PÁZMÁNY PÉTER CATHOLIC UNIVERSITY
DOCTORAL SCHOOL OF LAW AND POLITICAL SCIENCES

# *Entitled, but not credited*
# The position of creditors in liquidation

*Doctoral thesis*

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# CONTENT

# I. SUMMARY OF THE RESEARCH

The research objective of the thesis " Entitled, but not credited - The position of creditors in liquidation " is to examine the position of creditors in the context of liquidation proceedings of companies.

The main objective of this thesis is to demonstrate whether the current insolvency regime under the Bankruptcy Act and related legislation provides sufficient protection for creditors in the event of the debtor's insolvency, and what steps creditors can take to strengthen their position in the event of the debtor company's insolvency. The paper does not deal with insolvency or so-called pre-insolvency proceedings other than winding-up proceedings (e.g. restructuring proceedings), and special liquidation regimes are outside the scope of the analysis: in particular, insolvency of credit institutions and other financial services providers.

Government decrees in various emergency situations since 2020 have intervened in the insolvency law system in an ad hoc manner. Bearing in mind that these amendments and temporary rules are also part of the applicable law, we have decided not to analyse them in detail, as they may expire after 1-2 weeks: most of the rules created will probably never be part of the current or future new Bankruptcy Act regime.

Most of the authors who have published on the topic of this thesis deal with liquidation and the collaterals related to liquidation in their daily practice, and the thesis was primarily intended to present practical findings that can be used in practice. In addition to the relevant literature, the author's own practice and a detailed analysis of the relevant court decisions are emphasised in the research.[1] The descriptive method is used to present the sources of law and the related judicial practice. Given that many of the amendments addressed an acute problem, for example the service of a payment notification, the paper will also touch on the stages of historical development as necessary.

As it appears in the main text, the Bankruptcy Act has been amended so many times over the past three decades that, if it existed, its mother would not recognize it. The drafting of a new

[1] More than 140 cases are presented in the paper and more than 350 academic publications are cited.

Bankruptcy Act has been on the agenda for decades without exaggeration, so this thesis is perhaps one of the few works that provide an overview analysis of the existing Bankruptcy Act, and thus one of the tasks to be accomplished was to identify the points of intervention in the existing Bankruptcy Act that, if amended, would make the liquidation process more predictable for creditors.

# II. STRUCTURE OF THE THESIS

## Chapter I

In Chapter I of the thesis, we outlined the topic and objectives of the thesis and gave a general overview of the purpose and role of insolvency law in the legal system.

## Chapter II

In Chapter II we introduced the two main actors in the subject of this thesis: the creditor and the debtor, and the link between them, the claim. In the course of this presentation, we have sought to emphasise that the concept of creditor in insolvency law is not the same as the concept of creditor in civil law, since in the insolvency law system, a creditor is someone who has filed and registered a claim.

In relation to the debtor, we have briefly discussed its legal form and the importance of the centre of main interest (COMI) in relation to jurisdictional and applicable law issues. In the context of the provisions of the Resolution Directive, it was mentioned that the compensation mechanism may also make a public actor other than the debtor liable for the payment of debts, if the debtor is subject to a resolution mechanism instead of liquidation.

In the context of claims, the different stages of the claim were discussed, highlighting a case from the United States of America, where the possibility of a company's subsequent claimants - statistically predicted - to enforce their claims was the main issue. We also dealt with claims not included in the liquidation estate due to wrongful payment.

Different laws and procedures give different names to someone who makes a claim against a debtor. Perhaps it is not the name that matters most in this context, but the content. And the assertion of claims can be at various stages - and yet, in all cases, we are talking about a claim.

Andrea Csőke gives the following example of a debtor in liquidation: "*This claim - may still only be in the state of a claim, i.e. the liquidator may establish from the books that the debtor*

*has a claim against another; - it is possible that the debtor represented by the liquidator has already called on the debtor to perform or the debtor has admitted the claim; - it is possible that the liquidator has already taken the first steps towards recovery from the debtor who has not voluntarily complied (applied for an order for payment, filed a claim) or may have a non-appealable decision, - it is possible that a final decision has already been given, or - enforcement proceedings have already been initiated against the debtor. Of course, there may be intermediate steps, but the point is that the debtor has a claim against another* debtor *which has a monetary value.*" [2]

A person who wrongly makes a payment to a debtor is not a true creditor.[3] It was previously known in case law that a payment made in error is not included in the debtor's assets subject to liquidation,[4] and the amendment to the Bankruptcy Act[5] in force since 1 January 2012 codified this point.

