian rules for authorization of abortion (Act LXXIX of 1992 on the Protection of Foetal Life) are silent on the "rights of embryo and foetus", but refer to the mother's "right of free disposal of one's own self" in regulating authorization of abortion. Pregnancy nay only be terminated in case of "risk" and under the conditions determined by the Act (Art. 5). At the same time, in determining the causes of indication (Art. 6), the Act permits abortive treatment in view of the pregnant woman's situation. The indications for abortive treatment in Hungarian law are:

— causes gravely endangering the health of a pregnant woman;

— pregnancy resulting form a criminal offence;

— grave genetic impairment to foetus;

— crisis situation of a pregnant woman.

Termination of pregnancy is subject to a written request of a pregnant woman (Art. 7).

An expectant woman requesting abortive treatment is required to participate twice in antenatal counselling by the Family Welfare Service.

Counselling must not be neutral, but must serve the protection of unborn life, respecting pregnant women's emotions and human dignity (Art. 9).

4. Date of Conception and Protection of Embryo and Foetus

The date of conception is determined in Hungarian law by Art. 9 of the Civil Code: "The 300th day preceding birth shall be considered to be the date of conception, but it shall be open to proof that conception took place at an earlier or a later date. The day of birth shall be included in this period". Accordingly, the date of conception in Hungarian law is a *presumptive* one, which is subject to proof by medical experts to the effect that conception took place at either an earlier or a later date. "A live-born child shall have legal capacity from the date of conception" (Art. 9 of the Civil Code). Thus, under Hungarian law, conception creates a "conditional legal position", which becomes final upon the child's birth or the failure of delivery. On this ground, Hungarian law endows foetus with conditional legal capacity.

The details concerning the possibilities for the protection of embryo and foetus in legal theory and legislative enactment's have been set out in the preceding two paragraphs.

5. Legal Position of Father toward Embryo and Foetus

In actual fact, Hungarian law confers no right on the father with regard to the birth of foetus. The Act on the "Protection of Foetal Life" is confined to stating that crisis counselling must, so far as possible, be provided *in presence of the foetus's father* (para. 1 of Art. 9), but the father is not entitled to make declarations at law.

6. Protection of Embryo in Case of Artificial Fertilization (IVF Procedures)

"Special procedures for human reproduction and research on embryo and gametes" are covered by Hungarian law in Chapter IX of Act CLIV of 1997 on Public Health (Articles 165–186).

The preambular provisions of the related part of the Act distinguish "embryo" and "foetus" in the following terms: "Deemed to be an embryo is every viable human embryo from the completion of fertilization to 12 weeks of pregnancy" (Art. 165).

The Act itself regulates in detail the general conditions for reproductive procedures, gamete donation, embryo donation, and research on embryo.

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This part of the Act can be said to lego-technically regulate *in vitro* fertilization without vesting embryo with any rights. The Act creates rights and obligations for the participants in procedures (physician, spouses and life-companions). For that matter, it is characteristic of the Act to use *property-law terms* in connection with embryo ("deposit" of embryo, "possession" of embryo, "disposal" of embryo).

Such approach can be construed to mean that the embryo becomes a "thing" during IVF procedures.

Resolution 1100/1989 of the Counsil of Europe is known in the pertinent literature, but it has no influence to bear on the legislative text.

The main provisions of the said legislation are these:

— a reproductive procedure may be executed at the request of spouses or heterosexual life-companions in case of infertility;

— applicants must be advised in detail, orally or in writing, of the reproductive procedure;

— the "right to dispose of an embryo" formed outside the body and not implanted must be exercised in common by the spouses (life-companions). "Disposal" can be threefold:

a) "deposit of embryo" for purposes of later use;

b) donation to other persons;

c) offer for medical research;

— an embryo deposited or donated may be stored for a period not exceeding ten years and, after the lapse of that period, must be destroyed without separate procedure or may be used for medical research;

— an embryo may not be formed for research on embryo and may not be used for such research except with the approval of persons entitled thereto; to that end, there must be formulated a plan and purpose of research to be approved by the Human Reproduction Committee;

— currently no proxy pregnancy (surrogate motherhood) is admissible (although the original wording of the Act allowed such pregnancy, but it was repealed later).

7. Protection of Embryo and Foetus in Vivo

Hungarian law does not regulate the methods of and conditions for conducting diagnostic procedures in the uterus.

Act LXXIX of 1992 on the protection of Foetal Life enumerates the conditions for termination of pregnancy on grounds of genetic impairment among the causes for abortive treatment:

a) pregnancy may be terminated for genetic reasons up to the 12th week if the embryo "seems likely" to be gravely handicapped or otherwise impaired;

b) pregnancy may be terminated up to the 20th week if the probability of the foetus's genetic or teratological impairment reaches 50%;

c) pregnancy may be terminated up to delivery if the foetus shows a disorder incompatible with postnatal life.

Any reason of health concerning embryo and foetus is to be unanimously established by an obstetrical-gynaecological specialist of the genetic counselling service, the centre for prenatal diagnosis or the designated hospital each. The Act does not specify the causes or diseases that may justify termination of pregnancy on genetic grounds.

8. Foetus as an "Organ Donor" in Hungarian Law

The Hungarian legislation in force neither permits nor prohibits the use of viable foetus as an organ donor. In the case of living foetuses this possibility is probably ruled out in practice. Dead (aborted) foetuses may happen in practice to be used as organ donors.

9. Representation of the Interests of Embryo and Foetus in Hungarian Law

Act LXXIX of 1992 on the Protection of Foetal Life and the Chapter on Human Reproduction of Act CLIV of 1997 on Public Health (Articles 165–186) are *silent on representation* of the interests of embryo and foetus.

Art. 10 of the Civil Code allows appointment of a curator for an unborn child if there is a conflict of interests between such child and its legal representative. This means in practice a conflict of interests in matters of *property law* (e.g. both mother and foetus are heirs to assets of an estate). The curator is appointed by the guardianship authority.

It was in a single case, which received great publicity, namely in the "Dávod Abortion Case" (Decision No. 8.P. 20.367/1998 of the Town Court of Baja), that the guardianship authority appointed a curator for the foetus of a 13-year-old girl, who became pregnant through depravation. Since the termination of pregnancy was requested by the girl's legal representative (mother), the curator of the foetus instituted proceedings in the letter's interest. The court of first instance allowed the action by relying on the foetus's right to life and also recognized the curator's right to act in the case. The County Court (judgement No. 1 Pf. 20.532/1998) subsequently

overruled the Decision, holding that the foetus had no capacity to rights. The abortion was performed.

10. Summary and Conclusions

The position of embryo and foetus is *contradictory* in Hungarian law *de lege lata*. The contradiction results form the fact that the current regulations recognize and value the existence of embryo and foetus form the date of conception, affording protection for them, but are essentially silent about their status, legal capacity, rights and representation, particularly as regards the most important issues (abortion, IVF). This contradiction gave rise to serious debates over the past decades, with even the Legislature addressing the matter on three occasions in pursuance of two decisions handed down by the Constitutional Court.

The contradiction and the issue itself, however, have remained unresolved in legislation.

In my opinion, it is the foremost duty of the world's legislators and jurists to settle *de lege ferenda* the status and protection of embryo and foetus. The statement my be ventured that solution of this issue, or its present lack of solution has a decisive influence to bear on the existence of human civilization, since it has profound implications for the fundamental rules on procreation, family life, sexual life, and the medical profession and thereby for the existence or non-existence of individual human communities, for fundamental human rights.

Embryo of foetus is a human person of full value, medically as well as morally, from the date of conception.

It is inevitable for the legislative fora, both international and national, to resolve the questions affecting the status and the rights of embryo and foetus as well as the protection of their rights in such a way that the law will consider embryo and foetus as *human persons in a process of formation*. Such arrangement will result in solutions for a limited capacity to *rights* from the date of conception, for *recognition of specific subjective rights* for embryo and foetus, and for the *protection of their interests and rights through representation*.

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IV. D. 1. Insolvency of Public Entities other than State

ANDRÁS TORMA*

The Regulation of Public Institution Insolvency in Hungary

Abstract. In the Hungarian legal system—after 50 years—, formerly known legal institutions (such as self-governments, private companies, public institutions) reappeared. These legal institutions are independent of the state, they have their own revenues and properties. Thus the possibility of their insolvency was brought up naturally. The Hungarian legal system does not provide an unambiguous definition of public institution. However, with an eye to foreign legal solutions and the Hungarian specialities, we can formulate the concept of public institution which includes organs that are actually separated from the state, that have autonomy, legal personality, independent budget, their own booking (accounting), and that perform tasks of public utility. These criteria are met by three types of organs: self-governments, public bodies, public funds. However, legal regulations concerning these types are not homogeneous. After 1990, when public institutions were established, the state drew back from several public functions and has striven to withdraw itself from the responsibility for inadequate financial administration ever since.

Keywords: insolvency, public institution, self-government, liquidation

Introduction

From time to time the natural (peaceful) development of Hungary's legal system was interrupted by the conquests of external forces (the Turkish Empire, the Habsburg Empire, and the Soviet Union). Due to these influences the homogeneity of our legal system that was built on the Roman law ceased to exist as well from time to time.

This statement is especially true for the period of 1945–1996 when Hungary was put into the zone of interest of and under the authority and guardianship of the Soviet Union—based on the agreement made between the winning powers of World War II in Jalta. The Constitution declared as Law No. XX in 1949 made it clear that Hungary had come off the course of civil society abandoning the multi-party system, the division of powers and the equality

* Lecturer, University of Miskolc, Miskolc–Egyetemváros, H–3515 Miskolc, Hungary.
Fax: (36 46) 565-111; E-mail: jogtoa@gold.uni-miskolc.hu

of the forms of ownership. Instead Hungary started to build a so called socialist system of society that did not recognize the basic values of civil society. It was built on the one-party system, the unity of powers, and the exclusiveness and extreme priority of state property. The emphasis of these principles of course resulted in the rejection of market laws and the creation of the state planned economy. During the period of socialism the state took all the public functions, furthermore, it was the only party in the economy through its companies. All this resulted in an extremely centralized central and local administration (Soviet pattern: the council system) where there was no private property, nor autonomy. Some changes occurred in this social and economic system beginning in the 1970s. Private enterprises and companies appeared in Hungary, the force sticking the local administration to the central authority lessened.

This was the social and economic environment the legal system was adapted to. The socialist model meant that a series of institutions (economic companies, local self-governments, public boards, and public foundations) that had existed before 1945 had vanished from our legal system. At the same time a series of institutions had been established according to the Soviet pattern (state companies, councils). The speed of change in the legal system is properly demonstrated by the fact that 13769 measures were accepted (acts, government regulations, ministry regulations)! Due to the omnipotence of the state the question of insolvency was not raised at all (not even in the economy!), nor was the transfer of particular public tasks to private organizations.

1. The effects of the political changes in 1989–1990

As it is widely known, the collapse of the Soviet Union brought freedom to the Central European countries (Hungary as well) that belonged to the Soviet zone of power according to the above mentioned agreement made in Jalta. The people's republic ceased to exist in Hungary in the fall of 1989 and Hungary became a republic. The Constitution has been considerably amended. The Constitution now declares that Hungary is an independent state, it is a democratic country based on the multi-party system, the division of powers, the equality of forms of ownership and the market economy. According to these principles a proper state organization has been established that meets the requirements of constitutionality. New organizations have been created (the Constitutional Court, the State Audit Office, local self-governments, ombudsman etc.), and the powers and tasks of the institutions that had operated earlier (the Parliament, the Government, courts etc.) have changed. A radical transformation of the legal system has begun.

(For the sake of historical fidelity it must be recorded that the need to change the state organization and the legal system could be strongly felt in the middle of and at the end of 1980s. The transformation of the legal system and the preparation for a radical transformation already started in the mid-1980s. This is demonstrated by the fact that 47% of the 1835 valid acts and 73% of the 2082 ministry regulations were canceled!)

I would like to emphasize only those laws—besides the modification of the Constitution—that are most important in the subject regarding the radical transformation and renewal of the legal system:

— Act No. VI of 1988 on the companies,
— Act No. II of 1991 on the procedure of bankruptcy, liquidation and final settlement,
— Act No. LXV of 1990 on the local self-governments,
— Act No. XXV of 1996 on the settlement procedures of local self-government debts,
— Act No. XLII of 1993 on the amendment of the Civil Code (Law No. IV of 1959),
— Act No. XXXVIII of 1992 on the public finances,
— Act No. CLVI of 1997 on public utility organizations,
— Act No. XL of 1994 on the Hungarian Academy of Science,
— Act No. II of 1989 on the right of association,
— Act No. CXXI of 1999 on the economic chambers,
— Act No. XXXVIII of 1989 on the State Audit Office.

These laws mark the legal frames of creation, operation and winding-up of public institutions not owned by the state, including the procedures to be followed in case of insolvency.

The radical transformation of the Hungarian legal system is proven by the fact that Hungary has closed 22 chapters in 2001 in the negotiations on the accession to the European Union and the country has a real chance to close the negotiations completely by the end of 2002. The Hungarian legal system is practically compatible with the Union's legal system, the "acquis communautaire".

2. The sphere of public institutions in the Hungarian legal system

To define the sphere of public institutions one must start from the concept of public tasks. In my standpoint public tasks, in a vague sense, are all those tasks that must be carried out by the state as a whole entity. This includes legislation, executive tasks and jurisdiction as well. In a narrow sense

public tasks are those tasks that must be carried out by the executive branch of power according to the laws.

The state (the Parliament) has the public tasks of the narrow sense carried out by the government, ministries and the national central authorities and the local organizations of the latter. Also the state orders the local self-governments to execute some of these tasks or creates organizations that carry out public tasks independently but supervised by the state (public boards and foundations). In Hungary the organizations belonging to the first two categories (state administrative organizations and local self-governments) make up the executive branch of power and they represent the organizational system of the Hungarian administration together.

The local self-governments can take other public tasks besides those prescribed by the act. They can do this with two restrictions: 1. the tasks is not ordered to be done by another organization according to the law, 2. the performance of these tasks does not endanger the performance of the mandatory tasks. The local self-governments can establish public foundations, public utility companies and even economic companies to carry out the tasks of the local self-government.

In my standpoint due to the above mentioned facts it is necessary to give a definition of public institutions in a vague and a narrow sense as well. In a vague sense public institutions are all those state and non-state organizations that carry out public tasks (including the state administrative organizations as well). In a narrow sense public institutions are those that are really separated from the state and that carry out public tasks as independent legal entities with their own budget and accountancy. In my standpoint the following organizations belong to this category: local self-governments, public boards and public foundations.

The present review introduces the public institutions according to the narrow sense, concentrating on their management and insolvency and trying to answer the questions given by Professor Knapp who made the main review.

3. The viewpoints of the main review

The viewpoints of examination given by Professor Blaise Knapp raise the following questions regarding the insolvency of Hungarian public institutions:

1. What kind of sources of finance do these organizations have based on the law or whether they are entitled to take loans only as accepted by practice?
2. Whether the loans taken by these organizations are subjected to special administrative procedures or to the general rules of taking loans?

3. Whether it is necessary to provide a deposit toward the creditors (if yes, what kind of deposit)?
4. Whether there is a rule of law regarding the highest possible limit of indebtedness. Or this limit is defined by the supervising organization or by the principles developed during the operation. i.e. whether the highest possible limit of debt is determined by the general principles of "ordinary" management (balance of the budget)?
5. Whether there is a rule of law for the supervising organizations to make steps and inspections to prevent these institutions from getting into debt (internal audition, investigation of external organizations, Audit Office, Financial Supervising Body)?
6. How to define the concepts of indebtedness and that of insolvency? Should the public institution exceed a limit defined by law or exceed the ability to pay back the credits and interests? Or it does not have any more chance to take new credits, nor to extend the term of earlier credits? Or does insolvency mean a permanent state of indebtedness?
7. Who (which person or organization) should make steps in case of permanent insolvency and what kind of steps should be made to end insolvency?
   a) Should this be done by the public institution involved? (For example it increases the incomes by imposing more tax or by selling means or by reducing expenses or services or by reducing the quality of these or by privatizing the public services?)
   b) Should it be done by the supervising organizations? (Are there such organizations and what kind of authority they have?)
   c) Should it be done by the creditors? (who go to court)

   Do these possibilities complement or exclude one another?
8. Whether the creditors can ask for liquidation or termination of the public institution from the court? If not, what kind of possibilities do the creditors have?
   a) Selling the existing goods,
   b) giving an extended deadline for the payback of credit and its interests,
   c) giving up the claim,
   d) other means.
9. Whether the state is responsible for the debts of the public institutions without any legal basis and if yes, this responsibility is universal or complementary (secondary)? Can one make difference between the public institutions as legal entities or institutions having a budget separated from that of the state?
10. Can those creditors whose demands have not been met sue the organizations doing external inspection or the state because they have not

controlled the management (accountancy, budget) of the public institution properly?

11. Whether the situation is different when the state gives the task to a private organization (state-owned corporation or joint venture)?
12. Can criminal procedures be started against those persons who are responsible for the state of being in debt?

In Chapter 2 I referred to the fact that the concept of public institution is not homogenous, it is a collective concept for different organizations. The order of establishment, management, control and termination for the different types of public institutions is not uniform, it is different for each type. This means I need to answer all the 12 questions for each type of public institutions! Before answering the questions, however, I need to introduce the appropriate part of the Civil Code on legal entities (Chapter VI) to make understanding easier. Also I need to introduce the most important appropriate parts of the Law on public finances (Act No. XXXVIII of 1992). The latter is important because the assets of the local self-governments and the assets transferred to public bodies belong to public finances.

4. The appropriate and most important rules of the Civil Code and the Act of public finances

According to the Civil Code a legal entity is able and if the Act does not order otherwise, this ability extends to all those rights and responsibilities that can be connected not only people. The Act has an independent chapter on the different rules regarding the different types of legal entities. The following legal entities were named:

1. state-owned companies,
2. trusts,
3. other state-owned organizations,
4. budget financed organizations,
5. co-operatives,
6. economic companies with legal entity,
7. public utility companies,
8. associations,
9. public corporations,
10. companies of some legal entities,
11. affiliated companies,
12. foundations,

13. public foundations,
14. syndicates.

Due to the conceptual features of public institutions mentioned above, types 4, 9 and 13 are important for us. Type 4 is important because—as we will see later—the institutions established by local authorities and public corporations (schools, medical and social institutions, cultural institutions etc.) are budget financed organizations. The Act declares that the state is a legal entity as the subject of the legal relationship concerning assets. Finally I also need to refer to the fact that the local self-government is a legal entity too according to the Act of local self-governments. As regards the Act of public finances, the following features need to be emphasized:

The public finances is a system of the central government, the separated state funds, the local self-governments and the Social Security that performs and finances state tasks. This system has appropriate sub-systems: the budgets of the central government, the state funds, the local self-governments and the Social Security. These budgets together make up the national budget.

The budget of each sub-system is a financial plan that contains the approved expenses (as an estimate) for the performance of the tasks for the given period and also the expected incomes (as incomes).

The state performs the tasks belonging to the public finances through the so called budget organizations or it transfers the coverage partly or completely at the same time it transfers the task to the local self-governments, public corporations or public foundations.

A budget organization is a legal entity that is part of the public finances and performs tasks that satisfy social common needs as basic tasks. They are not for gaining profit and they operate according to the liabilities recorded in the founding charter or document with the recorded professional and economic supervision and sphere of jurisdiction and operation. The types of budget organizations are the following:

1. central budget organizations,
2. local self-government's budget organizations,
3. public corporation's budget organizations,
4. society inowance budget organizations.

The Parliament, the Government, the leader of the organization supervising the budget section, the local self-governments and the public corporations can establish a budget organization by law or foundation document. Then the budget organization is registered by the Minister of Finances.

A central budget organization cannot establish a foundation, but it can establish so called social organizations with the permission of the Govern-

ment. To establish an economic company or to optain shaire in economic companies the central budget organization should have a permission from the organization supervising the given budget section with the consent of the Minister of Finances.

A local self-government or public corporation's budget organization can establish a social organization or a foundation only with the permission of the local self-government or the public body. The local self-government budget organization can establish an economic company with the permission of the local self-government and it can optain shaire in such a company.

It is a serious restriction to state that a budget financed organization can take part in an economic company where its liability does not exceed the extent of its contribution in assets. The budget financed organization is subjected to manage within the estimate. It cannot loan money, cannot be a guarantor, cannot buy bonds — except the bonds that represent its share in the economic company, it cannot draw nor accept bills of exchange, cannot issue bonds. The budget financed organization has liabilities exceeding its budget. In this case the organization establishing the budget financed organization (the state, the local self-government, the public body or the Social Security) must hold on. This liability is valid in the cases of compensation, pay-off and making amends and also in cases when the organization took liabilities toward a well-meaning third party.

The law on public finances states that the exclusive purpose of the assets belonging to the sub-systems of public finances is the service of public interest. The Parliament makes arrangements regarding these assets by law and it should manage these assets with responsibility and according to the purpose. The treasury assets, the assets of local self-government's and the society inowance belong to the public finances. Also the assets transferred to public corporations by law belong to the public finances too. The Parliament controls the management with the assets belonging to the public finances through the State Audit Office. The assets connected to the subsystem of public finances—beyond a value limit determined by law or local self-government resolution—can be sold, its right to utilization can be passed only to those who make the best offer. This is done through a public tender. The proprietary and management rights can be transferred free of charge, the demands can be waived only in the cases and in the ways determined by law or by local self-government resolutions.

