

## Rules on Partnership in the New Hungarian Civil Code of 2013

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### I Regulatory History

The institution of partnerships was already regulated by the former Hungarian Civil Code (Act IV of 1959 on the Civil Code, hereinafter referred to as FHCC), but it was also known in earlier Hungarian private law. During the Socialist era it fulfilled numerous functions and was used to regulate various matters, ranging from the legal form of small undertakings to the regulation of the financial relationship between life-partners. Since the 1970s, it has become possible to make a limited private business in the legal form of partnership. Even earlier, the relation between unmarried partners who lived together in a common household for a longer period was decided according to the rules of partnership.<sup>1</sup> Partnership itself is even older and has its roots in the Roman law institution of a *societas*. The rules of the FHCC were established by the adoption of Act IV of 1988. This Act on business companies – which granted only limited scope of action for partnerships – was changed only by the adoption of the new Hungarian Civil Code (Act V of 2003 on the Civil Code, hereinafter referred to as NHCC). The rules of the FHCC allowed the establishment of a partnership only for activities and purposes that require the partners to cooperate ‘to achieve their common purposes involving economic activities’. A partnership may not pursue any business-like economic activity; the act of pursuing any such activity excluded the possibility to apply the rules pertaining to partnerships (see EBH 2011. 2323.).<sup>2</sup>

This limitation has been eliminated by the new regulations, and, technically, a partnership may be established for any lawful purpose. Other limitations of the former regulations were also deleted, which is to be discussed later.

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<sup>1</sup> Csehi Zoltán, ‘Das Recht der Eheschließung und Scheidung und parallel Fragestellungen bei nicht-ehelichen Partnerschaften aus ungarischer Sicht’ in Ch. Baldus, P-Ch. Müller-Graff (eds), *Europäisches Privatrecht in Vielfalt geeint / Droit privé européen: l’unité dans la diversité* (Sellier 2011, München) 111–137.

<sup>2</sup> Sárközy Tamás, ‘A társaság [Partnership]’ in Gellért György (ed), *A Polgári Törvénykönyv magyarázata. [Commentary to the Civil code]* (2nd book, Complex 2007, Budapest) 2030–2032.; Nochta Tibor, ‘Társaság [Partnership]’ in Nochta Tibor, Kovács Bálint, Nemessányi Zoltán (eds), *Magyar Polgári jog. Kötelmi jog. Különös része. [Hungarian Private Law. The Law of Obligations. Special part.]* (Dialóg Campus 2008, Budapest–Pécs) 220–225.

## II Partnership and Companies

According to the Companies Act of 1988, business companies may be established for ‘business-like economic purposes’, while a partnership cannot be established for such purposes. Another significant difference is that business companies are independent legal entities with legal capacity, while partnerships were – and have been ever since – considered merely as a set of contractual undertakings between the partners. Under the old and the new regulations, business companies are established upon written articles of association (s 3:5), while no written form has been, or is under the new regulations, required for the establishment of a partnership. The involvement of an attorney-at-law or a notary public during the establishment of a business company is a statutory requirement [s 3:95 (2)], while no lawyer is required for the establishment of a partnership. While having an independent organisational structure is an important feature of business companies – even unlimited and limited partnerships have an organisational structure –, it is not a feature partnerships have.

Even Title XXIV of Book 6 of the NHCC is different from the title of the chapter of the FHCC on the same subject, ‘The civil law partnership agreement’, while the FHCC used the title ‘The partnership’.

The regulations remained within the law of contract and the law of obligation and did not move toward the law of persons – as with their development in Germany. At first sight, it is pure contract law: a special contract, nothing else.<sup>3</sup> As a result of the history of partnership over the last 60 years, and the peculiarities of the case law, the new regulations made it more flexible and fit for all kinds of contractual cooperations, whether business, non-profit or any other. The main principle is that the rules on partnership are default rules and there are only a few mandatory provisions. A partnership is the origin of the situation where rights or receivables have several beneficiaries, or an obligation has several obligors, so the general rules of these kinds of obligations also apply (see Chapter VI and VII of Book 6, S 6:28–6:33) and the rules on partnership add these general rules.

