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**Implementing the Recast EIR:**

**Potential Problems in the Hungarian Legislation**

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*Introduction*

Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings[[1]](#footnote-1) has been replaced by Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) on 26 June 2017[[2]](#footnote-2) (“Recast EIR”). The Recast EIR has not revolutionised European insolvency law. Instead, it codified the case law produced by European courts in the last more than one decade and addressed some further issues that emerged since the entry into force of the 2000 EIR. Notwithstanding, the Recast EIR undoubtedly made it necessary to adjust the domestic insolvency regimes on some points.

The Hungarian Parliament adopted some amendments (“Amendments”) to the Hungarian Insolvency Act (“HIA”) in October 2017.[[3]](#footnote-3) The purpose of the new legislation is to harmonise the domestic insolvency framework with the new provisions of the Recast EIR. While, admittedly, the legislative proposal went through significant improvements before adoption, there are still several legislative solutions that should be criticised. In this piece, some of those issues are pointed out.

*Domestic Legislation in Relation to an EU Regulation?*

Article 288 of the TFEU[[4]](#footnote-4) provides that regulations have general application. They shall be binding in their entirety and directly applicable in all member states. The CJEU has addressed the question of direct applicability in several rulings.[[5]](#footnote-5) In the *Variola* case,[[6]](#footnote-6) the CJEU explained that the direct application of a regulation means that its entry into force and its application in favour of or against those subject to it are independent of any measure of reception into national law. By virtue of the obligations arising from the Treaty and assumed on ratification, member states are under a duty not to obstruct the direct applicability inherent in regulations and other rules of Community law. Strict compliance with this obligation is an indispensable condition of simultaneous and uniform application of community regulations throughout the EU. In practical terms, it means that national laws may not reproduce or repeat provisions of EU legislation and any such reproduction would amount to a breach of EU law.[[7]](#footnote-7)

The case law of the CJEU does not completely prevent member states from exercising some legislative powers in relation to EU regulations, however. Although it is true that in the event of difficulty of interpretation the national administration may be led to adopt detailed rules for the application of a Community regulation and at the same time to clarify any doubts raised, it can do so only in so far as it complies with the provisions of Community law and the national authorities cannot issue binding rules of interpretation.[[8]](#footnote-8) The settled case-law suggests that member states may adopt rules for the application of a regulation if they do not obstruct its direct applicability and do not conceal its Community nature, and if they specify that a discretion granted to them by that regulation is being exercised, provided that they adhere to the parameters laid down under it.[[9]](#footnote-9)

In that light, Article 291(1) of the TFEU states that member states shall adopt all measures of national law necessary to implement legally binding Union acts (like regulations). Also, the Recast EIR itself explicitly refers to measures of the domestic legislations being necessary in the context of “implementing” the Recast EIR.[[10]](#footnote-10)

*The Definition of the “Insolvency Practitioner”*

Article 2(5) of the Recast EIR defines the characteristics of the insolvency practitioners. However, those elements of the legal definition bears relevance, mainly, for the EU legislators when listing insolvency practitioners in Annex B of the Recast EIR.[[11]](#footnote-11) Namely, the list provided in Annex B is exhaustive; therefore, only those persons and bodies who are listed in Annex B qualify as insolvency practitioners in the system of the Recast EIR.[[12]](#footnote-12)

In the context of Hungary, Annex B indicates only *“felszámoló”* and *“vagyonfelügyelő”. Felszámoló* (liquidator) refers to the body who is responsible for the collection, realisation and distribution of assets, registering creditors’ claims and operating the debtor’s business on a temporary basis in the course of insolvent liquidation proceedings (“*felszámolás*”). On the other hand, *vagyonfelügyelő* (administrator) supervises the debtor’s activity in the event of solvent liquidation proceedings (*csődeljárás*).

