The Old - New Legacy of the General Partnership and Limited Partnership. Observations on the Rules for the ipso iure Dissolution of General Partnership and Limited Partnership

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The study examines the case where a member of a general partnership or limited partnership dies and the partnership becomes a single-member partnership, although the law requires it to have at least two members. Until recently, the law dealt with this situation by providing that the company would automatically cease to exist after a certain period of time. This paper describes the recent change and the legal policy reasons for it.
Keywords: *general partnership, limited partnership, death of one of the members, ipso iure dissolution, Civil Code*

In this paper we deal with a very important issue, the rules for the *ipso iure* dissolution of general partnerships and limited partnerships which become single-member companies due to the death of one of the members (a natural person). The currently applicable Civil Code, Act V of 2013, § 3:152, contains the following rules in this regard:

Section 3:152. § [Reduction of the number of members of a partnership to one]
(1) If the number of members of a general partnership drops to one, within six months from that time the partnership shall report to the court of registry the admission of a new member to the partnership, or shall resolve the transformation, merger, dissolution without succession of the partnership.
(2) Until the new member is registered, until the transformation, merger, dissolution without succession is carried out, or failing this until a liquidator is appointed the sole remaining member is entitled to resolve matters falling within the competence of the meeting of members, and shall be regarded as the partnership's executive officer, provided that he is able to meet the requirements pertaining to executive officers.

This rule was introduced in this form by Article 14 of Act XCV of 2020 and has been in force since 1 July 2021. Prior to that, the Civil Code provided as follows:

Section 3:152. [Dissolution of a partnership without succession]
(1) Apart from the general cases of dissolution of a legal person without succession, a general partnership shall be dissolved without succession if only one partner remains, and the partnership does not apply for the registration of a new member at the court of registry within a preclusive period of six months from that time.
(2) Until the new member is registered, or failing this until the time of dissolution without succession or until a liquidator is appointed the sole remaining member is entitled to decide matters falling within the competence of the meeting of members, and shall be regarded as the partnership's executive officer, provided that he is able to meet the requirements pertaining to executive officers. If no such member remains in the partnership, the court of registry shall appoint a supervising commissioner for the partnership.

Below we review the main elements of the legislation, starting from the version that is no longer in force. We will briefly analyse some of the essential features of the rule, which has more than three decades of history in Hungarian company law.[1] The cited rule, which has not been in force since 01.07.2021, may be considered modern in its possible wording, but it contains few differences compared to the relevant provisions of the first company law, Act VI of 1988. However, the economic role and impact of this rule may be significant.

The 1988 Civil Code regulates this issue as follows:

Section 46
(1) An economic association shall cease to exist when
a) the period of time stipulated in the articles of association (statutes) has expired, or another condition for termination has been realised;
b) the economic association decides to terminate its existence, without a legal successor;
c) the economic association consolidates with another economic associa-

1 On the rules of the limited liability company and the limited partnership in relation to the preparation of the currently effective Civil Code, see Wellmann Gy., *A közkereseti* és *a betéti társaság szabályozása az* új *Polgári Törvénykönyvben.* Gazdaság és Jog, 2011/7-8., 10-13. pp.

tion, merges into another economic association, de-merges or is transformed into another form of economic association;

d) the number of the members of the economic association - with the exception of a limited liability company and a company limited by shares - is reduced to one, and a new member is not registered with the court of registration within six months;

e) the court of registration declares the economic association terminated;

f) the court dissolves the economic association in the course of liquidation proceedings;

g) provisions of this Act relating to the various forms of economic association so stipulate.

The second Gt, Act CXLIV of 1997, reads as follows:

Section 98

(1) If, as a result of termination of membership, the number of the members of the partnership decreases to one, the partnership shall terminate only in the event that no new members are reported to the court of registration within a three month non-appealable deadline.

(2) If a partnership terminates on the grounds set out in subsection (1), a person in charge of voluntary dissolution shall be appointed by the court of registration.

A procedural, but very important difference is that the second Gt does not have a six-month deadline, but it contains a three-month-long one.

The legislation that preceded the present Civil Code, Act IV of 2006, reads as follows:

Section 105

(1) If, as a result of termination of membership, the number of the members of the partnership declines to one, the partnership shall cease to exist only in the event that no new members are reported to the court of registry within a six-month forfeit deadline.