<sup>3</sup> Csehi Zoltán, ‘A polgári jogi társasági szerződés [The partnership agreement]’ in Osztoivits András (ed), *A Polgári Törvénykönyvről szóló 2013. évi V. törvény és a kapcsolódó jogszabályok nagykommentárja. III.* (Opten 2014, Budapest) 1287–1309.; Kisfaludi András, ‘A polgári jogi társasági szerződés [The partnership agreement]’ in Vékás Lajos (ed), *A Polgári Törvénykönyv magyarázatokkal.* (Complex 2013, Budapest) 927–936.; Petrik Ferenc, ‘XXIV. Cím A polgári jogi társasági szerződés [The partnership agreement]’ in Wellmann György (ed), *Az új Ptk. magyarázata. VI/VI.* (HVG-ORAC 2013, Budapest) 498–512.; Fézer Tamás, ‘XXIV. Cím A polgári jogi társasági szerződés [The partnership agreement]’ in Csehi Zoltán (ed), *Az új Polgári Törvénykönyv kommentárja.* (HVG-ORAC 2014, Budapest) 316–329.; Kisfaludi András, ‘A polgári jogi társasági szerződés [The partnership agreement]’ in Vékás Lajos, Gárdos Péter (eds), *Kommentár a Polgári Törvénykönyvhöz* (Complex 2014, Budapest) 1195–2214.

### III Special Partnerships

The FHCC also regulated certain special kinds of partnerships, such as construction partnerships (s 578/B to 578/F) and the financial relations of persons (partners) living in the same household (s 578/G); Chapter XLVI of the FHCC even included the statutory definition of unlimited and limited partnerships (s 578/H) and also included a contractual provision regarding condominiums (s 578/I). In 2011, the rules pertaining to civil societies – a new phenomenon in non-profit law – were also inserted (s 578/I). This rather diverse regulation, a product of ad hoc legal development, was simplified by the provisions of the NHCC.

Regarding the special forms of partnerships, the regulation of the financial relationships between civil partners is of particular importance and will be covered with the relevant provisions of the Civil Code. Tibor Nochta noted the close relationship with syndicate agreements, which are in fact partnerships with the purpose of controlling and managing business companies and laying down the additional obligations of the partners.<sup>4</sup> A partnership may also be established by partners of a terminated business company by contracting (see BH 1990. 482.).<sup>5</sup>

#### 1 Partnership of Attorneys

A partnership of attorneys established under Regulation No. 2/2006. (III. 20.) of the Hungarian Bar Association is an example of a special partnership. Such partnerships may be established by an attorney or law firm with other attorneys or law firms by virtue of a written contract with a view to entering into permanent cooperation in the performance of mandates [section 23 (5) of the Act on Lawyers].<sup>6</sup> While the partnership is not a separate legal entity but a mere contractual relationship, this quality must be indicated in the name of the partnership, and the partnership must be registered with the chamber of attorneys. The particulars of the partnership are also entered into the register of the chamber.

#### 2 Civil Society

The institution of civil societies was established by Act CLXXV of 2011 on the freedom of association, on the charity status, and the operation and support of civil organisations. Civil societies are not independent legal entities but serve specific purposes, so the rules will remain relevant in the future only in the context of the charity law. The possibility of setting up a consortium to participate in public procurement procedures has been recognised in practice for a long time. A consortium is, in fact, a partnership (see EBH 2011. 2373.; BDT 2011. 2608; BH 2004. 474).

<sup>4</sup> Nochta (n 2) 224.

<sup>5</sup> BH – Decision of the Supreme Court of Hungary published in official letter, no. 482 from 1990.

<sup>6</sup> 1998. évi XI. törvény az ügyvédekről (Act XI of 1998 on attorneys).

## **IV Partnership or Partnership Agreement**

S 6:498 of the NHCC describes a partnership agreement rather than the partnership itself. The partnership is created by and throughout the partnership agreement. The rule states three main obligations of the parties of the partnership agreement: (i) cooperation (ii) capital contribution; and (iii) allocation and bearing the risk of the common activities. This is a civil law agreement between the parties to achieve the common goals of the partners. The purpose of the agreement is not the exchange of goods or to provide a service by one party to another, but rather to ensure continuous cooperation between the parties. Cooperation shall mean that the partner shall do something or act for or support the common goal of their agreement. Usually the partners provide capital – assets or money – for this activity, not to each other; the capital is needed for the activity to achieve the common goals. The details of this definition in the Civil Code will be examined in the following point.

## **V Partners**

The Code does not specify any statutory restriction regarding the partners, meaning that any human being or legal entity – i.e. natural persons, business enterprises – may be a partner in a partnership. However, public sector entities are subject to special rules. In other respects, the rules of legal capacity and disposal rights are applicable (e.g. a person with limited disposal rights may also be a partner in a partnership). Theoretically, a person may be a partner in any number of partnerships.

