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# Reform of the Hungarian Law of Security Rights in Movable Property

## 1. Introduction

The Hungarian law of proprietary security rights — contained in the Civil Code\*<sup>2</sup> — has undergone two major reforms since the transition to a market economy, the first taking place in 1996 and the second in 2000.\*<sup>3</sup> A third, minor revision of the Civil Code's provisions on security rights was undertaken in 2004, due to the transposition of the European directive on financial collateral arrangements.\*<sup>4</sup>

A third — or fourth, depending on one's view — reform is forthcoming, as Hungary is on the way to adopting a new civil code in the very near future. It was in 1998 that the Government decided to undertake a comprehensive re-codification of Hungarian civil law and set up a commission with the mandate of drafting a new code.\*<sup>5</sup> In co-operation with the Ministry of Justice, the commission, chaired by Professor Lajos Vékás, produced its draft in 2006 (known as the Commission Draft).\*<sup>6</sup> The commission was about to finalise a second, revised draft, on the basis of the comments received, when the Ministry of Justice unexpectedly terminated its mandate in September 2007. The Ministry of Justice published a revised draft in October 2007 (referred to as the First Ministry Draft). Professor Vékás and a group of experts — many of whom also contributed to the Commission Draft from 2006 — published a draft in March 2008 (called the Expert Draft).\*<sup>7</sup> Almost simul-

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<sup>2</sup> Act IV of 1959 on the Civil Code (CC). Complementary rules can be found in subordinate legislation: Government decree No. 12/2003. (I. 30.) on the extrajudicial sale of charged property and decree of the Minister of Justice No. 11/2001. (IX. 1.) on the detailed rules of the register of charges. The rules on the judicial enforcement of charges can be found in Act LIII of 1994 on judicial enforcement, the effects of insolvency on the rights of secured creditors are laid out in Act XLIX of 1991 on bankruptcy and winding-up proceedings (hereinafter: Insolvency Act). The legislation is available at government website: <http://www.magyarorszag.hu/kereses/jogszabalykereso> (in Hungarian).

<sup>3</sup> The statutes amending the Civil Code were: Act XXXVI of 1996 and Act CXXXVII of 2000.

<sup>4</sup> Directive 2002/47/EC on financial collateral arrangements was implemented by §§ 41–60 of Act XXVII of 2004, which amended the Civil Code, the Insolvency Act and Law-Decree No. 13 of 1979 on private international law.

<sup>5</sup> Government decision No. 1050/1998. (IV. 24.).

<sup>6</sup> For an account of the codification process until 2006 see P. Gárdos. Re-codification of the Hungarian Civil Law. – *European Review of Private Law* 2007 (15), pp. 707–722.

<sup>7</sup> L. Vékás (ed.). *Szakértői Javaslat az új Polgári Törvénykönyv tervezetéhez* (Draft of a New Civil Code for Hungary: An Expert Proposal). Budapest 2008 (in Hungarian).

taneously, the Ministry of Justice published a new draft (the Second Ministry Draft).<sup>8</sup> The Second Ministry Draft was again revised, and, on 28 May 2008, the Cabinet approved the final version of the draft, which was introduced to Parliament as the bill on the new civil code on 5 June 2008.<sup>9</sup> The Government expects the bill to receive the approval of Parliament by the end of 2008 and enter into force in 2010, a full 50 years after the entry into force of the current Civil Code.

This article presents and evaluates the post-transition reform of Hungarian secured transactions law and examines the impact that the wholesale reform of Hungarian civil law will have on this body of law.

Two preliminary remarks need to be made:

First, the regime of proprietary security rights as regulated in the Civil Code applies without regard to the status of the debtor and the creditor; i.e., there is no separate set of rules for company security interests and security interests created by unincorporated businesses or individuals. Likewise, the transposition of the financial collateral directive into Hungarian law made the rules of the directive applicable to all financial collateral arrangements, without regard to the status of the debtor and the creditor. There is only one form of security right that is not available to all debtors: the enterprise charge, which can only be taken over the patrimony of a company or other legal person.

Second, it is important to note that, although this article focuses on security rights in movables, the division between the law relating to immovables (real property) and the law governing personal property is not as deep as in some other jurisdictions. The rules on real and personal property law can be found in the same book of the Civil Code (although there is a separate statute on the land register), with the rules on security rights in immovables and movables under the same title. Both the current Civil Code and the bill on the new civil code contain a considerable number of common rules applicable to all security rights, regardless of the movable or immovable nature of the collateral. Differentiation, where necessary, is made on the level of particular provisions.

