An overview of the Hungarian PIL Codification: Law Governing Contracts

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I. Introduction

This short article provides an overview of the most important developments in Hungarian private international law rules concerning international contracts. Similarly to almost all Member States of the European Union, Hungarian private international law has recently been highly influenced by the Brussels legislators. These challenges, which mainly come from the flow of EU Regulations and the case law of the European Court of Justice, raise the question of the coherence of private international law rules between the national and European levels. Therefore, the national legislators of the Member States face the problem of how to modify their national conflict of law rules in order to harmonize them with the EU legislations. In the following section a brief summary of the Hungarian private international law codification will be described. Section III focuses on the national conflict rules of contracts, drawing attention to some differences between the solutions of the European regulation and the Hungarian Private International Law Code.

II. Brief Historical Background

In the 19th century there was no unified private international law (PIL) in Hungary, but there existed rules regarding PIL in certain domestic statutes. After the World War II, in 1948, *Professor István Szászy*, professor of private international law, introduced a draft which regulated in great detail both the general and specific questions of PIL. The draft, which was prepared with excellent scientific erudition, reflected the theoretical achievements of the age as well as Hungarian judicial practice. The political changes taking place at the end of the 1940s in Hungary, namely the communist takeover of political power, had a negative impact on the future of the draft. The question of the codification of Hungarian private international law did not arise for another two decades.

Works of codification were started in 1966 under the conduct of the Legal Institute of the Hungarian Academy of Sciences, and the second draft was completed in 1968. The Ministry of Justice took over the conduct of codification, and by 1970 another draft had been completed. The fourth draft was ready in 1978, accepted in 1979, and made public as Law Decree No. 13 of 1979 on Private International Law (hereinafter referred to as *Code*).

Minor modifications have been made on the Hungarian PIL Code several times. More comprehensive modifications started to take place from the beginning of 2000, primarily with the aim of harmonization with European law. In 2000, sections IX and XI, dealing with jurisdiction and the recognition and enforcement of foreign judgements, were re-regulated, and they were further modified in 2001, 2002, 2003 and 2004. Hungary has ratified the Convention of 1980 on the law applicable to contractual obligations (hereinafter referred to as *Rome Convention*) in 2006.[1]

The last modification took place in accordance with the results of EU unification of private international law. Act No. IX of 2009 is a rather technical modification with the

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[1] Act No. XXVIII of 2006

primary aim of drawing attention to the fact that beside EC Regulation on the law applicable to non-contractual obligations[2] (hereinafter referred to as *Rome II*) and EC Regulation on the law applicable to contractual obligations[3] (hereinafter referred to as *Rome I*) the Hungarian Code can only be applied to a limited extent. The amendments have also introduced a new provision in Section II concerning private individuals; it complemented previous provisions with a further rule regarding the use of name by natural persons.

The structure of the Code is the following: it consists of three big parts and eleven sections. Altogether there are 75 articles dealing with the basic questions of private international law (General and Special Part) as well as with issues regarding jurisdiction and certain procedural questions. Section I, called General Rules, contains provisions concerning the purpose of the law-book and certain basic PIL legal institutions such as qualification, *renvoi*, determination of the content of foreign law, reciprocity, *ordre public* (public policy) clause, and fraudulent connection. The Special Part from Section II to VIII determines the conflicts rules applicable to persons, law of intellectual property, property law and related rights, obligations, succession and family law. Sections IX to XI contain regulations regarding jurisdiction, procedural law and the recognition and enforcement of foreign judgements.

The purpose and operation of the Hungarian Code is governed by the Article 1 and 2. Article 1 states that the Code has a double purpose. First, in cases where elements of foreign private law are involved, it chooses from the conflicting legal systems the one whose substantive law should be applied (substantive law aim). Second, it determines what procedures the court should follow (procedural law aim). An element can be regarded as important foreign element only if it is relevant to the case. If the case contains foreign elements but they are not relevant to the judgement of the case, or if the case does not contain any foreign elements, the Hungarian Code cannot be applied. The Code emphasizes its own subsidiarity when it declares in Article 2 that it "shall not apply to matters governed by international treaty". Naturally, the law sources of the European Community enjoy priority to the application of the Code. The priority of community law applies e.g. to contract and tort law,[4] where the rules of Rome I and Rome II regulations prevail against the regulations of the Hungarian PIL Code. The scope of the Code extends only to cases which are not included in or regulated by these European instruments.

III. Law Governing Contracts

1. Party Autonomy

The freedom of party autonomy in choosing the applicable law to international contracts had already been accepted in Hungarian judicial practice before the birth of the PIL Code. The Code adopts the choice of law possible as the primary connecting factor of the law governing contracts. The laconic provision constructed in 1979[5] was supplemented with a few additions in 2009. According to the new provision: "A contract shall be governed by the law chosen by the parties at the time of contracting or later to the whole or a part only of the contract. The

[2] Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations, OJ L 199, 31.7.2007, p. 40–49.