## **VI Contents of the Partnership Agreement**

A partnership is established through a contract – i.e. in the articles of association – and constitutes a contractual relationship between the partners. The contract is a consensual agreement, meaning that it is concluded through the mutual intention of the parties and no written form is required by law. The contract may be also concluded by the occurrence of certain circumstances, even if the parties do not even know that their cooperation does, in fact, constitute a partnership. The general rules on the formation of contract of the Code shall apply to partnerships as well.<sup>7</sup>

This is because a contract may be concluded implicitly, and also because the cooperation and agreement by and between the parties meets the applicable statutory requirements. For this reason, attorneys tend to borrow and include in cooperation and similar agreements a common law clause, whereby the parties to the given agreement represent that their cooperation – e.g. joint tendering or participating in an investment together – may not establish a partnership

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<sup>7</sup> Especially S 6:4 (3) with s 6:63.

between them. The subject of such contracts is the cooperation between the parties and the achievement of a common purpose of the parties through their cooperation, so that the necessary assets can be provided and the risk, as well as the potential success and potential financial failure or the failure of the activity, is shared by all the parties. Such contracts do not serve the dynamics of the financial relations or secure the material obligations by and between the parties, but seek to regulate their cooperation in achieving their common objective.

The partner does not provide or do anything in order to receive a consideration from their partner – the essence is the pooling of the partners' resources; their money, property, labour force or a combination of them.

The partners in a partnership are not persons with rights and obligations regarding certain payments and services to be provided to each other, but they are partners subject to an obligation to cooperate in order to achieve their common purpose. A partnership is not a new kind of legal entity. It may or may not be a company. It is a contractual relationship between the partners, meaning that there must be at least two partners capable of establishing and managing the partnership. However, legal evolution may set partnerships off on a road leading toward becoming separate legal entities, as happened in other jurisdictions (see the regulation of partnerships in France or Germany).

## **VII Purpose of a Partnership**

As for the purpose of the cooperation, the new regulations lifted the restriction of the FHCC, and now the partners are allowed to establish a partnership for any lawful – i.e. not prohibited by law – purpose, including the purpose of pursuing economic, business activities, even in a business-like manner. While the courts used to find it null and void, it has now been clarified by the new rules that a partnership agreement may also be used for the implementation of the function of silent partners (BH 1999. 16.).

A partnership may also be used as an association of persons if the partners do not wish to establish an actual association – i.e. a separate legal entity – to pursue their common purpose.

It is a feature of partnership agreements that the partners provide the service jointly with a view to achieving their common purpose, and that the obligations of the partners are stipulated in the agreement (in addition to those stipulated by law). If a partner fails to provide the service as agreed, the other partners may take action against the partner at fault as described below.

## **VIII Supplementary Rules**

The provisions of the NHCC are supplemented by the general rules applicable to obligations (sections 6:1 to 6:57) and to contracts (sections 6:58 to 6:214). These rules are not covered here in detail but, in the context of contractual obligations, they are applicable as reasonable to any and all matters not regulated under Chapter XXIV, for example in the event of breach of contract.

## **IX Application of Existing Case-law**

The findings of old case-law to the FHCC regarding the distinction between contractual relations and partnerships remain applicable. Consignment contracts and loan agreements do not necessarily create partnerships (BH 1995. 217.); joint construction activities carried out by relatives may establish a partnership (BH. 1978. 118.); an agreement similar to a silent partnership – one partner provides the machinery and the profits of the activities carried out by the other partner, with the machinery shared – constitutes a partnership (BH 1977. 327.). The situation is more complicated regarding relationships of a predominantly personal nature, such as regarding settling the accounts after the termination of a relationship between spouses – due to the annulment of the marriage – which also included certain joint economic activities (see BH 1977. 23.). The old cases may be taken into account for legal development purposes with due regard to the new rules.

## **X Establishment and Capital Contribution**

A partnership can be created as an agreement by the partners. Registration or any other act is not required; the partnership agreement shall be made under the general rules of contract law. It is common understanding that capital, a minimum asset, is needed for a successful partnership; however, the Civil Code does not require any minimum value of asset to establish a partnership.

### **1 Capital Contribution**

Section 6:499 of the Civil Code states that each partner in the partnership shall provide capital contribution in equal proportions. The substance of ‘capital’ is described in subsection 2; the contribution can be money, transferable assets or intangible property and services provided by the partner. All these kinds of contribution will be the common property of the partners, because the partnership is not an independent entity, and not even an independent legal unit.

