

## **KRS: debtors setting lienors with their back against the wall**

**How can lienors proceed to avoid bankruptcy caused by the debtor? According to the expert of Kovács Réti Szegheő Attorneys at Law there are several ways in which debtors in rem can prevent getting into disadvantageous situations owing to omissions by debtors in personam.**

The question arises whether the extent of liability held by the debtor in rem (most often the lienor) will change after the debtor has reached a composition arrangement with its creditors?

Is the lienor liable for the entire original claim, or only for the amount determined by the composition arrangement?

### **The decision of the Curia**

According to Dr Enikő Vida, a recently published Curia decision has consolidated that the liability held by the debtor in rem for the original claim will survive until the debtor in personam has fulfilled its obligations arising from the composition arrangement towards all creditors.

The Curia has justified the decision by stating that from contract law aspect the conclusion of a composition arrangement in itself does not terminate the claim held towards the debtor in personam, it will only exclude enforceability thereof from the remitted part.

The reason is the pending possibility of debtor's liquidation, if so requested by any one of the creditors upon debtor's failure to comply with the composition arrangement, in which case the creditors may entirely enforce, within the initiated liquidation procedure, all of their outstanding claims submitted in the bankruptcy proceedings.

However, no such limit to enforceability is imposed upon the liability of the debtor in rem, until the termination of the liability of the debtor in personam. Therefore the restrictive effect of the composition arrangement concerning the enforceability of overdue receivables held against the debtor in personam does not extend to the debtor in rem, since the debtor in rem is not automatically entitled to this preference arising from the bankruptcy proceeding of the debtor in personam.

### **All the claims may be demanded from the debtor in rem**

Thus, as long as the debt cancellation towards the debtor in personam (the original debtor) resulting from the conclusion of the composition arrangement has not taken effect (due to nonconformity, or incomplete fulfilment of the conditions by that particular point in time), all the claims may be demanded from the debtor in rem.

Consequently, the lien established to guarantee the creditor's claim will remain enforceable – pointed out the expert of Kovács Réti Szegheő Attorneys at Law.

This leads to the possibility that the liquidator may sell the pledged property if the liquidation of the debtor in rem is initiated yet the debtor in personam has failed to fully satisfy the composition arrangement by that particular point in time; and in this event the total proceeds from the pledged



property sold will be primarily used to the satisfaction of the lien holder creditor with view to the amount of the original claim.

### **What can the debtor do?**

How can the debtors in rem proceed, to avoid getting to a detrimental situation due to the omission committed by the debtor in personam? According to the expert of Kovács Réti Szegheő Attorneys at Law, under certain circumstances the debtor in rem too may consider the possibility of initiating bankruptcy proceedings against himself, meaning that by way of an advantageous composition arrangement he too would be allowed to reduce its outstanding debts owed to its creditors.

It is crucially important regarding creditors that the liquidator is only going to register creditors' claims as privileged, in other words the creditor is only going to move forward in the ranking, if in the course of submitting its claims it also submits the proof guaranteeing its privileged satisfaction.

Should the creditor manage to submit its claim within the specified time limit, but fail to submit the documents in proof of his or her privileged satisfaction within the peremptory time limit, it would not lose its creditor's status, or its rank within the satisfaction ranking, nevertheless it would preclude the enforcement of its right to a more favourable ranking- pointed out in conclusion Dr Enikő Vida.