After clarifying the basics, the next chapter analyse how the insolvency of a debtor can be established in the event of the initiation of winding-up proceedings and under what conditions the court will order the liquidation of the debtor.

[2] CSŐKE Andrea: Követelés átadása a felszámolás végén. Céghírnők, 2016/10. 9.
[3] Bankruptcy Act § 28 (4)
[4] BH2015.168.
[5] Act XLIX of 1991 on Bankruptcy and Winding-up Proceedings, Act IV of 2006 on Companies, Act V of 2006 on Company Registration, Court Proceedings and Winding-up and Act CXCVII of 2011 amending certain related Acts,Act 31 (3) para.

## Chapter III

In Chapter III, we have listed the grounds for insolvency regulated by Section 27 (2) of the Bankruptcy Act. In examining the grounds for insolvency, we have also sought to illustrate the deliberative work of the courts, the inconsistencies found in law and practice, and the good practices to be followed.

The chapter started with a detailed overview of the most frequently encountered in practice, in terms of number, of the "contractual" insolvency ground, analysing in separate subsections the different elements of the rule. To the extent necessary, the historical background has been covered, since this rule has changed most in response to the needs arising in practice. For example, we have dealt with the problems that have arisen around the creditor's payment notice: the non-service of the payment notice and the related fiction of service. We have tried to demonstrate the strict system which orders the debtor to be liquidated only if all the circumstances are fully met.

In the context of a recognised debt, we have pointed out that there is an express legal declaration that the debtor considers the debt to be justified. In this context, the provisions of the Civil Code are undoubtedly applicable. 3:99 and the case law of the courts, since the relevant provision of the law deals with the assignability of claims recognised by the debtor. Since the declaration must be express, there can be no significant doubt as to its assessment.[6] In our view, the 'recognised' turn of phrase is not of much importance and could be omitted from the law - indeed, we would venture to suggest that it would be preferable to do so - since, as László Juhász notes,[7] the debtor can also challenge the recognised claim and in this case, in practice, the only recourse is litigation, where the parties can clarify whether the debtor actually owes the creditor, the framework of the liquidation procedure being inappropriate.

In the next part of the chapter, the insolvency ground related to enforceable judgments is examined, showing that although the possibility of contestation in this case is the most

[6] DARAI Péter: Elismert és vitatott követelés a felszámolási eljárásban I. Céghírnök, 2011/10. 12-14.
[7] JUHÁSZ László: A magyar fizetésképtelenségi jog kézikönyve I-II. HVG-ORAC, Budapest, 2019. 493.

limited, the procedure is not significantly faster than in the case of the application discussed in the previous subsection.

In the discussion of insolvency under Section 27 (2) (c) of the Bankruptcy Act, we addressed the problems related to aid contracts, highlighting that the rules do not currently provide adequate guarantees for companies that are obliged to repay aid. This should be changed in the future, not forgetting the objectives of the rules on the protection of public funds.

The analysis of the insolvency grounds regulated by Section 27 (2) (d)-(f) of the Bankruptcy Act was carried out by researching the available case law with a weighting according to their frequency of occurrence.

The analysis of the insolvency grounds concluded that the interests of creditors are hampered primarily by the slowness of the proceedings, despite the fact that the scope of investigation for insolvency grounds, which are predominantly cash-flow oriented, is rather narrow. We identified the most striking problem in the examination of insolvency based on point (b): given that the debtor's debt is already supported by a final and binding judgment, in most cases it takes several months - up to 6-8 months - to obtain a liquidation order, whereas, on a correct interpretation of the legal provisions, the debtor would only avoid liquidation if it had complied with the judgment.