5. The first type of public institutions: the local self-government

5.1. General informations on local self-governments

As I mentioned in the Introduction, the local self-governments are old-new institutions in the Republic of Hungary, because they had been operating before 1950 at a local and regional level, which was similar to the Western European pattern. In 1950 the councils took the places of these institutions—according to the Soviet pattern. Since the councils did not have autonomy nor own property, and they were supported only from the central budget, the problem of insolvency never came up. One of the determining changes in the state administration during the political changes of 1989–1990—as I also mentioned—was the cancellation of the council system and the reconstruction of the local self-government system.

According to Article 41 of the Constitution the territory of the Republic of Hungary is divided into a capital city, 19 counties, 260 towns and 2850 villages. The capital city consists of 23 districts.

Article 42 of the Constitution states that the citizens of the capital city and its districts, the counties, the towns and the villages have the right for local self-government. This liberal regulation means that practically all towns and villages have operating local self-governments and the number of these is about 3200!

The local self-government provides public services and manages local public affairs. It has its own legal entity, it has own property and incomes. It manages independently its own property, its incomes and expenses. It carries out its mandatory and voluntary tasks from its own budget. The budget of local self-governments is an organic part of the public finances. The budget of local self-government is separated from the public finances but they are closely related to each other because of the state subsidies and budget connections. The local self-government can freely establish associations with other local self-governments and can have enterprises for its own responsibility. The enterprise cannot endanger the mandatory tasks. The local self-government can take part only in such enterprises where its liability cannot exceed the extent of its support in assets. A further restriction regarding enterprises is that the so called basic assets (public utilities, public buildings owned by the local self-government, streets, squares) of the local self-government current or can be current only with restrictions.

5.2. Answers to the raised questions

Ad 1. The income of local self-government, taking out credits
The local self-government carries out the mandatory tasks regulated by law, the voluntary tasks via its own organization as a budget financed organization, or by establishing public foundations, public utility companies, economic companies or by concluding contracts with other management organizations (concessions, services, purchase etc.). Most tasks are practically carried out by the own organizations, but the other ways mentioned above are becoming widespread too. The local self-government chooses the forms of management freely adjusting to the type of the task. Also it creates the rules of concern within the frames of law. The necessary resources to carry out the tasks are taken from the incomes that make up the income part of the local self-government budget.

The incomes are the following:

1.) Own incomes:
   a) Local taxes regulated by law. These taxes are determined and imposed in local self-government regulations (The law permits the local self-government to impose asset type taxes, communal taxes and local trade taxes),
   b) profit, interest and rental coming from own activities, enterprises and returns of local self-government assets,
   c) a determined portion of duties,
   d) received financial means (e.g. from ministries or separated state funds),
   e) a determined portion from fines of environmental protection and protection of monuments,
   f) incomes from the utilization of hunting rights that belong to the local self-government,
   g) other own incomes.
2. *Central taxes given over by the Parliament:*
   a) a determined portion of income taxes collected from individuals (The rate was 100% in 1990, 50% in 1991 and 1992, 20% in 1998 and 5% in 2000),
   b) other divided taxes.
3. *The normative budget contribution provided by the Parliament:*
   (About two third of the state subsidies go to the local self-governments in this way!) The local self-government can have the normative budget contribution in two ways. The normative division of the financial means coming from the central budget cannot handle the local self-governments

that differ from the average, so the law ensures additional subsidies as well. These are the following: subsidies dedicated to special goals, addressed subsidies and additional state subsidies. These are further claims for further incomes.

4. *Subsidies dedicated to special goals:*
   The Parliament determines the socially relevant goals. The budget determines the sphere of subsidized causes, the order of priority for these causes, the amount and conditions of subsidies. The state wants to orient the local self-governments to get them to achieve important community goals (sewage network, construction of public facilities). The goal subsidy can be used only for the given goal.
5. *Addressed subsidies:*
   The Parliament provides this for the local self-governments to finance some investments demanding major expenses. Can be used only for the given goal.
6. *Additional state subsidies:*
   The Parliament provides this kind of subsidies for local self-governments who do not have their own sufficient resources. The amount is regulated in the law on State budget. (The total amount was about 10 billion HUF in 2000.) The purpose of additional subsidies is to enable local self-governments with insufficient resources to operate or to get them to operate, so that they could carry out their basic tasks even if they do not have sufficient own resources. The Parliament decides on the amount and conditions of subsidies in the budget law.

   Summary: regarding the incomes and the financial conditions, the local self-governments can manage about one quarter of the financial means centralized and re-distributed at the public finances. The current yearly expenses are around 1300 billion HUF, the value of their assets is beyond 2000 billion HUF. During the past 10 years the portion of incomes coming from the central budget decreased gradually (from 50% to 30%) among all available incomes. Meanwhile the portion of own incomes has been increasing (especially the local taxes). The local taxes were only 2.4% of the local self-government incomes in 1991, while in 1999 it was 12.9%. Of course this is still far behind the 52.8% of Switzerland, the 49.8% of Norway and the 34.9% of Germany.

The question of taking out credits

The Act on local self-governments also regulates the major questions of local self-government management besides the income claims. The Act states that the local self-government:

a) can establish a public foundation and can take on public tasks,

b) can take out credit and issue bonds, but cannot use the basic assets and the incomes mentioned under 1d, 2a, 3 and 6 to cover these,

c) decides to deposit the resources not connected to special goals,

d) decides on using other bank services.

It is a major rule to state there is an upper limit for taking on those yearly liabilities that could create debts. This is the so called own current income. This is 70% of the yearly estimate for the own current income minus the proportional part of the short-term liabilities for a year.

Ad2. The procedure of taking out credits

I referred to the fact that the law entitles the local self-governments to take out credits and there is no regulation that requires asking for permission. The bank and the local self-government make an agreement regarding the conditions of granting credits.

Ad3. Deposit

Whether the creditors ask for deposit or not, it is their business, whether the local self-government gives deposit, it is their business. So they have the power of choice in this matter. However, we cannot ignore the fact that there is a restriction: the basic assets and the incomes mentioned under 1d, 2, 3 and 6 cannot be used as deposit.

Ad4. The extent of indebtedness

The answer is under 1, so there is an upper limit!

Ad5. Control

The Act on local self-governments states that the representatives of the local self-government are responsible for the safety of management, the mayor is responsible for the regularity. If the local self-government as a legal entity manages with losses, they must bear all the consequences as well. So the state budget is not responsible for the liabilities taken by the local self-government. In case of loss-making management, a debt-arrangement procedure must be carried out. During the procedure the local self-government must stop financing the tasks (except authority tasks and the basic services for citizens) in order to rehabilitate solvency. (This topic will be mentioned later!)

The law on local self-governments puts emphasis on the control over the management. The following major rules are stated:

The State Audit Office controls the management of local self-governments. There is an independent law on the State Audit Office (Act No. XXXVIII

of 1989). This law states that the State Audit Office is the financial-economic controlling organization of the Parliament. It controls according to expedience, lawfulness and efficiency. The control of local self-governments by the State Audit Office is impeded by the scattered system of local self-governments, since there are nearly 3200 local self-governments, 13,000 local self-government institutions (budget institutions). The State Audit Office practically cannot control these at least once in a quarter of a year due to lack of capacity. The State Audit Office selects the local self-governments to be controlled according to a scientifically developed sample-taking system. In 1999 the Office controlled 802 local self-governments and 1533 institutions.

It is important to emphasize that the financial-economic control of local self-governments is not the monopoly of the State Audit Office, the state created a wide network of internal and external control. The external control can also be done by an independent certified public accountant (CPA) besides the State Audit Office. The audition is extended to the following:

a) the verification of reports, the balance, the yearly report on circulation of money and the statement on results,

b) making statements about the bylaw drafts on the budget and final accounts,

c) analysis of the financial situation.

The employment of a CPA is mandatory for only 30% of the local self-governments: the local self-governments of counties, those of the capital city and the capital city districts and the local self-governments of cities and also those local self-governments where the expenses of the preceding year exceeded 100 million HUF, the local self-government has credit or takes out credit.

The internal control is carried out by the mandatory Financial Committee and the internal auditor whose qualifications are determined by law. Another type of control is the mandatory control of the leaders and the control built in the processes of work and management.

Ad 6. The concepts of indebtedness and insolvency

The concept of indebtedness is not defined by law, the concept of insolvency can be defined on the basis of the law on debt arrangement procedures (Act No. XXV of 1996). According to this the debt arrangement procedure can be initiated by either the local self-government or the creditor at the competent county court. The procedure can be initiated if the local self-government or its budget financed institution

a) the invoice or notice sent by the creditor has not been disputed nor paid within 60 days after the date of fulfillment,

b) the debt was not paid against the agreement made at an earlier debt arrangement procedure,

c) the debt toward other sub-systems of the public finances was not paid within 60 days after the receipt of the immediate collection notice.

The result of these conditions is that insolvency means the following: the procedure can be initiated if the above mentioned conditions exist. The insolvency is a relatively permanent condition of being in debt (60 days), but it does not depend on the sum of money. Before starting the debt arrangement procedure the local self-government has a chance to solve the problems itself. Example: reducing expenses, taking out credits, selling real estates, imposing taxes, privatizing public services, however, all these activities have restrictions by law. If the procedure has started, the chances of the local self-government are reduced to those that are regulated by the law on debt arrangement.

Ad7. The question of permanent insolvency

I have already given a part of the answer in the preceding section and I am giving the other part here according to the following:

The debt arrangement procedure has a dual purpose. The first one is the protection of the local self-governments (and their institutions) and that of the creditors. The second purpose is the rehabilitation of the local self-government's solvency and ability to operate so that they can carry out their public tasks. It is necessary to emphasize that these purposes do not give any reasons to the state to take any responsibility for the local self-governments. The court publishes the decision on starting of the debt arrangement procedure in the Company Gazette, the mayor publishes it in two national newspapers with an announcement to the creditors, asking them to announce their claims within 60 days. The court assigns a financial administrator at the starting of the procedure. The mayor is obliged to inform directly the county administration office and the account-keeping bank about the starting of the procedure. After this the bank can charge the account and pay out money only with the financial administrator's counter-signature. After the start of the procedure the local self-government cannot make any more decisions on taking extra liabilities concerning assets, cannot establish any enterprises, cannot gain any property in enterprises in a commutative manner, cannot pay out any earlier debts. Except for the regular personal benefits and the expenses according to the crisis budget. The financial administrator registers the creditors who announce their claims, examines their claims and informs them within 15 days whether their claims are acceptable or not. The local self-government is obliged to

establish a debt arrangement committee within 8 days after the start of the procedure. This committee is entitled to decide on all economic issues, except for the issues that come under the exclusive authority of the board of representatives (personal affairs, making bylaws). The notary compiles a bylaw draft about the crisis budget within 30 days after the start of the procedure. This budget includes exclusively those expenses of services and authority tasks that are listed in the appendix of the law (example: operation of cemeteries, cleaning of public areas, ensuring water supply, street-lighting, operation of kindergartens, schools and health facilities etc.). The local self-government cannot finance such institutes where the capacity is less than 50%.

The debt arrangement committee (which includes the mayor, the notary and the financial administrator) discusses the bylaw draft, then the board of representatives passes it. The board of representatives makes a reorganization program and an agreement resolution. The program describes the economic situation of the local self-government and records the proposals regarding the utilization of assets involved in the debt arrangement and other planned steps (example imposing taxes, increasing taxes, reducing expenses, taking out credits). The agreement resolution lists the creditors into groups. The financial administrator sends the reorganization program and the agreement resolution to the creditors and invites them to a meeting of agreement. Minutes must be kept at the meeting. An agreement can be reached only if more than 50% of the creditors accepts it and their claims are 2/3 of the whole claim. The financial administrator hands in the document of agreement to the court, which wraps up the procedure and orders the announcement of this in the Company Gazette. At the same time the court relieves the financial administrator of their position. If there is no agreement accepted between the parties, the court orders the division of the assets within 210 days after the start of the procedure. The court orders the division of the assets if:

— the board of representatives is out of operation (due to any reason) or the dissolution of the board has been initiated due to operation against the constitution,

— the board has not accepted the bylaw on the crisis budget,

— the reorganization program and the agreement resolution has not been made, the creditors have not made their own proposal of agreement,

— the court has not accepted the document of agreement handed in by the financial administrator.

The local self-government can carry out the tasks only according to the resolution on the crisis budget until the court divides the assets. The financial administrator determines the forms of carrying out the mandatory tasks in

a report and determines which properties need to be sold to cover the expenses of these tasks and what central budget subsidies are necessary and also determines which properties can be included in the debt arrangement. The financial administrator sends the report to the creditors and the local self-government. They can make their comments within 15 days at the court. After the assenting decision of the court inures, the financial administrator:

— lists the creditors' claims in 30 days,

— attempts to sell the assets involved in the debt arrangement within 60 days (creditors have pre-emptive right).

After then the court obliges the financial administrator to execute the division of assets, then the court wraps up the procedure and relieves the financial administrator of their position. The law determines a mandatory order of pay-off. Until the first creditors' claims in the order are not paid off, the later creditors are not paid off.

If the local self-government established the conditions of the agreement with the creditors by taking out a credit, the central budget—at request—provides an interest-free refundable subsidy to pay off that part of the interest that the local self-government does not have coverage for. (About 200 million HUF were available for this purpose in 2000.)

The debt arrangement procedures of local self-governments occur very rarely in Hungary, opposed to the bankruptcy proceedings of companies. At the time of making the law on local self-governments in 1990 and in the following 5 years there was no need to make such a law. The explanation of this situation is that the local self-governments have been managing with responsibility and they rarely have taken on liabilities exceeding their abilities. When in 1995 several local self-governments indicated that their management had become troublesome, the Parliament modified the law on local self-governments (restricted the upper limit of taking on liabilities) and then made the Act No. XXV of 1996 on the debt arrangement procedure of local self-governments. In the past years there have been altogether 7 cases when such procedures were executed. In 5 cases agreement was made with the creditors, while in the other two cases the court divided the assets. It is noteworthy that it was not the creditors who initiated the procedures in either case!

Ad8. Can the creditors ask for bankruptcy proceeding, liquidation?

The answer is yes resulting from the facts mentioned above, but the terms of bankruptcy proceeding and liquidation can only be used in case of economic companies. In case of local self-governments—as we could see—the right term is debt arrangement procedure. The creditors can initiate debt arrangement procedures, the experience shows there have been such

cases so far. The local self-governments Act quickly in case of solvency problems: they try to reduce their expenses, mobilize their assets, take out credits and they try to get the loans rescheduled. It is important to emphasize that there is no possibility of liquidation of local self-governments during debt arrangement procedures!

Ad9. Is the state responsible for the debt?
I have already referred to the fact that in Hungary the local self-governments have autonomy, they are independent legal entities, they have their own properties and they have whole and exclusive responsibility in arranging the local public affairs. The state has no universal, nor secondary responsibility for the possible debts of local self-governments, including the debts local self-government institutions (schools, health facilities etc. as budget financed institutions) too. When the tasks are carried out by not the local self-government's own institutions, or the tasks are transferred to other organizations or the tasks are carried out in form of concessions, the local self-government is not exempted from responsibility of carrying out the tasks. If the contractual partner or the organization entitled to the concession goes bankrupt, this does not concern the local self-government's obligation to carry out the tasks. It is a different matter when the local self-government helps the contractual partner or organization entitled to the concession in case of solvency problems. It is possible for the local self-government to establish an own economic company to carry out the tasks. But this fact does not change what was written earlier, but if the economic company goes bankrupt, the resolutions of the bankruptcy law will be valid. The local self-government (as the owner or founder) has limited liability, as I referred to the fact that the local self-government. cannot be a member with unlimited liability of any economic company.

Ad10. Can those creditors initiate a trial who have not been paid off?
Those creditors who have not been paid off can theoretically initiate a trial against any organization that is entitled to carry out the financial-economic control of the local self-government. (I referred to these organizations under ad5.)

The Civil Code makes compensation possible when someone (or some organization) causes damage illegally. The amount of damage, the illegality and the relationship between the damage and the illegality should be proven by those who have suffered the damage. This is not an easy job. As far as I know, there have been no such trials so far in Hungary, but the theoretical possibility of such trials is not excluded! (The state initiated a similar trial against those world-famous auditing companies that audited Postabank

and the state claimed for compensation for inappropriate control. This trial is still going on.) I completely exclude the possibility of winning a trial against the state.

Ad11. The question of transferring tasks to private organizations
The state determines the mandatory tasks of local self-governments by law. These tasks are carried out by the own organizations of the local self-government (schools, health and social facilities) or by organizations the tasks have been transferred to (by establishing public utility companies, economic companies or with concessions). As we could see, the successful performance of the tasks is the responsibility of the local self-government and it has full responsibility as well.

There is a theoretical possibility that the state obliges private organizations, public utility companies or economic companies to carry out given public tasks. In this case the state is also exempted from any financial responsibility, because the responsibility as owner can be limited only. However the state is still responsible for carrying out the task. It is possible that the state trusts neither local self-governments nor, but public boards or foundations to carry out public tasks private organizations. I will write about this later.

Ad12 The question of initiating criminal procedures
The law makes it mandatory for the organizations entitled to control to make reports when they have a suspicion of criminal acts. The creditors do not have this responsibility but they have the possibility to make reports to the authorities. Several criminal acts can occur concerning this area, so the Criminal Code names several types of criminal act when someone is responsible for getting in debt. These are the following:

a) Breach of Trust
That person commits this crime who is trusted to handle foreign property and the person causes financial damage by failing to carry out their liabilities.

b) Negligent Breach of Trust
That person commits it who is trusted to handle or supervise foreign property based on law and the person causes financial damage by failing to carry out or neglecting the responsibilities.

c) Fraud
That person commits it who deceives others to gain illegal causes.

d) Embezzlement
That person commits it who theft foreign property that was trusted to them and they treat that property as if it was their own.

e) Violation of credit

That person commits it who takes away the coverage of the credit partly or completely or makes it impossible to pay off the creditor from the coverage in any other way.

f) Taking away the coverage of debt

That person commits it who takes away assets that serve as coverage for debt that comes from economic activities and thus makes it impossible to pay off the debt.

g) Unlawful preference of creditors

That person commits it who is aware of their insolvency, gives illegal advantage to one of the creditors to the disadvantage of the rest of the creditors.

h) Bankruptcy

That person commits it who hides or destroys the assets serving as the coverage for insolvency that comes from economic activities or the person makes a false deal or intentionally does loss-making businesses and thus makes it impossible to pay off the creditors.

6. The second type of public institutions: the public boards

6.1. General information on public boards

The Civil Code records the concept and most important feature of public boards. In this way a public board is a legal entity with self-government and recorded membership whose establishment is regulated by law and that carries out public tasks. The tasks are connected to the members or the activities done by the members. The public board is not established based on the free will of the members (as it is the case with associations), but it is established by law. The Parliament trusts public boards and not public administration organizations to carry out given public tasks. The law can order that some tasks can be carried out exclusively by public boards, on the other hand, some tasks can be carried out only as a member of a public board. The law can determine mandatory tasks for the public board. In this case the codifying organization ensures particular public licenses to the public board that is executed through self-administration. The codifying organization ensures appropriate assets to the public board. The board manages these assets independently, of course under state supervision. The rules valid for the associations are to be applied for public boards. I discussed the law on public finances in Section 4 and I referred to the fact that the assets trusted to public boards belong to public finances. These assets must be managed

appropriately and with responsibility. This is controlled by the State Audit Office. Public boards are the Hungarian Academy of Sciences, the economic chambers (chambers of commerce and industry, agricultural chambers), professional chambers (medical, pharmacist's and lawyers' chambers) and also mountain municipalities, the Hungarian Board of Standards, the Public Foundation of the Hungarian Television and the Public Foundation of the Hungarian Radio. As the establishment of public boards is ordered by law, there is law for each board. The regulation on the specific tasks, management, incomes, expenses and state supervision of public boards is not uniform due to the separate laws regulating each public board. That is why there is no uniform answer to the 12 questions only generalized answers can be given. I will try to refer to the differences.

6.2. Answers to the raised questions

Ad1. The income of public boards, taking out credits
The operational expenses of public boards are generally covered by the following resources:

a) membership fees paid by the members and other fees,
b) sums taken from the central budget,
c) foundation and other contributions,
d) sums won from competitions,
e) sums coming from national or foreign co-operations,
f) income from operation and utilization of assets,
g) other income not forbidden by law.

Taking out credits belongs to the latter category. The state ensured a considerable amount of goods and real estates for the Hungarian Scientific Academy of Sciences in Act No. XL of 1994. These assets ceased to be state assets, so these assets became the property of the Academy. The same can be told about the Hungarian Board of Standards, the Public Foundation of the Hungarian Television and the Public Foundation of the Hungarian Radio. This one-time allocation of assets from the state at the time of the establishment does not mean that these public boards cannot gain any income from other resources mentioned above. The exact amount and type of income is regulated by law in the case of each public board.

Ad2. The procedure of taking out credits
There is no special, mandatory procedure, the public board and the bank make agreements on the conditions freely. The internal rules of some public boards (Basic Rules) usually record the conditions of taking out credits.