The statutory rules regarding the obligation of the partners to provide capital contribution and the equality of such capital contribution are permissive. When should the contribution be made? Is it a one-time or a permanent obligation? All those are subject to the agreement of the partners. The capital contribution requirement is not necessary for all kinds of partnerships, being subject to the agreement of the partners. So, a partnership can be established without providing capital contribution. ‘Capital contribution’ may include the operating costs of the partnership, if they are borne by the partners. Such situations are examples of a continuing obligation to provide capital contribution. The beneficiary of the capital contribution – i.e. the person to whom the capital contribution must be provided by the partner – is not specified by the Code. The beneficiary of the contributions is the collective of the partners. The assets contributed by the partners belong to the collective of the partners. In comparison to the rules applicable to legal entities, the notion of capital contribution regarding a partnership is defined in a much broader sense: while a difference is made only between money and non-monetary

capital contribution for legal entities, and non-monetary contribution may be provided by transferring property or transferable rights of monetary value, the capital contribution for a partnership may include any other kind of service.

## **2 Valuation of the Contribution**

Capital contribution may even be provided as personal work, i.e. work personally performed by a partner for achieving the purpose of the partnership. The value of the non-monetary contribution is fixed by the partners themselves, and the share represented by each contribution to the whole is established by the partners accordingly. The Code does not provide guidance regarding the calculation of the present value of future services, so it can be established freely by the partners. Also, the partnership contract may be amended subsequently if any significant change occurs to the agreed and actually performed services.

## **3 Beneficiary of the Contribution**

The beneficiary of the capital contributions may be the community of the partners and of the beneficiaries of expenditures made to pursue the activities of the partnership, since – as noted above – a partnership is not a separate legal entity, and the services provided to the partnership may be performed to cover the costs and expenditures arising in the course of pursuing the common purpose (i.e. to third parties), but they also need to be taken into account for the purpose of the internal relationships between the partners.

## **4 Reimbursement**

If the capital contributions provided to the partnership deviate from the ratio stipulated in the partnership agreement, the affected partner may seek reimbursement of the difference from the other partners. When using third party materials for construction works, reimbursement may be claimed from the owner of the land (BH 1988. 84.).

## **5 Means of Contribution**

With regard to the obligation of the partners to provide capital contribution, the means and provision of the capital contribution need to be regulated by the partners in the partnership agreement. Since the Code states default rules, the agreement of the partners prevails over the rules. For the capital contribution to be transferred from the private ownership of a partner to the joint ownership of the partners, the partners must reach an agreement to this effect and the intent to transfer property must be specified. The contributed asset becomes the joint property of the partners upon performance by the obligor. As for exactly when and by what kind of legal act the joint property is created, we are of the opinion – in the absence of any other statutory provisions – that joint property is established by and at the time of making the item available for the collective. This means that, in with regard to chattels, the partner needs to hand over the

items to the partners in the partnership (or their proxies) according to the partnership agreement, and the joint ownership is established by and at the time of handing over (and taking over on behalf of the partners) the chattel. The process is more complicated regarding real property, as the registration of ownership is a statutory requirement [see S 5:38 (2)]. As for rights, handing over not being possible, a transfer transaction must be completed, meaning that a specific agreement is required for the provision of the capital contribution as stipulated in the articles of association. As the completion of this transaction implies the acquisition of property and rights by the other partners, the statutory provisions regarding duties and other fiscal powers of the state (e.g. taxation) may also apply.

## 6 Consideration for Contribution

The Code does not include any provision regarding the consideration payable during asset transfers (usage fee, interest, other payment obligation), not even the relevant rules that formed part of the previous regulations [S 569 (2) of the FHCC]. Thus, we believe it is possible to provide the contribution for a consideration, or the consideration may otherwise appear during the settlement of accounts between the partners. If the agreement of the partners does not include the intent to transfer ownership rights, the assets provided may be used for common purposes. Such use may be allowed to the other partners for free or against consideration, subject to the agreement of the partners. If the capital contribution is provided as money, the rules pertaining to financial obligations are to be applied (unless agreed by the partners otherwise), including the rules pertaining to the ownership of money and securities (s 5:40 – the transferee of money or security becomes the owner) and the consideration for using money (see s 6:383 or 6:388 – accommodation loan).

## 7 Consumables

Section 6:500 (1) of the Civil Code sets forth a special rule regarding the partnership's consumables: joint use – i.e. joint consumption for the purposes of the partnership – is specifically required regarding goods that are capable of being destroyed through use. On the other hand, all items transferred to joint property are to be used jointly according to the prevailing *in rem* rules (see Sections 5:74 et seq.). While the general rules guarantee their use for the individual benefits of the individual partners, the contractual behaviour, in the case of a partnership, is joint use for the achievement of the common purpose of the given partnership.

## 8 Limitation of the Right of Disposal

The ownership ratio held by a partner in an item transferred to the joint property of the partners is designated for being used for the purposes of the partnership; the provisions of the Code indicate this fact by depriving the partner of the right to dispose of his or her ownership ratio for the reason that the assets forming joint property may be used only for the purposes of the partnership. The asset of the partner is legally binding for the common goal and not transferable.