## 2. The reforms of 1996 and 2000

The pre-transition Hungarian law of proprietary security rights focused on immovables.<sup>10</sup> The primary aim of the 1996 and 2000 reforms was to provide a legal framework by which movables can be utilised efficiently as collateral. The main source of inspiration for the reform was the Model Law of Secured Transactions (1994) elaborated by the European Bank for Reconstruction and Development (EBRD).<sup>11</sup> It was on the basis of this Model Law that a charges register was established and two new types of charge were introduced into Hungarian law: the registered non-possessory charge over tangible (corporeal) movables and the ‘enterprise charge’.<sup>12</sup> By introducing these forms of security interests, the Hungarian legislator borrowed concepts and ideas from North American and English law, albeit only indirectly, through the filter of the EBRD Model Law.<sup>13</sup>

Prior to the reforms, two types of charge were available in respect of tangible movables: the pledge and the so-called ‘charge securing a bank loan’. The pledge requires transfer of possession to the creditor; therefore, it does not allow enterprises to raise financing against their equipment or inventory. The ‘charge securing a bank

<sup>8</sup> Both the First and the Second Ministry Drafts are available only on the website of the Ministry of Justice (in Hungarian) at <http://irm.gov.hu/?katid=1&id=104&cikkid=4413> (20.06.2008).

<sup>9</sup> Bill No. T/5949 on the new Civil Code.

<sup>10</sup> This branch of law was already highly developed before the Second World War, as evidenced by Act XXXV of 1927 on Hypothecs.

<sup>11</sup> In fact, one of the three Central European lawyers “requesting that the EBRD propose a basis for uniform or similar regulation of secured transactions across the region” was Professor Attila Harmathy of Hungary. See F. Dahan, J. Simpson. The European Bank for Reconstruction and Development’s Secured Transactions Project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere!) – E.-M. Kieninger (ed.). Security Rights in Movable Property in European Private Law. Cambridge: Cambridge University Press 2004, p. 99. Professor Harmathy was also member of the Advisory Board that assisted the EBRD in the drafting of the Model Law.

<sup>12</sup> The reforms also introduced a third new type of charge, the so-called ‘independent charge’, which is a non-accessory charge, modelled upon the German non-accessory mortgage, the *Grundschild*, but with a scope extended to movables. Also enterprise charges may be created in an independent, non-accessory form. However, this type of charge has not gained any significance in respect of movables. According to the data of the Hungarian Chamber of Notaries, only 210 ‘independent charges’ over movables and only 98 ‘independent enterprise charges’ have been created in the period between 1997–2006. The Bill on the new Civil Code restricts the scope of application of the independent charge to immovables, therefore this article does not deal with this type of charge.

<sup>13</sup> This is similar to what happened in Slovakia, where the EBRD Model Law had a significant impact on the reform of secured transactions law in 2002. In other countries of the region, US or Canadian law (in its Québec version) had a direct impact on law reform. For Romania see N. de la Peña, H. W. Fleisig. Romania: Law on Security Interests in Personal Property and Commentaries. – Review of Central and East European Law 2004 (29), p. 133 ff. For Ukraine see R. A. Macdonald. Commentaries on the Law of Ukraine on Securing Creditors’ Claims and Encumbrances on Moveables. Kiev: World Bank Office 2004. In some countries of South-Eastern Europe, e.g., Slovenia and Croatia, German and Dutch law were relied upon in the reform of secured transactions law.

loan' was free from this disadvantage. This special device was created by the socialist Civil Code of 1959.<sup>\*14</sup> It could be created over tangible movables without transfer of possession to the creditor or any alternative form of publicity, but only to secure a bank loan. According to the Official Commentary to the 1959 Civil Code, the drafters' intention was to allow for the extension of bank credit against a shifting pool of assets, particularly against inventory.<sup>\*15</sup> With the development of the credit market and the switch to a two-tier banking system in 1987, this special form of charge became untenable: it amounted to positive discrimination in favour of the banks, and, more importantly, the lack of publicity discouraged even lending by banks as soon as commercial banks appeared on the playing field.<sup>\*16</sup>

Similarly, prior to the reforms, a charge over a receivable<sup>\*17</sup> required notification of the debtor and transfer of any document relating to the encumbered receivable to the creditor. Thus, future receivables were incapable of being used as collateral and the creation of a charge over a multitude of receivables was also cumbersome.

The pre-reform Hungarian law of secured transactions resembled very much the German law on pledges and hypothecs as codified in the German Civil Code of 1900. Apart from the exceptional 'charge securing a bank loan', non-possessory security interest could be granted exclusively over immovables.

