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**INSTITUTIONAL REFORM IN  
EAST-CENTRAL EUROPE: HUNGARIAN  
AND POLISH CONTRACT LAW**

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## **Institutional Reform in East-Central Europe: Hungarian and Polish Contract Law<sup>1</sup>**

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East-Central Europe is awash in legal reforms. New constitutions, new property regimes, and new corporate laws clutter the legal landscape. Western commentators have tended to focus on the various means of "privatizing" state assets, while contract law reforms have been largely ignored. This study addresses that void.

Hungarians and Poles significantly amended their contract codes in 1990, and now reform commissions in those countries are considering further changes. This article identifies and critiques the changes in contract law currently underway in Hungary and Poland. Sources include English translations of the relevant contract codes, both prior to and following the current reforms.<sup>2</sup> In addition, the article draws upon interviews with Hungarian and Polish lawyers, academics, entrepreneurs, and government officials conducted during the author's July 1991 visit to Budapest and Warsaw.

The most striking feature of contract law reform is the fact that relatively few contract rules need to be changed. In fact, a comparison of contract rules under central planning with analogous rules in market economies reveals a remarkable degree of convergence. Thus far, Hungarian and Polish reforms have centered on deleting the contract rules that supported central

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planning and on removing socialist ideology from the existing codes. Additional steps are yet to come. New rules are needed to update the law to conform with contemporary business practices, and existing rules need to be reinterpreted in the light of emerging social and economic realities.

Reinterpretation of code provisions will prove to be the most critical and, perhaps, the most difficult step in the reform process. Throughout the West, interpretations of contract rules have evolved, with most rules having different meanings at different times. At any point in time, the same contract rules may be interpreted differently in various countries of the industrialized world. Contract rules also manifest themselves differently in diverse social settings. Hence, it is simplistic to think that one can merely take the German or French civil codes and transfer them to Poland or Hungary. This article closes with an analysis of the tough policy choices that Hungarians and Poles are now facing.

### ***Twentieth Century Polish and Hungarian Contract Law: From Market to Planning and Back Again***

Divided and annexed by Prussia, Austria, and Russia in the eighteenth century, Poland reemerged as an independent nation following World War I.<sup>3</sup> Polish contract law at that time reflected a complex mixture of foreign laws. To remedy this situation, Poland created the 1933 Code of Obligation, which was patterned after French and German models. This code unified Polish contract law and gave Poland a system that harmonized with Western practice [Zielinski 1984, 186]. Hungary, too, gained independence following World War I. During the interwar period, Hungary developed its contract law through a set of judicial precedents that incorporated Western law.<sup>4</sup>

Under the new socialist political structure created in the late 1940s, existing contract law remained in force unless inconsistent with socialist principles. Initially, most, if not all, of Hungarian and Polish contract law remained intact. The practice of central planning, however, soon required changes in contract law. These changes were implemented through promulgation of individual acts and decrees, resulting in a complex patchwork of legal rules. Within the realm of petty trade, the bourgeois law of the 1930s continued to control. But contracting was also used as a means to administer state plans. Separate rules were fashioned to regulate

the so-called administrative, or economic, contracts. Eventually, both Hungary and Poland enacted civil codes that reflected this patchwork system. The Hungarian Civil Code of 1959 and the Polish Civil Code of 1964 established mature systems of contract law under socialism and served as the starting points for the current reforms.

The recent reforms have centered on deleting the rules that regulated economic contracts. There is concern that what will be left is a contract law better suited to the 1930s than to the 1990s. Committees empaneled in both countries are studying ways to update their laws. Before turning to consider the choices that lie ahead, the changes that have occurred thus far will be outlined.

### *Deleting the Central Features of Socialism*

Three features distinguish the 1959 and 1964 Codes from contemporary Western practice: (1) the presence of central planning and the separate provisions for contracts involving state enterprises; (2) the socialist conception of property, including the limitations on private ownership and the preferences afforded state property; and (3) the socialist ideology embodied in the principle of social coexistence. The Polish contract reforms of July 1990 sought to remove those articles of the Polish code that reflected these three vestiges of socialism. The Hungarian reforms started earlier. Many of the changes enacted recently in Poland had already been reflected in the Hungarian civil code in 1977.<sup>5</sup>