In the next section, we look at ways in which creditors can prepare in advance for a better creditor position in the event of a liquidation, or ensure that the debtor does not reduce the liquidation assets, or in some way increase the scope of the liquidation assets - and thereby achieve a more secure return at the end of the liquidation, when the assets are distributed.

## Chapter IV

In the most heterogeneous chapter of the thesis, we discussed ways to strengthen the credit position of a creditor that is not very favourable at first sight. In the introduction, we gave an outline overview of contractual collateral and discussed fiduciary collateral used in the economy because of its flexibility and relative cheapness, and described the regulatory changes associated with the new Civil Code. Since these forms of security were absent from the new Civil Code for several years, since the legislator applied the sanction of nullity to them, the analysis was based primarily on the case law of the old Civil Code.

After the security in rem, we looked at personal security, such as sureties and guarantees. Here we have analysed the different situations that arise depending on whether the creditor, the debtor or the guarantor is subject to winding-up proceedings.

It does not constitute security in the traditional sense, but - precisely because of the slow turnaround time mentioned above - we see considerable potential in initiating enforcement proceedings if an enforceable instrument is available. In cases where the debtor does not have a main creditor (typically a bank) with a lien on assets or other equivalent - possibly stronger - security, this solution is the most likely to improve the creditor's chances of recovery, as it will transform the debtor from a category d or f creditor into a category b (49/D) creditor for a few months and a minimum financial investment.

The chapter also dealt with the appointment of a provisional administrator, which is a realistic scenario, especially in the case of high creditor claims and debtors with real assets. According to Section 24/A of the Bankruptcy Act, a provisional administrator may be appointed from the liquidation register to supervise the debtor's management. This has been possible since Hungary's accession to the European Union.[8] The appointment is subject to the condition that the creditor establishes the likelihood of the claim being jeopardised, proves the creation, amount and maturity of the claim by means of a public or private document with full probative value and pays the related fees. Note that a similar rule exists in the Enforcement

[8] BREHÓSZKI Márta: A felszámolási eljárást érintő legfontosabb változások. Közjegyzők Közlönye, 2006/10. 3-5.

Act,[9] which allows, as a precautionary measure, the seizure of property or the securing of a pecuniary claim when an enforceable instrument cannot yet be issued but the party is likely to be in danger of losing the satisfaction of the claim.[10]

At the end of this chapter, we have analysed at length the procedures that lead to an increase in the liquidation estate, either by introducing a new responsible person, the declaration of the liability of the managing director or the return of assets previously taken from the debtor to the liquidation estate. Section 40 of the Bankruptcy Act. (1)(a) of Article 40(1) of the Bankruptcy Act, the plaintiff must therefore prove that four conjunctive conditions are fulfilled in order for the action to succeed: (i) the impugned contract must fall within the statutory period, (ii) the plaintiff must prove that the contract has resulted in a reduction of the debtor's assets, (iii) that the debtor's intention in entering into the contract was to avoid creditors, (iv) and bad faith on the part of the contracting party, which exists where the contracting party knew or should have known of the debtor's intention to avoid creditors.[11]

According to a previous decision of the Budapest Court of Appeal, the purpose of the enactment of Section 63/A of the Bankruptcy Act was to create the liability of former members of the debtor who divested their shares in the company in order to avoid the liability of the members.[12] In practice, we are aware of several cases, even in the recent past, where plaintiffs have successfully asserted a claim,[13] but such is the focus of both legal

[9] The Budapest Court of Appeal's decision No.3.Pkf.25.996/2022/3. was in line with this: ORDER TO PROVIDE FINANCIAL SECURITY I. The obligation to provide financial security under the Bankruptcy Act and the order to provide security under Chapter X of the Bankruptcy Act serve the same purpose: the former is to secure the creditor's claims, the latter is to secure the claim of the applicant for enforcement. In order to avoid duplication of the legal instrument, the special rules of the Bankruptcy Act should be applied to the securing of creditors' claims as opposed to the general rules of the Bankruptcy Act on protective measures. II. Financial collateral is not in itself a claim, but only a security for creditors' claims. In the absence of a claim, even if it were applicable, the general condition for the ordering of an enforcement order would not apply, irrespective of the fact that an enforcement order has been issued.