*(2) * Until the new member is admitted, or until the opening of involuntary de-registration procedure the sole remaining member shall be considered to be entitled to manage and represent the partnership, even if did not have this entitlement previously..*

The essence of the regulation has not changed, but there are some differences in the location of the rule within the framework of the act and also

there are divergences in some details (e.g. deadlines), as well. It is clear from the three acts on companies and the new Civil Code that in the case of general partnerships and limited partnerships, if and to the extent that, for essentially any reason, the number of members is reduced to one and no new member is registered with the Companies Court within a specified period, i.e. the company is not again a partnership with more than one member, the company will *ipso iure cease* to exist. As it will be explained later, the reason for the reduction to one person is in most cases the death of the natural person.

For the sake of interest, it is also worth referring to the following provisions of Article XXVII of Act No. of 1875, the Commercial Code (Kt.):

§ 98 *The general partnership shall be dissolved:*
2. if a member dies, unless it has been contractually agreed that the company shall be continued with the heirs of the deceased member.

Thus, the rules of the Kt. expressly allowed the parties to agree in the partnership agreement that the partnership would continue to operate in the event of the death of a member with his or her heir and that the partnership would not be dissolved. Under the current version of the Civil Code Section 3:149 on the other hand, provides that the heir of a deceased member or, in the case of a legal person, the legal successor of a dissolved member may join the company by agreement with the other members of the company.

In the following, we will examine the legal policy rationale for the *ipso iure* termination rule described above and the practical and other problems that may have arisen in its application.[2]

The general partnership and the limited partnership are, as in other European legal systems, the basic type of partnership.[3] It is undoubtedly the

2 On the development of company law in the earlier company laws and its relationship with the Civil Code, see in particular Sándor I.: *A társasági jog fejlődése az első Gt-től a Ptk-ba való integrálásáig.* Gazdaság és Jog, 2019/2. 13 - 18. pp. For an overview of the relationship between company law and the Civil Code, see Sárközy T.: *Társasági jog a Polgári Törvénykönyvben. Előnyök, hátrányok, vitás kérdések.* XXI. Század Tudományos Közlemények 2012/27. http://epa.oszk.hu/02000/02051/00027/pdf/EPA02051_Tudomanyos_Kozlemenyek_27_2012_aprilis_017-023.pdf (Last accessed: 26.05.2021).
3 In German and Austrian law, these forms of company are known as *offene Handelsgesellschaft* or *Kommanditgesellschaft*, while in Anglo-Saxon law they are known as *partnership* or *general partnership.* For more details see Sándor I.: *A társasági jog története Nyugat – Európában.* Budapest,

case that the limited partnership is the more popular of the two forms of company in Hungary. According to the records of the Hungarian Central Statistical Office, as of 31 December 2018, 122,126 limited partnerships and 3096 general partnerships were registered companies, while in 2018, 2171 limited partnerships and 13 general partnerships were established.[4] However, in view of the fact that the Civil Code provides for the application of many of the rules of the general partnership to limited partnerships, it is also relevant to analyse the relevant provisions of the Civil Code.

In the case of limited liability companies and joint-stock companies, the personal contribution and personal involvement of the members is of fundamental importance for historical reasons and due to the nature of the operation of the companies. This is also reflected in the assumption of liability, since while in the case of general partnerships all members are jointly and severally liable for the company's obligations with their own assets if the company's assets are insufficient to settle the debt, in the case of limited partnerships this applies only to the full members.[5] For example, BH 2013.130 states that a member of a general partnership is liable for the debts of the partnership that have fallen due up to the date of termination of his membership.[6]

Looking at the above-mentioned legislation, it can be seen that all deadlines are terms of limitation, the failure of which will result in the dissolution of the company, which will take place in a compulsory liquidation procedure, in the context of a supervision procedure. The legal policy rationale for the regulation is based on the need to ensure the security of turnover and to protect creditors.

It is important to point out that in Hungary, small businesses in the form of general partnerships and limited partnerships are typically owned by private individuals and operated with the personal involvement of private individuals, although many economic project investments are often carried out in the form of general partnerships, as legal entities are also very often found among the members of the general partnership.[7] When a general partnership

2005. pp. 200 - 203 and 241 - 250.

4 See https://www.ksh.hu/docs/hun/xftp/gyor/gaz/gaz1812.pdf (Last accessed: 26.05. 2021)

5 On certain forms of liability in company law, see Sándor I.: Észrevételek *a társasági jogban a felelősségi alakzatokról*. Jogtudományi Közlöny 65 (2010) pp. 147 - 152.