First, both the 1964 Code in Poland and the 1959 Code in Hungary distinguished contracts between private persons from contracts between state enterprises. Within the realm of activity afforded private persons, parties engaged in contractual conduct in ways not dissimilar to those found in the West, and the law of the interwar period remained intact. By contrast, contracting between state enterprises reflected the needs of planning. For example, both codes established the possibility of "precontractual liability" for state enterprises. Articles 397-404 of the Polish Code of 1964 established a legal duty for enterprises to enter into contracts in accordance with state plans. Failure to accept a contract offer in harmony with a state target resulted in liability [Article 397]. Similarly, failure to create an offer in a timely fashion also led to damages [Article 384]. Once a contract was executed between state enterprises, each party became a fiduciary for the in-

terests of the other [Article 355]. Article 2 gave state agencies the authority to suspend the operation of the code and authorized administrative adjustment of contractual terms. Article 386 imposed a duty on all parties to cooperate with such adjustments. Contractual disputes between state enterprises were resolved through a system of state arbitration instead of through the courts [Article 398]. Parallel provisions can be identified in the Hungarian Code of 1959.<sup>6</sup>

Reforms in Poland and Hungary have largely removed the legal distinction between contracts among individuals and contracts among state enterprises. In Poland, Article 2, which granted administrative authority to suspend the operation of the code, has been repealed. All contracts, whether between state enterprises or private parties, are now governed by the same set of laws. In 1989, the system of state arbitration was dismantled, and all contractual disputes are now heard by the judiciary. And the system of precontractual liability, while still on the books, is seldom used. In Hungary, these reforms started earlier. The 1977 amendments to the civil code abolished the practice of state arbitration and unified the law to provide one set of rules for any given contract [Szilberek 1979, *Supra* note 6].

The second set of deletions centered on the socialist treatment of property. Articles 126-135 of the Polish Civil Code of 1964 provided for various types of property—social, individual, and personal. Social property was classified as state property, property held by cooperatives, or property held by other state organs [Article 126]. Social property enjoyed a special status. For example, it was the duty of every citizen to protect and defend social property [Articles 127-129]. Individual property was strictly limited to small holdings in land [Articles 130-131]. Personal property was limited to "ownership of things whose purpose is to satisfy the personal material and cultural needs of the owner and his relations" [Article 132]. Private ownership of the means of production was not possible.

Both Poland and Hungary have changed this property scheme. Today, each country has three types of property: property held by the state treasury, property held by other public enterprises, and personal property. The formal preference for state property has been eliminated. And, of course, there is no longer a limitation on the personal ownership of the means of production or any other type of property.

There were two major contract law implications of the socialist property classification scheme. First, the rules strictly limited the subject matter of private market activities. Bourgeois contract principles were allowed to apply only in the sphere of petty trade. For major commercial transactions, the contract principles associated with central planning were in effect. Second, contracts between private parties and state enterprises did not reflect Western contract principles. If a dispute arose, justice tended to favor the state litigant because of the protection afforded to state property.

The third major deletion involved the implementation of socialist ideology. Changing socioeconomic practices in the 1950s demonstrated the need for a more flexible enforcement of civil law in the interest of equity. Socialist ideology seemed to call for a new set of moral principles to guide business conduct. Both Poles and Hungarians responded to these practical and ideological needs by introducing the principle of "social coexistence" into their respective civil codes. Article 5 of the Polish Code provided: "A right cannot be used in a way which would be in contradiction with the socio-economic purpose of that right or with the principles of social co-existence in the Polish People's Republic." This section was used as a check on individual rights and created a possibility for introducing moral standards into contractual conduct.<sup>7</sup> Article 4 operated in a similar fashion. It stated: "Civil law regulations should be interpreted and applied in accordance with the principles of the political system and the objectives of the Polish People's Republic." Parallel provisions appear in the Hungarian Civil Code of 1959, where Paragraph 200 states that "a contract shall be null and void if it evidently injures the interests of society or disregards the norms of socialist coexistence."

The principle of social coexistence is somewhat similar to the Western notion of "good faith"; both invite the courts to instill moral criteria into the law. Reform, here, does not involve merely replacing one term—social coexistence—with another—good faith. Reform requires the development of precedents that give new meaning to the principle of social coexistence in light of new social and economic realities. Although Article 4 of the Polish Code has been deleted, Article 5 has been retained. Paragraph 200 and other references to social coexistence remain in the Hungarian code.

### *Adding New Provisions*

The reform committees empaneled in Hungary and Poland are currently reviewing potential additions to their respective codes. The goal of each country is to harmonize its laws with the laws of the European Community.<sup>8</sup>

The contract codes in Hungary and Poland are organized in the same way. Each provides some general provisions applicable to all types of contracts, such as the rules of offer, acceptance, and performance. Each code then provides standard implied terms for various types of transactions. For example, Hungarians have standard terms for sales contracts [Paragraphs 1382-1387], for real estate leases [Paragraphs 1403-1414], and for transportation contracts [Paragraphs 1427-1434]. The Hungarian code includes standard terms for about 25 various types of transactions. These standard terms facilitate contracting by eliminating the necessity for the parties to negotiate all the details of a given exchange. Most of these terms can be varied by agreement of the parties.

