

# MARKET WITHIN THE MARKET

## LIQUIDATORS IN HUNGARY WITH SPECIAL REGARD TO COUNCIL REGULATION (EC) NO 1346/2000 OF 29 MAY 2000 ON INSOLVENCY PROCEEDINGS

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### 1. Introduction

In 2012 the Hungarian government decided to conclude an overall reform considering the registry of liquidators<sup>1</sup> via opening the application for special operating licence. Under provisions of Act XLIX of 1991 [hereinafter: *Insolvency Act 1991.*], in Hungary, only those economic organizations (company form which is either limited liability company or private limited company) can operate as liquidators who obtained the operating licence. The licence permits the licensee to serve for seven years. As Hungary acts in line with its obligations deriving from the EU membership, by virtue of the 123/2006 EC directive it is mandatory to open up the market of liquidation proceedings. The relevant EC directive considers the conduct of liquidation proceedings by the professionals as a special service which can be carried out at European level, hence, falls under the principle of free movement of services.

It is without doubt that the conclusion of liquidations is loaded with legal shortcomings in Hungary.<sup>2</sup> That malfunctioning could be traced back to the inappropriate regulation of the legal institution and the solidified practice of the actors in liquidation, let it be the court ordering the liquidation, the debtor gone insolvent, the creditors unwilling to support any reorganization or the liquidator whose *status* is just as unclear in the Hungarian regulation as the creditors' expectation in a standard liquidation for any return on their claims against the debtor. The liquidator can be considered both as actor of the market of liquidations and as member of the juridical system.

On the one hand, the Hungarian practice has had its difficulties since 1991, which is the national level of the issue, on the other hand, since Hungary joined the European Union in 2004 one cannot ignore the European narrative of liquidations. That circumstance, however, is not even represented in the Insolvency Act 1991, while in other European Member states the effects of both international and European legal influences could be traced in acts by the incorporation of new provisions.<sup>3</sup>

With the creation of the internal market and later on the single market of the European Union, the lack of regulation of insolvency proceedings by general terms was a shortcoming

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<sup>1</sup> 114/2006 (V.12.) Government Decree.

<sup>2</sup> Korrupciós kockázatok a felszámolási eljárásokban, a Transparency International Magyarország riportja. [Corruption Related Risks in the Liquidation Proceedings in Hungary. A Report by Transparency International Magyarország], available at: [http://www.transparency.hu \[uploads/docs/tanulm2\\_level1.pdf\]](http://www.transparency.hu/uploads/docs/tanulm2_level1.pdf) (22 December 2013).

<sup>3</sup> Wessels, Bob: Current developments towards international insolvencies in Europe. *International Insolvency Review*, Vol. 13. (2004) 45.



until 1995.<sup>4</sup> In 1989, the then Member States articulated their wish for a unified and universal legal framework of insolvency proceedings that culminated in the Convention of Insolvency Proceedings signed in 1995<sup>5</sup> That Convention, as a multilateral agreement, applied for all Member States of the European Union.<sup>6</sup> This was the first time that the so-called main insolvency proceeding appeared at community level while secondary proceedings remained available at national level. Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings<sup>7</sup> replaced the Convention in 2002. As a result of German and Finish initiatives, the newly accepted Regulation 2000 set up rules about the governing jurisdiction of insolvency proceedings for an undertaking having its center of main interest in the territory of the Community. It also clarified the range of judgments that were „delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings”<sup>8</sup> and last but not least, some judgments and provisions of applicable law became recognized. The direct effect enables Regulation 2000 to operate both in the old Member States and the newly joining Member States such as Hungary, without any further legislative measures and this way it aims at proving the European way of creditors’ bargain theory in its own way.<sup>9</sup> By 2011, in Hungary, only a few number of cases<sup>10</sup> were brought before the Metropolitan Court of Budapest that is the authorized *fora* of both main and secondary proceedings of European seated undertakings in Hungary.<sup>11</sup>

At the European level the most important issues of insolvency proceedings are the assessment over the center of main interest,<sup>12</sup> the dual system of the main and the secondary proceedings and the most dominant of all is the satisfaction of creditors’ claims. Some of these fault lines are present in Hungary too,<sup>13</sup> however, due to the fact that only a few European main or secondary cases reached the Court in Hungary and these mostly cover the qualification of the C.O.M.I.,<sup>14</sup> for the purpose of present paper, it is better to observe those shortcomings that derive from the unsettled legal situation of liquidators in Hungary, and how it could affect the outcome of a European main or secondary insolvency proceeding. The author of present paper is, therefore, eager to provide a glimpse on the Hungarian market of the conclusion of liquidations within the single market of European insolvency.