Ad3. Deposit
There is no mandatory law, so the deposit is a subject of free agreement. Giving deposits can be restricted by the internal rules of the boards.

Ad4. The extent of indebtedness
There is no law, nor restriction, so this is also a matter of internal regulation. Each board is obliged to carry out the tasks determined by law, so it is obvious that the public board cannot endanger the performance of these tasks. So the extent of indebtedness is regulated by the general principles of "normal management".

Ad5. Control
There is no specific regulation on control to prevent indebtedness. The state, however, tries to prevent irresponsible management through internal and external control. The forms are the following:

1. The State Audit Office controls the appropriate and responsible management of assets belonging to public finances according to the law on public finances. Since the assets transferred to the public boards belong to public finances, the State Audit Office has the right to control these. Furthermore, the State Audit Office can control the whole management of the Academy and the economic chambers (not only the management of transferred assets) based on legality, expedience and successfulness.

2. The competent ministers control the respective boards legally. They see if the Basic Rules and other regulations of the boards are lawful, whether the resolutions of some organizations or officials break the law or internal rules or not. The minister can go to court and the court can suspend the operation of the board in case of violation of the law and can assign a supervisor to the public board. The court cannot liquidate the public board. The situation is different in the case of mountain municipalities because the court can dissolve the mountain municipality at the minister's request. In this case the municipality has to be re-established within 60 days. If the same thing happens within 5 years, the wine-growing area classification automatically ends.

3. The laws on each public board order the establishment of a mandatory internal control organization. This organization should control the given board and ensure the legal operation.

4. Some laws order that from time to time an independent CPA must check the management of the public board.

Ad6. The concepts of indebtedness and insolvency
There is no mandatory law on this. This question has not been raised so far in Hungary, maybe because there has not been any situation that would have made it necessary. (I would note here that in the case of local self-governments the rules of debt arrangement procedures have been made only in 1996, while the law on local self-governments was issued in 1990) In my opinion insolvency regarding public boards means that the board is unable to perform its obligation of payment within the given period of time. The deadline is always determined by the specific contract or the invoice written based on the contract.

Ad7. The question of permanent insolvency
There is no specific law on this, nor any legal definition of permanent insolvency. Who should make what steps in case of permanent insolvency can be answered as follows:

— first of all the officials and organizations of the public board must make the necessary steps to rehabilitate the financial balance (reducing expenses, selling mobilized assets, taking out credits etc.),

— the creditors have the right to help (but it is not mandatory), for example by rescheduling the debt or reducing the claims,

— theoretically the Parliament, which establishes public boards, is entitled to help by modifying the law on budget or giving budget subsidies.

These possibilities do not exclude one another. The supervising minister has limited possibilities as I mentioned at question 5. The minister can only emphasize the importance of keeping the laws. If this is not successful, the minister can go to court.

Ad8. Can the creditors ask for bankruptcy proceeding, liquidation? If not, what possibilities the creditors have?
As I mentioned in the chapter on local self-governments, bankruptcy proceeding or liquidation can be initiated only against economic companies. It cannot be done in case of public boards. Debt arrangement procedures cannot be initiated here either. If the public board becomes insolvent, and cannot pay off the debts, then it is responsible with its whole assets. It can attempt to sell its free assets, reduce the expenses or take out credits or have the debt rescheduled. If they cannot pay off the debt after all these steps, the creditor can go to court according to the civil law and can ask the court to oblige the public board to pay off the debts. If this happened and the board does not pay, the court will execute distress. When doing this, it is not possible to dissolve the public board. The only exception is the mountain municipality

from the court. If they cannot pay off the debt, they operate illegally. If the legal operation cannot be rehabilitated, the minister can ask for the dissolution of the municipality. The creditors cannot enforce their claims against the Parliament that established the public board by law as there is no legal possibility to do this.

Ad9. Is the state responsible for the debt?
The Act does not regulate this question, but based on the regulations, it can be deduced that the state is not responsible. The Civil Code states that the rules on associations are to be applied to public boards. In case of associations the law excludes the responsibility of the state. The association itself is responsible for the debts with its assets and the members are not responsible for the debts beyond the membership fees. The second part of this question mentioned in chapter 3 does not have any sense in this case, since the public boards are legal entities.

Ad10. Can those creditors initiate a trial who have not been paid off?
The answer is the same that I wrote down in case of the local self-governments. Briefly: yes, theoretically the creditors can initiate a trial according to the Civil Code against the persons or organizations controlling the public board. There have been no such cases so far in Hungary.

Ad11. The question of transferring tasks to private organizations
This question is only theoretical, since the state has established the public boards to carry out the public tasks recorded by law. However, it cannot be excluded theoretically that the state transfers the public tasks to private organizations, economic companies. In this case there are different rules of responsibility. These are the Civil Code rules of bankruptcy proceedings, liquidation and final settlement. This could happen if the Parliament trusted a minister who can establish an economic company or can obtain concern based on the law on public finances to carry out the task. This would be possible only with the permission of the Minister of Finances. A further restriction would be that the liability of the state in the established economic company could not exceed the extent of asset contribution. Another restriction would be whether the performance of the public tasks by the public board makes business like economic activities necessary or not. The prerequisite of establishing economic companies is the performance of businesslike economic activities. It must be made clear that if the state transferred the performance of public tasks to private organizations, the state would not be responsible for the debts as it is not responsible in the case of public boards.

Ad12. The question of initiating criminal procedures
The answer is the same that I gave in the case of local self-governments. Briefly: yes. Reports can be made in case of suspecting crime and the Criminal Code contains several crimes and punishments for those who commit such crimes.

7. The third type of public institutions: the public foundations

7.1. General informations about public foundations

According to the Civil Code a public foundation is a foundation that is established by the Parliament, Government or local self-government to carry out public tasks. A public task is a state task or local self-government task that must be carried out by the state or the local self-governments based on the law. The establishment of a public foundation does not concern the performance of public tasks by the state and the local self-governments, so the public foundation does not replace the state, nor the local self-governments. On the other hand, the state (local self-governments) are obliged to pay attention to the operation of public foundations and if the foundation does not carry out the tasks properly, they must take steps immediately. The establishment of a public foundation happens when a Foundation Charter is issued. The charter must indicate the organization of the foundation, its headquarters, its goals, the assets attributed to the accomplishment of the goals and the way of utilization, the trustee and the organization entitled to control the trustee. The Founding Charter must be issued in an official gazette.

If the law does not order differently, anyone can join the public foundation. The Charter may prescribe that the trustee's approval is necessary if someone wants to join the foundation. Assets must be provided for the foundation so that it can accomplish its goals. The Foundation is established when it is registered by the court and it ceases to exist when it is canceled from the registry. It is the founder who hands in a request of establishment to the court. The Founding Charter must be attached to the request. The court examines if the assets necessary to accomplish the goals exist, if the assets are enough to start the operation and they are proportional to the performance of the public tasks. The trustee manages the assets of the foundation according to the Founding Charter. The trustee is subjected to inform the founder of the management every year and is subjected to publish other major data as well. The trustee is continuously controlled by the controlling organization established by the Founding Charter. The legality

and expedience is controlled by the State Audit Office. The legal supervision is carried out by the prosecutor's office. The prosecutor examines if the foundation operates per the law and the Founding Charter. If the legality of operation cannot be ensured in any other way, the prosecutor goes to court. The court gives a deadline to the foundation to end the illegal conditions and rehabilitate the legal operation. If this is not successful, the court dissolves the foundation and orders its cancellation from the registry. The court dissolves the foundation based on the prosecutor's request if the accomplishment of goals has become impossible for any reasons. Finally, the court can dissolve the foundation at the founder's request if the need for the given public task has ended or there is a more effective way of performing the task. In case of dissolution the assets of the foundation—after the payoff of creditors—goes to the founder with the following restriction: the assets must be used for similar goals. The public foundation is a legal entity. It is responsible for the debts with its own assets.

Since the establishment of the public foundation happens with the issue of a Founding Charter, the specific regulation of goals, organizational structure and management cannot be uniform, as in the case of the public boards. That is why there are no uniform answers to the 12 questions. I will try to refer to the differences.

7.2. Answers to the raised questions

Ad1. The income of public foundations, taking out credits

A public foundation is an attribution of assets for public purposes. The founder is obliged to provide starting assets to the public foundation, the assets must be enough to start the operation and must be proportional to the magnitude of the task to be carried out. So here there is a considerable attribution of assets at the beginning — opposed to the public boards. The resources during the operation are less important here. The public foundation can be open or closed. It depends on the fact whether the Founding Charter allows new members to join or not. If yes, one of the resources of income is the contribution paid by the joining members. The further resources are usually the following:

— the avails of the founding assets,
— the contribution accepted in the budget,
— donations, contributions,
— offers from personal income taxes.

(An interesting thing is that the Miklós Wesselényi Sports Foundation carrying out public tasks related to sports gains income from the taxes of

drawing games (12%) and from the taxes of pools (100%) as a regular and normative income.)

If the management makes it necessary, the foundation can take out credits, except when the founder forbids this in the Founding Charter.

Ad2. The procedure of taking out credits
There are no legal restrictions, but the Founding Charter can contain restrictions or it can contain proper procedures regarding the credits.

Ad3. Deposit
There is no mandatory law, so the deposit is a subject of free agreement between the creditors and the foundation.

Ad4. The extent of indebtedness
There is no law, but the Founding Charter can contain restrictions. The general principles of "normal management" are of course valid for the management of public foundations as well, so the public foundation must manage so that it can carry out its public tasks. The Founding Charter usually expressly records that the public foundation manages according to a yearly budget (financial plan). This must keep the expected incomes and expenses in balance. This is the trustee's responsibility.

Ad5. Control
There are no regulations that expressly prevent getting in debt. The state tries to prevent irresponsible management through external and internal control. The forms of these are the following:

a) The State Audit Office controls the legality and expedience of the public foundations' management.

b) The prosecutor has a general legal supervision over the whole operation of the public foundations. If the legal operation is not ensured for any reason (including possible indebtedness), or the accomplishment of the goals determined in the Founding Charter has become impossible, the court will dissolve the public foundation at the prosecutor's request.

c) The founder is obliged to assign not only a trustee, but also a controlling organization of the trustee in the Founding Charter. The controlling organization (usually a Supervising Committee) has the job of controlling the whole operation and management of the public foundation. If necessary, the controlling organization informs the founder once a year of the management and operation.

d) Every year an independent CPA examines the management of the public foundation and uses the results in the yearly report that is sent to the founder.

Ad6. The concepts of indebtedness and insolvency
There is no law on this. In my opinion indebtedness or insolvency means that the public foundation is unable to pay within the given deadline. In this case they must try to rehabilitate the financial balance or the goals written down in the Founding Charter cannot be accomplished. If this happens, the court will dissolve the public foundation at the prosecutor's request.

Ad7. The question of permanent insolvency
There is no specific law on this, nor any legal definition of permanent insolvency. Who should make what steps in case of permanent insolvency can be answered as follows:

— first of all the trustee of the public foundation must make the necessary steps to rehabilitate the financial balance (reducing expenses, selling mobilized assets, taking out credits etc.),

— the founder theoretically has the right to help (but it is not mandatory) rehabilitate the financial balance, since the founder is responsible for the performance of public tasks,

— the creditors have the right to help (but it is not mandatory), for example by rescheduling the debt or reducing the claims.

The prosecutor's office who does legal supervision does not have the possibility to rehabilitate the balance of management, they go to court when they notice that the law was broken.

These possibilities do not exclude one another.

Ad8. Can the creditors ask for bankruptcy proceeding, liquidation? If not, what possibilities the creditors have?
The answer given in the case of public corporations can be repeated here with one difference: if the legal operation is not ensured, the accomplishment of goals determined in the Founding Charter become impossible (even because of indebtedness), the prosecutor can ask the court to dissolve the public foundation. The creditors cannot enforce their claims against the founder because they do not have any legal possibility to do it. The creditors can go to only the prosecutor, who can state the illegal operation and can initiate a trial for dissolution.

Ad9. Is the state responsible for the debt?
The law does not regulate this question, but based on the regulations, it can be deduced that the state is not responsible. Why? The Civil Code states in the rules on public foundations that in the case of issues not regulated, the rules on foundations are to be applied. In the case of foundations the Civil Code states that the rules on the management of associations are to be applied to the management of foundations. As I mentioned earlier, the association itself is responsible for the debts with its own assets. Again I need to mention the rule which states that the establishment of public foundations does not concern the performance of public tasks in the case of the state (local self-governments). If the public foundation is unable to carry out the public tasks due to insolvency or any other reason, the state (local self-government) as the founder must take steps immediately. It is not really important what they do (transfer the tasks to state administration organizations, establish management organizations etc.). The main point is that the public tasks must be carried out. The second part of this question mentioned in chapter 3 does not have any sense in this case, since the public foundations are legal entities.

Ad10. Can those creditors initiate a trial who have not been paid off?
The answer is the same that I wrote down in case of the local self-governments. Briefly: yes, theoretically the possibility initiating a trial exists. There have been no such cases so far in Hungary.

Ad11. The question of transferring tasks to private organizations
The main point of the answer is the same I gave in the case public corporations. The theoretical possibility of transfer exists and of course there are different rules of responsibility. Since the restrictions mentioned in the case of public boards exist here as well, the transfer is really theoretical. As regards the final responsibility of the state, the situation is the following as in the case of public boards. The state is not responsible for the debts of public foundations. It is responsible for the performance of public tasks. The way how the state solves this task is their business: it can trust state administration organizations, local self-governments, can establish public corporations etc.

Ad12. The question of initiating criminal procedures
The answer is the same that I gave in the case of local self-governmentss. Briefly: yes. Reports can be made in case of suspecting crime and the Criminal Code contains several crimes and punishments for those who commit such crimes.

8. Public utility companies

In chapter 2 I wrote that public institutions are such organizations that were established by the state to carry out public tasks. These organizations have autonomy. Examples: local self-governments, public corporations and public foundations.

However the Civil Code names and regulates public utility companies as legal entities. I think I need to mention them because of the following:

A public utility company is a legal entity that can be established and operated by anyone (individuals, legal entities, the state, the local self-governments etc.) according to the rules of private law, based on the law on economic companies. The peculiarity of public utility companies is that they do so called public utility activities and maintain businesslike economic activities to promote this public utility activity and the profit cannot be divided among the members. The rules on limited liability companies are to be applied to the operation of public utility companies and they must establish a Supervising Committee and they have to choose a CPA. The rules on company law and bankruptcy law are to be applied in case of the winding-up of public utility companies. There is a difference: the assets remaining after paying off debts must be used for public utility purposes.

The public utility activity carried out by a public utility company is an activity that satisfies the common needs of society without gaining profit or assets. Examples: helping families, education, protection of the nature, voluntary fire-fighting, protection of the environment, protection of human rights etc. As you can see, the public utility companies operate as non-profit organizations according to the rules of private law. They can be established either by the state or others to carry out public utility tasks. They do not carry out public tasks, but public utility tasks and they do not operate according to the rules of public law, but they are established and wind up according to the rules of private law. That is why I did not listed these organizations among the public institutions (local self-governments, public boards and public foundations) and I think it is not necessary to answer all the 12 questions in the case of public utility companies.

9. The public utility organizations

The Parliament passed a separate law on the so called public utility organizations (Law No. CLVI of 1997) to make the operation and management of these non-governmental, non-profit organizations clearer and to promote

their public service activities. The law determines the types of public utility activities in 22 points. I have already referred to these in the preceding chapter. These organizations can ask the court to be registered in the public-utility registry. If this happens, these organizations will have exemption from company tax and also allowances regarding local taxes, duties and dues and personal income tax. Only the following types of legal entity organizations can apply for registration:

— social organizations (except for political parties, organizations representing interests, insurance companies),
— foundations,
— public foundations,
— public utility companies,
— public corporations (if the establishing law allows it).

The Tax Authority controls the public utility organizations regarding taxes, the State Audit Office controls the utilization of subsidies from the budget. The legal control is done by the prosecutor's office. The prosecutor can ask the court to cancel the given legal entities from the registration if the organization operates illegally in spite of the official warning. If the yearly income of the organization exceeds five million HUF, a supervising board must be established even if there is no such obligation. This supervising board controls the operation and management of the organization. In case of illegal operations, they call for winding-up, finally they inform the prosecutor. The public utility organizations must keep separate records of incomes and expenses that come from the public utility activities and the enterprises. The incomes of public utility organizations are the following:

— contributions received from the founder or some sub-systems of public finances or other donations that must be used for public utility purposes,
— the income from the public utility activities,
— the income from the investment of means,
— membership fees,
— income from the enterprise,
— other income.

The public utility organizations cannot issue bills or bonds embodying credit relations and with the exception of public utility companies, they cannot take out credits endangering the public utility activities. They cannot use the contributions received from the different sub-systems of public finances to pay off credits, nor to cover credits. It is a major rule that the public utility organizations cannot divide the incomes coming from the management activities, they must use it for the goals determined in the Founding Charter. It can be stated from the above mentioned facts that the declaration of an

organization as a public utility organization is not relevant regarding our subject. Since the activities accomplished by these organizations are peculiar, I think the most important rules related to these organizations need to be presented, avoiding the answers to the 12 questions.

Summary

As regards the present review concentrating on the insolvency of public institutions, it should be stated that the Hungarian legal system responded relatively quickly to the political changes in 1989–1990. The legal system has created the legal institutions and their conditions of operation that are necessary to reduce the exaggerated overtaking of tasks on the part of the state. I believe these legal institutions operate pretty well, however not perfectly and the Hungarian state administration of 2001 is considerably "smaller" than the state administration before 1989 and this new administration serves the citizens' interests much better. This must not make us self-conceited, but we must not be silent when talking about the results. We should continuously pay attention to the ways of performing public tasks in these of other countries, as we have a lot to learn and we have a lot to give as well. The section IV.D.1. of the 16th International Congress of Comparative Law that the present review was made for provides an excellent opportunity to do this.

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IV. D. 2. Application of Administrative Law with Regard to Privatizations

MÁRIA BORDÁS*

Application of Administrative Law with Regard to Privatization: The Hungarian Case

Abstract. The essay analyses the process of privatization in the transitional period. In the early 1990's, the privatization of the competitive sphere in Hungary meant the purchase of state-owned companies. Besides the legal background, the essay gives an overview on the political aspects of privatization. The next step was the privatization of public services in the middle of the 90's. The privatization of the sector of public services is peculiar as privatised public services remain under governmental control even after their privatization: public administration is responsible for the continuity of the service, for its general accessibility and its quality. The essay deals with the issues of the application of law in this respect. The privatization of the welfare sphere was primarily characterised by the retreat of the state without applying alternative methods like initiating the participation of non-profit organizations. In the analyses of the privatization of the welfare sphere, the essay deals with the principles of privatization, as well as the constitutional problems involved and the conflicts of the central government and the self-governments.

Keywords: privatization, competitive sphere, sector of public services, welfare services, supervision of competition, public health

1. Privatization of the Competition Sphere

In developed Western countries privatization formed part of the neoliberal economic policy that occured from the 1980-s. This type of privatization focused on the *decrease of the public sector's scope*, which meant the state's withdrawal from the public services and at the same time the extension of market mechanisms in this field. Similarly to other Central and Eastern European countries, the first aim of Hungarian privatization was to *transform 90% of the state property in the sphere of competition to private ownership.*

* PhD, Department of Public Administration, Budapest University of Economic Sciences of Public Administration, Faculty of Public Administration, Budapest, H–1118 Budapest, Ménesi u. 5.
E-mail: mbordas@axelero.hu

So, the privatization of the countries in transition from communism has *a different function* and *meaning* at the beginning of the privatization processes. In Hungary the *new economic administrative law* concentrated on refining the administrative system from its old bureaucratic characteristics and elaborating market institutions which had been in existence before the transition. The *aim of this chapter* is to analyse the new functions and activities of administrative law that have played a role in shaping privatization.

1.1. Characteristics of the Bureaucratic Economic Administrative System

In Hungary the privatization process in the sphere of competition happened in a special way compared with other Central and Eastern European countries. The reason was the special features of Hungarian economic administration system which had the greatest effect on the methods of privatization. That is, from the 1960-s *a special economic administration system* had developed in Hungary as a result of economic reforms. The main characteristic of this so called *"neither planned nor market economy"* was that the legal regulations aimed to create market institutions, although in fact a high level of state intervention still existed.

In order to accelerate the disintegration of the traditional planned economy the most essential step was the *division of executive and proprietary administrative power* which was executed in 1984. It meant that most proprietary rights belonged to the administrative organs before being handed over to the state-owned enterprises, and came to be exercised by self governing bodies within the state owned enterprises. The administrative authority that had established the state owned enterprises *supervised its operation from the point of view of legality, and could not intervene by economic decisions.*

In 1968 another organization reform had already *remodelled the central economic administration* by eliminating the scope of the sectoral ministries in the execution of the central state plan. Instead, *a special directional method*—that of the *economic regulators*—typified the connection between the ministries and the enterprises. Economic regulators were legal norms, but in fact represented economic means, such as financial, price, wages, and employment factors in the direction of state enterprises.