There were two ways to overcome the rigidity of the system: to validate hidden security rights (i.e., fiduciary transfer of ownership and fiduciary assignment for purposes of security<sup>\*18</sup>) or to introduce an alternative technique of publicity replacing dispossession (in case of tangibles) and notification of the debtor (in case of intangibles). German case law and practice went down the first road, thereby circumventing and displacing the rules of codified law. North American law illustrates the second option: the establishment of a public register of security rights in movables that fulfils the needs of both the debtor and the creditor. The creditor can file a record of the security right in the public register, thereby achieving third-party effectiveness and priority, whereas the debtor does not have to surrender possession of the encumbered assets to the creditor; that is, the encumbered assets are not withdrawn from the business of the debtor but continue to produce income from which the secured loan can be repaid. The great advantage of the North American approach is that it results in transparency and predictability: third parties (potential creditors) can discover any existing security rights through a search of the public register.

## 2.1. Validation of non-possessory charge over tangibles and establishment of a charges register

In 1996, the Hungarian legislator opted for the North American model: a grantor-indexed register of charges was established and non-possessory charge over tangibles — perfected<sup>\*19</sup> by registration instead of dispossession — validated.

In case of the non-possessory charge, the chargor (grantor) remains entitled to the possession, use, and enjoyment of the encumbered assets. The Civil Code does not expressly confer upon the chargor the power to dispose of the charged property in the ordinary course of business, but such power is to be inferred from the provision according to which the non-possessory charge is extinguished by a disposition to a *bona fide* purchaser for value in the ordinary course of business.<sup>\*20</sup> Purchasers in the ordinary course of business are not expected to

<sup>14</sup> See CC (1959) § 262.

<sup>15</sup> A Magyar Népköztársaság Polgári Törvénykönyve. Az 1959. évi IV. törvény és a törvény javaslatának miniszteri indokolása (Civil Code of the People's Republic of Hungary. Act IV of 1959 and the Official Commentary to the Bill of the Act). Budapest 1963, p. 284 (in Hungarian).

<sup>16</sup> Prior to the introduction of the two-tier banking system, the central bank performed also the functions of a commercial bank. Besides the central bank, there existed three specialised state-owned banks: a national savings bank providing services to households, a national development bank providing services to state enterprises and a foreign trade bank. The foreign trade bank was not active in the field of lending, the savings bank and the development bank were engaged only in the business of lending on the security of immovables. The only bank that provided inventory financing and used the 'charge securing a bank loan' was the central bank.

<sup>17</sup> In this article, the term 'receivable' is used with a much broader meaning than in North American or English terminology. It simply refers to any right to the performance of an obligation (including monetary and non-monetary obligations). Obviously, the subcategories known in UCC terminology as accounts receivable and payment intangibles are the most suitable to be used as collateral.

<sup>18</sup> Under Hungarian law, transfer of ownership does not necessarily require actual physical transfer of possession to the transferee, assignment is not subject to the requirement of notification. See CC §§ 117, 328.

<sup>19</sup> The term 'perfected' is not used in its technical meaning here, it merely denotes the element additional to the charge contract. It will be explained later that Hungarian law does not know the distinction between creation and perfection and does not recognise unperfected security rights. See 3.2 *infra*.

<sup>20</sup> See CC § 262 (6). The language of the CC, according to which the charge is **extinguished** upon a disposition to a *bona fide* purchaser for value in the ordinary course of business, is unfortunate from more aspects. First, it creates the false impression that the non-possessory charge is altogether extinguished under these circumstances, whereas upon proper construction this provision only means that the charge is terminated in respect of the specific asset subject to the disposition, in other words: the transferee obtains an overriding title. Second, the CC should provide that the *bona fide* purchaser for value **takes free of the charge**, so as not to preclude the extension of the charge to the proceeds of disposition.

search the charges register in order to qualify as *bona fide* purchasers.<sup>\*21</sup> Although these provisions lack the accuracy and the precision of the corresponding rules of the Uniform Commercial Code<sup>\*22</sup>, the aim of the legislator was the same: to enable goods to move freely from inventory.

Also enterprise charges were brought under the system of registration. Unfortunately, the legislator did not extend the scope of the charges register to receivables and other intangibles; i.e., charges over intangibles are perfected by the mere conclusion of a charge agreement, without any need for publicity.<sup>\*23</sup> (Only charges over registered intangibles, such as patent rights and trademarks, are subject to a publicity requirement: registration of the charge in the appropriate specialist register.)

## 2.2. Abolition of the notification requirement in case of a charge over receivables

In order to facilitate the use of receivables as collateral, the reforms abolished the obligation of notifying the debtor of the receivable as a precondition to creating a security right in the receivable. Notice to the debtor is necessary only if the chargee wants to prevent the debtor from making payment to the grantor — as long as there is no notification, the debtor of the receivable is discharged by paying to the grantor. As notification is not a requirement for the creation of a charge over the receivable, it is also irrelevant for purposes of priority between competing chargees. It is the first chargee and not the first notifying chargee who obtains priority.

