DISTRESSED M&A

Hungary

LEXOLOGY
Getting The Deal Through

Consulting editor
Walder Wyss Ltd

Distressed M&A

Consulting editors

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Walder Wyss Ltd

Quick reference guide enabling side-by-side comparison of local insights, including market climate and legal framework; transaction structures and sale process; due diligence and mitigation of related risks; valuation and financing; documentation; regulatory and judicial approvals; dispute resolution; and recent trends.

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MARKET CLIMATE AND LEGAL FRAMEWORK

Market climate

How would you describe the general market climate for distressed M&A transactions in your jurisdiction?

Businesses from a great variety of industry sectors have remained exposed to the negative effects of the covid-19 pandemic, including consumer goods and services, business services, and hospitality and tourism. Companies operating in these business segments continue to be targets for distressed M&A transactions in Hungary in the mid- to long term.

The various forms of government rescue measures offered to owners, as well as the stringent screening of proposed acquisitions by foreign investors into Hungarian companies under temporary rules, are expected to further delay lucrative divestments in the market by opportunistic buyers at favourable valuations.

Accordingly, looking ahead, the general consensus is that distressed M&A deal activity is likely to remain modest in Hungary, with further domestic consolidation possibly generating some deal volume. High-profile collapses mean that potential investors are eager to purchase distressed targets at favourable valuations. Conversely, the sale of non-core operations and the disposal of weakened assets is expected to offer a reasonably stable deal flow in Hungary, as much as those transitions can be considered distressed.

Law stated - 01 September 2021

Legal framework

What legal and regulatory regimes are applicable to distressed M&A transactions in your jurisdiction?

No specific legislation is applicable to distressed M&A transactions in Hungary, but the relevant rules, depending on the actual situation of the targeted assets, are scattered around other general legislation relating to contract law, insolvency proceedings, enforcement and court execution. Accordingly, the main sources of law in this regard are found in Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings , the Act LIII of 1994 on Judicial Enforcement and the Act V of 2013 on the Hungarian Civil Code .

In Hungary, there are two different formal insolvency procedures: the bankruptcy procedure and the liquidation procedure. Both the bankruptcy and the liquidation procedures ultimately aim to satisfy creditors' claims, but the purpose of the bankruptcy procedure is to settle the debts in a mutually acceptable manner between the debtor and the creditors through administered negotiations, while in liquidation procedures the claims of creditors are settled from the administered proceeds of the sale of the debtor's assets.

The main enforcement bodies in the case of formal insolvency proceedings are the courts of companies' registration and the insolvency administrators, whereas in enforcement procedures they are the regular courts, notaries and bailiffs.

Law stated - 01 September 2021

Main risk in distressed M&A transactions

Summarise the main risks to all parties involved.

The main risks in distressed M&A transactions lie with the buyer. The key concern areas are the limited time available to complete deals prudently, no access to reliable due diligence information to fully understand the relevant risks and

the lack of any reasonable warranty protection from sellers.

As long as the transaction progresses out of court under non-administered pre-insolvency private restructuring schemes, the major risk (for all parties involved) is that some creditors' claims get accelerated and the ordering of formal insolvency proceedings combined with the appointment of an administrator for overseeing the distressed assets then automatically interrupts the deal negotiations. Such an administrator would have the right to challenge the debtor’s agreements and transactions or to file a request to reclaim any payments made from the distressed assets in breach of the relevant insolvency laws.

Law stated - 01 September 2021

Director and officer liability and duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of distressed M&A transactions in your jurisdiction?

Officers and directors of a company facing difficulties are already required to proceed very prudently when any threat of insolvency occurs for a company, since from that moment onwards they are under the obligation to observe and safeguard the interests of the creditors, instead of the interests of the debtor company or its shareholders (as during the ordinary course of business). This is particularly delicate because the thin line between the ordinary course of business and the threat of insolvency is not always a clearly identifiable moment, but rather a largely subjective interim period.

The same caution is expected from officers and directors of companies interested in acquiring assets from a company in difficulty, as transactions disregarding creditors' interests may later be challenged or be subject to clawback claims.

In general, there is no obligation for the directors of a company to proactively file for insolvency. If a company is threatened with insolvency, however, its directors must without delay escalate the matter to the shareholders by way of convening a shareholders' meeting to adopt the relevant resolutions on providing supplementary capital contributions or securing the equity situation by other means, or reducing the initial capital. The relevant resolution of the shareholders must then be implemented within three months.

