

CERHA HEMPEL CEE NEWSLETTER *Hungary*

LEGISLATION IN AN EPIDEMIC EMERGENCY: CHANGES IN INSOLVENCY PROCEDURES

The Amendment to the Insolvency Act adopted in August last year stated that the special rules on the reorganisation of business entities could be regulated by the government in a decree. Then, in an interview with *Világgazdaság*, a business daily, back on 31 March 2021, Finance Minister Mihály Varga also indicated that “bankruptcy and compulsory liquidation procedures will be modified, because their protracted nature and the extremely low rate of recovery are hurting many businesses”. It did not take long for the first batch of new rules to arrive, as three regulations concerning insolvency proceedings were published on 16 April 2021:

- firstly, Government Decree No. 179/2021 (“**Reorganisation Decree**”) introduces a new procedure for what is intended to be a simpler reorganisation of financially distressed companies;
- secondly, Government Decree No. 181/2021 (“**Asset Sales Decree**”) allows liquidators to carve out viable business units from “strategically important companies” in compulsory liquidation and sell them as stand-alone businesses; and
- thirdly, Government Decree No. 180/2021 raises the debt threshold over which creditors can apply for compulsory liquidation (just as it was raised in the first wave of the pandemic); plus new categories have been added to the list of companies that the government can qualify as strategically important (and will be subject to special insolvency rules as a result).

Finally, a bill has been proposed in Parliament on 20 April 2021 with regard to the transposition of the Restructuring Directive (Directive 2019/1023 of the European Parliament and of the Council),

which, if enacted, will also introduce reorganisation restructuring into Hungarian law.

Reorganisation Decree

The decree took effect on 17 April 2021 and will expire only after a few weeks on 23 May 2021. However, as it is proposed in the bill concerning the transposition of the Restructuring Directive that the act based on it will only take effect on 1 July 2022, it is likely that the effect of the Reorganisation Decree will be extended before then.

In line with the above, the purpose of the Reorganisation Decree is not to transpose the forms of restructuring governed by the Restructuring Directive into Hungarian law, although the decree also aims to allow for pre-insolvency reorganisation through a procedure which, if unsuccessful, will not automatically lead to compulsory liquidation (unlike bankruptcy proceedings at present). This may make reorganisation procedures more attractive compared to bankruptcy proceedings.

The reorganisation procedure is available to Hungarian-based companies that are threatened by imminent insolvency.

The procedure can be public or non-public. In the case of the non-public version of the procedure, companies will be fundamentally in control of which of their creditors they wish invite to participate in the reorganisation procedure, and they will have to reach an agreement with all of their participating creditors in order to successfully complete the reorganisation.

There are two main safeguards that are designed to protect debtors during the procedure:

- a payment moratorium of 90 days (that can be extended for another 60 days) against participating creditors, and

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- a moratorium that prohibits business partners that supply services necessary for a debtor's continued operations from terminating or modifying their contracts or suspending their service supplies.

A reorganisation expert, which can only be the government-owned liquidator entity (Nemzeti Reorganizációs Nonprofit Kft.), must also participate in the procedure. The reorganisation expert will give a preliminary opinion on whether the debtor is suitable for completing a reorganisation procedure in the first place. A court will only implement the moratorium if the outcome of the reorganisation expert's assessment is positive. Similarly, the court will only approve a reorganisation plan agreed with creditors if the reorganisation expert also concurs that it can preserve or restore the company's viability and solvency and complies with the regulations. A company's executive officer may only make declarations concerning the company's assets with the reorganisation expert's prior written approval.

The decree intends to increase the appeal of the procedure for creditors by stating that

- a court-approved agreement will qualify as the debtor's recognition of its debt and enable creditors to seek direct enforcement,
- they receive certain benefits if they apply for the debtor's compulsory liquidation, and
- creditors that provide temporary or new financing in connection with the reorganisation (with better conditions than the market conditions) will have priority status if a compulsory liquidation is ordered within a year, and their claims will receive the same treatment as liquidation costs.

Public reorganisation procedures will be subject to the rules applicable to bankruptcy procedures,

but with the deviations specified in the Reorganisation Decree. An agreement in a public reorganisation procedure can be validly reached if it receives 60% or more of the creditors' votes, where no creditor may receive less than 60% of the principal amount of its claim.

There have been positive reactions to the new rules in the market, welcoming the ability to have a more efficient and flexible reorganisation process. However, fears have also been expressed that the mandatory participation of the government's reorganisation expert gives extensive leverage for the government to intervene in the operation of private companies that are in a difficult financial situation. Some have also raised concerns about whether such rules should be included in an Act of Parliament rather than a government decree.

Asset Sales Decree

The decree states that in the compulsory liquidation of a strategically important company, a collection of assets that can viably operate as a stand-alone business unit can be carved out of the company and sold by the liquidator. (The government can categorise a business as a strategically important company if it is engaged in an activity with strategic importance for the national economy. This category includes a host of activities under the relevant rules, such as national security, public utility, telecommunications, transportation and national public service activities.)

The liquidator must sell the company that was spun off from the original company within two years, and it must operate the spinoff company until the sale. Such a spinoff requires the consent of the creditors holding 75% of high-priority (secured) claims.

The sale will be done at current market value, as determined by an independent expert. The part of the purchase price that can be paid to chargees will reflect the ratio of the value of the charged

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assets contributed to the spinoff company to the registered capital. Within such amount, the part of the purchase price that can be paid to a particular chargee will reflect the ratio that the given charged asset represents in the part of the registered capital that is assigned to all of the charged assets contributed to the spinoff company. Since assets are contributed to the spinoff company at book value rather than at market value, this may have a negative impact on payments made on the basis of charges.

Other changes

Government Decree 180/2021 once again raised the threshold, from HUF 200,000 to HUF 400,000, over which a creditor can apply for the compulsory liquidation of a debtor on the basis of principal debts owed under a contract or a final and binding court judgment. Additionally, the Decree has further increased the scope of the special insolvency rules applicable to strategically important companies: for example, the list now includes all companies in which the government has a shareholding, companies that perform public functions under a statute, and companies that carry out investment or development projects with EU or international funding in excess of HUF 500 million.

For more information:



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