These rules are parallel to the rules on assignment: a notice to the debtor is not required for the assignment to take place, the notification plays a role in the protection of the debtor<sup>\*24</sup>, and it is the first assignee and not the first notifying assignee who has priority in case of successive assignments by the same assignor.

In spite of the similarity of the legal regimes applicable to assignment and the charge over receivables, creditors preferred assignment by way of security to the creation of a charge, because of the unsatisfactory treatment of secured claims (i.e., claims secured by a charge) in insolvency until 2007.<sup>\*25</sup> By using security assignment, creditors expected to remain unaffected by the insolvency of the debtor (i.e., assignor). From 2001, when the Supreme Court held that the receivables not collected by the security assignee until the commencement of winding-up fall into the insolvency estate of the security assignor, creditors began to use charge and security assignment at the same time — in respect of the same receivables, to secure the same obligation. Outside insolvency, the creditor would act upon the security assignment, inside insolvency he would still enjoy the limited priority conferred on secured creditors. It remains to be seen whether the new insolvency rules favourable to secured creditors are going to change this practice.

## 2.3. Departure from the principle of specificity

The reforms also departed from the traditional principle of specificity<sup>\*26</sup>, according to which a proprietary right (or right *in rem*) can only subsist over a specific item of property to secure a specific obligation. It would flow from this principle that the encumbered assets and the secured obligations need to be specified individually in the charge contract and in the record in the relevant register.

Instead of adhering to this principle, the reforms allowed for a generic description of the encumbered assets (including after-acquired or future assets) in the case of the non-possessory (registered) charge over tangible movables and the charge over intangibles. In other words, there is no requirement that the encumbered assets be identified individually or that the borrower have rights in the assets at the time it grants the non-possessory charge.<sup>\*27</sup> To use the terminology of US law, the reforms validated the 'floating lien' on shifting collateral.

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However, this mistake is not one of drafting but of substance: the CC does not extend the charge to the proceeds of disposition. For this problem see the explanation under 3.7 *infra*.

<sup>21</sup> Law-decree No. 11 of 1960 on the introduction of the Civil Code § 47 (2).

<sup>22</sup> UCC § 9-320 and § 1-201 (b) (9). The language of § 4:154 of the Bill on the new CC is much closer to these provisions of UCC: it protects persons who buy tangible movables in the ordinary course of business from a person in the business of selling tangible movables of that kind, without knowledge that the person is not entitled to a disposition of the tangible movables free of the charge.

<sup>23</sup> See CC § 267 (1).

<sup>24</sup> I.e., the debtor may discharge his obligation by paying the assignor until he receives a notification of the assignment.

<sup>25</sup> See the explanation under 2.6 *infra*.

<sup>26</sup> Generally referred to as *Spezialitätsprinzip* or *Bestimmtheitsprinzip* in German legal terminology.

<sup>27</sup> For tangibles see CC § 262 (2), § 262 (5), for intangibles CC § 267 (1).

But the legislator did not stop here. The new species of the ‘enterprise charge’ was created.<sup>\*28</sup> This is an all-asset security right that can be granted only by a company or other legal person<sup>\*29</sup>; the individual assets comprising the fund do not need to be specified, the object of the charge is a shifting fund of assets. On the one hand, the range of assets that can be subject to an enterprise charge is broader than the range of assets susceptible to a ‘simple’ registered charge: the enterprise charge also covers the immovables and the registered movables of the debtor, whereas a ‘simple’ registered charge cannot be taken over these assets. On the other hand, as from the 2000 reform, an enterprise charge may be granted only over the whole or ‘an economically independent unit’ of the patrimony of a legal person.<sup>\*30</sup> Whether it was useful to introduce the enterprise charge as a distinct security right, in addition to the validation of floating liens, will be discussed later.

In respect of the secured obligation, the reforms maintained the possibility — already present in the Act on Hypothecs of 1927 and the Civil Code of 1959 — of creating a ‘maximal charge’<sup>\*31</sup>, which secures all obligations arising from a certain legal relationship between the debtor and the creditor, to a maximum amount. (Security rights may be created to secure future or conditional obligations; this was already permitted by the Civil Code of 1959.) Unfortunately, the legislator placed the article on maximal charge not among the common rules applicable to all types of charge but in the sub-chapter on non-possessory charges over tangibles, which created doubts as to the availability of this type of charge in cases of charges over intangibles or financial collateral.

## 2.4. Introduction of the enterprise charge

As has been mentioned above, one of the major innovations of the 1996–2000 reforms was the introduction of the enterprise charge.<sup>\*32</sup> This device is often compared to the floating charge of English law, but there are important differences between the two.