## 9 Claim against Partner of the Partnership for the Contribution

The provision of the capital contribution undertaken by a partner in the articles of association of the partnership may be claimed by any and all other partners [S 6:501 (1) 1<sup>st</sup> sentence]. Since no separate legal entity is created under the articles of association, the obligee of this claim in such cases is always the community of partners, the interests of which may be enforced by any of the partners. This rule is a mandatory provision of the Code, meaning that a partner may not be deprived of their right to demand performance of the obligation to provide the capital contribution undertaken by any other partner in the articles of association. [S 6:501 (1) 2<sup>nd</sup> sentence]. The essence of this rule is that the possibility of a partner to take action to enforce the provision of the capital contributions is not limited to their own share, but – without any further authorisation or power of attorney – may also be to protect the interests of the other partners.

## XI Protection of the Contractual Purpose

With regard to the obligations of the partners of the partnership, the Code prohibits the partners from taking any action that may jeopardise the success of the common activities or the achievement of the common contractual purpose of the partnership. The partners agree with each other in a contract to pursue the common activity. This contractual undertaking implies a duty of cooperation and a duty of actual performance, as well as a duty to refrain from any and all activities that may jeopardise the common activities or the achievement of the common purpose. If a partner breaches those rules – rooted in loyalty, based on fair cooperation and set forth in the articles of association of the partnership – they may be called up to perform such obligations by any of the partners. The general rules of the breach of the contract are applicable for partnerships as well. Those rules are also redrafted in the new Code.

## XII Share of Profits and Losses

### 1 The Rules on Share of Profit and Loss and the Rule of Societas Leonina

According to the default rules of the Code, the profit and loss generated by the common activities of the partners are to be borne by the partners in proportion to their capital contributions [S 6:502 (1)]. The meaning of this provision is twofold: it applies to the increase and reduction of the joint assets, as well as to the changes to the assets of the partners. A partnership has, or may have, initial assets provided by the partners; the losses can be construed as the reduction of those initial assets, and the partners may also incur additional debts. As such, the reduction of assets affects the joint assets as well as the private assets of the partners in the proportion specified in the articles of association. However, a capital increase means only the increase of the jointly held assets of the partners, and it is to be divided in proportion to the capital

contributions. The ratio of the capital contribution of the partners can be agreed freely by the partners; the distribution of the asset also can be agreed freely, so deviations from this rule are possible, provided that the agreement of the partners is consistent with the *societas leonina* rule. The rule of *societas leonina* states that a partner may not be excluded from sharing any and all losses or profits, but the partners are free to agree on the ratio of such sharing [S 6:502 (2)].

## 2 Settlement of Accounts

It is possible that a partner in the partnership is required to perform a payment obligation arising from a contract concluded with a third party in relation to the operations of the partnership if this contract was concluded in relation to the operations of the partnership, as the partnership itself is not a legal entity and, as such, cannot be a contracting party. If the payment of the partner exceeds their undertaking stipulated in the partnership agreement, the partner may request the other partners to reimburse the excess. In such cases, the partners in the partnership need to settle their accounts with regard to the performance of the given transaction. It is important to note that the third party contract must be related to the achievement of the common purposes set forth in the partnership agreement [s 6:502 (3)].

## XIII Management of the Partnership

According to the Civil Code, the partners are entitled to manage their cooperation and implement their common purpose and activities jointly. While the Civil Code lays down the rules of taking such actions jointly by the partners (s 6:32), the invoked rule of the Civil Code is neither useful nor practical enough in this context – this is probably because the rule specified in Paragraph (3) was adopted. The unity of obligees means that a concordant statement is required from all partners for making a given decision or statement. This would make management efforts significantly harder, if there are several (or even just two) partners. The regulations allow the partners to authorise one or more partners to manage the affairs of the partnership. In addition to the practical considerations, this option is also supported by the necessity of timely, uniform, and transparent management. The Code confirms that, if the partners make such a decision, it also implies that only the designated partner will be able to manage the affairs of the partnership, whereas the other partners will not. Only a partner can be elected to be the manager of the partnership.

### 1 Personal Management

Only a partner may be the manager of a partnership and the manager's power is also terminated if the partnership in the partnership is terminated or ceases for any reason. Management is a personal obligation; the transfer of management powers is prohibited by a mandatory provision of the Code and the partners cannot agree otherwise in a contract or with another decision. If the managing partner is not a private individual but a legal entity, the management obligation is

performed and the management right is exercised through an appointed natural person as reasonable.