By contrast, the Amendments extend the concept of *felszámoló* (liquidator) in order that it consists also of *“ideiglenes vagyonfelügyelő”* (provisional administrator) and *“rendkívüli vagyonfelügyelő”* (extraordinary administrator). While it is true that those latter persons are appointed from among the list of qualified liquidators, the position of the *ideiglenes vagyonfelügyelő* (provisional administrator) and *rendkívüli vagyonfelügyelő* (extraordinary administrator) is certainly different from that of the *felszámoló* (liquidator) in the system of the HIA. In other words, the Hungarian legislator attempted to bring those categories of insolvency practitioners under the umbrella of the Recast EIR through the back door.

Domestic legislation may not expand the scope of a definition used by an EU instrument. That would be in clear conflict with the requirement of simultaneous and uniform application of Community regulations throughout the EU.[[13]](#footnote-13) Therefore, it is highly questionable if those categories of Hungarian insolvency practitioners not listed in Annex B will qualify as insolvency practitioners in the context of the Recast EIR.

*The Definition of the Debtor*

The Recast EIR applies to insolvency proceedings irrespective of whether the debtor is a natural or legal person.[[14]](#footnote-14) Basically, it is up to the domestic regimes to determine those categories of persons against whom domestic insolvency proceedings may be brought.[[15]](#footnote-15) In other words, the Recast EIR is neutral regarding the personal scope of the domestic insolvency proceedings: As long as national insolvency proceedings meet the condition set by the Recast EIR (primarily listing in Annex A),[[16]](#footnote-16) they fall within the scope of the Recast EIR. Therefore, there are several types of domestic insolvency proceedings dealing with personal insolvency (bankruptcy) falling within the scope of the Recast EIR.[[17]](#footnote-17)

By contrast, in the regime set up by the HIA only organisations (economic operators) rather than private persons may qualify as debtor.[[18]](#footnote-18) That appears to be the explanation why the HIA insists that, in the context of the Recast EIR as well, only organisations may be considered as debtors. The Amendments have not substantially changed that situation.

Thus, the concept of the debtor in the HIA is narrower than it is in the Recast EIR. As long as the HIA applies only for domestic relations, that is in compliance with the Recast EIR. By contrast, in cross-border situations, the narrow concept of the debtor may cause difficulties. Namely, when the definition of “debtor” in the HIA refers to persons whose COMI is situated in another member state, the narrowly formulated concept does not cover those kinds of debtors who are not organisations. Therefore, although the HIA obviously cannot narrow the direct application of the Recast EIR, somewhat different rules will apply for different types of debtors. This is because natural persons who are not covered by the HIA may only rely on the Recast EIR, while those debtors who are organisations, and consequently are subject to the HIA, may also refer to the latter statute. Such parallel rules may not be in compliance with the requirement of uniform application of EU law.

*The Definition of “Establishment”*

Article 2(10) of the Recast EIR provides for a legal definition of the concept of establishment by stating that it means any place of operations where a debtor carries out or has carried out in the 3-month period prior to the request to open main insolvency proceedings a non-transitory economic activity with human means and assets.

The definition used by the Amendments refers, on the one hand, to the definition provided by the Recast EIR. On the other hand, the Amendments specify the concept of the establishment by stating that “‘Hungarian establishment’ shall mean any Hungarian place of operations provided for in point (10) of Article 2 of Regulation 2015/848/EU *where the qualification as establishment under the Act on the Rules of Taxation, the Act on Corporate Tax and Dividend Tax, the Act on Value Added Tax or international treaties on taxation may also be a proper basis for establishing the place of operations* [emphasis added]”.

A provision of the domestic law providing for a binding interpretation of the EU law appears to be in clear conflict with the law of the Union.[[19]](#footnote-19) The concept of establishment in the Recast EIR is to be interpreted autonomously.[[20]](#footnote-20) The autonomous interpretation is justified by the community nature of the regulation and the uniform application throughout the EU. Therefore, the legal definition provided by the Amendments seems to be incompatible with EU law.