Under English law, it is a distinctive feature of the floating charge — as opposed to a fixed charge — that the debtor company remains free to dispose of the charged assets in the ordinary course of business. Hungarian law does not know this distinction between fixed and floating charges: the non-possessory registered charge over tangibles also confers continued dealing power on the debtor. This follows from the rule that buyers in the ordinary course of business take free of a registered charge without having to search the charges register.<sup>\*33</sup> All non-possessory charges registered in the charges register (non-possessory charges over tangibles and enterprise charges alike) leave the debtor free to deal with the charged assets in the ordinary course of business, free from the charge.

In fact, there is some difference between the dealing powers of the chargor under a registered charge over tangibles and an enterprise charge. Under the latter, the chargor retains an unlimited right to dispose of the assets of the enterprise. According to the Civil Code, transferees acquire an overriding title, even if the disposition was not in the ordinary course of business and even if the transferee acquired in bad faith or at an undervalue.<sup>\*34</sup> Of course, the chargee can bring an action under § 203 of the Civil Code or § 40 of the Insolvency Act on the avoidance of transactions defrauding creditors, and thereby reverse fraudulent or gratuitous transfers. Still, this unlimited dealing power conferred upon the grantor of an enterprise charge does not seem to be justifiable.

Under English law, a floating charge does not attach to the specific assets comprising the security until crystallisation. Under Hungarian law, crystallisation is not a necessary precondition to the enforcement of an enterprise charge. Upon default, the creditor is entitled to transform the enterprise charge — by unilateral declaration — into charges over individual pieces of property, but he can also, at least theoretically, enforce the charge “with the preservation of the unity of the patrimony”, through the sale of the enterprise as a whole (as a going concern), without first having to transform the enterprise charge into charges over specific assets.<sup>\*35</sup>

<sup>28</sup> See CC § 266.

<sup>29</sup> But a mortgage (hypothec) registered in the land register or a charge registered in the appropriate specialist register has priority even if it was registered subsequently to the registration of the enterprise charge. See CC § 266 (3).

<sup>30</sup> In practice, there are doubts as to what constitutes ‘an economically independent unit’ of a company. The 1996 reform allowed an enterprise charge to be granted over the whole or **any part** of the patrimony of the enterprise.

<sup>31</sup> This form of charge is similar to the *Höchstbetragshypothek* of German and Austrian law or the *hipoteca global* of Spanish law.

<sup>32</sup> The exact, word-to-word translation of the Hungarian term *vagyont terhelő zálogjog* would be ‘charge over a patrimony’.

<sup>33</sup> See CC § 262 (6).

<sup>34</sup> According to CC § 266 (1), the enterprise charge automatically extends [attaches] to any asset acquired by the chargor after the conclusion of the charge contract, while any asset that ceases to be part of the chargor’s patrimony automatically becomes free of the enterprise charge.

<sup>35</sup> See CC § 266 (2). However, this remedy remained ‘law in the books’, since no procedure comparable to the ‘enterprise charge administration’ of the EBRD Model Law or the receivership of English law has ever been devised by the Hungarian legislator. In fact, a consultation of the Ministry of Justice in 2004 revealed that the widespread opinion among legal scholars and practitioners was that the holder of the enterprise charge should not be allowed to enforce the charge against the whole of the debtor’s patrimony outside of a collective (insolvency) proceeding, with the exclusion of other creditors.

Under English law, since crystallisation of the floating charge is not retrospective, subsequent fixed charges (arising prior to crystallisation) rank ahead of a floating charge. Under Hungarian law, crystallisation is in principle retrospective<sup>\*36</sup> and only subsequent mortgages<sup>\*37</sup> registered in the land register and subsequent charges registered in specialist registers (e.g., charges over ships and aircraft) have priority over the enterprise charge. Apart from these exceptions, the priority of the enterprise charge (and the charges over the specific assets created upon crystallisation) depends upon the time of registration. Therefore, an enterprise charge (and a charge over a specific asset created upon crystallisation) has priority over charges subsequently registered in the charges register.

Finally, the enterprise charge does not give its holder the power to appoint an administrative receiver as the English floating charge does.

## 2.5. Introduction of extrajudicial enforcement mechanisms

The reforms not only created new forms of proprietary security rights with a new system of publicity but also provided for speedier and more cost-efficient enforcement of security rights. Previously, enforcement was possible only by means of costly and time-consuming judicial procedures. The reforms allowed for an agreement between the debtor and the creditor that enforcement would take place by out-of-court sale of the encumbered assets. The agreement needs to be in written form and has to fix the lowest price for which the encumbered asset may be sold and the deadline before which the sale has to be effected.