This indirect directional method represented a looser connection between the central public authorities and the state enterprises, than the directives aimed to execute the central economic plan. The so called *"functional"*

ministries and central administrative authorities were entitled to pass economic regulators and the *sectoral ministries* were responsible for a sector of the economy, such as industry, commerce, agriculture etc.

Nevertheless this new direction showed the limitation of the public administration's intervention, but at the same time was capable of maintaining the enterprises' financial and political dependence in another form. Consequently this looser economic-administrative intervention allowed *market mechanisms and institutions* to develop and most of them seemed as a basis for the new administrative system.

1.2. Development of the Privatization Process

If the privatization is implemented by the transformation of ownership, it has generally two forms: the securities of the company can be issued on the Stock Exchange, or the shares are sold by tenders.

The money and security market being less developed in Hungary, the only possible means of state enterprises' privatization in the competition sphere was to invite tender for selling. Partly because of this fact, and partly for other reasons, *selling by inviting tender* remained the main form of privatization in the competition sphere.

The first form of privatization, the so called *"spontaneous privatization"* had already taken place during the rule of the last socialist government at the end of the 1980-s. By that time it was obvious, that although the self governing enterprises were more efficient and better organized than the previous organs of the planned economy, state ownership *could not be reformed in this way.*

Theoretical attempts to analyse this type of state ownership, could not answer the real nature of exercising property rights. The reason was that these enterprises did not operate in the form of commercial companies, but in public corporations. Secondly, in the lack of any real ownership the functions of the owner, the managers and representative organizations were interwoven and were exercised by the self governing body consisting of the employees.

Consequently, public corporations could not represent real business interests in any form. Legal regulations were passed in 1989, giving the enterprises an opportunity to become to *commercial companies*, in which the property rights were exercised by the former self governing bodies. In order to obtain capital investment and decrease the companies' debts the self governing bodies *sold some of its shares to foreign investors and banks*. In most cases the *managers* themselves also *bought shares*.

One of the advantages of this form of privatization is that being based on the company's decision it could adapt fairly well, increase the capital, decrease the debts and income was generated for development.

The first democratic government stated that it had to defend state property from this "wild privatization", and exherted *strong administrative control* on each step of the process of *privatization.* This defensive attitude displayed the characteristics of the old administrative culture which tried to strengthen its power by widening its proprietary functions.

But this change was also related to other political interests too: the government needed the income generated by privatization in order to finance the budget deficit and pay off state debts. Besides, the government intended to appoint its own supporters to the most important economic positions, so the populist wing accused the former élite of trying to salvage its political power in the form of economic power.

By that time more interest groups, such as the employees, local governments, claimants of reprivatization, etc., also declared their claims to state property, but these interests were not successful.

As a result of this economic policy the total *"renationalization" of the state owned enterprises* took place.

The *State Property Agency* which had merely been an advisory body earlier, now became an administrative organ under the government's direct control. The State Property Agency put the state enterprises under its administrative control and exercised property rights without censure and publicity. Actually, this organization was not based on its executive powers but on ownership. It meant that it was not possible to contest its decisions either by administrative or juridical means.

Furthermore, the State Property Agency, as an administrative organization was not capable of making business decisions properly and did not have enough professional administration to deal with the huge number of state enterprises. In fact this form of privatization was an *unrestricted political privatization*, which meant, that economic points of view were subordinated to political interests.

The process of privatization took place in two steps: the public corporations were obliged to become to limited companies, and the shares were sold without inviting tender. After some years it increasingly became obvious, that the process of privatization *had slowed down,* had become *bureaucratic, a "hotbed" of corruption*, although there were attempts initiated by the Governments to reform the privatization system.

So, besides selling, other legal forms of privatization, such as leasing contracts and *utilising contracts* were introduced. The reason was, that by that time, it was obvious, that privatization by selling contracts was not

realistic, because domestic capital investment was lacking. Besides, selling for foreign investors was not always acceptable because of the fear of the dominating influence of foreign capital.

The *State Property Managing Share Company* as a super holding company in state ownership was also established in order to run those bodies which were intended to remain in state ownership for a long time.

As a reaction to the inefficiency of the privatization process, public and political opinion increasingly stated the necessity of *"the privatization of privatization"* which meant the *decentralization and democratization of privatization.* In other words, the conditions *must be based on legal regulations*, and other groups, such as the employees, claimants of reprivatization, public foundations, and public bodies *must also have an opportunity to take part in privatization.*

Sharing the income of privatization between the state budget and the privatized companies was also among the claims.

This *new conception of privatization* came into being only after the coming to power of the socialist-liberal government in 1994. The main aim of the reforms was to implement the privatization as soon as possible, because the companies under state ownership were making serious looses because of the way they were run by the State Property Agency.

Although the Act on Privatization of 1995 regulates the opportunity for other groups to share in' the privatization, such as the claimants of reprivatization, the managers, the employees, domestic investors and social insurance companies, *privilege is given to the foreign investors.* The reason is, that only this group of buyers can pay in cash, which is needed to cover the state debts and to decrease the privatized companies' capital for development.

The privatization process must always be published, which means, that *openly published tenders* must be invited and the points of view of the decision also must be written in a memorandum. The *principles of privatization* that must be followed during the decision making are also regulated in the Act on Privatization of 1995.

While in the former regulation several public authorities, such as the State Property Agency, the State Property Managing Company and Ministries took part in the privatization, the Act on Privatization of 1995 placed all the companies in state ownership under the *State Privatization and Share Holding Company.*

The main aim of the State Privatization and Share Holding Company is to sell these companies, not to run them. If the selling by invited tender was not successful, or the company is intended to be maintained under state ownership, the State Privatization and Share Holding Company has to *make utilising*

contracts with private companies for the treatment. Those companies which are intended to remain as state property, such as central utilities, must be selected by the *Parliament* and enumerated in the Act on Privatization of 1995.

Considering the *legal status* of the State Privatization and Share Holding Company, special importance was given to the several kinds of *control* over it. The Parliament and the Audit Office have the right to supervise the activity of the State Privatization and Share Holding Company. Besides, the Parliament's approval is needed for the Government's most important privatization decisions. The privatization minister appointed by the Government has the rights to exercise property rights. The members of the Board of Directors are appointed by the Government and they have legal responsibility for their decisions. The Directors of the Board of the Supervision are drawn from candidates of the six political parties represented in the Parliament.

2. Privatization in the Field of Public Utility Services

2.1. Public Administration's Supervision over Public Utility Services

Before the 19th century the *provision of public services by the state was rather unusual,* and it was only after the industrial and demographic revolutions that it became more widespread. This period of time saw certain social changes notably an increasing urban population from which social problems, such as poverty, and poor public health arose.

From the 1980s in Western European countries and in the USA political, economic and social observers were *generally sceptical about intervention by the state*. These critics encouraged most governments to rethink their own economic policy. The previously positive attitude towards the state provision of public and welfare services came under increasing criticism.

Theories led to the conclusion that the role of the state in directing the economy must be queried. *Neoliberal economic policy* unequivocally held the increasing state intervention and the considerable state property responsible for inflation and the growing budget expenditure. Liberal economic thinking along these lines recommends an economic remedy for economic problems, *promoting the extension of market mechanism, instead of etatism.*

This was expressed in several economic policy programs, such as liberalism, deregulation, privatization, etc. Nevertheless privatization is perhaps the program which has had the greatest effect.

There are many ways to *define and interpret privatization:* in the most narrow sense privatization means the reduction of state property by selling

state owned enterprises. In a *wider sense* it is considered as a *decrease in the scope of the public sector,* the limitation of its function and generally the weakening of its influence, at the expense of an increase in private influence.

The new liberal economic policy presented a system of arguments on more levels for the approval of privatization: privatization was accepted favorably because it can give individual entrepreneurs the freedom to initiate undertakings in those areas which had hitherto belonged to monopolies, and as a consequence the differentiation of public services widens the customer's options.

The economic advantage of privatization is that it is capable of dissolving those monopolies which are not natural monopolies and which negate healthy market competition. Furthermore, the elimination of state property and the state's bureaucratic and administrative direction of public enterprises would give way to private companies which are much more able to adapt to market conditions.

Privatization of public utility services has special features compared with the enterprises of the competition sphere. The main characteristic is, that *public administration maintains its control over the privatized enterprises* so that continuity, general availability and quality of the services should be guaranteed. The main forms of public administration's control over the utility services are *price regu*lation and the *supervision of their operation.*

The reason of maintaining of these types of administrative control is, that public utility services are monopolies in two senses: state monopolies and natural monopolies. Public utility services are often declared as *state service monopolies,* that public authorities have to provide. *Natural monopoly* is considered to provide the most effective service if only one farm is in the market.

Special contracts are made in implementing privatization of public services, in which there is a special relationship between the public authority and the private farm. Contracts, such as franchise, concession and contracting out, are generally applied.

Public authorities often maintain their right of ownership in these contracts, and only the *economic functions* of the public service *are assumed by the private firm.* Public services are in the public interest, so public administration has to shoulder its responsibility, maintain its control, although these services are operated by private firms. The right of public authorities' supervision can be stipulated in the contract or regulated by legal rules. Inviting tender for the operation of public services also serves public interest, because that private firm will get the right for the operation of the service, which has offered the lowest prices and the best quality.

If the public services are *provided by state owned enterprises,* utility services are in most cases connected with welfare, and profitability is of no significance.

In this case the state gives financial support to the enterprises if they are running of a loss. Secondly, although the utility services are maintained by public authorities they have an economic, not an executive character.

If the public utility services are privatized, the conflict of *public and private interest* emerges. If the utility is operated by the private firm, the public authority gives an exclusive right of the operation to the private firm, so that the profit should be guaranteed. Consequently, the public authority establishes and recognizes a *private monopoly* instead of state monopoly. Being in a monopoly position, the private firm operating the utility service can increase its prices, because it is not subject to competition.

On the other hand, the interest of the customers requires a lower price and better quality of the service, which should be guaranteed by the state. In this case the public interest of the state and the profit interests of the private firms are always contradictory.

For this reason, the most problematic point of these contracts is the *way of determining the service's price.* In other words, these contracts are long term ones, and because of the changing economic circumstances, the prices can not be determined in a fixed way. Instead, the prices charged by privatized utility service enterprises are generally determined by means of *price regulation.*

It is generally accepted, that the role of price regulation must *substitute for competition* in those areas, where natural monopolies exist, and are operated by private firms. It means, that price regulation must perform the function of the *income allocation of the competition:* the service's best duality for the lowest price, and the guarantee of the private firm's profit.

The greatest problem of price regulation is that while the competition has perfect regulatory effects, price regulation is a *legal method*, which can not substitute competition in the same way. For example, application of price regulation is always based on the legislators' decision, and there has not been uniform agreement on prices.

Secondly, the process of price regulation is generally long and complicated, compared to the automatic effects of competition. Furthermore, the *principles of the prices* have not been elaborated in a sufficient way, although differentiated methods of price regulation have developed.

The institutions of price regulation—*the regulatory bodies*—are always independent from the governmental and political organizations, which is guaranteed by legal rules. It means, that only the Parliament has the right to regulate the framework of the prices, appoint the heads of the regulatory bodies, and supervise their activities. The decisions of the regulatory bodies can be contested in the courts. The regulatory bodies are public authorities

with professional staff. Their main tasks are to pass decrees regulating prices, decide in legal discussions between the customers and the private firms, supervise the budget of the firms, etc.

Former opinions emphasized, that price regulation is inevitable, because it must substitute competition. But regarding the inefficiency of the price regulations, more standpoints admit, that *price regulation* is less *effective, than competition supervision*. That is, one of the functions of competition supervision is to limit the abuses deriving from the monopoly. For this reason, the basic dilemma of the public service sector is whether the price regulation or the conditions of competition supervision must be applied.

Recently, developing technical requirements allowed market competition to be created in those areas, which had previously been natural monopolies. As a result, there is a tendency towards putting public utility enterprises under competition supervision instead of price regulation. These *deregulation programmes* intended, that the prices of the deregulated sectors must be determined by competition. But deregulation can not be implemented for every utilities, or in all the activities of the deregulated utilities. Consequently, the elements of competition law and the price regulation are interwoven, and it is not easy to decide in concrete cases, which one must be applied.

2.2. *Price Regulation and Competition Supervision over Public Utility Services in Hungary*

Privatization of public utility services was implemented in 1996 in Hungary. Earlier, public service enterprises were placed under *direct administrative control,* even after the economic administrative reforms of the 1960-s. At the beginning of the transition most of them were transformed to *commercial companies* and the property rights were exercised by the State Property Agency or the local self governments.

The 1990 *Act on Price Regulation* declared, that in the new economic system prices are to be determined by *market competition* and the intervention of the government in this field can happen only in *exceptional cases*. These exceptional fields are enumerated by the Act, when the means of the *competition supervision are insufficient* to prevent abuses deriving from the position of monopoly.

Almost all public utility services are included among these activities, and put under price regulation. Price regulation means, that the sectoral minister or the local governments are obliged to *pass a decree or by-law to determine the maximum level of the utilities' prices* to be applied.

Obviously, the reason for placing these utility services under price regulation is, that they are *natural monopolies and are not subject to the effects of competition.* In this case the legal rule determines the prices directly, and the provisions of *competition law are not applied.* The reason is, that price regulation instead of competition is responsible for determining the "right" price. Secondly, the price is regulated in legal rules which can not be revised either by the civil court or the Office of Competition. Certainly, if the utility services are not under price regulation, the price is stipulated by the parties of the concession contract, and the competition law can be applied, if the utility charges a monopoly price.

Although the traditional means of price regulation was adjusted to the requirements of the market mechanisms, it was *modelled to the state owned utility enterprises.* In another words, this system of price regulation does not meet the *profit interest* of the private firms and the *customers' interest.* The reason is, that although the Act declares that the profit must be guaranteed, does not regulate the *methods and principles* of the regulated price. It means, that the public authority is entitled to regulate prices and may exercise *discretion* in choosing the method.

The private company operating the utility only has the right to make proposals, which are not obligatory for the public authority. Being a legal rule, the regulated price could theoretically be contested only in the Constitutional Court, if it does not cover the profit for the private company. But in fact it is obviously not the task of the Constitutional Court. Furthermore, the sectoral ministers are *dependent from the government*, and represent its interests in determining prices. Besides, the local governments' staff do not have the necessary professional skills to regulate the prices.

Suffice to say, this *bureaucratic regulatory system* does not meet the requirements for the regulatory bodies' independence, the procedural guarantees and differentiated regulatory methods. Naturally, the privatization of public utility services could not have been implemented on the basis of this regulatory system. For this reason, *other solutions were sought to ensure the profit interest* of the private companies participating in the privatization.

Firstly, *regulatory bodies* were established by the legislation in those areas, where privatization had been performed. These bodies represent more modern principles of price regulation, such as professionalism, independence, participation of the companies in applying prices, the representation of the customers, the function of balancing several interests, etc.

Secondly, the methods of price regulation are regulated in *Government resolutions,* which mean, that if the decree or the by-law contradict the resolution, they can be challenged in the Constitutional Court. That is, in

this case the decree or the by-law violates the principle of the hierarchy of legal rules.

In other cases the contracting parties stipulated the methods of the prices to be applied in the *concession contract.* The minister or the local government obliged themselves, not to pass a decree or by-law regulating the utility's prices which contradicts the agreement of the contract. The problem is, that when the minister or the local government make the concession contract, they represent proprietary function, and can not oblige themselves as the executive powers.

On the basis of these analyses it can be proved, that the system of price regulation is fairly *contradictory* and *confused.* There could be two possible solutions. One of them is the creation of the regulatory bodies and procedures that represent *modern principles.* But many experts are unsure, whether it is possible without traditions and whether its costs could be financed.

The other possibility is the *extension of competition supervision.* In this case the Office of Competition would become a *"quasi" regulatory body,* which means that public authorities would determine only the methods of prices and the Office would have the scope to decide in the case of abuse of prices. But the Office of Competition declared in its decisions many times, that it is not the task of the Office to determine the "right" price of the utilities. That is, not all utilities are under price regulation, and in these cases the Office has the right to decide if the abuse of prices has occured. But the practice of the Office shows that it tried to avoid investigating prices, and so the costs of the companies operating the utilities.

2.3. Privatizing Public Utility Services in Hungary

In Hungary before 1990 almost all the public services were state monopolies with a few exceptions, which were allowed to operate privately as individuals or companies. After 1990 the liberalization of state monopolies was completed.

The Constitution makes it obligatory for monopolies to be regulated by acts of Parliament. Besides the Concession Act several acts contain the regulation of state monopolies, e.g. the Civil Code, the Post Act, the Bank Act. Some of these may not be operated by private persons, but are the exclusive monopoly and property of the state.

The listed state monopolies in the *Concession Act* are transferable to the private sphere only by concession. The Concession Act was created as a framework act containing the general rules of concession, and the detailed conditions are regulated in clauses.

Among the detailed activities listed in the Concession Act only a few belong to the field of public services, (the maintenance of public roads, railways, rivers, ports, airports, and public utilities, public transport, telecommunications, postal services) others are regarded as policy monopolies (the production of nuclear energy, and the production of drugs), and a third group of monopolies are regarded as financial monopolies (mining, state lottery).

Concession means those privileges, licenses, or advantages which were given by the state to persons or organizations for those activities which the state is obliged to perform. According to this interpretation concession is a license given by the state for executing public tasks by private persons. Concession is therefore often considered to be a form of privatization of public duties.

Licensing, the practice of a state monopoly for a private party is often identified as concession. The main difference between concession and licence is derived from the two divergent positions of the administrative organ: when granting a licence the administrative organ acts as an administrative authority, but when awarding a concession it decides to enter into a contract, as an owner.

Another difference between them is that the conditions of the license are determined onesidedly by the state. If the applicant suits all the legal requirements he or she will have the right to obtain the license. However, the awarding of concession is always the decision of the administrative organ, as well the selection of the person entitled to the concession also depends on it. Conditions of practice of concession are determined by the mutual agreement of the parties.

The subject of concession may be the granting of a monopoly by the state, or the permission to utilize state owned property. By granting concession on state owned property the state intends to keep its right of control by maintaining the right of the ownership of its own property.

The *concession contract* is faced with the contradictory elements of private and public law. This conflict is caused by the existence of a civil law contract representing entrepreneurial activity and of administrative control enforcing the public interest.

This dilemma is revealed in the question, as to whether the concession contract can be classified as a civil law contract, or as a separate category. However, no explanation has been given as to whether the state can legitimately be regarded as an equal party in the contract, despite the state maintaining rights as the bearer of executive power.

Concession contract consists of the preclusion of competition and assurance of *monopoly* for the party entitled to the concession. Obviously there are cases when the competition would anyway be excluded because of the character of the activity: e.g. the building of roads and motorways. But

generally the award of a monopoly is itself diametrically opposed to the principles of competition. The question is, what kind of solutions may be offered to eliminate this situation?

The Treaty of Rome tried to outline an alternative: EEC countries have to ensure that enterprises should not be awarded exclusive rights which would contradict the law of competition as laid down by the Treaty of Rome. At the same time the Treaty allows for exceptions: those enterprises providing public service are allowed to depart from these rules if they are limited in performing their tasks. But any departure should not be in conflict with the public interest.

Another specific feature of the concession agreement is that in most cases concession occurs in areas typified by high capital intensity and low rentability. The public administration has to guarantee benefits for the contracting party to attract private capital. The measure of the benefits of concession activity depends on the concession fee and the price of the service. As the concession contract is a long term one, the contract may only be modified by mutual agreement. In the event of poor calculations or inflation the enterprise may make losses, and it would result in the bankruptcy of the enterprise and at the same time the public would lose its services.

More variations are applied in determining the *price* of the public services. On one hand the enterprise should be entitled to raise its prices in the event of inflation, on the other hand the right to do so may justifiably be limited because the activities of such enterprises are not conducted under market conditions which would force them to reduce the prices. In most cases the price of the services are determined in legal rules by the authorities.

The most specific character of the concession contract is the public element. The object of the concession is always connected with *public property* or *public money*. For this reason it has become necessary to oversee the making of these contracts to safeguard against corruption, and ensure equal opportunities. This rule makes it binding for the administrative organ to announce its offer of contract and to judge it by way of public tender.

The first step towards concession is to invite *public tender* which is an obligatory condition of concession. Public tender may be initiated by the state, a ministry department, or the local government. The right to invite public tender is always determined by the bearer of property, or governed by the clauses within the Act. The right to select the candidate for the concession follows from the right to invite the tender.

Concession contracts will be made with whoever submits the most favorable offer for the concession. According to the interpretation of this provision it is not obligatory for the state to enter into a concession contract if the

administrative organ has declared the public tender invalid. If the public tender is declared valid the concession contract may only be made with the winning candidate.

The other reason why the administrative elements exist in concession contracts is the responsibility of public administration for the *continuity* and *quality of public service.* After the transfer of public services the public administration may not refuse responsibility. That is why public organs have the right to modify some provisions of the concession contract one sidedly.

Another departure compared to the civil law contract is the right of the administrative organ to *nationalize* the enterprise in the event of breach of contract. Immediate termination of a contract as a sanction of civil law would not suit the demand for continuity. As a consequence of being responsible for the continuity of services, the public administration has wide rights in *supervising* the enterprise, which may occur in three forms: the state may keep the majority of shares in the enterprise, thereby maintaining the right of control as the owner.