[3] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, OJ L 177, 4.7.2008, p. 6–16.

[4] The third regulation is concerned with matters relating to maintenance obligations. Council Regulation (EC) No 4/2009 of 18 December 2008 on jurisdiction, applicable law, recognition and enforcement of decisions and cooperation in matters relating to maintenance obligations, OJ L 7, 10.1.2009, p. 1–79.

[5] Article 24
The law chosen by the parties at time of contracting or later shall be applied to their contract.

choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case." (Article 25). The Code, similarly to the Rome I Regulation, mentions primarily the expressed choice of law and defines the implied choice of law as well. In this last point, however, there is a difference from the definition in the Rome I Regulation. The second sentence in Article 3(1) of the Rome I Regulation is the following: "The choice shall be […] *clearly demonstrated* by the terms of the contract or the circumstances of the case." In the Code it goes as follows: "[…] *demonstrated with reasonable certainty* by the terms of the contract or the circumstances of the case."[6] In this latter version, given by the Rome Convention, both implied and hypothetical choices of law can be included, while only the former one is permitted by jurisprudence.[7]

Regarding the time of choosing a law, it provides the parties the choice of law at the time of contracting as well as after concluding the contract ("at later"). According to the Code, the first time for the choice of law is the time of contracting, but it is also possible for the parties to select the applicable law before concluding the contract, for example within the framework agreement. Regarding the closing time for the choice of law, the beginning of the legal dispute[8] or the end of the evidentiary procedure at first instance[9] are considered in Hungarian legal literature as the theoretical limits. Hungarian judicial practice, as opposed to theoretical positions, permits the choice of law any time until delivering the judgement, even in procedure at the second instance (I should add that in these cases it has always meant the selection of the Hungarian law).[10] Similarly to Article 3(2) of the Rome I Regulation, it should have been settled in the Hungarian PIL Code that the subsequent choice of law, or the changing of the law originally selected shall not prejudice the formal validity of the contract or adversely affect the rights of third parties.[11]

Even though the partitioning of a contract, or choosing several laws at the same time (*depeçage*) was possible based on the Hungarian PIL Code, it was the Rome Convention's entering force that finally clarified the situation. The Rome Convention and Rome I Article 3(1) leave to the parties the complete or partial choice of law. The introduction of these rules removed the ambiguity that had been present before in the Hungarian regulation. Because the former rule of the Code phrased in one sentence the choice of law (Article 24), which, besides stating that the parties can choose a law either at the time of contracting or at a later time, contained no further provisions. From this regulation Hungarian jurisprudence[12] concluded that if the Code does not prohibit the partition of the contract, then the parties are free to apply this practice. The latest modification of the Code affects this issue, because in the new Article 25 the *depeçage* is expressed: "A contract shall be governed by the law chosen by the parties […] *to the whole or a part only of the contract*."

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[6] It should be noted that this passage of the Code can be the result of the inaccurate translation of the "clearly demonstrated" expression to be found in the Hungarian version of the Rome I Regulation.

[7] See Vékás, L.: A nemzetközi magánjogi törvény módosításáról. (On the Modification of the Act on Private International Law) *Magyar Jog,* 6 (2009) 322.

[8] Mádl, F., Vékás, L.: *Nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga.* (The Law of Conflicts and Foreign Trade) Budapest, 2004. 348.

[9] See Burián, L., Kecskés, L., Vörös, I.: *Magyar nemzetközi kollíziós magánjog.* (Hungarian Private International Law) Budapest, 2005. 205.

[10] Supreme Court of Hungary Pf.III.20 895/1992.; Supreme Court of Hungary Pf.VI.22 046/1993.; Supreme Court of Hungary Pf.III.20 998/1995. See Mádl, F., Vékás, L.: *Nemzetközi magánjog és nemzetközi gazdasági kapcsolatok joga. op. cit* 348.

[11] The legislator should have been made a provision concerning the question of the validity of the choice of law clause and the enforcement of the cogent rules of the law applicable in the absence of the choice of law against the rules of the chosen law (similarly to Article 3(5) and Article 3(3) of the Rome I Regulation).

[12] See Burián, L., Kecskés, L., Vörös, I.: *Magyar nemzetközi kollíziós magánjog. op. cit.* 203.

The Code has no specific provisions concerning the laws that may be chosen; therefore the choice of law is theoretically unlimited. It is even possible to choose a law which has no relationship of any kind with either the contract or the parties. In this respect, however, the choice of law clauses are interpreted strictly in Hungarian judicial practice.[13] Taking into consideration the further limitations of the choice of law, the Hungarian PIL Code does not specify any other devices besides the *ordre public* clause. In other words, it has no provisions concerning the enforcement of the imperative rules of the forum or a third state, and does not set any limitation similar to the Article 3(3) of the Rome I Regulation in case of contract where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen.