Law stated - 01 September 2021

Differences from non-distressed M&A

In general terms, what are the key legal and practical differences between distressed and non-distressed M&A transactions in your jurisdiction?

The key differences between distressed and non-distressed M&A transactions in Hungary derive from the additional legal and practical considerations around companies already facing or threatened by insolvency. These mainly concern the conducting of due diligence, the availability and quality of warranties and covenants in the transaction agreements, the determination and any subsequent adjustment of the purchase price, the complexity of the deal structure (which often has to involve third-party stakeholders, such as creditors) and protection against unwinding or challenging the transaction post-completion.

As long as a distressed M&A transaction takes place under the auspices of administered insolvency proceedings, the buyer will legally benefit from being able to acquire title clean and free from any third-party claims or encumbrances.

Law stated - 01 September 2021

Timing of transactions

What key considerations should be borne in mind when deciding when to acquire distressed companies or their assets?

Once liquidation proceedings have already commenced, the administrator must be involved in the transaction, which will have to proceed in accordance with the relevant insolvency law requirements, and creditors will also have certain rights to control the proceedings. Other key considerations in deciding when to acquire distressed companies or their assets are pricing differences, the possibility for the business operations to continue in a meaningful course without disrupting residual or potential values, the inevitable differences in deal complexities or the exposure to some regulatory consequences threatening any existing licences of the debtor.

Law stated - 01 September 2021

TRANSACTION STRUCTURES AND SALE PROCESS

Common structures

What sale structures are commonly used for distressed M&A transactions in your jurisdiction? What are the pros and cons of each, and what procedures and legal requirements apply?

Until insolvency proceedings have formally commenced, there are no major differences in structuring distressed and non-distressed transactions in Hungary, and alternative structures can be used (although mergers and loan-to-own transactions are less commonly used in Hungary). Thereafter, however, the distressed M&A transaction must proceed under the administered insolvency proceedings or court and out-of-court enforcement procedures, and, practically, only asset deals are allowed.

Under insolvency proceedings, the assets of the distressed company must be sold through a public sale by way of running a tender or opening an auction. The liquidator is primarily expected to attempt to sell the tangible and intangible assets of the company in whole as a going concern. As insolvency proceedings enjoy priority over enforcement procedures (both court enforcement and out-of-court enforcement), if the latter is pending when insolvency proceedings have been ordered, it will be terminated by virtue of law.

The structure of an enforcement procedure is very much dependent on the type of security established over the assets concerned. The rules of court enforcement procedures require that the assets of the distressed company should be sold by auction. The out-of-court enforcement procedure, which is available if a pledge has been established over the assets concerned, allows for more sale structures, both private and public. Only if the creditor's claims are secured by a share pledge is the share deal possible.

Law stated - 01 September 2021

Packaging and transferring assets

How are assets commonly packaged and transferred in a distressed M&A transaction in your jurisdiction? What procedural, documentary and other requirements apply?

Although acquiring shares in a distressed company is possible in a court enforcement procedure if a pledge over those shares has been established, the asset sale is the most common structure for acquiring a distressed company's assets in the case of both a court enforcement procedure and a liquidation procedure. During the sales procedure, the court bailiff (in a court enforcement procedure) and the administrator (in insolvency proceedings) will be responsible for the

sale. In that context, carve-outs and hive-downs are not possible and pre-pack administration is also not recognised as a formal tool for disposal in Hungary.

When running an out-of-court enforcement procedure, only a few specific requirements must be obeyed, such as that the transfer value of the pledged assets must be comparable with their prevailing market value. Otherwise, the parties concerned enjoy relative freedom to determine the terms of their transaction (ie, the sale of the assets or the sale of the distressed company) already in their security agreements.

Law stated - 01 September 2021

Transfer of liabilities

What legal requirements and practical considerations should be borne in mind regarding the acceptance and transfer of any liabilities attached to the distressed company or assets?

With respect to court enforcement procedures and in asset acquisitions out of formal insolvency proceedings, the restructuring privilege will allow the buyer to acquire title over the assets of the distressed company unencumbered (except for certain rights, such as easements on the land or usufruct) and free from any third-party liabilities.

In the case of out-of-court enforcement procedures, however, the successor liability theory will apply regarding the contracts concluded by the target. Therefore, thorough diligence should be conducted on those contracts, unless the buyer is able to contractually exclude the transfer of any or certain liabilities, which requires the consent of the relevant contracting counterparties.