According to § 257 CC, there are three forms of extrajudicial disposition of the encumbered asset: i) joint sale by the debtor and the creditor, ii) sale by the creditor alone, and iii) sale by a mandatary of the secured creditor. An agreement on extrajudicial sale by the secured creditor alone is permitted only if the encumbered asset has an official market price or the chargee is in the business of providing secured loans. If neither of these requirements is fulfilled, the debtor and the creditor may agree that, in the event of default, the encumbered asset will be sold by a mandatary of the creditor who is engaged in the business of providing secured loans or organising auctions.<sup>\*38</sup>

## 2.6. Gradual return to the principle of full (absolute) priority of secured claims in insolvency

In addition to the revisions of the Civil Code rules on security rights, legislative measures in the field of insolvency law also significantly improved the conditions of secured lending. Insolvency is the ‘acid test’ of security rights, and it is widely held that an essential feature of proprietary security rights is that in insolvency the secured creditor is entitled to payment in full out of the proceeds of sale of the encumbered assets before general unsecured creditors. The Hungarian Insolvency Act did not grant this right to secured creditors until recently.

In winding-up proceedings opened before 1 September 2001, an extensive list of privileged claims was granted absolute preference over secured claims. These preferential claims included not only the expenses of the proceeding and the remuneration of the liquidator but — *inter alia* — also the debts due to employees, the claims of the Wage Guarantee Fund<sup>\*39</sup>, and the costs of remedying any damage caused by the debtor company to the environment.

A 2000 amendment to the Insolvency Act introduced partial priority of the secured creditor: 50 per cent of the proceeds of the sale of the encumbered asset — less the costs of the sale — had to be paid directly to the secured creditor, with the other 50 per cent reserved for the preferential claims. Only the surplus — if any — could be paid to the secured creditor. This 50 per cent priority was restricted to the holders of charges created at least one year before the commencement of the winding-up.

A further amendment, made in 2006 and taking effect on 1 January 2007, granted absolute priority to secured creditors in respect of the proceeds of encumbered assets, provided that the charge was created before the commencement of the winding-up proceeding.<sup>\*40</sup> Thus, the rule that excluded the holders of ‘late charges’ (i.e., charges created within one year of the commencement of the winding-up) from the scope of the priority

<sup>36</sup> It is not the date of crystallisation, but the date of the registration of the enterprise charge that determines the ranking of the charges over the specific assets (created by the crystallisation).

<sup>37</sup> In this article, the term ‘mortgage’ simply refers to a security right in immovable property in the form of a limited real right (hypothec), without transfer of title to the creditor.

<sup>38</sup> Government decree No. 12/2003. (I. 30.) contains further rules of detail on the extrajudicial sale.

<sup>39</sup> This Fund pays the outstanding wages of the employees and is subrogated to their rights against the employer in insolvency.

<sup>40</sup> Act VI of 2006 on the amendment of Act XLIX of 1991 on bankruptcy, winding-up and voluntary winding-up proceedings. The present rule on the treatment of secured creditors in insolvency (§ 49/D of the Insolvency Act) is comparable to the German *Absonderungsrecht* or the Spanish *privilegio especial*.

rule was abolished as well. Only the costs of the preservation and the sale of the encumbered assets and a proportionate amount of the liquidator's fees may be deducted from the proceeds of the sale of the encumbered assets before applying the proceeds to the satisfaction of the secured claim. However, the limitation of priority (to 50 per cent of the proceeds) was retained for enterprise charges.<sup>\*41</sup>

The secured creditor is not a 'separatist'; he cannot simply remove his security from the insolvency estate. He is required to submit a formal claim to the liquidator and rely on the latter to complete the realisation (disposition) of the encumbered assets. It is only in the case of possessory charge over financial collateral<sup>\*42</sup> that the chargee remains unaffected by the winding-up: he retains his rights to enforce the charge by appropriation or sale in accordance with the rules of the Civil Code, as if no insolvency proceedings had been commenced.

### 3. The deficiencies of the current legal framework

Without doubt, the reforms proved beneficial for the Hungarian economy. They enhanced the availability of lower-cost secured credit by validating non-possessory security rights in movables, facilitating the enforcement of a security right, and providing for the priority of secured claims in insolvency. However, the current legal framework is far from optimal.

#### 3.1. Incomprehensiveness and formalistic approach — no functional concept of a security right

The present statutory regime is not comprehensive; it does not cover all rights that are created to secure the performance of an obligation. The rules applicable to charges do not apply to *quasi*-securities (functional security interests), such as retention of title, financial lease, transfer of ownership or assignment by way of security. The case law is ambiguous, it fails to provide *ex ante* legal certainty.