6 See in this context Osztovits A. (ed.): *A Polgári Törvénykönyvről szóló 2013.* évi *V. törvény* és *a kapcsolódó jogszabályok nagykommentárja. I.* Budapest, 2014. p. 553.

7 A relatively large number of family businesses in Hungary operate as limited

is used for the purpose described above, i.e. to carry out a project investment, the personal involvement of the members of the general partnership is overshadowed as a characteristic. It is clear that it is the unlimited pecuniary liability of the members that is decisive in this novel application of the general partnership.

As mentioned above, the termination of a general partnership and a limited partnership takes place in most cases due to the death of a natural person member. Analysing the rules, we can see that a conflict of laws arises in the event of the death of one of the members. The six-month limitation period starts to run on the death of the member. Although Hungarian law is based on the principle of *ipso iure* succession, this raises a number of difficulties in practice. After the death of the testator, a long probate procedure, possibly lasting more than a year, may have to be carried out, and the notary may not even wish to include a share in a limited liability company or a partnership in the estate, as he or she considers that it cannot form part of the estate and should be treated separately from the estate.

If there is unity of wills between the parties, heirs or beneficiaries, this is not a problem. The technical solution to avoid the six-month limitation period in this case is to register a new member with the consent of all the heirs. A problem arises if there is no agreement of wills between the heirs and an attempt is made to reach an agreement during the probate proceedings. The threat of a six-month limitation period may force a settlement between the parties, even against their original will. If the heirs are unable to reach an agreement, the six-month time-limit, which is not very long, and its restrictive nature, may lead to agreements which the parties would not otherwise have concluded, since it may create situations which are open to abuse by the heirs in the settlement of other assets in the estate, which is essentially a legal rule. In our view, a possible solution to this situation could be if and when the above time limit would not be six months, but would last

partnerships. For more information on family businesses and the types of companies and operational characteristics that are otherwise specific to them, see: Arató, Balázs: *A családi vállalkozások utódlásának és vagyonmegóvásának jogi aspektusai*; in: Glossa Iuridica 7:1-2.; pp. 141-177; 2020, see also: Arató, Balázs: *The Legal Institutions of Asset Preservation and Asset Transfer in Hungary*; in: Karoli Mundus 1:1; pp. 229-240.; 2021., or Arató, Balázs: *A családi vállalkozások jellegmegóvásának eszközei* (Instruments to preserve the character of family businesses), in: Gazdaság és Jog 3-4.; 2023.; Orac; p. 31-38., and Arató, Balázs: *Családi vállalkozások nemzetközi kitekintésben: Jogalkotási irányok, jó gyakorlatok*; in: GLOSSA IURIDICA 7: 3-4; pp. 263-285., 23 p. (2020).

until the final conclusion of the probate proceedings.[8] (Of course, the current legislation created another solution as it is discussed by this paper.)

It may also be the case that there remains only one member of the company who is not otherwise a director of the company. In such a case, it is necessary to provide for the appointment of a managing director until the company's articles of association are amended or, in the absence of an amendment, until the company is dissolved without succession or until the liquidator is appointed. According to the provisions of the Civil Code, in such a case, a member who meets the statutory requirements for executive officers is deemed to be an executive officer. In this case, an external member of the company may also be a managing director. Here we find an important exception to the Civil Code. 3:156, which precisely states that an external member cannot be a managing director of the company.

Previous case law also recognises the possibility mentioned above. According to the case-law of the BH 2007.82, following the order of liquidation proceedings, the managing member of a limited partnership may appoint an external person to carry out the tasks falling within the scope of the liquidation.

The termination of a limited partnership for a special reason is approached from a procedural point of view by the decision of the Metropolitan Court of Appeal No.14.Cgtf. 44.579/2009/2. This decision states that in the case of a limited partnership that is forced to cease to exist for a statutory reason, the occurrence of the condition for termination and the date of termination are determined by the commercial court in a special procedure for the supervision of legality. If the court is informed of the occurrence of the condition for dissolution in the course of its own proceedings, it will take its decision of its own motion.

It is also important to refer to the decision of the Debrecen Court of Appeal Cgtf.III.30.394/2017/2, which is also important for the practice with regard to the dissolution of the company. Based on the decision, the Court of Registration may order the payment of a supervisory fee by the company whose illegal operation is established by the Court of Registration in the course of the legal supervision procedure. Where the sole purpose of the supervision procedure is to determine the dissolution of a company which has ceased to exist under the law and to order the opening of compulsory liquidation proceedings, the company subject to the procedure cannot be ordered to pay the company court supervision fee.