If the transaction is structured as a share deal, which is very rare in a distressed context in Hungary, the purchaser will acquire the distressed company with all of its known and hidden liabilities.

Law stated - 01 September 2021

Consent and involvement of third parties

What third-party consents are required before completion of a distressed M&A transaction? What are the potential consequences of failure to obtain these consents? In what other ways are third parties commonly involved in the transaction?

Until an enforcement or insolvency procedure has been formally initiated against a distressed company, there is no substantial difference between the consent requirements for a non-distressed and a distressed M&A transaction. Other than the customary consent requirements, such as from shareholders as required under the articles of the company or from any third parties on the basis of the relevant contracts concluded with them, the completion of a distressed M&A transaction would normally require the consent of the creditors (financing institutions). Although the failure to collect such consent will not legally invalidate the transaction per se, it certainly results in a formal breach of the relevant contracts, allowing the creditors concerned to accelerate their loans.

If the distressed asset sale concerns a non-performing loan (NPL) portfolio, the consent of the relevant debtors may also be required under the provisions of the relevant laws. Therefore, the parties to such a distressed M&A transaction should consider certain deal structuring options (such as restructuring through a corporate spin-off of the NPL portfolio into a new company) to avoid the need to obtain the debtors' consent.

After court enforcement procedures or formal insolvency proceedings have commenced, the right to dispose of the assets of the distressed company is reserved for the administrator or court bailiff, respectively, who proceeds under the supervision of the competent courts.

As creditors have the right to form a creditors' committee for the protection of their interests (in particular, to monitor and control the insolvency administrator's activities), the prior consent of the creditors' committee will be required for certain dealings (eg, to forego the application of a tender or auction in the sale process) under the law.

In the course of an out-of-court enforcement procedure, the beneficiary may be vested in the right, on the basis of its contract with the debtor, to transfer the ownership of the assets on behalf of the distressed company and to settle its accounts from the sale proceeds.

Law stated - 01 September 2021

Time frame

How do the time frames and timelines for the various transaction structures differ? Can these be expedited in any way?

If the distressed M&A transaction progresses out of court, there is no major difference from the time frames and timelines applicable for the various transaction structures in a non-distressed M&A context. The involvement of third-party creditors (financing institutions) will, however, require that the parties to the transaction factor in additional time for any arrangements with these third parties (eg, for the negotiation and signing of a standstill agreement).

However, following the initiation of formal insolvency proceedings, the relevant statutory time frames pertaining to certain notification and consultation requirements or waiting periods must be observed by all parties, including the insolvency administrator and the supervising insolvency judge, which will inevitably add to the overall timeline.

With respect to the various transaction structures in Hungary, corporate reorganisation through a spin-off would commonly take at least four to six months, making it an option that does not reflect the prevailing interest of the parties to the transaction to complete their deal quickly.

Law stated - 01 September 2021

Tax treatment

What tax liabilities and related considerations arise in relation to the various structures for distressed M&A transactions in your jurisdiction?

As a general rule, capital gains realised by the transferor may be subject to a corporate income tax rate of 9 per cent. Furthermore, the net sales revenue resulting from an asset deal may have to be included in the base of the local business tax of the transferor. The transferee may incur transfer tax by acquiring title or certain other rights to real estate located in Hungary or to structures not qualifying as real estate located in public areas. In addition, transfer tax may arise for the transferee where assets are acquired in a public auction or, under certain circumstances, by acquiring shares in a real estate-rich entity. Moreover, as a general rule, asset deals are subject to VAT at 27 per cent, but the applicable VAT treatment should be assessed on a case-by-case basis.

However, M&A transactions can be structured in a tax-neutral manner as a corporate reorganisation (eg, spin-offs or demergers), exchange of shares or transfers of business units.

Law stated - 01 September 2021

Auction versus single-buyer sale process

What are the respective pros and cons of auction sales and single-buyer sales? What rules and common practices apply to each?

The obvious advantages of disposals carried out by auction sales or public tender processes, such as the stringent process and the seller's ability to maximise the sale proceeds, are always reserved for distressed companies already subject to formal insolvency proceedings. In these instances, the insolvency administrator is required to set out the conditions for the sale process in accordance with the relevant laws. Accordingly, the sale process in liquidation proceedings is slower and less flexible than in single-buyer sales.

