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**Insolvency Proceedings in Hungary: the New “Reorganisation” Model**

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*Introduction*

Since the COVID-19 pandemic, to mitigate its effect on the economy, the Hungarian Government has taken several measures, passed several pieces of emergency legislation and introduced new legal tools to help – among others –local businesses. As part of the emergency legislation, the Hungarian Government introduced a new type of insolvency procedure, designed to be the main alternative to the existing traditional bankruptcy procedure (in Hungarian: “*csődeljárás*”). This new procedure serves as a new potential tool for businesses to handle and survive an insolvency situation, to restore their solvency and to continue the business operations.

The new reorganisation procedure is relatively fresh and has not been widely used in the practice so far.[[1]](#footnote-1) It was introduced in April 2021 and already has been revised. Currently, it is regulated under Government Decree 345/2021 (VI 18)[[2]](#footnote-2) (the “Decree”) (and also – with the same wording – in Act XCIX of 2021).[[3]](#footnote-3) According to the relevant laws, businesses may file for the new procedure until 31 December 2022, and the ongoing procedures might be concluded thereafter. Interestingly, the Hungarian legislator – as a result of a long preparation, conciliation and legislation process – has also accepted the new law[[4]](#footnote-4) implementing the preventive restructuring frameworks,[[5]](#footnote-5) and that law will enter into force on 1 July 2022. It seems that both the new reorganisation procedure and the new restructuring procedure will be available for businesses facing insolvency in Q3/Q4 of 2022. We note that these procedures are very similar with respect to their purpose.

*A New Type of Insolvency Procedure*

The reorganisation procedure is generally a new type of formalized insolvency procedure in Hungary in addition to the existing bankruptcy (in Hungarian: “*csődeljárás*”) and liquidation (in Hungarian: “*felszámolási eljárás*”) proceedings. In terms of its purpose, the reorganisation procedure is similar to the existing bankruptcy proceeding, as the main purpose is to reorganize a debtor company in financial difficulty (insolvent or threatened with insolvency) in order to restore its solvency and continue its operations. A significant difference, however, compared to bankruptcy procedure is that a non-successful reorganisation does not automatically result in a liquidation procedure.

*Opening of a Reorganisation Procedure*

The procedure is available for local businesses and the Budapest Metropolitan Court has exclusive jurisdiction to conduct them. The procedure may be opened on the basis of the decision of the shareholders.[[6]](#footnote-6) The main condition precedent to this procedure is that the given company needs to be in “imminent insolvency” in order to be eligible for the procedure. The definition of “imminent insolvency”[[7]](#footnote-7) in the Decree is identical to the definition of this term[[8]](#footnote-8) under the Hungarian Bankruptcy Act.[[9]](#footnote-9) Its advantage is that there is extensive judicial precedent relating to the interpretation of the term “imminent insolvency”. However, this solution excludes businesses from the procedure that are remotely threatened with insolvency. The management of the debtor business has also an important task, it is required to prepare a preliminary reorganisation plan that requires – due to the usual timing issues – careful but appropriate planning and considerations within a short time.

The Decree contains an exhaustive list relating to those events where the procedure cannot be opened. These cases include the traditional grounds for exclusion, e.g. in the event of other insolvency (bankruptcy, liquidation), proceedings related to the termination of the company (dissolution, involuntary de-registration) or other reorganisation procedure is in progress but also a somewhat unusual event, i.e. if the company failed to publish and deposit its financial statement within 3 business years before the commencement of the reorganisation procedure.

Similar to bankruptcy and liquidation, the assistance of an external expert is mandatory in case of a reorganisation procedure. As per the law, exclusively, the National Reorganisation Non-profit LLC is entitled to act as such expert. Although the law does not explicitly mention this, the mandatory involvement of the National Reorganisation Non-profit LLC, the relatively high fees of the expert and the possibility to obtain certain state aids suggest that this type of procedure was designed for large-scale companies.