8 See: Boóc Á.: Új Polgári Törvénykönyv, változó polgári perrendtartás: *régi-új kérdések és régi-új válaszok.* Jogi Tájékoztató Füzetek, (ed: Szakál R,) Budapest, 2016. 85 – 91. pp.

In the literature, the question has been raised as to whether § 3:158 of the Civil Code can be considered as a potentially dispositive provision. Marianna Dzsula highlights the following in this regard. The parties may not derogate from the 6-month limitation period set out in Article 3:158 (1) of the Civil Code. Article 3:158 (1) of the Civil Code, as well as the provisions of the Civil Code cited in the appeal, do not regulate the legal relationship between the members of the association and the legal personality of the company. Article 3:152 (1) of the Civil Code sets a time limit for the submission of a declaration to the registration authority, thus it concerns a so-called external regulatory issue. Article 3:4 of the Civil Code does not extend to this legal provision and the time limit laid down therein. Therefore, the members may not derogate from this deadline in the articles of association; this provision of the Civil Code, which essentially affects the status of the company, is a cogent provision.[9]

Pursuant to the above-quoted decision of the Debrecen Court of Appeal - and analysed in detail by Marianna Dzsula -Article 3:158 of the Civil Code is expressly cogent, from which derogation is not possible. In this connection, it is worth referring to the opinion of the academic Lajos Vékás, who explained that the regulations on corporate law of the Civil Code contain more provisions of a cogent nature than the rules of contract law.'[10]

From the recent judicial practice it is worth referring to the case BDT2018. 3887. This decision states that the fact that the heir acquires the estate *ipso iure* on the death of the testator does not mean that the heir of the deceased member automatically becomes a member of the limited partnership. Membership is not the object of the estate, and its creation requires the agreement of the heir and the other members and an amendment of the partnership agreement. The absence of proof of heirship is not in itself an obstacle to the agreement and the amendment of the articles of association. The decision also stipulates that the existence of a full member and an outside member is a defining characteristic of a limited partnership, and that the termination of either of these two positions will result in the dissolution

9 See Dzsula M. *A gazdasági társaságok szervezeti és működési kereteit meghatározó diszpozitív és kógens szabályok.* Polgári Jog, 2017/10.; Dzsula M.: *Miért kógens a diszpozitív?* Céghírnök 2014/2. 3-5. pp. For a summary, see:
Auer Á.: *Gondolatok a Ptk. III. könyvének diszpozitív szabályozásáról* OPUSCULA CIVILIA 2016/3. https://antk.uni-nke.hu/document/akk-uni-nke-hu/2016_-evi-3_-szam_opuscula-civilia.original.pdf (Last accessed 26.05.2021).
10 Vékás L. : *A diszpozitív szabályozás elve* és *az elv kérdőjelei a gyakorlatban.* Magyar Jog 2018/7-8. p. 388.

of the limited partnership by operation of law. This legal consequence does not apply if the members duly amend the articles of association within six months and notify the Company Court. The decision also states that the six-month time limit for notifying the restoration of the conditions for operating as a limited partnership is a term of limitation.

In the same context, a relatively recent decision of the Constitutional Court, the decision No 3366/2020 (X. 22.) on the rejection of the constitutional complaint, is also worth mentioning.[11] The petitioner claims that the Civil Code. The petitioner invokes Article 3:158 of the Civil Code, which, in his view, is contrary to Article II and Article XIII(1) of the Fundamental Law. According to the petitioner, Article 3:158(1) of the Civil Code infringes Article II of the Fundamental Law because it is unfair that the entry of the heir into the company is subject to an ad absurdum agreement with a third person.

The Constitutional Court rejected the petition. In its ruling, it referred to an earlier decision of the Constitutional Court, No. 3222/2019 (X.11.) on the rejection of a judicial initiative, which dealt with the same problem. The Constitutional Court emphasised that, in the absence of a fundamental change of circumstances, there is no place for a constitutional complaint for a declaration of unconstitutionality or for an examination of the unconstitutionality of a judicial initiative, based on the same legal provision and the same right guaranteed by the Fundamental Law, and in the same constitutional context. As regards the substance of the question, the Constitutional Court has defined its practice in relation to Article XIII as follows: *"The legal concept and content of property are not generally defined directly by the Fundamental Law, but by other legal norms. However, the scope and content of the rights protected by the Fundamental Law must be determined on the basis of the Fundamental Law. ... The petitioner considered that the Civil Code should be applied to the person who becomes a member of the limited partnership (the heir of the deceased member or a person other than the heir). The petitioner considered that Article 3:158 (1) of the Civil Code infringed the right to property.*