<sup>4</sup> Report on the Convention of Insolvency Proceedings by Miguel Virgos and Etienne Schmitt, The Council of the European Union, Brussels, 3 May 1996, 6500/96, 6. (Hereinafter: *Virgos-Schmitt Report*), available at: <http://aei.pitt.edu/952/> (22 December 2013).

<sup>5</sup> Cf. Virgos-Schmitt Report, 7.

<sup>6</sup> Omar, Paul J.: Genesis of the European Initiative in Insolvency Law. *International Insolvency Review*, Vol.12. (2003), 161.

<sup>7</sup> Published in the Official Journal of the European Communities 30.6.2000, L 160/1. (hereinafter *Regulation 2000*).

<sup>8</sup> Regulation 2000 Recital (6).

<sup>9</sup> de Weijs, Rolf J.: Harmonisation of European insolvency law and the need to tackle two common problems: common pool and anticommons. *International Insolvency Review*, Vol. 21. (2012), 69.

<sup>10</sup> Juhász, László: *A magyar fizetésképtelenségi jog kézikönyve* [Handbook of the Hungarian Insolvency Law]. Novotni Alapítvány, Budapest, 2012, 52-54. and 58.

<sup>11</sup> Insolvency Act 1991 Section 6 paragraph 2.

<sup>12</sup> Hereinafter: C.O.M.I.

<sup>13</sup> Csöke, Andrea: *A határokon átnyúló fizetésképtelenségi eljárások* [Insolvency Proceedings Having Cross-Border Effects]. HVG-ORAC, Budapest, 2008. 97.

<sup>14</sup> Cf. ÍH.2008.122. and ÍH2009.139. (only in Hungarian).

## 2. Liquidators at Work in Regulation 2000 and Insolvency Act 1991

However Recital (6) of Regulation 2000 confirms competence to the European Union only in matters of jurisdiction, recognition of judgments and recognition of certain substantial, member states-law it is also important to note that by observing the abovementioned Regulation 2000 more accurately, there are provisions mostly covering substantial regulation relative for liquidators.<sup>15</sup> More interestingly it is even Article 4 paragraph 2 (c) which declares that „*respective (...) powers of the liquidator*” must be determined by „*the law of the State of opening the proceedings.*”

Still, Regulation 2000 empowers European liquidators to operate broadly in case they are nominated as third person for insolvent undertakings to „*administer or liquidate assets*” and even „*supervise the affairs*” of economically failed organizations.<sup>16</sup>

The substantial power of liquidators confirmed by Regulation 2000 can be divided into two major groups based on the dynamics of the insolvency proceeding: (i) *the first category of rights* covers the competence of the liquidator of the so-called main proceeding by which he/she is authorized to „request the opening of secondary proceedings”<sup>17</sup> in another state different from the one where the main proceeding takes place and by requesting the proceeding, the court of the secondary proceeding is automatically obliged to order the opening of the secondary proceeding which proceeding must be a liquidation proceeding. Such substantial competence of the liquidator reaches far beyond the general aims of Regulation 2000 and creates doubts regarding its conformity with national regulation, especially in Hungary. The (ii) *other group of powers* confirmed upon the liquidator of the main proceeding is typically limiting power against the actors of the secondary proceeding, let it be the liquidator of the secondary proceeding, the court or even the creditors.