In connection with the priority of protective law, these restrictions usually refer to contracts in which one party is perceived to be systematically in a weaker position, most importantly consumer contracts, employment contracts and insurance contracts. In the EU Member States these limitations are expressly laid down in the Rome I Regulation, therefore the 2009 modification repealed the relevant rules of the Code.

Finally, it is important to emphasize that a new development related to the party autonomy resulted from the *Garcia Avello* case,[14] made by the Court of Justice of the European Union. Consequently, the Hungarian PIL Code allows the application of the choice of law rule not only in contract law, but in case of name bearing as well. According to Article 10(2), name bearing is governed by the *lex personae* of the individual, but in case of a request made by the individual involved, at the registration of the name of birth the law of that country shall be applied which the individual is a citizen of as well.

2. Connection between Choice-of-Law and Choice-of-Forum

In preliminary it can be stated that jurisdiction alone is not a connecting factor in conflicts law. The jurisdiction of the court of a state does not necessarily mean that the substantive law of the given state should be applied. The function of PIL rules is overtly to make it possible for the forum not to use its own law. The rules of jurisdiction do not have a direct impact on the applicable substantive law, and it is true the other way round as well; the fact whether the applicable law is a domestic or a foreign one does not have any impact on the existence of jurisdiction. Consequently, the existence of jurisdiction and the choice of law are two separate issues. Although, the „*qui eligit iudicem eligit ius*" (if you choose a judge, you choose a law) is an old proposition in PIL, this principle does not generally apply in modern PIL. It should be noted however, that the picture is made more subtle by the preamble (recital 12) of the Rome I Regulation, according to which an exclusive choice of forum clause "should be one of the factors to be taken into account in considering whether a choice of law has been clearly demonstrated".

In the judgement of international contracts by a Hungarian court, there is a separation between jurisdiction and the selection of the applicable law. The freedom of party autonomy can extend to the choice of the forum as well as to the choice of law. In Hungarian judicial practice these clauses in general, either choice of law clauses or choice of forum clauses, are

[13] For example, it "generally" chooses the Austrian law in legal disputes resulting from loan contracts, it does not extend its scope to the collateral contract securing the loan. (Supreme Court of Hungary Pf.I.25.615/2002/11.)
[14] C-148/02. *Carlos Garcia Avello v. Belgian State* [2003] ECR I-11613.

interpreted rather strictly,[15] but the appropriately phrased or unambiguous clauses, including the arbitration clauses, are treated in the same way.

3. The Applicable Law in Absence of Choice

In sum, with the EU Regulation coming into force the contract law rules of the Hungarian PIL Code play only a complementary role. Therefore, the demand of the modification of the "old" provisions of the Code was entirely justified. According to the new general rule of the Code, in the absence of the choice of law, the contract should be governed by the law of the country with which it is most closely connected (Article 28). Regarding questions which are not within the scope of the Rome I Regulation, for example the contract of inheritance, marriage settlement, or the scope of the rights of the representative, the trust, the Code contains no specific provisions (which can be a source of problems related to qualification).

Some "old" rules of exception however have remained in the Code, which are the following:

- The law of that state shall apply to contracts concluded on exchanges, at tender negotiations or auctions, in the territory of which the exchange is or the tender negotiation or auction is conducted. (Article 26(1));
- A contract of association shall be adjudged according to the law of the state, in the territory of which the company pursues its activities. The personal law of the legal entity shall apply to a contract of association founding a legal entity. (Article 26(2));
- The law governing at the place of performance shall apply to the existence and extent of obligations based upon securities. (Article 27(1));
- The emergence, devolution, termination and enforcement of contractual rights and obligations based upon bonds issued on the basis of a public loan shall be adjudged according the issuer's personal law. (Article 27(2));
- If a security provides the right of disposal over goods, the provisions of this Law-Decree relating to real rights shall apply to the real right effects. (Article 27(3));
- If a security embodies membership rights, the emergence, devolution, termination and enforcement of the rights and obligations based upon the security shall be adjudged according to the personal law of the legal entity. (Article 27(4)).[16]

IV. Concluding Remark

To sum up, regarding the selection of the law applicable to contracts (similarly to the choice of law rules in torts) it can be stated that at the modification of the Hungarian PIL Code the legislator failed to exploit the opportunity provided for the modernization of the old rules.[17] Therefore, Hungarian courts will remain responsible for the task of harmonizing the Rome I Regulation with the Code until a comprehensive codification is finally made.

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[15] *Per exemplum*, the "jurisdiction of Brussels or courts of Brussels" clause was not acceptable, for only "the courts of a state or a certain court" should be selected. (Metropolitan Court of Appeal 14.Gf.41.315/2003.)

[16] Judicial practice regarding the above mentioned remaining rules is unknown.

[17] See Vékás, L.: *A nemzetközi magánjogi törvény módosításáról. op. cit.* 322.