Both Hungarians and Poles are concerned that their codes do not provide standard terms for certain types of business transactions prevalent in the West. For example, neither code has rules to regulate franchise agreements.

Although the addition of this and other transaction types would be helpful, it is not necessary. The general contract rules in each code already enable private parties to fashion such agreements. In addition, the notion that reform involves merely deleting central planning from the codes and adding Western-style provisions is simplistic. True reform requires tough policy choices, which will not be made by drafting new provisions; they will be made by reinterpreting the provisions that already exist.

### *New Interpretations: Tough Policy Choices*

The most striking feature of the socialist contract codes promulgated in the 1950s and 1960s is the degree to which they mirror market-based codes. Most of the contract rules that support central planning look surprisingly similar to those that regulate market economies. Each system employs rules of offer, consideration, fraud, and duress, as well as other familiar contract doctrines. These provisions did not need to change when the economies were transformed in the 1950s, nor do they need to

change now. They do, however, need to be reinterpreted in light of new business practices.

To Western observers, a contract has four essential elements.<sup>9</sup> First, all contracts involve an exchange of economic value or consideration. Second, all contracts require at least the legal appearance of an offer and an acceptance. Third, a contract is only valid if the state requires performance or provides a sanction for breach. And fourth, contracts must, in some respect, reflect the "free will" of the parties.

A contract entered into pursuant to a state plan is similar to a market contract in the first three respects. The key distinction resides in the role played by the fourth factor—deference to the "will of the parties." An economic contract has all the formal trappings of a contract, but it retains a very restrictive scope for the will of the parties. Both an economic contract and a market contract embody an exchange of consideration, but for an economic contract to be valid, it has to conform to the centrally determined plan. Both types of contracts require a formal offer and acceptance, but under planning, the offer and acceptance are often compulsory. Also, both types of contracts provide sanctions for breach; however, sanctions for breach of a planned contract are doled out less in accordance with the language of a contract than with regard to the necessities of state planning at the time of the breach. The key to all these differences resides in the deference paid to the will of the parties, or, in other words, on the scope of the principle of "freedom of contract."

Future critical policy decisions must be made with regard to the *scope* of this doctrine. It is not merely a matter of accepting or rejecting freedom of contract; it is a matter of interpreting what freedom of contract means. For example, freedom of contract has meant different things at different times in American history. Once taken to an extreme, the principle of freedom of contract weakened other areas of American law. During the early twentieth century, it was used as a constitutional principle to invalidate legislative attempts to regulate the workplace. Worker safety laws, minimum wage laws, and other attempts to regulate employment contracts all were destroyed in the name of free contracting. Furthermore, the doctrine of freedom of contract has differing scopes today in various industrialized nations, but it is generally more expansive in the United States than in Western

Europe. Again, Hungarians and Poles will find the need for interpretation and choice.

Choices regarding the scope of free contract will impact on the interpretation of all other contract rules. For example, the Hungarian civil code currently contains the rule of *laesio enormis*,<sup>10</sup> which requires the court to weigh the substantive fairness of any given exchange. Overly one-sided contracts are not enforced. The same rule once shaped American common law. Today, American common law lives by the rule of "adequacy of consideration," which leaves it solely to the parties to determine the substantive fairness of their exchange. If a party wishes to sell the family farm for a mere peppercorn, he or she is free to do so. Choosing between the rule of *laesio enormis* and the doctrine of adequacy of consideration, or fashioning some intermediate doctrine that combines elements of both, is a matter of public policy. Hungarians and Poles must determine for themselves the degree to which the state will support one-sided exchanges.

Policy choices regarding freedom of contract will also impact on the rules of offer and acceptance. Offer and acceptance rules, both in Western Europe and in the United States, were initially shaped by, and continue to reflect, an increasingly outdated social setting. These rules generally assume that the parties to a contract enjoy equal bargaining power. The rules also assume that the parties have fully negotiated and completely understood the express terms of their own agreement. However, business reality suggests otherwise. Much of modern business is conducted via a standard form, or "adhesion contract." In such contracts, the weaker party—often a consumer—is not fully aware of the terms printed on the form and is powerless to negotiate other terms. Under American common law, adhesion contracts generally are treated the same as individually negotiated contracts. *The result is a contract that looks much like an economic contract under central planning.* The formal requisites are present, but there is little true expression of the free will of the parties. On the other hand, both Germany and the United Kingdom have separate statutes that regulate the content of adhesion contracts.<sup>11</sup> Here again, Poles and Hungarians face tough policy choices. They must choose whether to protect consumers or to enhance the exercise of private corporate power.

