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CONSEQUENCES OF INVALIDITY OF CONTRACT

In this article, we provide a brief overview of the Civil Law Opinion no 1/2010 of the Supreme Court of Hungary on the consequences of the invalidity of a civil law contract.

The Supreme Court of Hungary issued Civil Law Opinion no 1/2010 on 28 June 2010 on various practical issues concerning the consequences of the invalidity of a civil law contract.

Legal Background

Under the Hungarian Civil Code, unless otherwise provided by law, anybody may plead the invalidity of a void contract without a time limit. No special procedure is required for the establishment of a contract being void.

A challengeable contract shall, in consequence of being challenged, become invalid as of the date on which it was concluded. The aggrieved party and persons with a legitimate interest in challenging a contract may challenge the relevant contract.

Pursuant to the Civil Code, in case of an invalid contract, the original state that existed prior to the conclusion of the contract must be restored ("*in integrum restitutio*"). If the original state that existed prior to the conclusion of the contract cannot be restored, the court declares the contract effective for the period up to the date of judgment. An invalid contract may be declared valid if the cause of invalidity can be eliminated, in particular, by eliminating the excessive benefit in the case of a usurious contract or the blatant discrepancy between the services to be rendered by the parties. In such cases, the court is required to provide for the return of any services that might remain without consideration.

Opinion of the Supreme Court

The general legal consequence attached to the invalidity of a civil law contract is that no right may be grounded on an invalid contract. In other words, the legal aims the parties wish to reach may not be reached lawfully. This is a consequence of invalidity the court is required to apply *ex officio* and the parties may plead without any time limit. In case of a challengeable contract, this general legal consequence may only be applied if the party entitled to challenge the contract successfully challenges the same.



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Under the Civil Code, there is a difference between a void and a challengeable contract. The main difference between the two forms of invalidity is that while a challengeable contract becomes invalid as of the date of conclusion only if it has been successfully challenged, a void contract is invalid as of the date of conclusion *ex lege*. In other words, no special procedure is required to establish that a contract is void. Under consequent judicial practice, the court is required to take notice of the fact that a contract is void.

The court may not apply the consequences of invalidity (restoration of the original state, declaring the contract as valid or declaring the contract as effective) *ex officio*. Such consequences may only be applied at the request of the respective party.

Pleading the void nature of a contract without any time limit only means that the general consequence of invalidity (*i.e.* the fact that no rights may be grounded upon an invalid contract) may be applied without any limit in time, however, does not mean that a claim to restore the original state or to settle accounts may be asserted without a time limit. The latter consequences (*i.e.* restoration of the original state and settling accounts after the contract has been declared valid or effective) may only be applied within the statutory period of limitation and, respectively, the time set for acquiring ownership through adverse possession.

The Supreme Court makes it clear in the Civil Law Opinion that restoration of the original state may only be in kind restoration and that no restoration of the original state may take place if the services rendered under the respective invalid contract are irreversible at the time of claiming back of the asset received. In the court's view, it does not qualify as restoration of the original state if the asset received based on the contract can only be returned by way of paying the monetary equivalent of the said asset.

Claiming back an asset on grounds that the original state should be restored qualifies as a material claim (*rei vindicatio*) which does not lapse, whereas claiming back money based on an invalid contract qualifies as a non-material claim which lapses in five years. In order not to allow space for an unfair situation where one of the parties may claim back the asset and the other may no longer claim back the money, the Supreme Court is of the view that the return of the asset and the money may only take place simultaneously. In other words, only that party may claim back the service due to him who is able and willing to return the service he has received.



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In case either the original state may be restored or the invalid contract may be declared valid (*i.e.* both of said solutions are available for the court), the court may freely decide which options it wishes to apply. If said two options are available, courts need to examine whether there is a way to declare the contract valid so as to rectify the legal fault of the contract. Upon deciding which option to choose, certain factors must be taken into account, such as the extent of performance up to the date of the judicial proceeding, changes in the parties' circumstances, declarations made by the parties etc. If the court decides to declare a contract valid, the contract becomes valid as of the date of the conclusion of same.

If neither the original state may be restored nor may the contract be declared valid, the court declares the contract effective. This means that an invalid contract becomes valid as of the date of the decision of the court. The court is required to provide for the settlement of accounts, *i.e.* any service left without proper consideration must be settled.

However, there is one rule that prevents the court from making an entirely free decision. Namely, the court may not make a decision to which all of the parties object. In addition, the court is required to make sure that no party will be harmed as a consequence of the decision of the court, in other words, the court must pay attention that no groundless enrichment takes place as a result of the court's decision.

It is worth noting that *bona fide* parties to an invalid contract may not be obliged to pay interest or fee for the use of the relevant asset. If, however, one of the parties to an invalid contract acts in bad faith, that party is obliged to pay interest / usage fee to the other party.

The contents of this article are intended to provide only a general overview of the subject matter. Specialist advice should be sought for specific matters. Queries relating to this article should be addressed to the author at:

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