The state can also create opportunities for controlling the enterprise by *legal rules* or may entitle the ministry or government department to supervise it. Finally, the contracting parties may stipulate the right to control the enterprise by the state.

Concession contacts are made for a definite time to avoid the indefinite transfer of state monopolies. The maximum period of the contract is 35 years although there was an exceptional contract made for 47 years.

In the concession contract on one hand the state's obligation is the transfer of the right of the operation of the public service, on the other hand the contracting party's obligation is to pay the *concession fee.* During the existence of the contract the state is not allowed to change monopoly position disadvantageously for the party entitled to the concession, i.e. the administrative organ is not permitted to invite another tender, or to establish any new state owned enterprise in that field of public service. This regulation is necessary to guarantee benefit to the company.

After making the concession contract it is obligatory to establish a *business association*, and to obtain the *licenses* which are necessary for the practice of the public service activity.

3. Privatization in the Banking System

After the aforementioned process of economic liberalization had taken place in the 1960s the *banking system* had to be adjusted to the changed

circumstances. Previously, all the banks performed the same functions and came under the state budget control. The lack of scope meant that the banks' functions were limited to the *execution of the central state plan* and the *financing of state investments.*

The indirect economic administrative system needed a banking system which could promote the *development of a capital based market.* In this case the role of the banking system would have been to influence the market processes by economic regulators on the basis of the central economic policy.

For this reason the *division of the functions of the central and credit banks* occurred by the end of the 1980-s. The *central bank* (National Bank of Hungary) as the part of the administrative organization system performed only the *monetary regulatory functions*, but *5 state owned commercial banks* were separated from the central bank. Although the central bank was empowered with monetary regulatory rights, its *close dependence on the government* was maintained.

The government appointed the president of the central bank and it was empowered to set credit and monetary policy. Furthermore, legal rules set by the government and the finance ministry were obligatory for the activities of the central bank. But the *budget policy* had the greatest influence on the central bank's operations: the deficit of the budget was financed by the central bank's credits, and the amount was not limited by any legal rule.

The legal regulations of the transition *stated the independence of the central bank* from the Government in 1991. That is, the Act on the National Bank declares, that the *Government can not control* the activities of the National Bank. The role of the Government relating to monetary policy was narrowed down to an advising capacity and *representation* by a minister in the Bank's meetings. The *Minister of Finance* only has the right to *reconcile* the monetary policy and the finance of the budget deficit with the National Bank. Besides, the president and vice president of the National Bank are appointed by the president of the Hungarian Republic. The directors of the Board of Supervision are appointed by Parliament.

The National Bank is a share holding company under state ownership, but it is also *"quasi" public authority entitled with executive power.* That is, the National Bank has the rights *to pass decrees* which are obligatory for the commercial banks and which provide monetary regulations. The other executive task of the National Bank is the *supervision of the commercial banks* as to whether they operate according to the provisions of its decrees.

However the intervention of public administration began to prevail once more which *adversely affected the operation of the capital market.*

Although the Act limited the amount of credit to be given to the budget by the central bank, the budget can pressurize the central bank to issue government securities. So the *budget's financial demands still affect the capital market* and squeeze credit out of the commercial banks and increase inflation in the economy.

The *state monopoly* of banking activity was dissolved, and as a reaction, new banks were established, primarily by foreign investors.

The *Office of Banking Supervision* was established in 1991 under the Government's direction. The main function of the banking supervision is to *guarantee the interests of the investors*. The Office gives *the licences* needed for their establishment. Besides the technical, financial and personnel requirements, the Office has to investigate, whether the bank's business plan serves the interests of the investors.

The *supervision* of the Office is extended to the commercial bank's activity from the aspects of *legality* and *safety of investment*. The Office has the right to apply *several sanctions* in cases of abuse, such as to oblige the bank to take the necessary measures, impose fines, withdraw licences and relieve managers from their office.

Obligatory privatization was also legislated in order to decrease the scope of public administration in this sphere. But in reality an *opposite tendency* appears. The state owned credit banks made heavy losses partly because they had many unpayable claims in the state owned enterprises, and partly because of the old management. Therefore the state saved them from bankruptcy with an increase of capital subsidy and consolidation of credit. As a consequence, the *proportion of state ownership has increased* by 70% in the banking sphere.

The property rights were exercised by the State property Agency, and later by the Ministry of Finance. Obviously, these administrative organizations can not have business interests in the banks' activities which fed—among others—to banking scandals in many cases.

The *conclusion can be made that public administration can not assume many different divergent functions (supervisory, monetary and proprietary) at the same time*. The National Bank saves the state owned credit banks from bankruptcy with refinancing credits, and the Office of Banking Supervision performs a lenient supervisory activity over them. Furthermore, the National Bank determines high reserve rates for the credit bank's in order to balance the budget. Consequently, the saving of state enterprises from bankruptcy, hinders the proprietary state's monetary and supervisory functions. The state thus finds itself in a contradictory position.

4. Privatization of the Welfare Sector

4.1. State-Responsibility in Welfare

The provision of welfare services as a task for the state has been strongly influenced by the European welfare traditions. European governments continue to treat welfare services as activities that cannot be adequately supplied by the market alone and that must receive state subsidies. In recent years, however, U.S. policies have increasingly been based on the idea that only the market can assure the quality of welfare services and that the state therefore should incorporate market principles in welfare policy.

There is a persistent debate in the Continental European political literature on the question of whether American public administration, which is based on a public management approach, has established a new relationship between the public and private sectors and whether such approaches can be applied to law-governed European systems. This question is especially important in the field of welfare, because in Europe the *welfare rights of citizens* are specified in national constitutions and the welfare responsibilities of the state are detailed in public law.

Other pressing questions include whether the law-governed character of European public administration can provide adequate welfare services and whether such services will be maintained in the manner intended by law.

Western European theories traditionally have stressed that the *public interest* is better served when providing welfare services is accepted as a state responsibility. However, this has become somewhat muddy as a result of the neoliberal tendencies of the 1980s.

From a comparative viewpoint, the United States has provided only a minimum level of welfare service. The *individualist tradition* stresses equal opportunity. It is the responsibility of individuals to improve their situation by their own efforts. The Constitution declares political, not social or welfare, rights of citizens. The provision of welfare has been a mutter of public policy, based on the needs and influence of different economic groups.

However, American culture has always had an aversion to centralized power. This has encouraged the establishment of voluntary and charitable organizations. In lieu of strict regulation, public policy often encourages private administration of welfare services with public oversight.

Excluding the Great Depression, U.S. social policy never intended to provide more than a few *governmentally administered welfare programs.* This follows the belief of many that poverty is in many ways the fault of the individual, hot the result of social inequality. For this reason, social

welfare allocations are provided on a case-by-case basis for people in need. Awarding welfare is always based on discretion. It is the duty of clients to prove their financial condition warrants assistance. And provision of welfare allocations also depends on whether clients observe behavioral rules established by public authorities. With unemployment in the United States at relatively low levels in recent years, most Americans believe they should no longer finance welfare services for poor people.

Europeans view the American welfare system as *stigmatizing* because it does hot focus on the social conditions that lead to poverty, but instead emphasizes treatment of the symptoms of those conditions. In Continental Europe, the public interest is the reason cited for the state's responsibility to shoulder welfare programs. *Social rights are mandated in many national constitutions.*

Distinctions between the welfare services of the public and private sectors are reflected in the differences between applied public and private law. *Under public law, welfare belongs to the public sector.* It aims to promote the poor, and the state must intervene to compensate for unequal market mechanisms. For this reason, European approaches regard the application of business principles in welfare services as inconsistent with the public interest.

4.2. Privatization of Welfare Services

Conservative U.S. economic theory holds that because of the New Deal, public administration began shouldering more public tasks than it could effectively manage, thus interfering with economic development. In this view the principle of *free choice is violated*, because welfare services are provided by the state and hot the marketplace.

This theory of privatization often is criticized in Europe, where it is widely held that providing welfare is fundamental to the public interest. In contrast to the U.S., European theories claim that there is justice in providing welfare services because these services are based on fair redistribution. In the European way of thinking, freedom means *recognition of social citizenship*, including the right of individuals to be protected from inequality brought about by the market. Welfare services based on market principles are regarded as being inconsistent with state responsibility.

However, American style privatization may not mean transferring welfare services entirely to the private sector. Instead it may mean shifting to a so-called *"regulated market"* where government maintains the responsibility but it can assign the operation of welfare services to private enterprise. Social policy is also expressed in the U.S. by other means, such as subsidies

and vouchers. In American government redistribution of wealth is contrary to market mechanisms. Rather, individuals in society should accept responsibility for their own welfare.

Free choice and efficiency due to competition reduces costs and encourages partnerships between the private and public sectors.

The European approach attempts to maintain a boundary between the two sectors. But once privatization emerges, the dichotomy of public-private law was no longer clear. The public interest that earlier determined what kinds of welfare services the state should provide has now become a vague, intractably political principle.

Under U.S. policy, public administration's role is to maintain the *quality of welfare services*. When non-competition is unavoidable, government must regulate the price of services. For example, institutions for the homeless cannot be easily shifted to a competitive environment or performed on a fee basis. Government must exercise near or at least distant control over quality and costs.

In the United States, some welfare services have been privatized by *contracting out*. When a fee cannot be charged for a particular welfare service (as is the case for services for drug addicts), the public authority often assists non-profit enterprises in providing services. While competition is often not possible in these fields, costs can be reduced by contracting for the best quality service at the lowest cost.

U.S. privatization occurs if the enterprise providing the welfare service is a profit or non-profit organization operating under market conditions. Free-of-charge services are regarded as impractical, because only fees can assure reasonable consumption. Direct assistance to the needy provided by vouchers enable the exercise of choice and at the same time provides benefits to individuals who are in need.

Typically, European approaches do not embrace this form of privatization. Vouchers are issued directly by public authorities. Privatization of welfare to non-profit (and for profit organizations) is rare. Moreover, this approach is not likely to displace centralized state systems.

Many Americans consider nonprofit organizations to be more reliable than for-profit businesses, especially when customers cannot judge and choose the quality of service. Further, where these organizations operate in a competitive environment, public authorities can reduce price supervision over them.

Consumers of *nonprofit* services can benefit from advantages such as flexibility, autonomy, customer-oriented services, and satisfaction of special needs. These public-nonprofit partnerships meet the requirements of the American public. But there are those in the United States who fear that

nonprofit organizations risk losing their identities as their quasi-state role expands.

The U.S. practice of incorporating competition in providing welfare services could well serve as a model for Europe. The state's role in providing welfare services continues to be dominated by a monopolistic, centralized system.

4.3. Privatizing Welfare Services in Hungary

In Hungary since the demise of Communism, welfare has been provided by both the public and the private sector. There is a tangible movement toward *withdrawal of the state from welfare services*. But this drawback is occurring without benefit of either well-defined political concepts or elaborated theory. The "public interest" in welfare must be redefined.

The question is as to whether change in the welfare systems in Hungary since the transitions are more heavily influenced by American or Western European traditions? Is the central challenge to welfare systems meeting legal requirements, or is it to provide a loose safety net? Moreover, with constitutional and administrative regulations emphasizing that the state has a high-level responsibility to support welfare, how can the withdrawal of political support and funding for welfare be justified from a legal standpoint?

During the Communist era, welfare in Hungary served as part of the wealth redistribution system of the state-controlled economy. The Communist state *assured the welfare of citizens* by dictating how certain goods and services were provided to the general population. Not only were welfare services provided free of charge, but below-market prices for goods such as flats, foods, and utility services were established and subsidized by the central government.

Communist budgets served the interests of production more directly than the interest of welfare. For example, they often subsidize money-losing state-owned enterprises. Until the 1960s, the so-called *"bureaucratic redistribution"* based on a macro-economic plan meant that markets existed only on the periphery of the economy. Central planning, state investments, and bureaucratic allocations prevailed. Starting in the 1960s, however, market allocations gained precedence. When that system disintegrated after the 1990 transition, a small portion of the society became wealthy but most became poorer and poorer. This special market produced a new entrepreneurial class that have obtained great wealth and a political elite that has achieved

great power. The interests of these two elites are often able to suppress what remains of the bureaucratic state redistribution system.

Recently, groups whose incomes were provided historically by the state bureaucracy have found themselves at tremendous economic disadvantage. The guarantee of low incomes and subsidized basic goods and services, such as food, homes, and utilities under Communism has disappeared.

With the privatization of state-owned enterprises and creation of open market institutions in the post-Communist era, a *"gray economy"* prevails and the state budget is under great pressure. The percentage of the state budget devoted to welfare is higher in post-Communist countries than in developed Western nations. The political elite and "new rich" argue that welfare costs shouldered by the state in the former Communist regimes are far beyond the state's ability to pay for them. These circumstances have forced the state to further withdraw from many welfare services. As a result, the current system can be viewed as a mechanism for maintaining a permanent economic underclass. Social policy continues to reflect the interests of the new political and entrepreneurial elite, whose members are economically independent from the state welfare system and are not interested in addressing the growing poverty which could eventually jeopardize their own economic success.

In post-Communist economies there is a pronounced pattern among the entrepreneurial class of successfully avoiding the payment of taxes and social insurance. As a result, the state budget is further depressed. The reaction of the government is to further increase fees and taxes, which, ironically, further encourages people to avoid paying them.

The consequences of fiscal duress are well illustrated in Hungary, where the *contradiction* between, on one hand, the constitutional requirements regarding social rights and, on the other, major reductions in welfare services has resulted in legal challenges in the Constitutional Court. The Court has been forced to interpret welfare rights within the framework of today's more restrictive financial reality. As a result, it has enabled the legal reduction of welfare services. There was an attempt to amend the Constitution to eliminate some mandated welfare requirements. However, this attempt failed.

Although laws in the post-Communist countries still emphasize the state's responsibility, this tendency by the state to withdraw from welfare services is increasing. The sharp difference between legal requirements and reality in Hungary and other post-Communist countries would be better served by administrative innovation and adaptation rather than intervention by the court.

Reflecting the policy of developed Western countries, former political elites in post-Communist countries have attempted to develop a so-called *"premature welfare state"* theory. However, the "premature welfare state" theory misinterprets "non-intervention." Non-intervention does not mean the radical withdrawal of the state from welfare.

Hungary has attempted to decentralize and privatize social welfare services in order to modernize the system. But replacement of state-welfare services by so-called self-organizing institutions has not taken place; instead, serious deterioration of welfare services has occurred.

Welfare privatization in Hungary has been fairly limited. The private sector is not sufficiently developed to allow the state to withdraw from providing welfare services. Due to a lack of state funding, few, if any, welfare services have been shifted to nonprofit organizations. Market conditions have been created, but there are relatively few private initiatives in the field of welfare, since the majority of citizens do not earn enough to pay for welfare services. In the wake of transition, social policy depending on privatization is not an attractive proposition for the near future.

5. Privatizing Health Care

5.1. Privatization Policies in Health Care

The aim of this chapter is to introduce privatization concepts of health care from a comparative approach. Privatization issues of Hungarian health care will be examined in the post-communist political-administrative environment. The paper will also briefly look at some principles and trends in the privatization of health care in the US and Western Europe.

Health care in Western Europe has been provided in the public sector as an important public service. Even in the US, where the provision of health care is largely based on private participation in a competitive environment, the government plays an important regulatory role.

More examples can be mentioned as to how traditions of public administration have affected reforms in health care. Reforms aimed at establishing general access to health care in the US failed. Such health care reform would require a central health authority, which is not realistic in the decentralized, business-oriented US public administration. Any national health insurance system, based on citizens' mandatory contribution, would limit customer choice and increase taxes in the US. The European practice of public financing of health care is inconsistent with American traditions.

The privatization of health care is unlikely to alter public finance systems in Europe. This is because authorities have to respect health services as a universal constitutional right when organizing health care. Instead, reduced subsidization and increased cost sharing, as a result of privatization, signals state withdrawal from health care. The privatization of health care has not always resulted in an extension of market mechanisms in Europe, but heavier state intervention and regulation. The aforementioned limitations of privatization are closely related to the nature of the centralized and law-governed European public administrations.

Several variations of market mechanisms vs. state regulations have developed in health care. Health care is probably the area of the economy in which public vs. private elements in finance, regulation and services have interwoven in the most complex way. Privatization in the widest sense means reduction of the public sector, but several forms of privatization can take place in practical reality.

Health care in the US, similar to other services, is a business activity, and privatization policies aim to achieve even more efficient health services by using business principles. Health care services in the Scandinavian countries, as opposed to the American practice, are provided by the state based on social welfare principles.

It is important to define the public purpose which privatization policy has to follow in health care, as privatization will determine the roles of the state, market and civil sectors.

While the possibilities and limitations of privatization in health care are clearly seen in developed western countries, privatization is an unpredictable issue in post-communist Europe. The need for privatizing health care is evident, but it is difficult to predict exactly which kind of health care model may evolve in these countries.

Hungary has created a public law system based on the continental European model, but bureaucratic administrative traditions from the communist state remain. The premise of this chapter is that these *communist attitudes have effected health care reforms and developed a different form of practice for privatization than in Western Europe.* For this reason, health care reforms in Hungary are fairly vague.

5.2. Public Interest in Health Care

European health care policies have followed two main areas of public interest since the 2nd World War, named *solidarity* and *efficiency*.

Solidarity means that services are available for all citizens and contribution to health care should be proportional to their income. This is a main principle of health care everywhere in Europe.

National governments are obliged by federal laws to provide free health services for poor and elderly people in the US. Medicare and Medicaid obviously represent welfare issues, but are exceptional, rather than a general commitment on the part of the government. Solidarity has not developed in the individualistic American society. The ideology of customer choice represents the interest of the American middle class which can obtain health services at market prices, but is unwilling to contribute to health care for the poor.

Efficiency in health care in the widest sense means that funds generated for health care should provide the best outcome, such as quality of services, customer satisfaction, health conditions for the population, etc. It also includes the improvement of other factors outside health care, such as preventive programs.

American theories, not accidentally, have established a most differentiated way of efficiency and effectiveness in health care. This is due to American administrative traditions. Not only health care, but all public administration has always been based on business principles in the US.

The privatization policy in Europe was expected to assure more efficient health services from reduced financial resources. Privatization of health care did not merely mean withdrawal of the state, but an increase in the role of market mechanisms, such as competition, deregulation, additional private insurance, etc. This way of privatization is called "regulated market" in health care.

Opportunities for privatization are limited in European health care. Solidarity has been protected by constitutional regulations as citizens' universal right to health services. Regulated prices or bureaucratic financial rules still prevail here, due to the requirement of global cost containment in public finance, too.

Privatization practices in Europe cannot evidently prove that privatization has resulted in greater economic efficiency in health care, or just transformed financial resources by altering contributions.

The most important difference between a regulated or free market in health care is the public and private character of the finance system. The percentage of public finance is low in American health care (only Medicare and Medicaid) but dominant in Europe. Only one example can be mentioned as to regulation limiting market mechanisms in the US: the regulated prices of Medicare

and Medicaid. Due to the influence of the medical business lobby, the requirement of global cost containment has less relevance there than in Europe.

Privatizing health care is problematic in Hungary, because neither solidarity nor efficiency can be enforced.

The Hungarian Constitution declares that everybody has the right to the best health care which should be guaranteed by the state through its health care system. This kind of regulation obviously contradicts the increased state withdrawal from health care: universal access to health care is still guaranteed by law, but provision is inadequate. The sharp difference between constitutional regulation and practical reality is a basic characteristic of the so-called "premature welfare state".

Redistribution that has recently developed in the Hungarian health care system does not insure reasonable contribution from citizens to the health services.

Theoretically, national health insurance is an insurance-based system, which means that citizens have to contribute after their incomes. National health insurance in fact assures the universal right of health care to citizens. So, the costs of the health care of the growing number of unemployed and pensioners should be financed by citizens' contributions.

At the same time, the budget for national health insurance has been decreased by half in the last ten years, due to the lack of proportionate sharing in contributions. Business associations ere unwilling to pay contributions to health care, and can successfully avoid doing so. Wealthier people can afford private health-care services, or pay under-the-table money for better state health services.

People with lower incomes, such as civil servants and the employed, contribute the most to the budget of the national health insurance. As a result, the percentage of private finance is increasing, but *public finance is proportionally* decreasing in the total cost of health care.

According to general opinion, increasing contribution of citizens to health care is not realistic in the current system. Additional Financial resources could be drawn in the following way: a) Imposing tax on unhealthy products, such as alcohol, tobacco, etc., and transferring it to health care. b) Establishing additional health insurance using private insurance companies. c) Compulsory co-payment for health services d) Selling state/local government owned health institutions.

No single government has to date made any plan for drawing financial resources from anything other than citizens' contributions.

Greater economic efficiency of health care has not been achieved in Hungary, either. This is especially difficult because many bureaucratic

features of the former economic administrative system still prevail, and have led to a waste of the decreasing financial resources for health care.

Health care under communism was funded from the state budget in a bureaucratic, centralized system. The funding of various health services was determined by political decisions. The provision of health services was a state monopoly and health care institutions were owned and closely controlled by the state. As in the case of state enterprises, health care institutions were financed by the state, no matter how inefficient they were. Informal bargains between politicians and the directors of health care institutions determined how financial resources were transferred to health care.