Interpretation of the doctrine of freedom of contract will also impact on the interplay between the general provisions of the Hungarian and Polish codes and the specific customary terms provided

for specific transaction types. Express contractual terms that vary from customary terms can be misleading, and judicial deference to the express terms can lead to injustice. For example, the Hungarian and Polish courts must determine whether private parties will be able to use contract terms to excuse themselves from their own negligence. Similar issues will arise with regard to privately drafted penalty clauses, repossession clauses, warranty disclaimers, and a host of other express terms that seek to change other areas of Hungarian and Polish law.

### *Conclusion*

The task of redrafting the Polish and Hungarian contract codes is highly technical and complex. Yet, these complexities pale in comparison to those involved in interpreting the provisions, once they are drafted. One cannot overestimate the important role that the judiciary will play. This may pose a problem in both countries. In Hungary, 70 percent of the judges serve part time. Judges are not well paid, and they generally lack experience. In Poland, 90 percent of the judges were recently replaced. Traditionally, the courts have not enjoyed a high level of prestige; a situation that needs to change.

On a note of optimism, this author was impressed with the high level of sophistication of those people currently responsible for implementing contract law reforms. Most, if not all, were intimately familiar with Western European contract law traditions. Several of these people expressed a desire to learn more about the history of American contract law and to study the current insights found in contemporary law and economic research. Institutional economists could make a significant contribution.

### *Notes*

1. Financial support for this research was provided by the Institutional Reform and Informal Sector (IRIS) Center at College Park, Maryland, and by the Center for International Business Education and Research (CIBER-Maryland).
2. The Polish Civil Code of 1964 was published in English by the Polish Academy of Sciences Institute of State and Law in 1981. Herein, all code cites to Polish law rely on that transla-

tion. Recent contract reforms in Poland are published only in Polish. The author wishes to thank the people associated with the law firm of Gide Loyrette Nouel Polska for a translation of these recent changes. Responsibility for any errant statements with regard to these reforms remains with the author.

An English translation of the Hungarian Civil Code of 1959 appears in the *Hungarian Law Review* 1-2 [1977]: 21-153. An English translation of the current Hungarian code was published by the Hungarian Chamber of Commerce in 1990. A copy can be obtained by writing the Hungarian Embassy in Washington, D.C.

3. For an excellent discussion of the history of the Polish civil code, see Leon Kurowski, ed., *General Principles of Law of the Polish People's Republic* [Warsaw: Polish Scientific Publications, 1984]. This work, published in English by the law faculty of the University of Warsaw, sets forth the essentials of Polish law as of January 1, 1981. Articles of particular relevance for current use include: Andrzej Gwizdz and Sylwester Zawadzki, "Constitutional Law," 11-62; Adam Zielinski, "Civil Law," 161-186; and Marek Madey and Andrzej Stalmachowski, "Socialized Trade Law," 187-208.
4. A history of early Hungarian contract law is provided by Istvan Kovacs, "Hungary," *International Encyclopedia of Comparative Law* 1 [1978]: 13-27.
5. For a discussion of the relationship between the 1977 contract law reforms and the so-called "New Economic Mechanism," see Jenő Szilbereky, "The Civil Code Amended and Restated," *Hungarian Law Review* 1-2 [1979]: 5-18. See also Gyula Erosi, "Contracts in Hungary After the Economic Reform," *Hungarian Law Review* 1 [1969]: 25-34.
6. See Hungarian Civil Code of 1959, *supra* note 3, paragraphs 205, 277 (duty to cooperate), paragraph 206 (compulsory contract).
7. See A. Zielinski, *supra* note 3, p. 171 (citing the use of Article 5 to protect long-term tenants from the harshness of eviction and to shield debtors against the demands to pay interest accumulated over long periods of time).
8. See generally, Attila Harmathy and Agnes Nemeth, eds., *Questions of Civil Law Codification* [Budapest: Hungarian Academy of Sciences, 1990]. A collection of essays that addresses the current Hungarian civil law reforms.

9. A similar taxonomy appears in Gyula Erosi, "Contracts in the Socialist Economy," *International Encyclopedia of Comparative Law* 7 [1981]: 3-16.1
10. Hungarian Civil Code, *supra* note 2, paragraph 201.
11. For a discussion of the German approach to adhesion contracts, see Walter Rolland, "The Role of the Law of Obligations in the Legal System of a Free Industrial Society," in *Questions of Civil Law Codification*, *supra* note 10, edited by Attila Harmathy and Agnes Nemeth [Budapest: Hungarian Academy of Sciences, 1990].

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