*Provisional or Protective Measures in “Synthetic” Secondary Proceedings*

One of the substantive novelties in the Recast EIR is that, in order to avoid the opening of secondary insolvency proceedings, the insolvency practitioner in the main insolvency proceedings may give a unilateral undertaking in respect of the assets located in the member state in which secondary insolvency proceedings could be opened, that when distributing those assets or the proceeds received as a result of their realisation, it will comply with the distribution and priority rights under national law that creditors would have if secondary insolvency proceedings were opened in that member state.[[21]](#footnote-21)

Article 36(9) of the Recast EIR enables local creditors to apply to the courts of the member state in which secondary insolvency proceedings could have been opened in order to require the court to take provisional or protective measures to ensure compliance by the insolvency practitioner with the terms of the undertaking.

The Amendments explicitly determines what kind of measures may be applied by Hungarian courts. Article 6/J(8) of the HIA provides that the Hungarian court may order the foreign insolvency practitioner to provide financial security in the form of cash deposited on an escrow account at the court’s financial administration office.

Although the provision implemented by the Amendments is, *prima facie*, not necessarily incompatible with the Recast EIR, the requirement of a financial deposit may frustrate synthetic secondary proceedings.[[22]](#footnote-22) Local creditors enjoy *in respect of the local assets* the distribution and priority rights under the national law of the synthetic secondary proceedings. Therefore, the measures to ensure compliance with the terms of the undertaking should be limited to the local assets. Providing financial security from the assets belonging to the main proceedings to the creditors of the (synthetic) secondary proceedings would “overprotect” the local creditors who already enjoy distribution rights under the local insolvency law.

Furthermore, the cash-flow situation of the debtor would rarely enable insolvency practitioners of the main insolvency proceedings to place cash deposit at the Hungarian court (as the court of the synthetic secondary proceedings). Therefore, it would have been advisable for the Hungarian legislator to provide for provisional or protective measures which would concern local assets only and not involve assets from the main insolvency proceedings.

*The Question of Court Approval in the Context of Group Coordination Proceedings*

The Recast EIR empowers a two-thirds majority of the insolvency practitioners appointed in insolvency proceedings in respect of the members of a group to make a choice of court agreement and to place the group coordination proceedings under the exclusive jurisdiction of the agreed court.[[23]](#footnote-23) The Amendments, however, provide that such choice of court agreement may be concluded only with the prior approval of Hungarian courts.[[24]](#footnote-24)

Most probably, the intention of the Hungarian legislator was not to make the choice of court agreement concluded by other insolvency practitioners conditional on the prior approval of the Hungarian court. Rather, they intended to tie the Hungarian insolvency practitioner’s hands so that he could not enter into a choice of court agreement without the approval of the court. However, even this latter interpretation appears to be in conflict with the concept underlying the Recast EIR. The latter explicitly empowered the qualified majority of the insolvency practitioners to determine the court having exclusive jurisdiction; other courts are required to respect that special prorogation of jurisdiction.[[25]](#footnote-25) In other words, the European legislator placed the decision into the hands of the insolvency practitioners. Therefore, the provision of the Amendments requiring prior approval of the Hungarian court to the conclusion of the choice of court agreement by the Hungarian insolvency practitioner seems to contradict the aim of the Recast EIR.

*Conclusion*

As explored in this piece, the adjustment of the HIA to the Recast EIR in the national context may raise several questions. Time will tell if some of the problematic points of the new legislation analysed here will end up being resolved by the case law explaining the Recast EIR.

1. Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings [2000] OJ L160/1. [↑](#footnote-ref-1)
2. Regulation (EU) 2015/848 on insolvency proceedings (recast) [2015] OJ L141/19. [↑](#footnote-ref-2)
3. Act CXXVI of 2017 on amendments to the Insolvency Act with view to legal harmonisation. [↑](#footnote-ref-3)
4. Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47. [↑](#footnote-ref-4)
5. For a concise summary of the relevant case law, see Paul Craig and Gráinne de Búrca, *EU Law Text, Cases and Material* (6th edn) (OUP, 2015), 198 ff. [↑](#footnote-ref-5)
6. Case 34/73 *Fratelli Variola SpA v Amministrazione Italiana delle Finanze* [1973] ECR 981, paragraph 10; see also Case 50/76 *Amsterdam Bulb BV v Produktschap voor Siergewassen* [1977] ECR 137, paragraphs 4-6; C-94/77 *Fratelli Zerbone Snc v Amministrazione delle finanze dello Stato* [1978] ECR 0099, paragraphs 23-25. [↑](#footnote-ref-6)
7. Réka Somssich, “Cohabitation of EU Regulations and National Laws in the Field of Conflict of Laws” (2015/2) *ELTE Law Journal* 69, available at: <http://eltelawjournal.hu/cohabitation-eu-regulations-national-laws-field-conflict-laws/>. [↑](#footnote-ref-7)
8. C-94/77 *Fratelli Zerbone Snc v Amministrazione delle finanze dello Stato* [1978] ECR 0099, paragraph 27. [↑](#footnote-ref-8)
9. Case C‑113/02 *Commission* v *Netherlands* [2004] ECR I‑9707, para 16; C-316/10 *Dankse Svineproducer* ECLI:EU:C:2011:863, paragraph 41. [↑](#footnote-ref-9)
10. E.g. Recitals (21), (34) and (64); Articles 24, 27 and 79, Recast EIR. [↑](#footnote-ref-10)
11. Kristin van Zwieten, “Article 2 – Definitions” in Reinhard Bork and Kristin van Zwieten (eds), *Commentary on the European Insolvency Regulation* (OUP, 2016), 103; Peter Mankowski, Michael Müller and Jessica Schmidt, *EuInsVO 2015 Kommentar* (Beck, 2016), 64. [↑](#footnote-ref-11)
12. Gabriel Moss and Tom Smith, “Commentary on Regulation 134/2000 and Recast Regulation 2015/848 on Insolvency Proceedings” in Gabriel Moss, Ian Fletcher and Stuart Isaacs (eds), *EU Regulation on Insolvency Proceedings* (3rd edn) (OUP, 2016), 436; Christoph Thole, “Art 2 EUInsVO 2015” in Hans-Peter Kirchhof, Rolf Stürner and Horst Eidenmüller (eds), *Münchener Kommentar zur Insolvenzordnung: InsO Band 4: EGInsO, EuInsVO, Länderberichte* (4th edn) (Beck, 2016), 405; Mankowski *et al.*, above note 11, 64. [↑](#footnote-ref-12)
13. cf Case 34/73 Fratelli Variola SpA v Amministrazione Italiana delle Finanze [1973] ECR 981, paragraph 10. [↑](#footnote-ref-13)
14. cf Recital (9), Recast EIR. [↑](#footnote-ref-14)
15. Ibid., Article 7(2)(a). [↑](#footnote-ref-15)
16. Ibid., Article 1. [↑](#footnote-ref-16)
17. e.g. Bankruptcy in England, see Part IX, Insolvency Act 1986. [↑](#footnote-ref-17)
18. § 3(1)(b), HIA. [↑](#footnote-ref-18)
19. C-94/77 *Fratelli Zerbone Snc v Amministrazione delle finanze dello Stato* [1978] ECR 0099, paragraph 27. [↑](#footnote-ref-19)
20. van Zwieten, above note 11, 97-98.; cf Miguel Virgós and Etienne Schmit, *Report on the Convention of Insolvency Proceedings*, paragraph 43. [↑](#footnote-ref-20)
21. Article 36, Recast EIR. The concept has its roots in the English case law: *Re MG Rover Belux SA/NV (in Administration)* [2006] EWCH 1296 (Ch); *Re Collins & Aikman Europe SA* [2006] EWHC 1343 (Ch); *Re Nortel Networks SA* [2009] EWHC 206 (Ch). [↑](#footnote-ref-21)
22. Cf Burkhard Hess *et al*. (eds), *The Implementation of the New Insolvency Regulation* (Nomos, 2017), 137ff. [↑](#footnote-ref-22)
23. Article 66, Recast EIR. [↑](#footnote-ref-23)
24. § 6/P (6), HIA. [↑](#footnote-ref-24)
25. Article 66(3), Recast EIR. [↑](#footnote-ref-25)