In 2002 and 2003, the Supreme Court held that parties are free to secure a loan by a sale under suspensive condition or a sale with an option of repurchase (right of redemption) granted to the seller/debtor and that such sales contracts concluded to secure an obligation are not sham transactions but reflect the true and lawful intention of the parties.<sup>\*43</sup> In decisions from 2006, the same court held that contracts of sale with a right of redemption granted to the seller (debtor) are simulated and therefore void contracts, since the parties' true agreement was to create a hypothec in favour of the buyer (creditor).<sup>\*44</sup> However, there is nothing in the decisions from 2006 that could serve as an explanation for the change in the attitude of the court.<sup>\*45</sup> Quite the contrary — one of the 2006 decisions refers, *en passant*, to the 2003 decision with approval. The incompatibility of the 2002–2003 decisions with those from 2006 seems to reflect a disagreement between different chambers of the Supreme Court.<sup>\*46</sup>

Another, frequently used title-based security device is the option to purchase, used both independently and in combination with a charge. The creditor is thereby granted the power to create a contract of sale in respect of an asset of the debtor by a unilateral act, a simple declaration.<sup>\*47</sup> The grant of an option to purchase is

<sup>41</sup> This is very similar to what happened in the Czech Republic, where a 2000 amendment of the old Insolvency Act (dating from 1991) introduced the limited priority of secured creditors in insolvency (70 per cent of the proceeds of the sale of collateral). The new Czech Insolvency Act that entered into force on 1 January 2008 reintroduced full priority of secured creditors in insolvency (subject only to capped costs of the preservation and the sale of the collateral, and to the remuneration of the insolvency administrator). See T. Richter. One Flight over Czech Security Interests: Priorities and other Monsters of Post-transformation Debtor/Creditor Law. – IES Occasional Paper 2006/3, Institute of Economic Studies, Charles University of Prague. Available at <http://ies.fsv.cuni.cz/sci/publication/show/id/1915/lang/en> (20.06.2008).

<sup>42</sup> Also transfer to the creditor's account or to a blocked account in the name of the debtor or a third party amounts to possession. Possession includes also what is called 'control' in UCC, except for control agreement which is not a recognised form of dispossession under current Hungarian law.

<sup>43</sup> Legf. Bir. Pfv. VI. 20.398/2001. BH 2002. 182. and Legf. Bir. Pfv. VI. 22.404/2001. EBH 2003. 857. The 2002 case concerned a sales contract subject to the condition precedent of failure to repay the loan (sale under suspensive condition). When the debtors defaulted under the loan, the sales contract came into effect. The 2003 case concerned the sale of three flats with a right granted to the sellers to rescind the sales contracts upon repayment of the purchase price equivalent to the loan. The right of rescission (right of redemption) had the same effect as a condition subsequent (resolutive condition).

<sup>44</sup> Legf. Bir. Pfv. IX. 21.703/2005. BH 2006. 118. and Legf. Bir. Gfv. IX. 30.118/2005. BH 2006. 17.

<sup>45</sup> All these cases concerned immovables, but the reasoning of the judgments is not confined to the law of immovables. Apart from the different regimes of publicity (land register vs charges register), security rights over immovables and movables follow, in many respects, the same rules.

<sup>46</sup> The decisions from 2002–2003 were handed down by the Sixth Civil Law Chamber (Pf. VI.), whereas the 2006 judgments were delivered by the Ninth Commercial Law Chamber (Gf. IX.).

<sup>47</sup> See CC § 375.

sometimes additional to a charge created over the same asset, in which case the creditor's option to purchase amounts to a circumvention of the prohibition of the so-called *lex commissoria*.<sup>\*48</sup> This notwithstanding, the Supreme Court considers the use of the option to purchase with a security function to be perfectly legitimate, provided that the purchase price reflects the real market value of the collateral and the creditor accounts to the debtor for any surplus. Only those agreements are held void that entitle the holder of the option to purchase to exercise the option at a price equivalent to the outstanding obligation of the debtor, irrespective of the real market value of the asset.<sup>\*49</sup> There is a dispute between two chambers of the Supreme Court as to whether the grant of the option to purchase (the option contract) or only the contract of sale that is formed upon the exercise of the option can be avoided on the ground of inadequacy of consideration (*laesio enormis*).<sup>\*50</sup>

The assignment by way of security has also been held valid by the courts<sup>\*51</sup>, but the receivables not collected by the assignee until the commencement of winding-up proceedings are held to fall into the insolvency estate of the assignor.<sup>\*52</sup>

Retention of title and finance lease are treated as if they had no connection with security rights. The retention-of-title seller and the finance lessor are considered to be owners, unaffected by the insolvency of the buyer/lessee, with a right to rescind the sale and reclaim the sold/leased property. There is no registration requirement in either case. However, retention of title is not such a powerful security device as, for example, under German law, since Hungarian law permits only simple retention of title agreements. Only the outstanding purchase price can be secured by a retention of title: 'all sums' or 'all monies' clauses in which the seller retains title until all debts owed by the buyer to the seller have been discharged are not valid. Neither can the seller retain title to the proceeds or products of the goods supplied under retention of title.