Many think that the failures of the health care system are caused by the influence of bureaucratic coordination and an unregulated market. Alongside the existing bureaucratic coordination, there has developed an unregulated market, such as the pharmaceutical and medical equipment industry, private clinics, etc. The government controls the health system by traditional bureaucratic means, or lets it remain uncontrolled.

5.3. Health Care Policies in the Politico-Administrative Environment

Health care policy in *Western Europe* is determined by political consensus. In other words, ad hoc or regular organizations representing several groups of health care, such as health authorities, providers, patients, etc., are established to negotiate health care policy. Health care policy in Europe means no more than an informal consensus-based political decision that should be regulated by laws. Political decisions on health care reforms are made in a democratic way, although the public administration system entrusted to regulate them has been centralized.

The Americans are adverse to any centralized power, and believe that only decentralized public administration and a wide civil sector can guarantee democracy. Health care matters are not extensively regulated by public laws there. Neither federal nor state laws determine accountability for health departments with regard to health services, with only a few exceptions, such as AIDS, health care for the poor, etc. Public laws deal with the quality of health services or other technical issues, but typically do not determine tasks for health authorities.

In the absence of intense legal regulations, nonprofit organizations in the US have more freedom to influence health care policy. This is also due to the traditions of self-governance. The lobby (pressure group), for example a medical association, is a kind of nonprofit organization which represents an interest group. Lobbies are not informal, but legally regulated and registered

organizations in the US. Lobbying activities are a most important guarantee to American democracy.

Nonprofit organizations are in no way limited to deal with public matters in the US. This is because there are no public issues that only public authorities are entitled to deal with. Consequently, health care policy is primarily developed by nonprofit organizations, rather than government authorities. Health care policy, similar to other public policies in the US, is in fact an applied practice.

The Hungarian government has not yet established a clear health care policy. Instead, it is left to day-to-day political goals as to how health care issues are regulated. Steps toward health care reforms that have been seen during the last ten years can be concluded only on the basis of legal rules, not on health care policy, because government decisions on health care are often kept in secret, and made behind the scenes.

The process of legislation is governed by law in Hungary. It is the task of the Ministry of Health Care to elaborate a proposal for laws on health care. The minister who is accountable for the operation of the ministry is appointed by, and can be recalled by, the prime minister. Acts on health care are passed by the Parliament, where political parties in power have a majority. Therefore, both the preferences of the minister of health care and the strongest political party currently in power prevail, when health care issues are enacted.

There are "checks and balances" in the legislation, with varying degrees of impact. The president of the Hungarian Republic has not exercised his right to veto when it comes to health care issues, but more acts on health care have been attacked before the Constitutional Court. The Constitutional Court has refused to decide in those cases where health care policy was debated.

Health care pressure groups also influence legislation. Government is legally obliged to withdraw representative organizations from the codification of health care. However, laws do not state clearly which lobbies (consultative, opinionative, etc.) should be withdrawn, nor how to do so.

Under communism, representative organizations were established by state order. The role of these "artificial" representative organizations was to demonstrate to the public that the communist state was democratic. This type of tradition still prevails when government authorities do not take pressure groups' opinions into account and consider that only the government is competent to make important decisions. Government authorities often violate acts in the process of legislation, wherein they exclude publicity and arrive at informal political bargains.

Health care is declared by law to be a public issue which only government authorities can deal with. The state is accountable for providing

health care. Health care policy, however, should be based on a consensus between both state and civil sectors, including physicians, citizens, health employees, etc. Only a consensus-based health care policy has any chance of modernizing health care.

Lacking consensus, inadequate government decisions are implemented regarding health care. This is generally because government authorities cannot represent public interests in health care, such as solidarity and efficiency; rather, these authorities reflect the personal interests of their leaders. Political parties in power choose to share the benefits of privatization through means of corruption and via the acquisition of the property of health care institutions.

The modernization of health care, on the other hand, would hurt the interests of certain social groups, and not result in any political benefit for the government. Business firms, for example, which share extra profits with the management of health institutions for providing diagnostic services and senior physicians, who receive most of the under-the-table money from patients, are interested in maintaining the status quo, but manifestly have no interest in modernizing. The public would most likely be against additional health insurance, seeing as people would see an increasingly narrower state health services in such a reform.

5.4. Efficiency of Health Care in Developed Countries

It is well-known that health care providers are interested in extending services in order to achieve higher income. Customers do not have enough information to judge if health services are really necessary. This is called "asymmetrical information" in the market relations of health care. Not only are health services typified by "asymmetrical information," but as being healthy is the most important value for individuals, demand for health services is less limited than that for other goods.

All financial regulations *in Europe* which have tried to limit the costs of health services at the level of health care providers, while assuring the quality of services, have failed. All of the applied incentives have disadvantages. The system of "global budgeting" encourages providers to provide less service, but does not guarantee quality. Providers are interested in serving more patients in the "fee-for-service" or "day system". The most widespread method is the DRG (Diagnosis-related groups) system, which incites efficient service, but only in the case of one patient, not many.

Insurance companies in the *American* private insurance system can transfer higher costs to customers by increasing insurance fees, although competition between insurance companies forces them to be prudent. The

price for health services and insurance is stipulated by contracting parties, such as health care providers, insurance companies and patients. Only the prices of Medicare and Medicaid are regulated in the US.

Transferring higher costs to customers is not possible in the European publicly financed system, because the measure of contributions to health care is determined by law. Therefore, financial rules must meet the requirements of global cost containment. In case of loss, the state subsidizes health care from the state budget, rather than increasing contributions from citizens. Such a subsidy is not well received by the economic policy.

American health insurance companies control the costs of providers by using differentiated means for cost-effectiveness. Cost-effectiveness is enforced by competition between health providers, customers and insurance companies. There is a belief in the US that only market mechanisms, such as competition, private ownership and profit-motive, can enforce the quality and efficiency of services. Regulated prices and transfer of capacity are the rule in European publicly financed systems.

Health providers, both for- and nonprofit, are interested in profit in the US, although in a different way. Communities often establish nonprofit hospitals. The nonprofit character of hospitals has a different meaning than in Europe. Nonprofit hospitals in Europe can not pursue business-like activities, nor make a profit. Nonprofit hospitals are normally financed by the state or the national health insurance plan so that social welfare issues in the provision of health services can be maintained.

The community, as the owner of nonprofit hospitals, can not directly share in the profits, but can generate it for publicly beneficial investments. Nonprofit hospitals in the US are a special legal form of business associations. Nonprofit hospitals in the European sense are exceptional in the US, because they are thought to be inefficient, and a waste of taxpayers' money. Scandinavian examples, on the other hand, show that state-owned health institutions can provide efficient and high-quality services.

According to American practice, health services are one of the most marketable services. Only the technical requirements of health services should be regulated by laws. According to American privatization theories, European governments provide services as public goods, because these services are thought so important for the public that the government guarantees them, regardless of whether consumers can pay for them or not. These services are directly provided by public-owned institutions or simply subsidized by central or local government authorities. Demand for these services necessarily increases due to the low price, which leads to a waste of financial resources.

However, Europeans consider the American health care inefficient in terms of insufficient global cost containment. Americans argue that the reason why the US spends a higher proportion of GDP for health care is not the ineffective provision of health care, but a better quality of service based on a higher level of medical techniques and research. Higher global costs of health care are also a result of customer choice. In the US, the customer decides how much to spend on health care.

5.5. Spontaneous and Regulated Privatization in Hungary

Spontaneous privatization of health care happens when local governments, without any relevant legal regulations, initiate privatization of their health institutions. When *privatization is regulated*, legal rules, determining basic principles and requirements, serve as a framework for privatization.

Health institutions were under state ownership during communism, but at the beginning of the 1990s they were handed over to local governments. Local governments, with few exceptions, such as national clinics and medical universities, own health institutions in Hungary.

Constitutions declare general state-accountability for health care, but it is the responsibility of local governments to provide health services in their administrative areas. Financial resources for this task are assured by the state budget, but not at the necessary level.

Health institutions operate in a dual financial system: local governments are obligated by law to provide the building and medical equipment for their health institutions, but the national health insurance finances services in a DRG system. Financial laws do not say in what manner local governments have to maintain the building of the clinic and assure medical equipment. Local government can not afford to pay much for their health institutions.

Local governments are entitled by the act on local government to decide important issues of their health institutions. These rights of local governments, like the rights to autonomy and ownership, are protected by the Constitution, as well. Actually, it is the right of local governments to sell, lease, or transform their health institutions into business associations. *Any proposal for acts on privatizing health care can not violate these constitutional rights.*

All physicians were public servants before 1990. Laws entitled family doctors to provide primary health services in the form of business associations. Local governments must contract with them to supervise their activity from the point of view of continuity and general availability of services.

Family doctors legally received the right to praxis in 2000. Right to praxis is an exclusive right to provide primary health services in a given area determined by the local government. The owner of the right to praxis can sell and inherit his or her praxis. Family doctors often buy the clinic and medical equipment from the local government, too. Privatization of the primary health system has almost been completed in Hungary.

Spontaneous privatization has to some extent taken place in the secondary health care system. Private firms have invested in medical diagnostic equipment and own and operate them in health institutions. Due to their lobbying activity, national health insurance finances diagnostic services to such a high level that extra profit can be achieved. Paradoxically, health institutions are often loss-making and close to bankruptcy, thanks to the insufficient finances of the national health insurance and the poor maintenance of local governments.

Another way for spontaneous privatization of the secondary health system is when local government gives the right of operation to a private firm. The private firm will have the right to buy or use the property, such as the building and medical equipment, and to reorganize health institutions. This kind of privatization can theoretically be justified with better professional skills on the part of the private firm which can operate health institutions more efficiently than the bureaucratic local government authorities.

The practical reality shows that in most cases members of the political elite are the beneficiaries of this kind of privatization. Local governments are not required by law to invite a tender open to the public. There are no professional or other requirements for privatization, either.

Neither quality nor efficiency of services can be guaranteed, nor can the accountability of local governments be enforced in this system. The private firm can not be controlled if it generates financial resources of its own, but not for public benefit. This path to privatization can *easily become the hotbed of corruption, as well.*

Privatization of secondary health care systems should be regulated by laws. Legal regulations have to define some principles of privatization, such as *democracy* and *legacy*, in order to guarantee incentives for better quality and efficiency.

5.6. Efficiency in Hungarian Health Care

It is generally accepted in continental Europe that national health insurance can serve efficiency better than if health care is financed from the state budget. The reason is that it is clearer for the customers how their contributions

will be spent on health care, if the national health insurance is separated from the state budget and owns the funds, than if it is up to day-to-day political decisions as to how health care will be financed from the state budget.

Continental European countries traditionally organize health care by national health insurance. Funding of the national health insurance is collected from the compulsory contributions of citizens. The contribution is proportional to income, which serves social policy. (Wealthier people pay the costs of the poor and the chronically ill.) Health care provision is equal in national health insurance, regardless of contribution.

When national health insurance (NHI) was established in 1990 in Hungary, it was thought to be a step toward a more efficient health system. However, the government's idea was to shake off responsibility for health care as the most problematic area of welfare. It could be seen at that time that the income of the health care budget would decrease due to the black economy. The recent government centralized the NHI fond under government control again in 1998.

The NHI was governed by a body represented by government authorities, health care providers and customers, and lost its right to determine its financial issues in 1998. Instead, it is the right of the government to make important decisions about the fond of the national health insurance. The NHI is actually a part of the state budget in the recent system. Losses of the NHI can be compensated from the state budget, as well.

We can see that the government has a conflict of interest when the NHI is formally separate from the state budget, while the government still maintains control by keeping the right to determine its budget. The fond of the NHI is decreasing and wasted, due to the insufficient finance system. It does not serve efficiency, either, if the state subsidizes the losses of the NHI. The government keeps the right in this way to make a cost/benefit trade-off, depending on the current political situation.

Laws determine 20 sub-areas of the health care budget, such as operational costs, medicine, primary and secondary health care, etc. The Ministry of Health Care calculates how many hospital-beds can be financed in each county. Then the Office of the NHI makes an agreement on bed-capacity in each county. These agreements are in fact administrative decisions made by the Office of the NHI. The Office of the NHI is a public authority, not a purchaser, when it comes to distributing capacity, which circumstance basically determines these agreements.

The current health finance system is still characterized by a communist-type planned economy, wherein a central plan has been broken down into a number of steps to a group of state enterprises.

It would serve economic efficiency, if, instead of a public authority, the legal form of the national health insurance were either regional not-for-profit companies, or business associations in the country. It would be important to transfer capacities to these insurance companies so that they as purchasers could buy health services in a finance system based on financial incentives, and sufficient quality control. Health care providers would bell their health services, and compete both for financial resources and patients.

Health care providers, similarly to the former state enterprises, are still not entitled to make their own economic decisions, such as investments, making and using profit.

Local governments, as the owners of health care institutions, can afford to spend much on maintaining buildings and buying medical equipment. Health care providers sell their health services in a market, where the Office of NHI is in a monopoly position and prices are regulated to be low, due to the pressure of the state budget. Furthermore, health care providers are purchasers when buying medicine at market prices. The pharmaceutical and medical equipment industries having been privatized and deregulated, charge monopoly prices.

Health care providers are forced to broaden their services in order to avoid bankruptcy. The Office of NHI is not sufficiently interested in checking these exaggerated services. The more services are provided on global level, the lower prices will be determined to be by the Office of NHI. Paradoxically, those health institutions that provide adequate services are operating at a loss.

This tendency does not serve efficiency on the global level but is instead a waste of financial resources.

Incentives should promote the requirement for "service on an adequate level." It is a general tendency in the Hungarian health system that physicians treat patients in hospitals, even if it is not necessary, so that hospitals receive a higher income, and physicians more under-the-table money. The requirement of "service on an adequate level" can be achieved by dividing in- and outpatient systems. Physicians will be interested in treating patients in an outpatient system if they get the right to praxis and finance in a DRG system.

Health institutions would undoubtedly be more efficient were they to operate in the traditional business manner. Business is regulated by corporate law in a refined way so that sufficient economic decisions and financial accountability can be assured. Health institutions are closely controlled by local government. Limiting the autonomy of health institutions does not aid in rational economic activity. Health institutions should compete for financial resources in a system that allows the national health insurance scheme to buy higher quality, more efficient services.

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ILONA GÖRGÉNYI*

Fighting International and National Corruption by Means of Criminal Law

Abstract. In Hungary there is a wide range of acts of corruption forbidden by criminal law. As of 1 April 2002 the measures of penal law applicable in the crackdown on corruption were further extended. In the Hungarian Criminal Code the system of corruption offences are as follows: bribery (official bribery, economic bribery, bribery in connection with hindering of official procedure), failure to report bribery, trading in influence, persecution of a conveyor of an announcement of public concern, crimes against the propriety of international affairs. Furthermore passive forms of bribery are traditionally judged more strictly than active bribery patterns. As regards the comparison of official and economic bribery, the degree of penal law sanctioning gradually came closer time to time. The criminal law regulation on bribery in international relations was introduced by Act of 1998 with due consideration to the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The sanctioning of bribery offences committed in national and international relationships is very similar in the Hungarian Criminal Code.

Keywords: bribery of public officials, corruption other than bribery of public officials, bribery having international features, corporate responsibility, confiscation of proceeds, money laundering

I. Notion of "Corruption"

According to official criminal statistics concerning criminal corruption, Hungary is in a much better situation than if we regard corruption in general. The absolute number of registered corruption crimes fluctuated between 400–500 and 1,000 in the last 20 years. In the background of criminal corruption there are such corrupt relationships in the evaluation of which as well as regarding the general notion of corruption hesitation can be felt in several respects.

As regards the role of material criminal law in combating corruption, in our country there is a particularly wide range of acts of corruption forbidden by penal law. As of 1 April, 2002 the measures of penal law applicable in the crackdown on corruption were further extended.

* Lecturer, Head of Department of Criminal Law and Criminology, University of Miskolc, H–3515 Miskolc-Egyetemváros.
E-mail: bolilona@gold.uni-miskolc.hu

II. Recent significant bribery cases and cases of corruption other than bribery and recent law reform in this field

Regarding recent penal law reform in this area, titles VII (Crimes against the purity of public life) and VIII (Crimes against the propriety of international affairs) of Chapter XV of the Criminal Code were significantly modified from 1 April, 2002:

— Punishments for corruption offences became more severe.
— In cases of conviction for crimes related to organized crime, confiscation of the property gained by the perpetrator during the period of time when he/she was in contact with organized crime became possible. Perpetrators involved in the procedure have the possibility of giving evidence of the lawful origin of the enrichment, in order to overcome the above presumption.
— Punishability was created of officials becoming informed about corruption cases, but not fulfilling their obligation of reporting the case to the competent authorities (Criminal Code Article 255/B).
— In order to have more effective measures against bribery, new criminal law regulations were introduced, which ensure the termination of punishability not only for the active official briber (before 1 April, 2002) but also for the passive official briber and also in the cases of economic bribery (Criminal Code Article 255/A).
— In accordance with the contents of documents of the OECD, the Council of Europe, the European Union, especially in order to fulfil expectations of law harmonization, the possibility of sanctioning of legal persons was created by Act CIV of 2001. The entry into force of this Act is the day of the accession of Hungary to the European Union.

In the light of these amendments the system of crimes against the purity of public life (corruption offences) from 1 April, 2002 is:

A) *Bribery* (Criminal Code Articles 250–255/A)

Official bribery	Economic bribery	Bribery in connection with hindering of official procedure
— passive	— passive	— active
— active	— active	— passive

B) *Failure to report bribery* (Criminal Code Article 255/B)

C) *Trading in influence* (Criminal Code Article 256)
   — official type
   — economic type
D) *Persecution of a conveyor of an announcement of public concern* (Criminal Code Article 257)
E) *Crimes against the propriety of international affairs* (Criminal Code Articles 258/B-258/F)
   — Bribery in international relations
   — Profiteering with influence in international relations

III. Bribery of public officials

1. Protected legal interests

The circle of legal interests to be protected by punishing bribery was continuously broadened. Hungarian penal law first put the interest of the purity of jurisdiction and then that of public administration under the protection of penal law, which was later gradually extended to the economy, too.

Act V of 1878, the first modern Hungarian Criminal Code basically contained regulations to punish illegal official activities. The scope of public officials was gradually extended primarily due to the modifications introduced in the 1940s with more and more people becoming public officials from the point of view of criminal responsibility and trafficking in influence was ordered to be a punishable offence, too.

The first socialist Code, Act V of 1961 extended the penal law measures against corruption to economic life, as well, but contained the definition of the individual corruption offences dispersed in four different chapters.

The presently prevailing Criminal Code, Act IV of 1978 regulates offences against the purity of public life consistently in one chapter.

2. Definition of bribery

Definition of passive official bribery in the Hungarian Criminal Code (Article 250, Paragraph 1): Any public official who requests an undue benefit in connection with his actions in an official capacity, or accepts such benefit or a promise thereof, or agrees with the party requesting or accepting the benefit.

Passive economic bribery (conducts identical to passive official bribery) and from 1 April, 2002 passive bribery in connection with the hindering of jurisdiction (i.e. acceptance of unlawful benefit) are also punishable.

Concerning the relationship between the official duties and the bribe, it is required that the unlawful benefit should be connected with the duties of the public official.

It is possible that such a relationship occurs in connection with the management of a concrete case under way, or within the framework of a permanent official relationship arising from the position of the public official (e.g. regular monitoring by the public official), or as a result of the general work of the public official.

It is important how close this relationship is when it comes to the infliction of punishment. It is closest in the case when the public official asks for an advantage concerning a case under way before fulfilling his official duties. It is also a case of bribery, however, if he only asks for the advantage after arranging the case. A public official may ask for an advantage independently from any concrete case. The point in such bribery is to win the "goodwill" of the public official in the hope of some future return.

It has decisive importance that the request for and acceptance of unlawful advantage by the public official and his agreement with the one asking for or accepting unlawful advantage should take place basically in connection with his activities in an official capacity. The request etc. for the advantage related to his activities may be simultaneous with the proceedings of the public official (the public official gets the advantage while he is proceeding in the case), or this act may precede (it is expected that the public official will proceed in the case of the person giving the advantage) or follow that one.

3. *Various forms of bribery*

According to the Hungarian Criminal Code bribery (as well as trafficking in influence) can be of an official or economic type, and bribery in connection with hindering of jurisdiction is also punishable from 1 April, 2002.

Official bribery (Criminal Code Articles 250., 253.): the perpetrator is either the public official, or criminal corruption is committed in connection with his activities. Official bribery may be related, for example, to the persons or activities of policemen, customs officers, borderguards, Tax Office inspectors or social security inspectors.

In the case of *economic bribery* (Criminal Code Articles 251–252., 254.) the perpetrator is the employee or member of a budgetary agency, economic organization or non-governmental organization, or an employee or member who is authorised to act on behalf of a budgetary agency, economic organization or non-governmental organization, and the offence is committed in

connection with his activities in an official capacity. One characteristic field of economic bribery is the granting of credit.

With respect to the conducts of perpetration, a distinction is made between *passive bribery* (Criminal Code Articles 250–252.) and *active bribery* (Criminal Code Articles 253–254.) for both official and economic bribery offences.

The offence of *bribery committed in a judicial proceeding* (Article 255., Paragraphs 1–2.) was introduced into the Criminal Code by Act CXXI of 2001, which makes both an active and passive perpetrator punishable (with identical punishment).