*Private or Public Procedure?*

The law provides for two types of reorganisation procedure: private and public. It is quite a new element in Hungarian insolvency law that the procedure may also be conducted in a private way.

The private procedure shows similarities to contractual restructuring. The main difference between the two types is that the private procedure only applies to creditors involved in the reorganisation, so the debtor has the chance to select certain creditors for the purpose of the reorganisation. The court resolution ordering the procedure will not be published and only the creditors involved may access the information relating to the procedure.

In case of a public procedure, slightly different rules apply. First of all, the company name is supplemented by the suffix “under reorganization” (“r. a.”) in the company registry that is publicly available. In a public reorganization procedure, with the exceptions set forth in the relevant Decree, the rules on bankruptcy procedure apply *mutatis mutandis*.

*Further Significant Elements*

As in a traditional bankruptcy procedure, the debtor business is entitled to a payment holiday (moratorium) in case of a reorganisation procedure. The duration of this moratorium in private procedures is 90 days, which can be extended by an additional 60 days, while in public procedures it is 170 days (which cannot be extended). In case of a private procedure, the moratorium will not be published in the publicly available Company Gazette. It is also important that this moratorium does not give protection against the claims of non-involved creditors.

Generally, the debtor business remains in the position to dispose of its assets and conduct daily operations.[[10]](#footnote-10) However, the reorganisation expert also has certain powers during the procedure: for example, from the start of the moratorium, the company's executive officer may only make declarations and commitments relating to the company’s business activities that go beyond the scope of usual business operations with the prior written approval of the expert.

Another main step during the procedure is the negotiation and acceptance of the reorganisation plan. The reorganisation plan may contain any measure to restore the financial stability of the company, including the reorganisation of its operations, changing its ownership structure and state funding. In the reorganisation plan, the creditor (including the state, the local government and any tax collection entity) may offer payment relief to the company, or even entirely waive its claim. Relating to the approval of the reorganisation plan, in the private procedure there are no specific minimum thresholds, instead the approval of all involved creditors are required for a successful procedure. This means that a cramdown is not possible relating to dissenting creditors. In case of a public procedure, 75% support from the creditors is required.

It is interesting that, in contrast to the bankruptcy proceedings, in reorganisation proceedings there are no separate creditor classes. Theoretically, it may result in that the unsecured creditors vote down the secured creditors, which is rather unusual in Hungarian insolvency law, but the secured creditors are still protected by a minimum 75% recovery threshold that is set out in the regulation. The reorganisation plan is approved by the court on the basis of the positive opinion of the reorganisation expert.

The reorganisation procedure also offers protection from *ipso facto* clauses under certain conditions. The debtor company enjoys legal protection against *ipso facto* contractual clauses which, allow the company's contractual partners to suspend, terminate or unilaterally amend the contract, if the company has a permanent legal relationship with its contractual partner, on the basis of which the contractual partner carries out a continuous supply of goods or services for the operations of the company.

The new procedure enables the use of temporary or new financing for the implementation of the reorganisation plan. Lenders that provide such financing will be involved in the procedure. Temporary or new financing may be financial or through asset support, or a loan structure that is more favourable than market conditions, which is necessary for the operations of the debtor during the reorganisation procedure or for the implementation of the reorganisation plan. It is interesting why only below-market loan structures could fall into this category, given that businesses at risk of insolvency typically have difficulty to access financing even on market standard terms. Temporary or new financing is protected by law, i.e., if the reorganization expert has approved it and the financing is included in a reorganization plan approved by the court, it may be challenged only based on circumstances of which the reorganization expert could not have been aware.

*The Hungarian Pre-pack: the “Separation”*

The pre-pack is a well-known technique in the UK that has impressed continental legislatures. In Hungary, there is no pre-pack available, but a new method introduced by the reorganisation Decree shows some similarities. This procedure is the so-called “separation” and it might be particularly important in cases when the usual asset selling and distribution methods are not the most efficient way to save the business or part of the business of the debtor company.