Conversely, proprietary deals in which the buyer has some influence on the sale process and enjoys exclusivity would be more likely to occur in private transactions run out of court. If sellers nevertheless elect to organise an out-of-court auction sale before the commencement of formal insolvency proceedings, they will enjoy relative freedom to determine their preferred private auction rules and procedures.

Law stated - 01 September 2021

DUE DILIGENCE

Key areas

What are the most critical areas of due diligence in a distressed M&A transaction?

Although the preferred scope of the due diligence significantly depends on whether the transaction is structured as a share deal or an asset deal, there are certain areas that require dedicated attention from the buyer in a distressed context, in addition to common diligence review areas (as those can later trigger certain third-party challenges of the transaction, which threaten legal validity):

- if a status of threatening insolvency can already be argued, and if so, the dealing shareholders or the management have taken the relevant preventive steps or conversely have failed to do so;
- any insolvency filings or seizures by company creditors;
- any petitions for insolvency or restructuring;
- any wrongful trading or fraudulent conveyances by the company directors that can be argued;
- any breach of covenants and cross-defaults by the debtor in the context of its agreements with creditors (financial institutions); and
- any demand letters from or acceleration by creditors.

The considerations above are not relevant in transactions concluded under the auspices of a formally administered insolvency, in which the transfer of title will be free and clear of any third-party claims and encumbrances.

If the transaction concerns the transfer of a non-performing loan portfolio, the relevant regulatory requirements will have to be carefully considered as well.

Law stated - 01 September 2021

Searches

What searches of public records should be conducted as part of a due diligence exercise in distressed M&A transactions in your jurisdiction?

In the case of court enforcement and insolvency procedures, conducting searches in the relevant public registers is less important, as the buyer will benefit from acquiring ownership over the assets without encumbrances and third-party rights (except for some easements or usufruct rights).

Potential buyers in out-of-court distressed M&A transactions or out-of-court enforcement procedures in Hungary are advised to check in the following public registers to determine if they contain any pledges or other encumbrances with respect to the targeted assets or their distressed seller: the companies' register for any quota pledges, transfer restrictions, pending court enforcements or any insolvency proceedings already pending; the IP register for any pledges over registered IP; the land register for any mortgage, restraint on alienation and encumbrance or any pending lawsuits or court enforcements freezing the property status; and the collateral register for any account pledges, receivable pledges, fixed asset pledges or share pledges.

In Hungary, each of these registries can be accessed online.

Law stated - 01 September 2021

Contractual protections and risk mitigation

What contractual protections and other strategies are commonly used to mitigate diligence gaps in a distressed M&A transaction?

In transactions completed in the context of court enforcement or insolvency proceedings, only legal title warranty is available from the seller in accordance with the relevant laws. The trade-off is that the same laws ensure that title will transfer free and clear of any encumbrances and third-party claims.

Experience shows that sellers in a distressed M&A transaction taking place out of court are equally not inclined or, in some instances, are simply not able to offer standard warranty protection. The buyer will, therefore, be principally interested in exploring the availability of any of the other special contractual terms aimed at protecting its position in a distressed M&A transaction, such as clawback provisions, requiring the seller to repurchase the transferring assets in the case of termination by the buyer for breach or because of the occurrence of a material adverse effect, or deferred payment terms to secure a reasonable amount available from the purchase price for a reasonable period post-completion to satisfy any valid warranty claims.

The buyer's alternative to contractual terms is taking warranty and indemnity insurance, which is available in distressed sales and can provide the buyer with additional deal comfort and security.

Law stated - 01 September 2021

VALUATION AND FINANCING

Pricing mechanisms and adjustments

What pricing methods, adjustments and protections are commonly used in the valuation of distressed M&A transactions in your jurisdiction and what are the pros and cons of each? How are they used to balance the interests of the parties?

If court enforcement procedure or administered insolvency proceedings have not commenced, all pricing methods, adjustments and protections that are otherwise commonly used on the Hungarian M&A market are equally available in the valuation of a distressed M&A transaction. This most often means a locked-box mechanism in Hungary, which takes overriding precedent over pricing methods such as completion accounts or earn-outs.

In the case of out-of-court enforcement procedures, the prevailing market practice is that a valuator is already appointed by the parties in the relevant security (pledge) agreement, who will then be required to determine the fair

market transfer price for the assets concerned. The security agreement also determines the minimum sale price at a certain percentage of the fair market price and further includes the parties' mutual declaration that they will accept the valuation prepared by their preferred valuator absent manifest error.