The right to represent the partnership is regulated separately – i.e. from the matter of management – by the new regulations, as all representation-related matters are regulated separately by the Civil Code.

## 2 Opposition to Management Decisions

Partners who are not authorised to act regarding the affairs of the partnership are entitled to have access to information on the activity of the partnership and to supervise and object to the actions taken by a managing partner. The right to information is regulated in S 6:507. The non-managing partner's right to object means that a partner is entitled to object to any measure taken by management, and, as a consequence, making the respective decision will be delegated to the competence of the level of all partners (s 6:504). The decision by the management objected to by any non-manager partner may not be implemented and the right to object may not be excluded.

## 3 Objection

The act does not set forth any limitation period with regard to the right to object. Already implemented decisions of the management may be reviewed retrospectively; in other respects, the right to object may be exercised within a reasonable period, i.e. within a period that allows the partners sufficient time for a reasonable review of the decision and the legal consequences thereof.

## 4 Revocation of Management Powers

If the partners are dissatisfied with the managing partner's conduct, the other partners may revoke the management power from the managing partner by unanimous decision, without having to meet any further statutory requirement [S 6:505 (1)]. It is unclear why unanimity is required by the Code, as a simple majority would seem to suffice. In our understanding, the provision that this right may not be excluded or restricted applies to the revocation of management powers. In our view, the articles of association may require a mere majority decision, as doing so would not violate the rights of any partner. The related managing partner has no right to vote. The Code states that the managing partner has a right to step down, the only hindrance to this being that they cannot frustrate the partnership with their resignation [S 6:505 (2)]. The Code requires that the resignation may not be made at an unsuitable time, i.e. during a period when the partners are unable to appoint another manager or when pressing matters cannot be handed over to anyone else. To whom the resignation is to be addressed is a practical issue. While the addressee of such a resignation is not identified by the Code, the resignation is to be made toward the other partners – i.e. in the form of an addressed statement – since the manager was elected by the other partners (s 6:505).

## 5 Right to Information

The Code grants a right to information about the deals and activities of the partnership – i.e. the right to learn about the state of affairs of the partnership – to all partners. The partners may exercise this right primarily against the managing partner. The right of the partners extends to having access to the documents and books relating to the operations of the partnership; this right may also be exercised against any partner in possession of such documents. The partners may exercise this right without any justification or explanation; the Code grants these information rights to the partners as subjective rights. The information right of a partner may not be excluded or limited (6:507).

## XIV Representation of the Partnership Toward third Parties

As a contractual form of cooperation between the partners for the achievement of a common purpose, the partnership may also be enabled to act as a community toward third parties. In the case of a partnership, only a partner may provide proxy for another partner in connection with the common goals; the partnership itself cannot be appointed as a representative because it is not an independent legal person (s 6:506). Undertakings cooperating in a consortium frequently authorise one of the partners to represent the consortium and to make statements on its behalf during the tender procedure (see BH 2004. 474).

The authorisation may be granted in the articles of association or in a separate document. In the context of mandates, representation powers may also be granted by law (see S 6:274).

The detailed rules of representation are laid down in the third book of the Civil Code (s 3:29 to 3:31) for legal entities, while the general rules of representation are laid down in the sixth book (s 6:11 to 6:20) of the Civil Code.

## XV Creditor of the Partner

When the partnership is established, the assets contributed by the partners become the joint property of all the partners of the partnership and these assets are designated for the common goals of the partners and protected by the law. The partner's right of disposal is not given over to those assets through their share of the joint property (s 6:500). While a creditor's interest and creditor's right cannot be excluded from this asset or from this share of the common property, the Code provides a special legal way of how the creditor can enforce it. The creditor of the partner may seek satisfaction from the ownership share of the partner, but they may not have direct access to the asset in this way.

The creditor of the partner is however entitled to terminate the partnership. The rules for this process are similar to those applicable to general partnerships; this is a legal person among

companies, regulated in the 3<sup>rd</sup> book of the Civil Code,<sup>8</sup> i.e. the creditor of a partner may terminate the partner's partnership and thereby, with the termination of the partnership, the remaining partners shall settle the relationship between the partner and the partnership. If the balance of the settlement is positive for the partner, the creditor will be entitled to this receivable. The creditor may not demand that the share due to the partner from the joint property be released in kind. If the partnership agreement was concluded for a specific term, the partner's creditor may terminate the agreement by giving three months' notice, provided that more than one year is left from the fixed term. If the remaining period is shorter, the creditor becomes entitled to enforce the partner's claim upon the termination of the partnership (in the course of the settlement with all partners). Until that time, the creditor may secure its obligation according to the Judicial Enforcement Act.