However, the Constitutional Court has already pointed out above that - contrary to the petitioner - a new member, in particular the heir of a deceased member, is always entitled to join the company on the basis of an agreement with the other members of the company, in accordance with the Articles 3:155 and 3:149 of the Civil Code, which also apply to limited partnerships. Thus, upon the death of a member, his share in the company is not automatically

11 For the full text of the order, see: http://public.mkab.hu/dev/dontesek.nsf/0/ca4f24822207e57cc125853c005c9530/$FILE/3366_2020%20AB%20order.pdf (Last accessed: 25.05. 2021)

transferred to the heir by operation of law. Since the heir does not automatically acquire the company's shares, the Civil Code does not provide for the automatic transfer of the shares. Analysing Article 3:158(1) of the Civil Code, it cannot be stated that this provision restricts the heir's acquired property (company share) and thus the right to property in the constitutional sense. In the case of a person other than the heir, the challenged provision does not constitute a restriction of property already acquired and thus of the right to property." (Abh. [19]-[20])". Accordingly, the Constitutional Court has interpreted Article 3:158 of the Civil Code, and the Constitutional Court did not find a violation of human dignity or of the constitutional protection of property in relation to the petition, which is in line with the subject of the present study.

The Act XCV of 2021 amending Act V of 2013 on the Civil Code (the Amendment Act) affects company law to a relatively large extent. The Amendment Act actually also affects important substantive legal issues, but in certain places it provides detailed rules and clarifies certain terms. The Amendment Act was published in the Hungarian Gazette (Magyar Közlöny). It was submitted to Parliament in May 2021 in the form of a bill *(Bill No. T/16207.)* amending Act V of 2013 on the Civil Code, which contains a relatively detailed General Explanatory Memorandum.

Until 1 July 2021, the situation was that the dissolution of the one-person general partnership and the one-person limited partnership occurred after six months. The legislator's intention was that these companies, which by their very nature could not operate as one-person companies, could only operate with one member for a transitional period, which of course also served legal security purposes.

In this respect, the explanatory memorandum of the Act states that it removes the limitation period of six months and does not link the legal consequence of the dissolution of the company to the failure to comply with this obligation. In the future, in the event of a failure to comply, the company will be subject to a legal supervision measure by the registry court and will only be dissolved if the measure is unsuccessful. Obviously, delay will not go unpunished by the application of the legality supervision procedure, but we all know that the seriousness of dissolution and the legality supervision measure are not comparable, since the *ipso iure* dissolution of a company is done with the claim and legal effect of finality, whereas in the context of a legality supervision procedure, there is still a lot that can be done, including the disclosure that there is a succession dispute between the parties and that the restoration of the legal operation is therefore pending. The room for manoeuvre for the company and its surviving members is therefore much wider in this case.

On the basis of the above, Article 3:152 of the Civil Code, already quoted above, but quoted here for the sake of clarity:

Section 3:152. § [Reduction of the number of members of a partnership to one]

(1) If the number of members of a general partnership drops to one, within six months from that time the partnership shall report to the court of registry the admission of a new member to the partnership, or shall resolve the transformation, merger, dissolution without succession of the partnership.

(2) Until the new member is registered, until the transformation, merger, dissolution without succession is carried out, or failing this until a liquidator is appointed the sole remaining member is entitled to resolve matters falling within the competence of the meeting of members, and shall be regarded as the partnership's executive officer, provided that he is able to meet the requirements pertaining to executive officers.

The importance of the issue is shown by the fact that the number of general partnerships and limited partnerships is still very high, including the forced companies created in the 1990s as well as successful micro-enterprises in many professions, e.g. in the health sector, such as doctors, where it is of course possible that a member may be eliminated at any time, for example due to death, and in such cases the fact that partnerships have got rid of the old legacy of *ipso iure* dissolution can be a great relief.

It is an essential rule of law that these new rules (Article 3:152 and Article 3:158) apply if the six-month period provided for therein has already started on 1 July 2021, but the last day of the period falls on or after the date of entry into force of these provisions. Although there is not yet any significant case law on the provisions in force since 1 July 2021, there is a good chance that these new provisions will lead to a satisfactory resolution of the issue outlined in this paper, which has a very long history and, as we have shown, could in some cases give rise to serious problems.