### *Right to request for secondary proceeding*

According to Recital (19) in line with Article 27 and Article 29 (a), liquidator of the main proceeding may request for a secondary proceeding. In such case, the secondary proceeding results in the lack of the examination of the debtor’s insolvency; by legal terms, the secondary proceeding will be an automatically ordered proceeding which must be liquidation<sup>18</sup>, hence, the termination of the debtor and the realization of the debtor’s assets. Insolvency Act 1991 is not in line with Regulation 2000 which deficiency may result in misleading legal practice in Hungary.<sup>19</sup> At first, Section 22 of Insolvency Act 1991 defines the list of parties who may file for liquidation proceeding against the debtor in Hungary, these are: in case the liquidation proceeding was preceded by bankruptcy proceeding that failed to result in composition, the court will ex officio order the liquidation, then the

<sup>15</sup> In terms of Regulation 2000 relative for the Hungarian cases, under liquidators the present publication understands *bankruptcy trustee and liquidator* in line with the informative summary of Regulation 2000 incorporating previous modifications, the consolidated text is available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32000R1346:en:NOT> (22 December 2013).

<sup>16</sup> Regulation 2000 Article 2 (a).

<sup>17</sup> Regulation 2000 Recital (19).

<sup>18</sup> Regulation 2000 Article 27.

<sup>19</sup> For the aims of the present publication, the comparative analysis of Regulation 2000 and Insolvency Act 1991 solely covers liquidation proceeding out of the enumerated insolvency proceedings in Annex A of Regulation 2000.

debtor, the creditor or a third party being responsible for the voluntary dissolution of the debtor may request, while the court of registration may dispose of the claim, and in case of criminal charges, the criminal court may request. In the abovementioned enumeration there is a clear lack of the liquidator of the main insolvency proceeding from a different jurisdiction.

It is the incoherent codification that resulted in the obscurity of the Insolvency Act 1991. In some provisions it has implemented the rules of Regulation 2000,<sup>20</sup> while in other cases ex. enumeration of entities empowered to request for liquidation or exceptions are completely misleading. Besides the fact that such a shortcoming is a legislation malfunctioning and raises questions about the clarity and transparency of legal matters, it also gives ground to the loopholes of the legal system. Does this shortcoming about the failed enumeration mean that in the Hungarian legal system the Court can rule out the order on the request for the secondary proceeding?<sup>21</sup> The answer should be negative; however, from the viewpoint of a liquidator without Hungarian origin, such question might occur before filing the request at the Metropolitan Court of Budapest and raising costs for the procedure.<sup>22</sup>

One can also ask the question about the independence of the Court ordering the secondary proceeding. According to Section 26 of Insolvency Act 1991, the court „shall investigate the insolvency of the debtor” which means that the court must substantially observe the debtor’s position. Such a conflict must be resolved; however, in principle in course of a potential conflict between European law and national law, the former shall prevail. In that case the Hungarian legislator is in default since Insolvency Act 1991 should have covered the exceptional cases where European provisions prevail over national regulation.

The issue about Article 27 of Regulation 2000 is twofold. The second part is more related to the dichotomy of main and secondary proceedings that are launched within the European Union.<sup>23</sup> It could, though, happen that while the main proceeding aims at the reorganization of the undertaking concerned so that the continuation of economic activity is of high probability, secondary proceeding against the same economic organization in a different country cannot be other than a liquidation which proceeding is – by definition – the mean of termination of activities and existence of the undertaking.<sup>24</sup> Legal practice shows that the liquidators of main proceeding try to avoid the dichotomy of proceedings. Evaluation of the dichotomy of proceedings shows that it may result rather in disadvantages than advantages.<sup>25</sup>

<sup>20</sup> Insolvency Act 1991 Section 6 paragraph (2), Section 6/B.

<sup>21</sup> However Article 26 of Regulation 2000 describes public policy principle applicable for only the recognition of opened insolvency proceedings and judgements of insolvency proceedings, by secondary interpretation the main proceeding’s liquidator’s request may be ruled out since the liquidator’s appointment could be founded on a judgement and his request for the secondary proceeding presupposes an ongoing main proceeding that the court must implicitly acknowledge while deciding upon the request for secondary procedure.

