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When Can a Debtor Avoid Insolvency Proceedings by Invoking Set-Off?

In a recent insolvency case, the Hungarian Curia (Supreme Court) provided important guidance on when and how a debtor may invoke set-off to avoid being declared insolvent.

Set-off may be exercised through a unilateral declaration addressed to the creditor—it does not require the creditor's consent. Its legal effect is that it discharges the obligation owed to the creditor, effectively extinguishing both the debtor's and creditor's mutual claims.

In the case at hand, the court had to assess whether a creditor's claim should be deemed disputed if the debtor asserted that it had acquired a counterclaim via assignment and intended to set it off against the creditor's claim.

As a general rule, a debtor can avoid insolvency if it disputed the claim in writing before the creditor issued a payment demand. A valid dispute may include the debtor's prior set-off declaration, which indicates that the debtor no longer acknowledges the creditor's claim and disputes its continued existence.

The situation differs, however, if the debtor wishes to invoke set-off after the deadline for disputing the claim has passed. In such cases, under Section 27 (5) of the Hungarian Bankruptcy Act (Cstv.), the debtor may only rely on set-off under specific circumstances.

These exceptions include scenarios where:

- The counterclaim existed before the creditor's payment notice but became due only after the dispute deadline; or
- The debtor became aware of the existence or maturity of the claim only after the payment notice; or
- The creditor acknowledges the validity of the counterclaim to be set off.

In the case reviewed by the Curia, the debtor argued that it had acquired the counterclaim by assignment and that its legal predecessor had already invoked set-off.

Even in this scenario, the timing of the counterclaim's maturity and the debtor's awareness of it must be assessed. If the debtor was not yet the holder of the counterclaim when it became eligible for set-off, the point of reference must be when the predecessor became aware of the claim's existence or maturity.

Since the debtor submitted only the assignment contract and failed to prove when the predecessor became aware of the counterclaim's maturity, the Curia ordered a retrial.

The key takeaway from the decision is this: a debtor can only avoid insolvency by invoking set-off after receiving a payment notice if the debtor's legal predecessor also became aware of the creditor's claim only after that notice.