[10] Article 185 of the Act on the Enforcement of Judgments in Civil and Commercial Matters If an enforceable instrument cannot yet be issued pursuant to Article 13 in order to satisfy the claim, but the applicant for enforcement has established that the subsequent satisfaction of the claim is likely to be jeopardised, the court shall, at the request of the applicant for enforcement, order it as a protective measure:
(a) the provision of the financial claim, or
b) the closure of the specified thing.

[11] Metropolitan Court of Appeal Gf.40.284/2023/9.

[12] Metropolitan Court of Appeal 12. Gf. 40.162/2012/6.

[13] E.g. Metropolitan Court of Appeal Gf.40014/2022/6 - Note that the plaintiff had already won at first instance, the appeal was limited to the reduced litigation costs.

representatives and creditors' managers on litigation under section 33/A of the Bankruptcy Act[14] that it is rarely raised as an option.

As regards the procedures leading to the breakthrough of limited liability, we have pointed out that in our view the two-stage procedure of the Hungarian Bankruptcy Act, based on declaratory and adjudicatory proceedings, does not sufficiently support creditors, mainly due to the length of the procedure. In particular, we have highlighted that the abolition of the time limit for bringing an adjudication action has made the provision on the unity of the former managing director and the consolidation of the proceedings difficult to apply in practice. Our suggestion in this regard was that the dual structure should be reviewed, either by imposing a detention analogous to that of the sole member of the partnership or of the law firm, or by introducing a non-litigation procedure for this purpose, given that in the detention proceedings the former officer has essentially no defence - thus rendering the proceedings themselves meaningless.

In the next section, we have analysed the chances of a liquidation asset that has been confirmed under the provisions of this chapter - or that has been declared without them - starting with a distribution of the liquidation assets, and the expected return on investment. Furthermore, whether it is realistic for the parties to agree on a settlement other than the one provided for by law, we will take an example from the United States of America, where it is possible to reach a settlement even if the creditor classes object, if it is otherwise in the interests of the creditors. Although this solution is only applicable in bankruptcy proceedings, its lessons could serve as a model for liquidation, and would not be unprecedented - one need only think of the compensation mechanism of the resolution directive, which is also mentioned in this paper.

[14] MOHAI Máté: A vezető tisztségviselők felelősségének hitelezővédelmi aspektusairól. Gazdaság és Jog, 2016/1. 10-14.; CSEHI Zoltán: A vezető tisztségviselő polgári jogi felelősségének alapjai és irányai az új Polgári Törvénykönyv alapján. In: Csehi, Zoltán; Szabó, Marianna (Szerk.) A vezető tisztségviselő felelőssége. Budapest, Complex, 2015. 9-50.

## Chapter V

In Chapter V, we have shown that it is possible to divide the liquidation assets if the creditors can reach a consensus, failing which the statutory methodology should be followed. Prior to the presentation of the relevant rules of the Act, we have provided a foreign example of the options available where a group of creditors justifiably wishes to deviate from the satisfaction methodology offered by the Act.

Following the description of the simplified liquidation, the substantive rules on the distribution of assets are outlined. We did not go into detail on the issue that has been a problem in practice for decades: what constitutes liquidation costs. Although this does have an impact on the position of creditors, since the liquidation costs are the first item in the order of satisfaction, excluding secured creditors, it is likely that a discussion of liquidation costs would take up a PhD thesis.

Thus, we have mainly provided a brief outline overview of the distribution of assets; the problems of registering as a creditor and confirming a creditor's claim have been analysed in earlier chapters of this thesis.

Finally, and interestingly, we have mentioned a European Court of Justice decision dealing with the right of recovery of state aid where the state aid continues to be granted to another economic entity: showing that, in very exceptional cases, even in the event of the liquidation and thus the dissolution of the debtor, all pre-existing creditor rights and claims are not always extinguished.

## III. BRIEF SUMMARY OF THE SCIENTIFIC RESULTS AND THEIR POTENTIAL APPLICATIONS

In this paper, we have tried to present the liquidation process through the eyes of creditors. The average creditor is probably the most innocent party in the process, yet he will bear most of the consequences of the winding-up proceedings.