In the case of sales completed in court enforcement or administered insolvency proceedings, the fixed purchase price results from the auction sales or public tender processes, in which the administrator is required to collect market valuation with respect to the transferring assets from an expert valuator. The relevant laws will determine the minimum sales prices for the different stages of the relevant procedure as a certain percentage of the market value confirmed by the expert valuator. If the administrator receives tender bids with identical pricing, it will be required under the law to hold a price negotiation with the bidders. The purchase price must be remitted by the buyer to the bank account of the administrator or the court bailiff in full and already ahead of legal completion of the transfer. The buyer assumes no risk in this rigid approach, however, as its title resulting from the transaction is governed by the provision of the relevant laws.

Law stated - 01 September 2021

Fraudulent conveyance

What rules govern fraudulent conveyance of distressed assets sold undervalue in your jurisdiction? How can clawback risks be mitigated when negotiating the deal price?

The insolvency administrator or an aggrieved creditor may challenge any agreements or transactions of the distressed debtor if it is likely to result in the unlawful diminution or elimination of the assets of the debtor. Such a request must be filed with the competent court within 90 calendar days from becoming aware of this transaction, but not later than one year after the commencement of the formal insolvency proceedings. If such a challenge of the agreement or transaction is successful, then the underlying agreement is declared null and void by the court, and restitution of the original status is ordered.

Principally, there are three groups of agreements or transactions under law that may become subject to a challenge by the insolvency administrator or a creditor:

- fraudulent decrease of the debtor’s assets: any agreement or transaction concluded by the debtor within five years prior to filing the request for the commencement of the insolvency proceedings or after the filing of such a request can be successfully challenged if each of the following three conditions can be evidenced: the debtor concluded such an agreement or transaction with the intention of evading its creditors; the contracting counterparty was aware, or should have reasonably been aware, of such an intention of the debtor; and the agreement or transaction resulted in a decrease of the debtor’s overall wealth;
- undervalue transactions: any agreement or transaction concluded by the debtor within two years prior to filing the request for the commencement of insolvency proceedings or after the filing of such a request can be successfully challenged, if the subject of such an agreement or transaction was the sale of the debtor’s assets at significantly below their value to the benefit of the counterparty. Relevant court decisions tend to interpret ‘significantly below their value’ as at least a 40 to 60 per cent price reduction in comparison to the prevailing market price of the asset concerned; and
- preferential treatment of a creditor: any agreement or transaction concluded by the debtor with one of its creditors within 90 calendar days prior to the filing of the request for the commencement of insolvency proceedings or after the filing of such a request can be successfully challenged if such an agreement or transaction has resulted in the preferential treatment of that creditor, particularly the resulting in the amendment of a contract of the debtor to the benefit of a creditor; or granting of a collateral by the debtor to a previously unsecured creditor.

Law stated - 01 September 2021

Financing

What forms of financing are available and commonly used in distressed M&A transactions? How can financing be secured?

Obtaining commercial financing for the purchase of a distressed company is very rare in Hungary and commercial banks operating locally seek to avoid any such risky lending unless the buyer is prepared to offer very significant financial backing. Therefore, any such financing will be largely subject to the success of negotiations with the financier regarding its preferred security from the buyer. In addition, the clawback risk extending to dealings prior to the formal commencement of insolvency proceedings may affect the validity of the financier's collateral (security agreements) concerning the distressed debtor or its assets.

Accordingly, the main form of financing of distressed M&A transactions in Hungary remains financing from equity, which may be combined with shareholder loans. The latter would also be subject to insolvency threats not benefiting from any priority in insolvency.

Law stated - 01 September 2021

Pre-closing funding

What provisions are typically agreed to secure pre-closing funding of distressed businesses and assets?

The preconditions preferred by financiers for the pre-closing funding of distressed assets and businesses are the establishment of new securities in their favour over the relevant assets and the release of any prior existing security. Typically, the buyer and its financier will require that all relevant agreements are executed by the distressed company's existing management prior to their resignation at closing.

As the administered sale of the distressed assets in court enforcement or insolvency proceedings conveys title without encumbrances and third parties' rights, any agreement on the repayment of the outstanding debts is relevant only in the case of an out-of-court enforcement procedure. However, in an administered sale, the financier would require that the advanced payment of the purchase price required in a tender or auction be advanced by the buyer from their own resources before funding.

