

Avoidable contracts in the context of liquidation proceedings

Now that the economic downturn is slowly over, still many companies are getting in a situation of insolvency from day to day. When it becomes impossible to rescue the given company, everyone is about the protection of his own interest: some creditors try to conclude separate agreements with the debtor to ensure satisfaction of their claims or they demand advance provision of the services under an already existing contract, whereas the debtor – sometimes via a creditor company influenced by the debtor – tries to remove and conceal its assets. The below provisions about the protection of the creditors' interests may provide effective measures to prevent the debtor from misusing the asymmetric information in its possession in order to discriminate against the majority of its creditors.

I. Contestation of avoidable contracts under the Bankruptcy Act

The creditor and the liquidator (on behalf of the debtor company) is entitled to file for avoidance (to contest) before the court within a 90-day time limit from having gained knowledge of (but within a one-year forfeit deadline from) the publication date of the liquidation order, those contracts (or other commitments) concluded by the debtor within:

- 5 years preceding the date of receipt of the petition by the court for opening liquidation or thereafter, if the contract/commitment intended to conceal the debtor's assets or to defraud creditor(s), and the other party had or should have had knowledge of such intent;
- 2 years preceding the date of receipt of the petition by the court for opening liquidation or thereafter if intended to transfer the debtor's assets or to undertake any commitment for the encumbrance thereon without any compensation, or if the stipulated consideration constitutes unreasonable and extensive benefits to a third party;
- 90 days calculated preceding the date of receipt of the petition by the court for opening liquidation or thereafter if intended to give preference and privileges to any one creditor, such as the amendment of an existing contract to the benefit of a creditor, or to provide financial collateral to a creditor that does not have any (perhaps this last one may be of greatest relevance in the present subject matter).

Subject to a successful contestation, the respective contract is considered invalid.

Moreover, the liquidator can reclaim within the same 90-days time limit as above, any services the debtor provided within a 60-day period preceding the date of receipt of the petition by the court for opening liquidation or thereafter, if it was provided to give preference to any one creditor and if such service is not usually provided under normal circumstances. This reclaim option differs from the last bullet point above in a sense that the particular service can be reclaimed even in the absence of the conclusion of a "new" contract within the 90 days statute of limitation, e.g. when the service preferring one creditor was rendered under a contract preceding such deadline, but the provision of the actual service took place within the referred 60-day period. Prepayment of a debt is, in particular, considered as giving preference or privileges to any one creditor.

Also, the liquidator, if notified of a transaction of the foregoing nature within the said 90-day deadline, shall inform the creditors' committee or the creditors without delay. Creditors shall have the right to contest the contract within 15 days following receipt of such notice.

II. Termination/recession power of the liquidator

The liquidator can terminate with immediate effect contracts concluded by the debtor, or if none of the parties rendered any services, the liquidator may rescind from the contract. The claim of the other party arisen thereupon is to be enforced by reporting it to the liquidator within 40 days from the date when the rescission or termination was communicated (so the claim of the other party will be registered by the liquidator). There are certain types of agreement which cannot be avoided on the basis of the foregoing, such as tenancy agreements of natural persons, contracts concluded with a school or student for the organization of vocational training, employment contracts, loan contracts which are not related to business activities, collective bargaining agreement, etc.

III. Disadvantaged creditors and the creditor's knowledge of insolvency

One can see from the third bullet point and the reclaim right detailed above that this issue is given importance by the law in a way that the right of contestation/reclaiming depends on whether preference/privilege is given to one creditor and this would take place obviously on the detriment of the others, hence placing other creditors in a more disadvantageous position.

As for the creditor's knowledge of insolvency, or more precisely, given the applicable Hungarian legal term, its awareness of "the situation threatening with potential insolvency", it is only relevant if a creditor being majority shareholder in the debtor company willing to create collaterals (pledged assets, floating lien) following the occurrence of the said situation. By law, a situation is

considered to carry the danger of insolvency as of the day when the shareholder was or should have been able to predict that the debtor will not be able to satisfy its liabilities when due. This would basically result in the loss of the creditor's otherwise privileged position as to the security on the collateral created thenceforth. The state of mind issue regarding the insolvency situation may also arise with respect to the liability of the debtor's company officers.

IV. Civil Code fraudulent conveyance and false contract

The Hungarian Civil Code also recognizes the principle of fraudulent conveyance/transfer (Actio Pauliana) and prescribes that a contract by which the base for satisfying a third person's claim has been deprived (entirely or in part) shall have no legal force toward that third person provided that other party acted in bad faith or received a gratuitous advantage from the contract. This is the more general legal avenue comparing to the special rules of the Bankruptcy Act, which can be pursued to attain invalidity of fraudulent contracts. Moreover, the issue of false contract might be of relevance (for instance if it aimed to disguise a fraudulent conveyance), whereby such contract is null and void, and if it is intended to disguise another contract, the contract is to be judged on the basis of the disguised contract.

bpv | JÁDI NÉMETH Attorneys at Law |

H-1051 Budapest, Vörösmarty tér 4. |

Telephone: (+36) 1 429 4000 | Facsimile: (+36) 1 429 4001 |

budapest@bpv-jadi.com | www.bpv-jadi.com

bpv | LEGAL

Brussels – Bucharest – Budapest – Prague – Vienna –
Baden – Bratislava – Mődling
www.bpvlegal.com