

When is the termination of liquidation contract illegal?

The termination of contracts with immediate effect in liquidation proceedings

Under the regulation of Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (hereinafter referred to as “Cstv.”), due to the insolvency of so called economic operators specified therein, a multitude of ex-officio proceedings initiated by debtors or creditors are ongoing. Since the economic operators, in many cases, perform their economic activity across borders – and the territory of the European Union is mainly worth mentioning here – it is good to know when and which law shall govern during liquidation proceedings.

Domestic law or European Union law – Council Regulation No 1346/2000 on insolvency proceedings

Therefore, if it is about cross-border cases, the regulation clearly expresses that – unless otherwise specified- the law of the Member State in which the proceeding was initiated shall be applicable. Lex fori concursus defines every legal effect – both material and procedural - of insolvency proceedings with regard to the persons and legal relations concerned, therefore it regulates all conditions of opening, conduct and closure of insolvency procedures. The courts of the Member States, in whose territory the registered office of the debtor can be found shall have jurisdiction for opening insolvency proceedings.

I would stress the case as an example when the court ordered winding-up proceedings against a Hungarian undertaking and the appointed liquidator terminated the contracts of the debtor, including the contracts with foreign (EU) partners even under other EU jurisdiction with immediate effect in accordance with the provisions of Cstv. or taking the opportunities provided therein. (Of course, the those explained below also apply to the reverse case, when the winding-up proceeding of an undertaking seated in another EU Member state is opened, the foreign liquidator will terminate the contract with its Hungarian partner under the legislation of that other member state.)

When is it not allowed for the liquidator to apply his own domestic right?

I would like to draw the attention to Articles 5-15 of the Regulation, which specifies those exceptions applicable in cross-border legal relations, in which not the national law of the member state in which



the main proceeding is conducted shall be applied. The reason of the exceptions listed as examples below is that the automatic recognition of the legislations of the State which opened the insolvency proceedings may interfere with the rules under which the transactions are carried out in other Member States. Thus to protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provisions had to be made for a number of exceptions to the general rule.

The third parties' rights in rem can be also listed here, such as virtue of a lien or a mortgage in particular but the usufruct right also belongs here. The opening of insolvency proceedings in one Member State shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, movable or immovable assets, which are situated within the territory of another Member State at the time of the opening of the proceedings. In relation to these rights, the law of the other Member State shall govern.

It is important to note the **contracts relating to immovable property**, namely, the effects of insolvency proceedings on a contract conferring the right to acquire or make use of immovable property shall be governed solely by the law of the Member State within the territory of which the immovable property is situated. The situation is similar in respect of **payment systems and financial markets**, where also the effects of insolvency proceedings on the rights and obligations of the parties to payment or settlement systems or to financial markets shall be governed solely by the law of the Member State applicable to that system or market.

Returning to the Hungarian or European Union undertaking, against which insolvency proceeding was opened in the Member State of its registered office, particular attention has to be paid to the contracts, which are defined as exceptions in the Regulation, and it has to be examined whether the liquidator is entitled to terminate them with immediate effect or not. If it is not entitled to do so, the provisions of the contract on the termination must be examined, or if they do not resolve the question then the relevant rules of law of the Member State of the jurisdiction of the contract must be applied, which have proved to be more favourable in several cases than a termination with immediate effect.

What to do when the liquidator has nevertheless terminated the contract contrary to the laws?

It can be experienced sometimes in insolvency practice that the liquidators do not always take the rule of EU regulations into account. Thus, the creditor has to act against the illegitimate measures of the liquidator. He may do so that he may enter objection within 8 days of learning of illegitimate measure,



namely, when he was notified of the termination of the contract before the court ordering the insolvency. If the court, which has to forthwith decide on the objection, finds the objection well-founded, terminates the liquidator's measure and restores the original status or requires the liquidator to take new measures. It may require it in the particular case since the conditions and legal consequences of the termination of the contract prove to be more favourable in many cases on the basis of the legislation relating to the contract than a termination with immediate effect.