The separation procedure is available solely in public reorganisations and for businesses that qualify as strategically important business entities.[[11]](#footnote-11) The Government is entitled to specify in a decree whether a business entity is entitled to the separation procedure. The separation procedure is also available in traditional liquidation procedures.

The separation takes place in such a way that the part of the debtor's business that is capable of carrying on its business is separated as an independent corporateentity. The shares of this NewCo are sold during the reorganization procedure and the incoming funds are used as part of the reorganization plan of the debtor. The essence of the separation is that NewCo is created through a separation from the debtor's company, and the debtor provides the assets (including contracts and rights) to it, so that it ensures the continuous operation of the economic activity or business.

The question arises as to the limits of the separation whether a given economic activity can be sold and what to extent in view of the purpose of the new procedure, namely, to ensure the continuous operation of the debtor entity, unlike in a liquidation procedure, which closes the debtor's business and terminates the company. Obviously, the ability of a company to continue its operations becomes at least questionable if the healthy and viable economic activity is separated and sold. It is not entirely clear what is the purpose of the legislation with this procedure: to rescue the reorganized company or to carve out and rescue the “business” affected by the separation. The latter solution, although it may be very appropriate in the case of liquidation-type insolvency procedures, shows a little contrast with the declared purpose of the reorganization procedure.[[12]](#footnote-12)

*Summary*

To our knowledge, very few (if any) reorganization procedures were conducted in the country – of course, the number of private procedures is unknown -; however, the next wave of the pandemic is imminent, the price of energy is skyrocketing, and there are other economic and market factors, which can easily result in more reorganisations. While many details are yet to be worked out in the course of the actual implementation of the reorganisation proceedings, we are of the view that this new (and possibly temporary) mechanism may turn out to be a useful tool in some cases.

1. Therefore, no actual practice and very limited number of published analyses is available currently. [↑](#footnote-ref-1)
2. Only available in Hungarian: *“a vállalkozások reorganizációjáról, valamint a csődeljárásról és a felszámolási eljárásról szóló 1991. évi XLIX. törvény, továbbá a cégnyilvánosságról, a bírósági cégeljárásról és a végelszámolásról szóló 2006. évi V. törvény eltérő alkalmazásáról szóló 345/2021. (VI. 18.) Korm. rendelet”.* [↑](#footnote-ref-2)
3. Only available in Hungarian: *“a veszélyhelyzettel összefüggő átmeneti szabályokról szóló 2021. évi XCIX. törvény”.* [↑](#footnote-ref-3)
4. Only available in Hungarian: *“a szerkezetátalakításról és egyes törvények jogharmonizációs célú módosításáról szóló 2021. évi LXIV törvény”.* [↑](#footnote-ref-4)
5. Directive (Eu) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency). [↑](#footnote-ref-5)
6. There is no “duty to file” or similar obligation, the decision whether to initiate a reorganization procedure remains in the discretion of the shareholders of the relevant company. [↑](#footnote-ref-6)
7. Section 2 of the Decree. [↑](#footnote-ref-7)
8. According to Section 33/A (3) of the Hungarian Bankruptcy Act, imminent insolvency is “*a situation is considered to carry potential danger of insolvency as of the day when the executives of the business entity were able to foresee, or had reasonable grounds to foresee as is expected from a person in such positions, that the business entity will not be able to satisfy its liabilities when due*”. [↑](#footnote-ref-8)
9. Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings. [↑](#footnote-ref-9)
10. “Debtor-in-possession” type insolvency procedure. [↑](#footnote-ref-10)
11. However, it is not prohibited for the debtors and creditors to agree on “pre-pack-like” terms in the reorganization plan in a private procedure as well. The only difference, in such case, the general company law rules are applied and not the rules set out in the Decree. See Csőke Andrea, Reorganizáció és egyebek – megjegyzések a 345/2021. (VI. 18.) Korm. rendelethez, Wolters Kluwer, Fizetésképtelenségi Jog 2021/1., [79]. [↑](#footnote-ref-11)
12. Reorganization Decree Section 1 Article 3 [↑](#footnote-ref-12)