The domestic legal literature has been debating the creation of a new bankruptcy law for decades, but the announcements that have popped up from time to time have not yet turned into a new law. In our view, the new law is not far off, and the main aim of this paper is to shed light on the problems that the new law and the practice it will shape will have to address. In our view, the basic theses of the liquidation procedure, such as who qualifies as a creditor and what constitutes a claim, do not need to be substantially modified.

It would be desirable, however, to have a change of terminology, at least in terms of doctrinal clarity, so that we can be sure that when we talk about the opening of liquidation, we mean publication in the Official Gazette or the initiation of a liquidation proceedings by a creditor against a debtor.

The emergence of electronic procedures and the mandatory use of electronic communication methods due to related legislation are all opportunities that offer the possibility to speed up liquidation procedures substantially. Electronic procedures have removed a major uncertainty factor, namely service of process, but have not led to any significant speed-up. It is outdated to consider the 60-day time limit available to the courts as a so-called incentive time limit, since the legislator has a purpose in setting a time limit in a piece of legislation. It is in the interest of both creditors and debtors that either the declaration of insolvency or the rejection of the application is made as quickly as possible.

A frequent criticism - perhaps not without reason - is the practice of courts in relation to the order for liquidation, where it is questionable whether it is really necessary to give the parties a wide opportunity to make a statement, even several times, or whether the application and

the response to it should already provide the courts with sufficient information to assess insolvency.

The rules of the liquidation procedure cannot be treated in isolation, as they intersect with the rules of both contract and property law at several points, just think of the securities, the invalidity of contracts and many other reasons.

Although there are apparently many opportunities for creditors to strengthen their creditor position, either before, during and sometimes even after liquidation, in the hope of a more certain return, it must be seen that being a creditor is primarily fraught with uncertainties. Uncertain returns, uncertain timing.

# IV. PUBLICATIONS RELATED TO THE WORK

1. Kovács Krisztián: Szellemi alkotások kényszerértékesíthetősége. In: Pogácsás Anett (Szerk.): „Szellemi alkotások az ember szolgálatában”: Professzor Dr. Tattay Levente tiszteletére szervezett emlékkonferencia tanulmánykötete. Budapest, Pázmány Press, 2022.

2. Kovács Krisztián: A magyar fizetésképtelenségi jog története a rendszerváltástól napjainkig. In: Bándi Gyula (Szerk.): A sokoldalúság okán: Doktorandusz tanulmányok a Pázmány jogászképzésének 25. tanévében. Budapest, Pázmány Press, 2020.

3. Kovács Krisztián: Felszámolás vagy végrehajtás pénzkövetelés érvényesítése érdekében. Executio, 2019/3.

4. Kovács Krisztián: Fennmaradó követelések a felszámolási eljárás után. In: Koltay András – Darák Péter (Szerk.): Ad Astra Per Aspera: Ünnepi kötet Solt Pál 80. születésnapja alkalmából. Budapest, Pázmány Press, 2017.

5. Kovács Krisztián: Cramdown in U.S. Bankruptcy Law: Lessons for Hungary. In: Csehi Zoltán (Szerk.): Magyar Kereskedelmi Jogi Évkönyv. Budapest, Magyar Közlöny Lap- és Könyvkiadó, 2017.

6. Kovács Krisztián: Írásbeli forma az új Ptk.-ban. Polgári Jog, 2016/2.

7. Kovács Krisztián: A tulajdonjog védelme Magyarországon és az Európai Emberi Jogi Bíróság magyar vonatkozású ügyeiben. In: Pogácsás Anett – Szilágyi Pál – Láncos Petra – Ádány Tamás (Szerk.): Értékek mentén rendet tartani. Budapest, Pázmány Press, 2015.

8. Kovács Krisztián: Az utolsó szó jogán - búcsú a fiduciárius opciótól. Jogifórum, 2014.

9. Kovács Krisztián: A szintetikus értékpapírosításról. In: Pogácsás Anett – Szilágyi Pál - Ádány Tamás (Szerk.): Varietas Delectat. Budapest, Pázmány Press, 2013.