## **XVI Termination of the Partnership**

The partnership agreement may be terminated by any of the partners with three months' notice; this terminates the partnership agreement [S 6:509 (1)]. The addressee of the notice is the managing partner of the partnership; if there is more than one managing partner it is sufficient to send the notice to one of them. If there is no managing partner, the notice must be sent to all partners. The termination ceases all legal relationships and the relationship between the terminating partner and other partners, as well as the legal relationships between all other partners, and the partnership will no longer exist between the non-terminating partners. On the basis of the freedom of contract, the partners may agree that the partner wishing to leave the partnership does not terminate the partnership agreement; the only thing he can do is to leave the partnership but the partnership remains among the remaining partners. This solution, exercising the right or option to 'quit' the partnership (or a similar option), which terminates the partnership of the leaving partner only without having any affect to existence of the partnership itself, does not infringe the subjective right of the partners to terminate their own partnership in the partnership, while it saves the partnership from being terminated by the departure of a single partner – which is in line with the intent of the remaining partners.

### **1 Limitations on Exercising the Right to Terminate**

The Code states that the right to terminate cannot be excluded by the partners, but the partners may agree a shorter or even longer notice period. The three-month notice period provides the partners with a reasonable option to terminate their cooperation and settle their accounts. The other factor with a real impact on the exercise of the right to terminate includes all other circumstances that may affect the outcome, success, or important interim stage of the cooperation, or would generate any financial gain or similar event. Such circumstances may limit the exercise of the

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<sup>8</sup> S 3:140.

right to terminate, provided that the terminating partner was informed accordingly – either before or after termination – and the exercise of the right to terminate would be detrimental and damaging to the cooperation of the partnership. Primarily material damages may be claimed as damages according to Sections 6:142 and 6:143 of the Civil Code.

## **2 Termination without Notice**

‘Termination without notice,’ a form of termination regulated by the Civil Code, is not available for partnership unless justified for ‘substantial reasons’ [S 6:510 (1)]. Termination without notice means that the partner does not need to wait three months for the termination to take legal effect – i.e. for the partnership to be terminated – but it becomes effective, and the partnership is terminated, at the time of receiving the notice of termination. The notice is to be sent to the managing partner of the partnership or, if there is no managing partner, to all partners. The ‘substantial reasons’ may be facts, acts of breach of contract or other actions defined as such by the partners in the partnership agreement, which prevent the partners from cooperating with each other. In this context, the breach of contract by the other partner must be a fundamental or substantial breach that affects a ‘material obligation’ of the partner. The breach of contract must affect an obligation that has a material and detrimental impact on the cooperation between the partners. Termination without notice is groundless, unlawful, and inconsistent with the partnership agreement if its basis is missing or it is based on false facts. In such cases, termination without notice does not have any legal effect and the partnership is not terminated.

## **3 Termination of the Partnership**

As already explained in the context of representation, partnership constitutes a personal contractual relationship, where the person of the partners is of paramount importance and the rights and obligations of the partners are to be exercised and performed personally. The question of between whom the partnership is established is of fundamental importance, as it identifies the partners trying and wishing to cooperate in order to achieve a common purpose. This feature of partnerships is further strengthened by the rule according to which the partnership terminates upon the death or termination of a partner without a legal successor. If a partner with legal personality is terminated and no longer exists, the underlying partnership is terminated without any further action and without taking any other fact into account as of the occurrence of the respective event. For natural person partners, the death of a partner has the same legal effect. For legal entities, the termination of – the respective legal entity without a successor – e.g. deregistration of the legal entity under Section 3:48 of the Civil Code – is the event that triggers the termination of the partnership simultaneously.

## 4 Keeping a Partnership in Effect

Upon the termination of a partnership, the Code allows the remaining partners to establish a new partnership or even to keep the partnership agreement in effect between the remaining partners, despite the death or termination of a partner. The phrase ‘keep in effect’ indicates that the remaining partners shall confirm the continued existence and renovation of the partnership between themselves for legal purposes; this means that the partnership is maintained by and between the remaining partners without the deceased (terminated) partner. As the number of partners in the partnership is reduced by one and because the accounts are to be settled with the deceased (terminated) partner, the partnership agreement is to be amended due to the death of a partner and the resulting material implications. The act uses the phrase ‘keep in effect’ because the partnership continued by the remaining partners and with reduced assets – if the balance of assets is positive – is not in fact the same as, or even identical to, the original partnership. Hence, the death of a partner can cause the partnership to be amended, but the agreement of all remaining partners is required for such an amendment. Naturally, if certain partners do not wish to continue the partnership, the partnership agreement may be concluded by and between the remaining and willing partners.