<sup>22</sup> Cf. *Korrupciós kockázatok...*[Corruption Related Risks...].

<sup>23</sup> Moss QC, Gabriel: The Impact of EU Regulation on UK Insolvency Proceedings. *International Insolvency Review*, Vol.11. (2002) 142.

<sup>24</sup> Csőke: *op.cit.* 210-211.

<sup>25</sup> Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) No 1346/2000 of May 2000 on

While in Recital (19) the Regulation 2000 describes the liquidator's right to request for secondary proceeding as a necessary measure in case the debtor's assets are of great complexity. However the secondary proceeding as liquidation may threaten the interest of creditors in the Member State of the secondary proceeding.<sup>26</sup> In addition to that shortcoming, it must be mentioned that by virtue of Article 18 paragraph (1) of Regulation 2000, the liquidator of the main proceeding even „in particular remove[s] the debtor's assets from the territory of the Member State” in which the secondary proceeding takes place. For such a power Article 5 and 7 uphold limitations that may be a relief only for creditors having *in rem* rights.<sup>27</sup> That limitation, however, has not yet brought case law based explanation at the European level; hence, mostly jurisprudential modeling is available.<sup>28</sup>

The right to the removal of assets leads to the second category of rights conferred to liquidators of main (and second) proceedings which are the rights of disposition.

### *Rights of disposition*

The right of disposition is a collective category mostly covering Article 18 of Regulation 2000. According to Article 18 paragraph 1, the liquidator of the main proceeding „may exercise all the powers conferred on him by the law of the State of the opening of proceedings in another Member State.” The full empowerment of the liquidator of the main proceeding is not without exceptions. In case there is a secondary, territorial proceeding in that other Member State or preservation measures were taken in line with a filed request for an insolvency (mostly liquidation or bankruptcy proceedings in Hungary) proceeding, the liquidator of the main proceeding is restricted. Article 18, therefore, underlines that in the European framework of insolvency proceedings; the liquidators of the main and the secondary proceeding cannot be identical.<sup>29</sup>

In Hungary, the only preservation measure that the Court may order is the appointment of a trustee in liquidation.<sup>30</sup> There used to be an interpretative loophole between the regulation of Insolvency Act 1991 and Regulation 2000. In Article 38 of Regulation 2000, it is clearly regulated what kind of powers are conferred to the temporary administrator by European standards are.<sup>31</sup> He/she may “request any measures to secure and preserve any of the debtor's assets situated in another Member State.” Whilst in Hungary, the necessary modification of the Insolvency Act 1991 was delivered by introducing Section 24/A in the Act only in 2011.<sup>32</sup> By standards of Section 24/A, the trustee, however, only has a limited and rather informative role. The trustee may only check the books and other documents of the debtor and may be authorized to enter the working areas used by the debtor. In case of potential infringements, the trustee is not authorized to file any claim, by strict

insolvency proceedings, Strasbourg, 12.12.2012. COM(2012) 743 Final, 13-14., available at: [http://ec.europa.eu/justice/civil/files/insolvency-report\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency-report_en.pdf) (22 December 2013).

<sup>26</sup> Csóke: *op.cit.* 212.

<sup>27</sup> Moss: *op.cit.* 146.

<sup>28</sup> Smart, Philip: Rights *in rem*, Article 5 and the EC Insolvency Regulation: An English Perspective. *International Insolvency Review*, Vol. 15. (2006) 18.

<sup>29</sup> Cf. also Article 31 of Regulation 2000.

<sup>30</sup> Csóke: *op.cit.* 181.

<sup>31</sup> By observing Hungarian regulation of the trustee in liquidation and the European regulation of the temporary administrator, they can be considered as correspondents of each other.

<sup>32</sup> *Act CXCVII of 2011* introduced the modification, that act affected the act on Business Associations and the act on Public Company Information, Company Registration and Winding-up Proceedings.

interpretation of Section 24/A paragraph 7, he/she may only *inform* the court any may only *warn* the debtor for taking measures in order to avoid violation of law.