Trafficking in influence, which can be regarded as indirect bribery, was defined in the Criminal Code on the one hand in connection with passive forms of perpetration and on the other with regard to official and economic patterns of bribery.

As for passive bribery, the simple definition can be found in Article 250, Paragraph 1 of the Criminal Code (see point 2).

Aggravated passive bribery

A) *if the crime* is committed

— by a public official in a high office, or by one entrusted to take measures in important affairs,

— by another public official in an important matter of great importance.

B) *if the perpetrator* breaches his official duty in exchange for unlawful benefit, exceeds his competence or otherwise abuses his official position, or if he commits the act in criminal conspiracy or in a pattern of criminal profiteering.

4. *Definition of a bribe*

The *unlawful advantage* may be of a material or personal, moral character.

With regard to the fact that international anti-corruption agreements use the attribute "unlawful" to qualify the advantage in defining offences of bribery punishable in penal law, this attribute was entered into Hungarian penal law regulations of bribery offences, as well, by Act CXXI of 2001 amending the Criminal Code. At the same time it needs to be emphasized that in judicial practice it is generally typical to refer to the "advantage" as "unlawful advantage".

Material advantage is most commonly a money payment or any material benefit that can be expressed in money value, but the cancelling of debt also qualifies as an advantage. Besides, granting a loan or credit is likewise to be regarded as material advantage (if interests are to be paid, the acquisition of

credit constitutes the advantage, while in the case of granting interest-free credit or cancelling debt we are concerned with unilateral monetary benefit).

Not only the act of giving free of charge benefit or presents but the entering into onerous contracts (e.g. a contract of sale) may also result in unlawful material or probably even personal advantage as described in the state of affairs if it occurs in connection with the activities of the public official in an official capacity.

Personal advantage is e.g. the acceptance of the opportunity to earn money or income, the entering into sexual intercourse or in some cases into onerous contracts. A career advantage of the *moral type* is e.g when the person concerned is recommended for decoration.

With regard to the perpetration of offences of bribery it shall not be regarded as an advantage if the person is offered such a tiny benefit the acceptance of which complies with social customs in the given circumstances so it does not constitute misdemeanour (e.g. the acceptance of coffee, drinks or cigarettes during official discussions). The unlawful advantage *must be in connection with the activities of a public official in an official capacity.*

5. *Scope of public officials and related persons to be punished*

The following official persons are important from the point of view of both active and passive bribery (Criminal Code Article 137, point 1):

a) Members of Parliament;
b) the President of the Republic;
c) the Prime Minister;
d) members of the government, political state secretaries;
e) constitutional judges, judges, prosecutors;
f) ombudsmen of citizens' rights and national and ethnic minority rights;
g) members of local government bodies;
h) notaries public and assistant notaries public;
i) independent court bailiffs and assistant court bailiffs;
j) persons serving at the constitutional court, the courts, prosecutors offices, state administration organs, local government organs, the State Audit Office, the Office of the President of the Republic, the Office of Parliament, whose activity forms part of the proper functioning of the organ;
k) persons at organs or bodies entrusted with public power, public administration duties on the basis of a legal rule, who fulfil tasks of public power, or state administration.

Other persons are the subject of passive (and active) economic bribery: on the one hand any (simple) employee or member, on the other hand any employee or member who is authorized to act in the name and on behalf of a budgetary agency, economic organization or non-governmental organization.

6. Conducts to be punished

The perpetrating conducts related to both official and economic passive bribery (request for unlawful advantage, acceptance of unlawful advantage or the promise thereof, agreement with the person who requests or accepts the unlawful advantage) are the same in Articles 250–252 of the Criminal Code. The perpetrating conducts related to active official and economic bribery are likewise identical (giving or promising an unlawful advantage) with the exception of paragraphs (3) and (4) of Article 253 of the Criminal Code.

The table below presents conducts of perpetration.

Passive bribery	*Active bribery*
request an anlawful benefit accepts an anlawful benefit	gives anlawful benefit
accepts an anlawful benefit agrees with the party requesting or accepting the anlawful benefit	promises anlawful benefit
	new special forms

If the perpetrator commits the passive bribery in criminal conspiracy or in a pattern of criminal profiteering, he can be punished for aggravated passive bribery.

7. Mental elements

Until the recent modification, which came into force on 1 April 2002, intention as a mental element was necessary for punishing in all cases of bribery. From that time the intention is generally needed for the perpetrator to be punished for bribery, except in the new forms of active official bribery (Criminal Code Article 253, paragraph 3–4), because in that case negligence is sufficient.

Furthermore, active economic bribery (Criminal Code Article 254, paragraph 1) requires the so called "purpose" (to induce a person to breach his duties) and it presumes direct intention. "Purpose" of the act (although different)

is also an element of bribery in connection with hindering of jurisdiction [Criminal Code Article 255, paragraph (1)–(2)].

8. Active bribery

According to the Hungarian Criminal Code both active official bribery and passive economic bribery can be punished.

Article 253 of the Criminal Code punishes as *active official bribery* the bribery of a public official or another person with respect to him, and it is the supplementary state of affairs for passive bribery as defined in Article 250.

The *unlawful advantage is to be given or promised* to a public official or to another person with respect to him. It is not a condition, however, that the perpetrator of active bribery should inform the public official about the unlawful advantage given or promised to another person with respect to him. The criminal offence is perpetrated even if the public official does not know about the unlawful advantage given or promised to another person with respect to him, or if he knows about it but does not agree with the actual or potential beneficiary of the unlawful advantage as acceptance is not a necessary condition.

Until the modification with Act CXXI of 2001 it was a criterion of the active official bribery that the advantage should be such as "may influence the public official in his activities adversely for public interest". This statement was eliminated and in harmony with the definition of passive official bribery the unlawful advantage must be in connection with the activities of the public official according to the active official bribery, as well. The criminal offence is completed with the giving or promising of unlawful advantage and this is not influenced by the fact that the public official refuses to accept the advantage.

Article 6 of the convention on combating corruption concerning the public officials of the member states of the European Union and the public officials of the European Communities provides for the criminal responsibility of company leaders if a person under their supervision or control commits active bribery while proceeding in the interest of the enterprise. For the sake of the harmonization with this convention Act CXXI of 2001 modifying the Criminal Code introduced paragraphs (3) and (4) into Article 253 as a new form of criminalization, thus creating the possibility of penal law punishing of the leader, the member authorized to supervise or control, or the employee of a corporate organization in the case of active official bribery.

As *active economic bribery* the legislator only punishes the giving or promising of unlawful advantage with the purpose of the breach of duties of the employee or member defined in the Criminal Code. Therefore it is not sufficient if the giving or promising of unlawful advantage takes place in connection with the activities of the employee or member concerned, in contrast with the basic case of active official bribery of more severe evaluation in accordance with paragraph (1) of Article 253, with regard to which the giving or promising of unlawful advantage is a criminal offence even when related to the activities of a public official. On condition that the purpose of an advantage given or promised is not the breach of duties, active economic bribery does not take place even if the person on the passive side commits a breach of duties.

Active bribery committed in official proceedings is perpetrated with the purposeful acceptance of unlawful advantage. The purpose is that the person targeted should not exercise his lawful rights in court or other official proceedings or should not fulfil his duties.

IV. Corruption other than bribery of public officials

1. Bribery in the private sector

As it was mentioned under point III/5, passive and active economic bribery is punishable in connection with the activities of the following persons: on the one hand a "simple" employee or member of and on the other hand an employee or member who is authorized to act in the name and on behalf of a budgetary agency, economic organization or non-governmental organization. Their conducts are mostly to be punished in the same way as in the case of official bribery, namely in connection with their duties but in the case of active economic bribery the so called "purpose", i.e. to induce the person to breach his duties is also required (see point III/8).

2. Trading in influence

Similarly to offences of bribery, we distinguish between *trafficking in official influence* [Article 256, paragraphs (1)–(2)] and *trafficking in economic influence* [Article 256, paragraphs (3)–(4)]. The person trafficking in influence requests or accepts the unlawful advantage for himself or another person with reference to the fact that he influences a particular person. The person trafficking in influence who proceeds in the interest of another person

falls between the possible subjects of active and passive bribery but he has an independent role.

The offence of trafficking in influence is *completed* with the request for or acceptance of the unlawful advantage without any return. It is not necessary that the person trafficking in influence should get into contact with the public official or any other particular person or that the advantage requested should actually get to him. The person who gives the unlawful advantage in order to influence a public official commits active official bribery. The perpetrator of the offence of trafficking in influence can be anyone with the exception of the public official in charge and the other persons listed. In connection with their activities, the request for and acceptance of unlawful advantage is passive bribery.

3. *Bribery of voters in elections*

According to the Hungarian Criminal Code (Article 211): Any person in the course of election, plebiscite and popular initiative held under the Act on Election Procedures, with the following conducts among others commits a crime, if

- — he obtains recommendation by virtue of financial advances in violation of the provisions of nomination procedures,
- — he obtains signature by virtue of financial advances in the interest of initiating a national referendum or popular initiative,
- — he makes any attempt to influence the election or plebiscite by offering financial benefits.

4. *Corruption other than bribery*

In the Hungarian Criminal Code corruption offences other than briberies—in the framework of crimes against the purity of public life—are as follows:

- — Failure to report bribery (Criminal Code Article 255/B)
- — Trading in influence (Criminal Code Article 256)
  - ➢ official type
  - ➢ economic type
- — Persecution of a conveyor of an announcement of public concern (Criminal Code Article 257).

V. Sanctions and related measures

1. In Hungary passive forms of bribery are traditionally judged more strictly than active bribery patterns

As regards the comparison of *official* and *economic* bribery, the patterns of bribery arranged in one chapter during the codification of the present Criminal Code made it easier to compare the penal law regulations concerning economic and official bribery from time to time. Bringing the former norms of penal law nearer to the latter is justified by the fact that the recent changes affecting the economic sector involved the multi-step tightening of penal law regulations concerning economic bribery. The degree of penal law sanctioning gradually came closer in the case of economic and official bribery. *Act CXXI of 2001* further diminished the difference between the judgement in penal law of economic and official bribery. On the other hand it generally introduced a new type of *termination of punishability* because it was extended to twice as wide a circle.

In accordance with the 1997 OECD Convention, the definition and sanctioning of bribery offences committed in national and international relationships is very similar in the Hungarian Criminal Code (almost identical disregarding 1 or 2 exceptions).

Act CXXI of 2001 (from 1 April, 2002) made it possible to sanction all offences of bribery more rigorously as the imposable punishments were raised with one bracket.

The special part of the Hungarian Criminal Code sanctions every offence of bribery with imprisonment. According to the regulations in the general part in some cases it is possible to suspend the sentence or replace it with a fine. In most severe cases, imprisonment can extend from 5 to 10 years (for example Criminal Code Article 250, paragraph 3 and Article 252, paragraph 3).

2. Corporate responsibility

Last year in Hungary Act CIV of 2001 on the Measures Applicable against Legal Entities under Criminal Law was accepted by the Parliament. The entry into force of this act is the day of the accession of Hungary to the European Union.

The main elements of the Act are the following:

The penal measures against the legal persons are applicable only if the court has imposed a punishment concerning the natural person. There are

two exceptions to the rule: if the perpetrator is not punishable because of his death or mental incapacity.

The natural person who committed the intentional offence could be

a) persons having an authorization for the representation or management of the legal person, being a member of its supervisory committee or being a substitute of the abovementioned persons,

b) an employee of the legal person, but the exercise of control or supervision by one of the persons mentioned in point *a)* could have prevented the commission of the offence,

c) any person (not even an employee of the legal person), if the legal person has enriched because of or through the commission of the crime.

The responsibility of the legal person is based on the connection between the legal person and the natural person, and on the fact that through the commission of the offence it has enriched or at least it was the aim of the perpetration of the offence.

The measures applicable against the legal persons are the following:

a) judicial order for winding up

b) temporary restriction of the activities of the legal person

c) fine (minimum: 500,000 HUF, maximum: 3 times the enrichment obtained or aimed to obtain through the commission of the crime)

First measure is applicable only as a single sanction, while second and third one can be inflicted both single measures and in mixed form together.

Act CIV of 2001 regulates—separated from the Criminal Code and the Penal Procedure Code—the penal measures applicable against legal persons, the conditions how they could be applied and the procedure of the application. The Criminal Code and the Penal Procedural Code only contain a provision which refers to the new Act.

The criminal procedure shall run parallel with the procedure against the legal person in front of the same court and judge. The professional legal representation of the legal person shall be obligatory. The rights of the legal representative of the legal person shall be more or less similar to the rights of the defender.

3–4. Confiscation of proceeds derived from bribery and other corruption offences; Freezing of proceeds

Article 77/B of the Criminal Code contains completely new regulations on the forfeiture of assets as a penal measure from 1 April, 2002.
The following is seized subject to forfeiture:

a) any financial gain or advantage resulting from criminal activities, obtained by the offender in the course of or in connection with a criminal act,

b) any financial gain or advantage obtained by the offender in connection with crimes committed in affiliation with organized crime,

c) any financial gain or advantage that was used to replace the financial gain or advantage obtained by the offender in the course of or in connection with a criminal act,

d) any property that was supplied or intended to be used to finance the means used for the commission of a crime. Any financial gain or advantage resulting from criminal activities, obtained by the offender in the course of or in connection with a criminal act, also if it served the enrichment of another person, shall be seized subject to forfeiture. If such gain or advantage was obtained by an economic organization, it shall be subject to forfeiture.

Any profits, intangible assets, claims of monetary value and any financial gain or advantage shall be deemed assets.

Confiscation of an object shall not be ordered if it is included in a forfeiture of assets.

Furthermore Article 77 of the Criminal Code on confiscation contains that an object

a) actually used or intended to be used as an instrument for the commission of a criminal act,

b) the possession of which constitutes an endangerment to public safety or is illegal,

c) which is created by way of a criminal act,

d) for which the criminal act was committed

shall be confiscated.

Confiscated objects shall become the property of the state and seized assets shall also become the property of the state unless prescribed by law to the contrary.

The abovementioned new criminal law regulation came into force from 1 April, 2002 concerning both forfeiture of assets and confiscation as penal measures.

It is to be emphasized that Hungary joined the 1990 agreement on money laundering and the localization, seizure and confiscation of objects originating from criminal offences, the promulgation of which was ordered by Act CI of 2000.

5. Money laundering

In Hungary the year 1994 was of outstanding importance in the fight against money laundering. On the one hand, Parliament passed Act XXIV of 1994 on the prevention and impeding of money laundering and on the other, Act IX of 1994 recodifying economic crimes reintroduced money laundering into the Criminal Code, the regulation of which has been modified several times recently.

In the meantime Parliament adopted Act LXXXIII of 2001 on combating terrrorism, tightening up the provisions on the impeding of money laundering and the ordering of restrictive measures. This Act extended the personal scope of the Act on prevention and impeding of money laundering to auditors, accountants, tax advisors, real estate agents, traders of high-value movable assets and the legal professions. It means that these persons are also obliged to report to the police the emergence of any data, fact or circumstance indicating money laundering. The entry into force of this Act was December 2001.

The definition of money laundering as a criminal offence was altered by Act CXXI of 2001 (coming into force on 1 April, 2002), the essence of the modification being the extension of the supplementary character of money laundering and thus the scope of fundamental criminal offences.

The perpetrator of money laundering can be any person who uses items obtained by the commission of criminal activities punishable by imprisonment in his business activities and/or performs any financial or bank transaction in connection with the item in order to conceal its origin.

Both intentional and negligent forms of money laundering are punishable as well as the non-performance of the reporting obligation in connection with money laundering.

VI. Laws and measures to facilitate the investigation and prosecution of corruption

Concerning the *conversion of burden of proof* it should be emphasized that Act CXXI of 2001 exceptionally introduced this possibility in connection with forfeiture of assets as a criminal measure (see point V/3–4). According to the Hungarian Criminal Code any financial gain or advantage obtained by an offender in connection with crimes committed in affiliation with organized crime shall be subject to forfeiture until proven otherwise. The assets cannot be seized if their origin is proven legitimate.

The perpetrator of bribery—except in some aggravated cases—shall be exonerated from punishment on the passive side of bribery if he confesses the act to the authorities first hand, surrenders the obtained unlawful financial advantage in any form to the authorities, and reveals the circumstances of the criminal act.

On the active side of bribery the perpetrator shall be exonerated from punishment if he confesses the act to the authorities first hand and reveals the circumstances of the criminal act (Criminal Code Article 255/A).

As far as the authorities prosecuting corruption are concerned, according to Act XXXI of 2001 on the amendment of Act V of 1972 on the Prosecution Service of the Republic of Hungary, the investigation of official bribery shall be conducted exclusively by the public prosecutor. In the interest of a coordinated, more efficient action against criminal corruption, it is reasonable to conduct investigations on concentrated organisational bases.

VII. Offences having international features and the question of international cooperation

The criminal law regulation on bribery in international relations was introduced by Act LXXXVII of 1998 with due consideration to the OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

Comparing on the one hand bribery (title VII) and on the other hand bribery in international relations (title VIII) in the Hungarian Criminal Code some differences can be shown.

Bribery in international relations can be committed in connection with foreign public officials and foreign economic organizations.

Foreign public official shall mean (Criminal Code Article 137, point 3):

a) a person serving in the legislature, law enforcement or administrative body of a foreign state,

b) a person serving in an international organization created under international convention, whose activities form part of the organization's activities,

c) a person elected to serve in the general assembly or body of an international organization created under international convention,

d) a member of an international court that is vested with jurisdiction over the territory or the citizens of the Republic of Hungary, and any person serving in such international court, whose activities form part of the court's activities.

Foreign economic organization shall mean organizations functioning as an artificial person according to its personal law, which is entitled to perform economic activities in its prevailing organizational form (Criminal Code Article 258/F).

As penal law sanctions must be similar to those prescribed by the given state in the case of bribing its own public officials, these criminal offences mirror domestic criminal offences of bribery. As regards further differences, an important one is that in the case of official bribery patterns committed in international relations the order is different as active bribery is listed first. The other important difference is that in the Hungarian Criminal Code the active but not the passive form to be punished from among cases of economic bribery committed in international relations.

The OECD's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was ratified by Hungary (Act XXXVII of 2000). Furthermore in 2000 the Hungarian Parliament made a resolution to confirm the Criminal Law Convention on Corruption of the Council of Europe and in the same year the Minister of the Interior subscribed to the UN Convention against Transnational Organized Crime, as well.

VIII–IX. Prevention of corruption, combating against corruption

Significant steps were taken towards the implementation of the governmental strategy, among which the most important one from the point of view of everyday practice is that the general obligation of *assets declaration* concerning persons working in the public sphere.

Concerning the measures of the prevention of corruption, it is also important to mention that the Government has significantly increased *the salaries* of public officials and law enforcement officials.

It is reasonable that *the immunity right* of persons performing public power offices, elected for a definite period of time, should only guarantee immunity for the period of time of the mandate and should not mean a definite obstacle to the initiation of criminal procedure.

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ERIKA RÓTH*

Prosecutorial Discretion and its Limits

Abstract. The traditional "continental" criminal procedure is not able to cope with the increasing number of cases and to respond to the newly developing types of crime. So the legislator has to allow authorities dealing with criminal matters to select cases, to decide which categories of cases should have priority and to create exceptions to the principle of legality. At the same time the requirements of fair process should not be forgotten when a state fulfils the claim for the simpler and quicker arrangement of criminal cases. This study pays attention to the Recommendation of the Committee of Ministers of the Council of Europe (No. R. (87) 18) and compares its guidance with the features of discretionary power of the Hungarian public prosecutor. By now due to the intention of the legislator who has the requirements of our age and the limits of the ability of the criminal justice in sight, the discretionary power of the prosecutor has become wider and wider. In Hungarian law discretionary prosecution requires previous consent of the suspect and in other cases the suspect has right to remedy and challenge the judicial judgements. Rules of the new Code of Criminal Procedure (Act XIX of 1998) strengthen the role of the prosecutor in the criminal process.

Keywords: Council of Europe, criminal procedure, discretionary power, human rights, investigation, offender, prosecution

First of all I would like to emphasise that the Hungarian law of criminal procedure belongs to the so called continental "mixed" system of the law. The convergence of two traditional law systems in the field of criminal justice did not avoid our rules of criminal procedure either. The changes of the law connected with our joining the human rights conventions (UN International Covenant on Civil and Political Rights and European Convention for the Protection of Human Rights and Fundamental Freedoms) are the most significant.

The extent of the discretionary power of the prosecutor is influenced first of all by requirements put by the given state before the criminal investigation. Whether the system of law requires the compulsory investigation, prosecution on the basis of the principle "legality" or gives larger scope the "opportunity", authorises the prosecutor not to bring every case and every

* Lecturer, University of Miskolc, Faculty of Law, H–3515 Miskolc–Egyetemváros, Hungary.
E-mail: jogerika@gold.uni-miskolc.hu

offender to the court, bearing in mind the point of view of appropriateness and economic efficiency.

Although in most part of Europe theoretically every person who commits a crime is brought before the court, nowadays the principle and practice of opportunity are more and more spreading.