## XVII Exclusion of a Partner

The new provision of the Civil Code implements the institution of excluding partners as previously regulated by the provisions of company law.<sup>9</sup> In the event of termination, the partner decides and acts to leave the partnership. In the case of exclusion, the other partners decide and act that the targeted partner shall leave the partnership [S 6:512 (1)]. A partner may be excluded in those cases specified by the partnership agreement. However, a written agreement is required for such exclusion, though it should be noted that a partnership can be established without a written agreement as well. The unlikely scenario of invoking the provisions of a verbal agreement is also lawful and such important matters should be regulated in writing. Exclusion of a partner may be based on the act or actions of a partner that give rise to the right of the other partners to terminate without notice. As seen in the context of Section 6:510 (2), an accountable breach of contract by a partner affecting a material obligation gives rise to the right of the other partners to terminate without notice, meaning that such breaches may also serve as grounds for exclusion. The partners concerned must decide whether to exclude the partner, if they are at fault or to terminate the agreement, since the two options are mutually exclusive. The decision shall be passed by the unanimous votes all partners, excluding the affected partner.

<sup>9</sup> Act V of 2006, or in the NHCC s 3:107–3:108.

## 1 Effects of Exclusion

While termination ceases the partnership itself, the legal effect of exclusion is different, as it only terminates the partnership of the partner in breach of a material obligation, while the partnership of, and the contractual relationship between, the other partners remains unchanged. The law requires the unanimous decision of all other partners for the exclusion of a partner. The articles of association may deviate from this provision, but the decision must be made by majority at least.

## 2 Duty to Settle the Accounts with an Excluded Partner

The partnership of an excluded partner is terminated by virtue of exclusion, so the assets due to the excluded partner in relation to their participation in the partnership must be released and the financial claims relating to their partnership must be settled – this is the meaning of the statutory phrase of settling the accounts [s 6:512 (3)]. The Code does not set a statutory deadline for releasing such assets, so the similar rules set forth in Book 3 may be invoked by analogy (see S 3:150 of the Civil Code). In the course of the settlement, the excluded partner may not demand the release of the assets in kind; such assets may not be released in kind to the excluded partner unless the remaining partners decide otherwise [s 6:512 (3)].

## XVIII Settlement

Partnerships provide a legal framework for the partners to cooperate with an intention to achieve a common purpose, and the termination of the cooperation accordingly has an impact on the assets of the partners. A successful partnership may realise extra profits that would increase the assets of the partners but the operations of a partnership may also result in various obligations on the side of the partners. For this reason, the managing partner – upon the termination of the partnership – must make the necessary arrangements for settling the accounts and dividing the common property, with due regard to the provisions stipulated in the partnership agreement. On the basis of the prepared documents, the partners make decisions concerning the means and method of settling the accounts and dividing the common property. According to a default rule of the Code, the property must be divided in proportion to the capital contributions of the partners, but the partners may agree otherwise in the articles of association at the time of contracting [s 6:513 (2)].

The assets handed over for joint use are to be returned to its owner [s 6:513 (3)] and the amortisation and wear and tear of such items are to be taken into account during the settlement by the partners according to the relevant provisions of their agreement. The work and activities performed by a partner is to be valued according to the partnership agreement, and the value is to be taken into consideration during the settlement with due regard to the activities and purpose of the given partnership. As such, the consideration for personally performed works must be taken into account where the cooperation served business purposes, provided economic benefits, and increased the assets of the partners, but personal contributions and works by



partners are not justified in a partnership serving public purposes useful for the society, the prosperity of a community, or cultural purposes. However, the agreement by and between the partners remains the primary regulatory instrument, even in such cases.

## **XIX Conclusion – Partnership at the Crossroads**

The new regulation of partnerships in the Hungarian Civil Code was cleaned of the unnecessary restrictions of the earlier Code Civil of 1959 and so it could play a more important role on the field of freedom of contracts. The new regulations, with default rules, bridge the gap between company law and the law of contract. Under the new regulation of partnerships, they are eligible for such a business agreement earlier; it is only possible before the establishment of a new company. As such, the new regulation of the partnership provides the parties with more freedom in the field of business agreements and cooperation in a contractual way without creating a new legal entity. Despite the special character of partnerships, the community of the partners, like a 'quasi entity', can be a legal subject, which is subject to the interpretation of the rules in the future of the case law. The new regulation of partnerships enriches the regulation of law of property; it creates a special common property of the partners, which is the legal basis of common property linked to a common goal of the partners, and serves the economic and legal protection of the common goal of the partners. This regulation of partnerships creates a transition between contract law, property law, the law of individuals, including company law, and enriches the possibilities of Hungarian private law.