There is a hypothetical possibility of coordinated procedure for entities dealing with liquidation in the Member States of the European Union offered by the Hungarian insolvency regulation, indeed. Since 114/2006 (V.12.) Government decree offers the chance for European seated economic organization to gain licence in Hungary for the conclusion of liquidation proceedings,<sup>33</sup> the court ordering insolvency may choose a liquidator different from the one offered by the special electronic system, in case, based on the need for special knowledge, it finds derogation necessary.<sup>34</sup> In case of the undertakings having both their C.O.M.I. and establishment in at least two different Member States of the European Union and out of the two States one is Hungary, if they finally become insolvent, a coordinated „European liquidator” with establishment and licence in Hungary as well can operate more effectively.

Paragraph 2 of Article 18 of Regulation 2000 clearly identifies the major fault line between the liquidator of the main proceeding and the one of the secondary proceeding. While the liquidator of the main proceeding can directly operate in accordance with the laws of the State of the secondary proceeding, the liquidator of the secondary proceeding may „claim through the courts.” Out of court there is a limited power conferred to the liquidator of the secondary proceeding, while the power to bring any action „to set aside which is in the interest of the creditors” remains at the national level of the secondary proceeding.<sup>35</sup> In case the liquidator of the main proceeding removes assets of the debtor from the State of the secondary proceeding, the liquidator of the secondary proceeding only remains with virtual power to exercise.

It is clear that the liquidator of the main proceeding is empowered to conduct his/her activity in any Member State, the liquidator of the secondary proceeding, actually, may only assist. Unfortunately, the Hungarian Insolvency Act 1991 does not cover the details of such a cohabitation of liquidators, while Regulation 2000 remains silent on the precise cooperation of the two, separate liquidators. What is absolutely clear is that the liquidator of the main proceeding has two further controlling powers over the secondary proceeding. According to Article 31 paragraph 3, the liquidator of the main proceeding may submit proposals to the liquidator of the secondary proceeding which proposals can even be instructions. The provision explicitly confirms the hierarchy of the two separate liquidators which is missingly not regulated in the Hungarian Insolvency Act 1991, either. Considering the dynamics of a liquidation, it is without surprise that the liquidator of the main proceeding also has his/her final words upon the closure of the secondary proceeding according to Article 34 paragraph 1.

Considering the lack of coherently and transparently implemented regulation relative for the liquidators of both the main and secondary proceedings, that situation widens the loopholes in the practice of the Hungarian insolvency proceedings. Inaccurate regulation of the conduct of liquidators may result in corruption risks.<sup>36</sup> On top of the the abovementioned disadvantages the most critical aspect of a disfunctioning liquidation may

<sup>33</sup> 114/2006 (V.12.) Government decree Article 2 paragraph 2 (b).

<sup>34</sup> Insolvency Act 1991 Section 27/A paragraph 1.

<sup>35</sup> Csőke: *op.cit.* 184.

<sup>36</sup> Cf. *Korrupciós kockázatok...* [Corruption Related Risks...].

be added, namely, the harm of the creditors' interests.<sup>37</sup> Let it be the main or the secondary proceeding, in case rules and powers are not clearly conferred upon participants of a liquidation, creditors may lose their chance to gain satisfaction at the end of procedure.

### 3. Concluding Remarks

Conclusion of insolvency proceedings, more accurately, liquidations, by liquidators of both the main and the secondary proceedings raises questions in Hungary. Besides the fact that there is a clear governmental dedication about the renewal of the market of the conclusion of insolvency proceedings, Insolvency Act 1991 still remains effective with its shortcomings. However, Hungary is member of the European Union since 1 May 2004, Insolvency Act 1991 has not caught up with the European legal flow. The incoherent regulation may result in conflict of national and European law. Liquidators coming from Member States different from Hungary may face serious difficulties.

The most comprehensive solution for the abovementioned shortcomings would be the drafting and passing of a new insolvency act that should be in full conformity with the European regulation and the demands of the single market.

<sup>37</sup> Csőke, Andrea: Problems Related to Collective Insolvency Proceedings Having Cross-Border Effects – From the Perspective of Hungary. *International Insolvency Review*, Vol. 13. (2004) 84.