Law stated - 01 September 2021

DOCUMENTATION

Closing conditions

What closing conditions are commonly agreed in distressed M&A transactions? How do these differ from non-distressed transactions?

In transactions completed in the context of court enforcement or insolvency proceedings in Hungary, the only condition to closing legally allowed is the payment of the purchase price into the relevant bank account of the administrator or the acting court by the buyer.

However, in distressed transactions proceeding out of court one would expect the parties to try to negotiate deal conditions that resemble those for non-distressed transactions. Therefore, the typical closing conditions would be the release of existing securities and the establishment of new ones in favour of the buyer's financier, or the replacement of

existing management. The buyer will also be principally interested in exploring the availability of any of the other special contractual terms aimed at protecting its position in a distressed M&A transaction, such as clawback provisions, requiring the seller to repurchase the transferring assets in the case of termination by the buyer for breach or because of the occurrence of a material adverse effect. However, sellers will firmly try to oppose including such an arrangement in a distressed M&A transaction.

In any case, the collection of the relevant mandatory and often suspensive regulatory consent, such as from the merger control authority or any competent industry regulator, must also be observed by the parties as closing conditions.

Law stated - 01 September 2021

Representations, warranties and indemnities

What representations, warranties and indemnities are commonly given in distressed M&A transactions?

In transactions completed in the context of court enforcement or insolvency proceedings in Hungary, only legal title warranty is available from the seller in accordance with the relevant laws (ie, an 'as is' basis), although this title will transfer free and clear of any encumbrances and third-party claims.

In a distressed M&A transaction running out of court, the buyer would usually try to obtain both fundamental and operational warranties related to the distressed assets, such as the absence of hidden liabilities, encumbrances and status of enforcement.

Law stated - 01 September 2021

Remedies for breach

What remedies are available and commonly sought for breaches of closing conditions, representations, warranties and indemnities in distressed M&A transactions?

As transactions completed in the context of court enforcement or insolvency proceedings in Hungary proceed on an 'as is' basis without any business warranties and indemnities, there is little room for any dispute between the parties. These transactions are irreversible unless any serious fraud or criminal offence affects the administered sale.

The conventional remedies for any breach are equally difficult to seek in distressed M&A transactions running out of court in Hungary, as sellers are usually not so willing, or simply not able, to offer any reliably solid remedy that they can subsequently sustain.

Law stated - 01 September 2021

Insurance

Is warranty and indemnity (W&I) insurance available for distressed M&A transactions in your jurisdiction? If so, what provisions and exclusions are commonly included in W&I policies?

W&I insurance has been reasonably embedded in distressed M&A transaction processes, although it is still not predominantly customary in Hungary. The coverage provided by the relevant insurance policy is most dependent on the warranties ultimately negotiated into the transaction agreement. As those few warranties in distressed deals are usually unsatisfactory for the buyer, insurers are asked to cover synthetic warranties.

Law stated - 01 September 2021

REGULATORY AND JUDICIAL APPROVALS

Merger control

What merger control rules and filing requirements govern the acquisition of distressed businesses and assets in your jurisdiction? Is the ‘failing firm’ defence recognised in your jurisdiction?

Transactions with a Hungarian angle that otherwise do not meet the EU's relevant turnover filing thresholds and require antitrust approval from the European Commission will still need to consider any filing requirement with the Hungarian national competition authority.

The merger control clearance requirement in Hungary may be triggered by purchases of assets forming a going concern, acquisitions of minority shareholdings coupled with veto rights, setting up joint ventures or changes in shareholder voting structures, provided the relevant local filing thresholds are exceeded.

The relevant Hungarian merger control thresholds are based on the parties’ Hungarian net turnover. When calculating the ‘net turnover derived from Hungary’ thresholds, only net turnover derived from Hungary must be considered. The practice of the Hungarian competition authority regarding the method of calculating the relevant turnover and the allocation of this turnover among the members of groups of undertakings is fully in line with that of the European Commission in the context of the EU merger control rules.

The long-existing turnover-based notification threshold test in Hungary requires a transaction to file for prior clearance from the Hungarian competition authority if:

- the combined net turnover of all undertakings concerned (including companies controlled jointly by members of the groups of undertakings concerned) derived from Hungary in the previous financial year exceeded 15 billion Hungarian forints; and
- at least each of two of the undertakings concerned derived net turnover from Hungary in excess of 1 billion Hungarian forints in the previous financial year.

