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**Terminating Insolvencies in Hungary:**

**Potential Problems in the Legislation**

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*Introduction*

**The recent amendment to the Hungarian Insolvency Act (HIA), which entered into force in July 2018, concerned a seemingly minor issue. The newly implemented provision, section 26(3b) of the HIA, makes it possible to terminate the liquidation proceedings even after the delivery of the final decision opening of the liquidation proceedings (but prior to the publication of the liquidation in the Official Gazette) *without the consent of the creditor* who initiated the liquidation proceedings. The precondition of such “extraordinary termination” is that the debtor provides proof of having paid the debt underlying the final court decision opening liquidation to the creditor.**

**Perhaps surprisingly, the story provoked strong responses even in the “mainstream” media. Some have criticised the amendment suggesting that the new provision would deprive the “liquidation proceedings aimed at debt collection” of its efficiency and give the non-performing debtors unfair advantage.**

For my part, I do not share those concerns. It would be difficult to deny that “**liquidation proceedings aimed at debt collection” are an integral part of Hungarian legal practice. Apparently, the legislature has no reason or intention to change this situation. Against this backdrop, the amendment, by enabling “extraordinary termination” where the debtor has paid off the creditor initiating the liquidation proceedings, points in the right direction. On the other hand, the termination of the liquidation proceedings after delivery of the final decision on the opening does not appear to be in full compliance with the system of civil procedural law and therefore courts and parties may face some practical difficulties when applying the new provision.**

***Reasons behind the “Liquidation Proceedings aimed at Debt Collection”***

**Liquidation proceedings aimed at debt collection have become widespread in Hungary in the last few decades. The main characteristic of those proceedings are that a creditor, in order to exercise pressure, initiates liquidation proceedings against his debtor. The debtor, if he wants to avoid being liquidated, has to pay off the sole creditor initiating liquidation proceedings or settle the case. The specific details have changed many times in the past (almost) three decades, but the underlying principle has remained the same: should the debtor fail to dispute an overdue claim *vis-à-vis* the creditor, then the court, at the request of that creditor, establishes the debtor’s insolvency and opens the liquidation proceedings. In effect, liquidation proceedings aimed at debt collection have become a cheap, simple and relatively quick alternative to “ordinary” civil proceedings in the area of uncontested claims.**

**It would be easy to argue that liquidation proceedings aimed at debt collection are contrary to the original objectives of the liquidation proceedings, the latter being the collective distribution of the insolvent debtor’s assets among the creditors according to a ranking order defined by law followed by deregistration of the debtor entity. If so, selective payments to the sole creditor(s) initiating liquidation proceedings, possibly to the detriment of the general body of the creditors, indeed should not be sufficient for the termination of the liquidation proceedings. Ideally, when terminating an already-opened liquidation proceeding, due consideration should be given to the interests of the general body of the creditors; in practical terms, the termination would presuppose a composition agreement binding on the creditors. Indeed, such a solution would better comply with both the collective nature of the liquidation proceedings and the system of civil procedural law.**

**Having said that, legal practice has apparently developed liquidation proceedings aimed at debt collection and we are not aware of any legislative intention to restrict this opportunity in the future. If we accept the existence of the liquidation proceedings aimed at debt collection as part of the legal reality, then it will indeed be a requirement to figure out a way to terminate liquidation proceedings subsequent to the final court ruling opening those proceedings. Namely, without such an “extraordinary termination”, the liquidation proceedings aimed at debt collection could not properly operate: if the debtor pays off the creditor after the final court ruling (rather than going into liquidation), its only motive to do so is to avoid the opening of the liquidation proceedings. Should the debtor be liquidated in spite of the selective payment to the creditor filing for liquidation would such payments not be incentivised at all.**

**Accordingly, even before the recent amendment, the HIA made it possible to terminate the liquidation proceedings after the final decision on opening (but prior to the publication thereof). The precondition for such a termination was, however, that the creditor initiating the liquidation proceedings was ready to withdraw its petition prior to the publication of the liquidation in the official journal. Generally, that was the case if the debtor paid off the creditor initiating the liquidation proceedings or provided collateral acceptable to that creditor.**

***The Problem of the Creditor’s Consent***

**However, the withdrawal by the creditor as a precondition for the termination of the liquidation proceedings has created an imbalanced position to the detriment of the debtor. This was because situations may have arisen where the creditor did not limit itself to collecting the claim underlying the insolvency proceedings but made the withdrawal conditional on some further unrelated performance by the debtor or simply refused to withdraw the petition for liquidation. This was obviously incompatible with the aim of the proceedings: namely, a court order opening liquidation proceedings, due to the non-payment of a specific claim, may not provide the creditor with a blank cheque to enforce its unrelated or even unlawful claims *vis-à-vis* the debtor.**

**Beyond this, the fact that no termination of liquidation proceedings was possible without the consent of the creditor (withdrawal of the petition) resulted in distortion in the proceedings. The reason for this was that the disproportionally strong position of the creditor at the termination of the liquidation proceedings retrospectively restricted the debtor’s room for manoeuvre during prior proceedings. Namely, even if the debtor considered its position as strong in the liquidation proceedings, it may not have wanted to run the risk that the court delivered a judgement opening liquidation. Unless the debtor could avoid actual liquidation by unilaterally paying off the underlying claim, in the event that the court opens liquidation, the potential of an (irreversible) opening judgement represents such an overwhelming risk which incentivises the debtor to prematurely settle the case before the court delivers judgement.**

**In effect, requiring the consent of the creditor to the termination of the liquidation proceedings aimed at debt collection distorted the proceedings and put that creditor into a disproportionately favourable position. On the one hand, the requirement of creditor’s consent incentivised the debtor to prematurely settle even those claims which he considered as unfounded in order to exclude the risk of a potentially irreversible liquidation order. On the other hand, this structure provided the creditor with unjustified extra bargaining power *vis-à-vis* the debtor when trying to enforce unrelated claims.**

**In view of the above, the abolition of the requirement for the creditor’s consent to the “extraordinary termination” of the liquidation proceedings appears to be justified.**

***Concerns and Remarks de lege ferenda***

**The implementation of the new law, however, raises some concerns. The most important one finds its roots in the fact that the “extraordinary termination” of liquidation proceedings by definition occurs after the delivery (but before the publication) of the opening judgment. It is difficult to see how the court can be satisfied about the full performance of the underlying claim by the debtor in that late phase of the proceedings, particularly if the creditor disputes that the payment has indeed been fully performed. In this context, it would be worth considering setting up a special court deposit regime enabling the debtor to perform his monetary obligation directly by depositing the sums at stake before the court. By doing so, the problem of evidencing performance would be overcome very simply.**