What is the reason of this phenomenon? First of all the traditional "continental" criminal procedure is not able to cope with the increasing number of cases to respond to the newly developing types of crime. So the legislator has to allow authorities dealing with criminal matters to select cases, to decide which categories of cases should be dealt with first and so create various exceptions to the principle of legality. The quantitative changes of the crime (complicated, referring to special knowledge or so-called "monstre" cases) were not followed by the raising of the staff number and by the development of facilities of the organisations dealing with crime.

At the same time the requirements of fair process should not be forgotten when a state fulfils the claim for the simpler and quicker arrangement of criminal cases. The Convention for the Protection of Human Rights and Fundamental Freedoms (Rome, 4. November 1950.) requires a fair and public hearing within a reasonable time. (Article 6. Paragraph 1.) However, as the exact content of words "reasonable time" are not determined, every member state has to work out a more effective way of dealing with criminal cases without unnecessary delay. With regard to these two requirements the Recommendation of the Committee of Ministers of the Council of Europe [No. R (87) 18] gave guidance concerning the simplification of criminal justice reserving significant role to the discretionary prosecution.

In this study I try to have this guidance in sight and compare it with the features of discretionary power of the Hungarian public prosecutor.

Public prosecution and the public prosecutor play a key role in the criminal justice system as well as in international co-operation in criminal matters. Functions of the public prosecutor are multiple. As another recommendation of the Committee of Ministers of the Council of Europe (Rec (2000) 19) defines:

Functions of the public prosecutor

1. "Public prosecutors" are public authorities who, on behalf of society and in the public interest, ensure the application of the law where the breach of the law carries a criminal sanction, taking into account both the rights of the individual and the necessary effectiveness of the criminal justice system.

2. In all criminal justice systems, public prosecutors:
— decide whether to initiate or continue prosecutions;
— conduct prosecutions before the courts;
— may appeal or conduct appeals concerning all or some court decisions.
3. In certain criminal justice systems, public prosecutors also:
— implement national crime policy while adapting it, where appropriate, to regional and local circumstances;
— conduct, direct or supervise investigations;
— ensure that victims are effectively assisted;
— decide on alternatives to prosecution;
— supervise the execution of court decisions;
— etc.

In this list there are two (or in wider sense three) functions concerning the discretionary power of the public prosecutor:
1. when he decides to initiate or continue prosecutions,
2. when he decides on alternatives to prosecution,
3. (in wider sense as I mentioned above) when he conducts prosecution before the court.

In Hungary the prosecution service headed by the General Prosecutor is independent of the government. Investigations in certain cases (prescribed in the Act V of 1972 on the public prosecution service) are carried out by the prosecutor. In the overwhelming number of cases investigations of other authorities (mainly of police) are supervised by the prosecutor. So he/she should scrutinise the lawfulness of investigation and shall ensure that the persons taking part in investigation may enforce their rights and shall supervise the lawfulness of the application of coercive measures.

The legal background[1]

The legal situation in the field of criminal procedural law is very specific nowadays. Our Code of Criminal Procedure in its basis was socialist, however survived a lot of amendments. In the opposite side there is a new Code which hasn't enter into force yet. This new Code preserving former values puts the criminal process on mainly new fundament, changing, strengthening the

[1] I mention the original number of the Act and instructions, but all of them were modified several times.

role of parties (i.e. the role of the prosecutor and on the other hand the role of the defence lawyer and the accuse) in examination of evidences; the relation between investigation and court process and the structure of court-system. The new Code will enter into force in 2003, but some provisions of the new Code have been embodied into the existing Code as amendments since 1998.

The organisation of public prosecution service is based on the Constitution. Article 52. para 2. says that the General Prosecutor shall answer to the Parliament and shall provide a report on his activities. The Act V of 1972 says about the organisation of the public prosecution office. The Code of Criminal Procedure (Act I of 1973) contains several paragraphs concerning the role of the public prosecutor in the criminal procedure. Last but not least the instructions of the General Prosecutor determine the every day work of prosecutors. Among them, of outstanding significance are the instruction 2/1999 regarding the supervision of the investigation in criminal cases, tasks of the public prosecutor after finishing the investigation, the instruction 10/1995 on the investigation conducted by the prosecutor and the instruction 6/1987 on the activity of the prosecutor before the court.

In our country there was serious opposition against the discretionary prosecution until quite recently. Some experts held that the discretionary power of the prosecutor means that he has similar power to that of the court, judges of criminal cases and can impose sanctions. By now due to the intention of the legislator who has the requirements of our age and the limits of the ability of the criminal justice in sight, the discretionary power of the prosecutor has become wider and wider. The facts and figures of how often prosecutors use this power can be found in the statistics (see next pages). We have to admit that statistics never show how many cases go through the prosecutors' hands in which the possibility of discretionary prosecution exists. It will be very demonstrative to compare the data of French and Hungarian practice. We have French statistics from the year 1998. In that year 1,193,994 cases became known to the investigating authorities—in Hungary 140,083 offenders became known. In France in 34.9% of cases the investigation was refused with reference to the opportunity. In 13.7% of cases the prosecutor applied mediation, therapy, obliged the offender to do some kind of professional training or warned them. So 48.6% of cases were not brought before the court. In Hungary 12.48% of the cases were quashed.[2]

[2] In: Nacsádi, P.: Az opportunitás kérdése a francia jogban (Problem of the Opportunity in the French Law). *Ügyészek Lapja* No. 2. 2001. 17.

These figures show that in our country the prosecutor—if he has the possibility to stop the procedure—is not very keen on using his discretionary power, or not to such an extent that would be desirable.

Which are the stages of the process where the discretionary power of the prosecutor may be exercised?

1. *Ordering of the investigation:*
   The prosecutor may decide to refuse the investigation if the offence committed is of negligible degree of the dangerousness for society or its dangerousness became negligible, if the suspect collaborates with the authorities or in the case of covered agent.
2. *In the stage of prosecution:*
   — The prosecutor may quash the process in cases mentioned in point 1 of this section,
   — he may postpone indictment or set aside the prosecution.
3. *In the stage of court procedure*
   The prosecutor may withdraw the indictment.
4. *If the suspect pleads guilty:*
   The prosecutor may propose the application of the following special procedure providing a simpler and quicker judgement of the case:
   — bringing to court,
   — waiver of trial,
   — omission of trial.

The basic principle is that the offender's consent is necessary wherever conditional waiver and conditional discontinuation of procedure is envisaged. So if the prosecutor quashes the case and applies reprimand and the suspect does not agree with it, he has a right to legal remedy called "complaint". The consequence of this complaint is that if there is no other reason to quash the investigation, the prosecutor has to prosecute because the consent of the suspect to arrange the case without court procedure is absent.

On the next pages we look over conditions of discretionary decisions.

1. If the offence committed has negligible degree of the dangerousness for society (this is a reason when punishability shall be precluded according to the rules of Criminal Code) or if the offence became dangerous for the society to a negligible degree (this is a reason in Criminal Code when the punishability shall be terminated) the prosecutor may refuse the investigation and reprimands the offender. Reprimand is a measure similar to

warning. As it is written in the Criminal Code Section 71 paragraph 3 "By a reprimand, the authority expresses its disapproval, and invites the perpetrator to restrain himself in the future from the perpetration of a crime."[3]

If this reason exists, the investigating authority has no power to take such decision, although the decision to refuse the investigation is generally in their competence. But in these cases balancing is the most important feature of the decision-making and the legislator did not entrust this task to the investigating authority. So they have to refer the case to the prosecutor with a recommendation and the prosecutor takes the final decision.

Similarly active participation of the prosecutor is necessary for the refusing of investigation in the case of collaborating suspect and the covered agent (in the first case the prosecutor's consent is necessary, but in the latter case the prosecutor himself makes the decision).

At this point we try to make clear what is meant by the collaborating suspect and the covered agent. *Collaborating suspect* is the person with whom the interest relating to co-operations is more important from investigating or national security point of view than the interest relating to the enforcement of the criminal law claim of the state: i.e. in exchange for his co-operation (collaboration) authorities let him off.

The *covered agent* supports the successfulness of the investigation with cover his character. His application is allowed only with the permission of the prosecutor, and if he commits a crime during the performance of his duties and the interest of the investigation (for which he is working) is more important than the interest relating to the enforcement of the criminal law claim of the state, the investigation can be refused. Only the county chief prosecutor or his deputy is entrusted to give the consent mentioned or make such decisions. They decide on the basis of the proposal of the police and after examining the file.

[3] Whole text of this section is:

Section 71 (1) That person shall be reprimanded, who is not punishable due to the negligible degree of the dangerousness for society of his act (Section 28) or its becoming negligible (Section 36).

(2) Reprimand may also be given to a person, who is not punishable due to the cessation of the dangerousness for society of his act (Section 36), or whose punishability has ceased to exist for another reason defined in the Act [Section 32, paragraph *e)*].

No other investigating authorities (such as Customs Police, Investigating Unit of the Tax and Financial Control Office and the Border Guard) acting in the criminal procedure are excluded to propose to the prosecutor to refuse the investigation or to quash it in the case when collaborating suspect or covered agent is concerned.

2. In the *stage of prosecution* the prosecutor has much wider possibilities to make the most adequate decision—taking into consideration the seriousness of the offence committed, circumstances of commission of the crime and the personality of the offender. In this stage the procedure could be quashed because of the same reasons as during the investigation. A new possibility is the omission of prosecution, where the expansion of the principle of opportunity is observable. In this case the prosecutor may omit prosecution for a criminal offence which, compared to the criminal offence of greater weight made subject of the charge is of no significance for the purpose of liability under criminal law, and this shall accordingly be applicable also to petty offences connected with the criminal offence. It is to be noted that because of the same reason the investigation would have been omitted by the investigating authorities and the prosecutor deals with this question only when he investigates himself or in the frame of the supervision of the lawfulness of the investigation. In Hungarian legal system we can find a very new institution introduced at the end of the 1990s called *postponing of prosecution.* First it was applicable only in the procedure against juveniles and only since 1999 it is possible to postpone the prosecution in the case of adult offenders. However, conditions are different: while juveniles have one more chance to prove that personally they are not dangerous for the society if they commit a crime punishable not more than 5 years imprisonment, this merit of punishment is 3 years imprisonment in cases of adult offenders.

Prosecution may be postponed if this measure could influence the future conduct of offender favourably (in cases of juvenile in the interest of proper tendency of his development). This means a conditional discontinuation of the case, its period is between 1 and 2 years and during this time the suspect is under the supervision of a probation officer. If this time passes successfully the prosecutor quashes the procedure.

The postponing of the prosecution is "not successful" if the suspect was charged with an offence perpetrated intentionally during this period or he breaks the rules of conduct imposed seriously. In these cases the procedure is not closed but the prosecutor charges him.

Which conditions preclude the possibility of postponing of the prosecution?

The first reason is the police records concerning the suspect: if he is habitual recidivist, the possibility of postponing the prosecution is excluded.[4]

The second reason connected with the time of commission of the offence in question: if the suspect commits the intentional crime during the probation when imprisonment suspended for probation or after he was sentenced to imprisonment but the enforcement of this punishment is not ended. The explanation of these exclusionary rules is that postponing of the prosecution is planned to make possible to avoid the trial for offenders behind whom are not so called "criminal career", for whom it is enough to keep him back from committing further crime (special prevention): overhead of him hang the possibility of the continuation of the process as Democles's sword. Postponing of the prosecution is more frequent in cases of juveniles, the explanation of this phenomenon is not only the wider possibility written in the law, but the difference in the structure of offences committed by juveniles and adults and the intention of the prosecutor.

The decision on diversion connected with two circles of crimes does not definitely belong to the prosecutor, but we would like to say some words about it.

a) In the Criminal Code a special reason of termination of punishability for drug-dependant suspects is created.[5] In this case the investigation may be suspended for one year conditionally if the suspect promises to undergo continuos treatment for drug-addiction for at least six months.

b) The investigation may be suspended once in the case of omission of support if the satisfaction of offender's obligation is expected.

[4] Habitual recidivist shall mean a person, who has been sentenced to imprisonment without probation as a recidivist prior to the perpetration of a premeditated criminal act, and three years have not yet passed from having served the last term of imprisonment or the termination of its executability until the perpetration of another criminal act punishable by imprisonment. (Criminal Code of Hungary Section 137. 16)

[5] Criminal Code, Section 282/A. (6) A drug-addicted person shall not be punishable

a) in respect of Paragraph a)-b) of Subsection (5), or

b) if having committed another criminal act related to the use of narcotic drugs that is punishable with two years of imprisonment at most,

provided, that he proves with a document prior to the rendering of the sentence in the first instance, that he has received continuous treatment for drug-addiction for at least six months.

The reason of suspension of the process in these cases is that the treatment of drug-dependent suspect and that the entitled party receives the allowance which is necessary for his/her existence are more important, than the enforcement of the criminal claim of the state.

These circumstances giving basis for the suspension of the investigation will turn back in the stage of prosecution and before the court: if earlier it has not happened the process may be suspended in these stages, because it is a fundamental condition that these reasons—essentially the promise of the offender—may serve as the reason of suspension only once during the process, may block the process once and it is not allowed to give a ground to the suspect to cause delay in the criminal process.

The decision of the prosecutor about how significant he considers the confession of the suspect is connected with the stage of the prosecution: whether he proposes the application of some quick and simplified special procedure or not. Pleading guilty has importance in bringing the suspect before the court, concerning waiver of trial and omission of trial. While the two previous procedures combine only the advantages of quickness and simplicity, in the case of the waiver of trial the suspect receives obvious advantages: punishment may be imposed against him in the sense of the law could be diminished at least by half.[6]

After the prosecutor's proposal, the court, may find the defendant guilty (in charges which are not to be punished with more then eight years of imprisonment) and may also come up with a sentence with a verdict pronounced in an open session, if defendant waivers its right to a trial and pleads guilty. In case of a waiver of trial the sentence of imprisonment is imposed according to Article 87/C of the Criminal Code (Section 355/J. paras (1) and (2) of the Code of Criminal Procedure).

The prosecutor, after giving weight to all the circumstances of the case—especially the personality of the suspect and the nature of the offence—may propose the trying of the case in an open session if the suspect pleaded guilty during the investigation and proposes the open session-procedures

[6] Section 87/c of the Criminal Code says:

In the case of waiver of right to trial (CP, Chapter XXV) the term of imprisonment may not exceed

a) three years in respect of crimes punishable by more than five but less than eight years of imprisonment,

b) two years in respect of crimes punishable by more than three but less than five years of imprisonment,

c) six months in respect of crimes punishable by imprisonment of up to three years.

(Section 355/K. para (1) of the Code of Criminal Procedure). Even if the suspect did not pleaded guilty during the investigation, he/she may propose the open session-procedures for fifteen days after the delivery of the indictment. If the prosecutor finds that there is a chance that the court will accept the proposal, will hear the accused and send the proposal for an open-session procedure to the court (Section 355/K. paras (3) and (4) of the Code of Criminal Procedure).

In court process the court is bound by the charge as a principle, which means that

— judicial procedure can be instituted only on the ground of a lawful indictment,

— judicial procedure can go on until the lawful indictment exists,

— court can judge only the act contained by the indictment,

— court can make decision only against the accused who was charged,

— the indictment must be exhausted regarding both acts and persons.

The right of disposal of the prosecutor manifests itself in what the prosecutor brings before the court, what he makes subject of the indictment. At this point we would like to mention that the classification of the offence by the prosecutor does not bind the court.

The prosecutor can drop the charge even before the court until the court convenes a divisional session for passing its decision. During the preparation of the trial he can do this without offering any explanation, but after the trial was appointed, the prosecutor has to explain his decision on withdrawing the indictment. The court is not allowed to examine whether the explanation is reliable or established, it is bound merely by the fact that the prosecutor withdrew the indictment and so the court must quash the procedure. Explanation of the withdrawing of the charge may be important only within the organisation of prosecutor office. The prosecutor can withdraw the charge if the act made subject of the indictment is not a criminal offence, or it has not been committed by the accused. Really this rule of criminal procedure gives the prosecutor a possibility to correct the lack of the former procedure—i.e. insufficiency of fact-finding, insufficiently supported indictment—because this solution is much more elegant than the acquittal. The reason of being the acquittal so "discreditable" for the prosecutor has its root in the statistical measuring of the work of prosecutors: so called effectiveness of indictment as measurer must approach 100%.

Statistics

Now we try to support our statements with statistical data.

In 2000 the number of offences supervised by the prosecutor was 220,716. The investigation was discontinued in 1,788 cases (9.74%) and the prosecutor instructed investigating authorities to quash proceeding in 19 cases (0.1%).

This year 364,325 criminal cases were registered and the prosecutor's supervision concerned 80,724 cases (22.16%). (The difference between the offences and cases comes from the fact that most criminal cases contain more than one offence committed.) In 3,152 (3.9%) out of 80,724 supervised cases supplementary investigation was ordered, in 2,618 (3.24%) some addition of the investigation was necessary and in 373 cases the prosecutor himself executed investigating act.

I mentioned that the effectiveness of the charge is a very important measure in the life of every prosecutor and in every prosecutor's office. This index shows in how many cases decisions of the court corresponded with the proposition of the prosecutor. In the last five years this index varied as follows:

1996: 95.07%; 1997: 94.61%; 1998: 94.85%;
1999: 94.40%; 2000: 96.22%.

From the point of view of discretionary prosecution the rate of postponing and omission of prosecution is more important. The number of decisions regarding the omission of the prosecution (because the minor offence has no significance beside the more serious offence) was:

1996: 13,502; 1997: 12,087; 1998: 11,811;
1999: 6,980; 2000: 2,761.

The proportion of this decision is decreasing among the so called "other way of closing" of the case between 2.65% and 0.55.

As we mentioned the postponing of prosecution as a relatively new measure, could be taken by the prosecutor (since 1996 in juvenile cases and since 1999 against adults). Although the proportion of this kind of decision is increasing, very few suspects were concerned:

1996: 793; 1997: 744; 1998: 896;
1999: 1,999; 2000: 2,686.

In the last 5 years 36.98–45.02% of accomplished cases were settled with bringing the case before the court.

The investigation was refused and the suspect was reprimanded only in few cases:

1996: 237; 1997: 223; 1998: 460
1999: 251; 2000: 214 cases.

Far more cases were quashed and the reprimand applied:

1996: 10,676; 1997: 10,987; 1998: 12,351;
1999: 11,403; 2000: 10,856
(1.90–2.15% regarding every closed investigation).

The new Code of Criminal Procedure

Rules of the new Code of Criminal Procedure strengthen the role of the prosecutor in the criminal process:

— refer some decisions containing averting of the institution or continuation to the exclusive competence of the prosecutor,
— widen the circle of cases when the prosecutor entrusted to waive prosecution. Adjoining to limitation of the prosecution and the waiver it because of "bagatelle" (petty) offences the prosecutor will have power not only to prescribe rules of conduct for the suspect (both adult and juvenile) against whom the prosecution postponed, but he may call the suspect to fulfil some duties: pay compensation for the victim, pay certain amount of money for the particular purpose or work for the public. But juveniles could not be bound to pay money for particular purpose or to work for the public: namely these may impose impracticable obligation for juveniles and so couldn't serve the aim of their proper development.

As it is written in the reasoning of the Act XIX of 1998 regarding preconditions of prosecution: It follows from the principle of legality that if evidence gathered in the preparatory stage of the procedure gives enough ground for the prosecution, the indictment is well-founded in respect of facts and law as well, the prosecutor has to prosecute; he has discretionary power only if the law entrusts him to do so (postponing of prosecution, omission of prosecution etc.). The new Code stops the possibility of the prosecutor to apply reprimand if he quashes the case. The reason of this rule is that every kind of sanctions could be imposed according to the new code only by judge.

Postponing of prosecution is compulsory if a drug-dependant suspect promises to submit himself to treatment for drug-addiction for at least six

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months or the suspect charged with alleged commission of omission of support to satisfy his obligation.

The consent of the suspect is necessary for imposing obligation if the prosecutor postpones the prosecution. The prosecutor has to hear the suspect for making clear conditions of postponing of the prosecution, whether the suspect wants and is able to fulfil his duties. The compensation of the victim supposes the consent of the suspect and of the victim as well.

Conclusions

The Recommendation R(87) 18 requires that "The principle of discretionary prosecution should be introduced or its application extended wherever historical development and the constitution of member states allow...".

As we can see, the discretionary power of the prosecutor has become wider and wider during the last ten years in Hungary. But as opposed to the way of thinking usual in the Anglo-Saxon legal system, in Hungary the preference is on the side of prosecution. Even the reasoning of the new Code stands by the principle of legality.

Instructions created by the General Prosecutor are very generally phrased regarding the discretionary power, provide hardly any help for prosecutors and so give wide scope for the local variations and applying possibilities of diverting of the offender from the court proceeding not consistently.

The main problem of the discretionary prosecution is that this decision may be accompanied with some kind of sanctions: nowadays with reprimand and supervision by a probation officer, but after the new Code enters into force these possibilities will widen with obligation the suspect to pay a certain amount of money for a special purpose, to work for the public and pay compensation to the victim. Even the European Court of Human Rights dealt with this question, but the conclusion was that if the discretionary prosecution depends on the suspect's consent, the presumption of innocence is not injured.

In Hungarian law discretionary prosecution requires previous consent of the suspect and in other cases the suspect has right to remedy and challenge the judicial judgement.

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