In addition, according to an alternative filing test, a merger control review will also be necessary for the implementation of a concentration if it is not obvious that the concentration does not result in any significant impediment to effective competition in any of the relevant markets and the undertakings concerned have a combined aggregate net turnover derived from Hungary that exceeds 5 billion Hungarian forints. This alternative filing test intends to capture mergers concerning new emerging technology markets that are not necessarily generating the levels of net turnover that would trigger a merger filing requirement under the old filing thresholds.

Although there is no longer any filing deadline under Hungarian law, the parties are required to refrain from giving effect to the transaction prior to the merger clearance. A notification form must be lodged with the Hungarian competition authority following the signing of the contract or the acquisition of control (whichever is earlier), or, in the case of a public offer, following the publication of the public offer.

The Hungarian competition authority may attach conditions or obligations to its approval, which must be met by an appropriate deadline. The approval may be amended if the company does not fulfil an obligation or meet a condition prescribed by the decision for a reason that is not attributable to it. Unless the conditions are met, the approval is ineffective, and the Hungarian competition authority may initiate measures to recreate a state of effective competition on the market.

The Hungarian competition authority has the right to prohibit a concentration if it constitutes a significant impediment to competition in the relevant market, particularly if it creates or strengthens a dominant position.

The failing firm defence is recognised in the practice of the Hungarian competition authority.

Law stated - 01 September 2021

Foreign investment review

Are distressed M&A transactions subject to foreign investment review in your jurisdiction? What rules, procedures and common practices apply?

Ahead of the framework regulation of the European Union that entered into force in the spring of 2019, the Hungarian parliament adopted an Act in 2018 that sets out rules to enable the screening of foreign acquisitions of certain Hungarian companies engaged in providing strategic services (such as finance and telecoms), or the handling of critical infrastructure or technologies by investors whose background is outside the European Union or the European Economic Area.

Until then (except for certain sectorial reviews available in selected regulated industries, such as energy or banking, in which the acquisition of certain controlling stakes has long been subject to prior approval of the competent national regulator), there have been limited and unsophisticated mechanisms available for the Hungarian government to screen and potentially prohibit acquisitions by non-EU investors in strategic companies that could potentially be detrimental to national security or public policy. However, Hungary's foreign direct investment screening legislation now makes the acquisition of a stake in excess of 25 per cent in Hungarian companies (10 per cent with respect to publicly listed Hungarian companies), or the acquisition of de facto control by other means over Hungarian entities operating in selected strategic businesses, subject to the prior review by and the approval of the Hungarian Minister of Interior.

The rendering of the ministerial decision on whether to restrict a given investment carries a reasonably wide amount of discretion, as it is dependent on essential public policy concerns only and could – in a worst-case scenario – be delayed by as long as 120 days. Although a decision on prohibiting an acquisition remains subject to judicial appeal, the competent Hungarian court will not be allowed to overturn the ministerial prohibition; it can only refer the case back to the minister for reconsideration, and then solely on the grounds of procedural mistakes.

In May 2020, the Hungarian government adopted additional temporary requirements for investors both from and outside the European Union to seek prior ministerial approval for their investments into Hungarian companies engaged in certain strategic industries, which substantially expanded the previous scope. The strategic fields of industries concerned by the prior screening requirement in the Decree are now wide-ranging and go far beyond that which was previously covered in Hungary to date.

Approximating what is set out in the framework Regulation (EU) 2019/452 of the European Parliament and the Council, the industries now covered by the sweeping Hungarian legislation include manufacturing and chemicals, food and agriculture, health and medical, waste and building materials, transport and logistics, and all retail and wholesale activities.

The Decree requires that investors make a filing for prior approval if they intend to acquire, directly or indirectly, an interest of at least 10 per cent with a deal value of at least 350 million Hungarian forints or otherwise acquire effective control over any Hungarian legal entity in the industries concerned.

In addition to the straightforward acquisition of shares, the deal structures that are now under the scope of the Decree include the acquisition of convertibles or rights in usufruct as well as corporate transformations, asset acquisitions, capital injections and even in-kind contributions, irrespective of whether the deal is for good consideration or for free.

Without the minister's approval, the transaction will be considered null and void under Hungarian law, and no changes can be entered into any relevant public registries (such as the corporate registry), nor will the acquirers be allowed to be entered in the relevant books of shareholders. Furthermore, the minister can impose administrative fines for any breach of the approval requirements in the amount of at least 1 per cent of the acquirer's annual net turnover and up to an

amount of double the transaction value.

With respect to the procedural aspects, the filing must be made within 10 days from concluding the relevant agreement, and the ministerial decision must be rendered within 45 days thereafter, which if circumstances so require can be further extended with an additional 15-day review period.

This Decree entered into force for a temporary period and is now expected to expire in December 2021.

Law stated - 01 September 2021

Bankruptcy court

What rules and procedures govern the bankruptcy court's approval of distressed M&A transactions in your jurisdiction?

Only distressed M&A transactions progressing in the context of court enforcement or insolvency proceedings in Hungary are subject to the supervision of the court that ordered those proceedings against the debtor. The main role of the court is the adjudication of any objections filed during the proceedings against the administrator's allegedly unlawful actions or omissions. Upon completion of the insolvency proceedings, which results in the removal of the debtor from the Hungarian companies register, the acting court will be required to approve the administrator's final report and the relevant closing balance sheet of the debtor.

Law stated - 01 September 2021

DISPUTE RESOLUTION

Common disputes and settlement

What issues commonly give rise to disputes in the course of distressed M&A transactions and what practical considerations should be borne in mind when seeking to settle such disputes out of court?

As long as there are no formal insolvency proceedings pending against the debtor, the most typical issues in disputes in the course of distressed M&A transactions in Hungary relate to hidden liabilities, breach of payment obligations, issues with third-party financing and, less frequently, to warranty breaches.

Once formal insolvency proceedings have commenced against the debtor, the issues giving rise to disputes are limited to the administered process, including any allegedly unlawful actions or omissions of the administrator; the process of appraising the debtor's assets and the resulting values; any alleged unfair preference of a creditor or unlawful terms in the transaction agreement; any breach of pre-emption rights; and any breach of payment obligations.

Law stated - 01 September 2021

Litigation and alternative dispute resolution

What litigation forums are used to resolve disputes arising from distressed M&A transactions in your jurisdiction and what procedures apply? Is alternative dispute resolution (ADR) commonly used?

Disputes arising from distressed M&A transactions progressing in the context of court enforcement or insolvency proceedings in Hungary are exclusively submitted to the jurisdiction of the court that ordered those proceedings against the debtor.

In distressed M&A transactions running out of court, any disputes would be resolved by the competent state courts, unless the relevant parties are prepared to submit those disputes to ADR available in Hungary, most commonly to the Permanent Arbitration Court attached to the Hungarian Chamber of Commerce and Industry proceeding in accordance with its own rules.

Law stated - 01 September 2021

UPDATE AND TRENDS

Recent developments and outlook

What have been the most significant recent developments and trends affecting distressed M&A in your jurisdiction, including any notable court decisions, regulatory actions and deals? What is the general outlook for future transactions?

In asset disposals concluded in the context of insolvency proceedings in Hungary, the recent remarkable trend is the increasing preference by administrators to sell the debtor's business as a going concern, rather than selling individual assets in distinct attempts, allowing cherry-picking by informed buyers to the detriment of creditors' interests.

In addition, the Insolvency Act authorises the Hungarian government to declare insolvency proceedings running against debtors with significant market presence, engaged in specific regulated industries or otherwise holding strategic assets as proceedings of 'strategic national importance'. This then elevates the oversight of those proceedings to higher state courts and exempts the administrator from the obligation to observe certain cumbersome and time-consuming procedural requirements.

Finally, the Hungarian government has proposed to reform and modernise insolvency proceedings by preparing an entirely revamped new Hungarian Insolvency Act. The ministerial draft is not available for public consultation yet, but the overall market expectation is that the new Act will resolve all of the problem areas embedded in the current rules, in some instances those dating back 30 years.

Law stated - 01 September 2021

Jurisdictions

Austria	Wolf Theiss
Brazil	Machado Meyer Advogados
Bulgaria	Wolf Theiss
Canada	Cassels Brock & Blackwell LLP
France	JEANTET
Greece	VAP Law Offices
Hungary	Wolf Theiss
Netherlands	Van Doorne
Poland	Wolf Theiss
Portugal	PLMJ
Romania	Wolf Theiss
Switzerland	Walder Wyss Ltd
United Kingdom	Morgan, Lewis & Bockius LLP
USA	Cravath, Swaine & Moore LLP