### 3.2. No distinction between effectiveness as between the parties and effectiveness against third parties

Many jurisdictions draw a distinction between the creation of a security right *inter partes* and the perfection (opposability) of the security right *erga omnes*. These jurisdictions admit the notion of a right *in rem* enforceable only against the debtor: even in the absence of transfer of possession or registration of the security right, the secured creditor is entitled to exercise various pre-default rights (e.g., in the case of deterioration in value of the encumbered assets) and may also be entitled to realise the collateral upon the debtor's default. Beyond being enforceable between the parties, an unperfected security right may also be good against unsecured non-insolvency creditors.<sup>\*53</sup>

Hungarian law does not make such a distinction: the charge (pledge, mortgage) is by definition a right *in rem*, created by the charge contract and the additional element of publicity (transfer of possession or registration in the appropriate register). The first is sometimes referred to as the legal ground (*causa* or *titulus*), the latter as the mode (*modus*) of the acquisition of the charge. A charge (a right *in rem*) effective only against the grantor is considered to be a contradiction in terms. Thereby transfer of possession or registration is required for the creation of the security right even as between the grantor and secured creditor. A security agreement alone creates at best an obligation to transfer possession to the creditor or to give consent to the registration of the security right.

This approach is based on dogmatic rather than practical considerations and attaches more importance to the element of publicity than what can be justified by the underlying policies. Publicity is required to safeguard the interests of third parties, particularly those of prospective creditors, by providing them with an objective source of information about security rights that may already exist. Therefore, it seems to be unreasonable to deny the unperfected secured creditor the rights and remedies of a secured creditor even in the absence of competing creditors.

<sup>48</sup> Also called *pactum commissorium*. According to CC § 255 (2), a pre-default agreement, according to which the chargee acquires the ownership of the charged asset upon default, is null and void.

<sup>49</sup> Legf. Bír. Gf. I. 30.339/2000. BH 2001. 584., Legf. Bír. Gfv. X. 32.615/1997. BH 1998. 350. The same reasoning is followed by the Court of Appeal of Szeged: Szegedi Ítéltábla Gf. I. 30.578/2003. BH 2005. 73.

<sup>50</sup> According to a decision of the Supreme Court from 2007 (Legf. Bír. Pfv. VI. 21.674/2006. BH 2007. 293.) only the contract of sale can be avoided. According to a decision of the Supreme Court from 2008 (Legf. Bír. Gfv. IX. 30.406/2006. BH 2008. 48.) the option contract itself can be avoided.

<sup>51</sup> Fővárosi Ítéltábla (Metropolitan Court of Appeal, i.e., Court of Appeal of Budapest) 6. Pf. 20.5562004. BH 2005. 16.

<sup>52</sup> Legf. Bír. Gfv. X. 31.608/1999. BH 2001. 489.

<sup>53</sup> See, e.g., R. Goode. *Legal Problems of Credit and Security*. London 2003, pp. 59–60; J. J. White, R. S. Summers. *Uniform Commercial Code*. 5<sup>th</sup> ed. St. Paul 2000, p. 748. Québec law adopts a more restricted view on the unperfected secured creditor's rights, denying the holder of an *hypothèque non publiée* the right to enforce the security right upon the debtor's default. See L. Payette. *Les sûretés réelles dans le Code civil du Québec*. 3<sup>rd</sup> ed. Éditions Yvonne Blais 2006, p. 157.

### 3.3. Complexity

The system of the traditional security rights is overcomplicated: there are too many sub-types with special rules instead of a simple, 'user-friendly' regulation with as many general rules as possible and a minimal number of special requirements for the individual types.

### 3.4. Lack of publicity of security rights in receivables

As already mentioned, there is no publicity of security rights in receivables, in spite of the existence of a charges register. Only charges over tangible movables and enterprise charges have to be registered; charges over receivables are exempt from the registration requirement. Thereby, in the context of receivables financing, prospective creditors have to rely on the statements of prospective debtors and their contractual liability in case of fraud.

### 3.5. Excessive costs of creation

The formal requirements in respect of the creation of non-possessory registered charges are too burdensome. The registration requires the notarisation of the charge agreement, for which an *ad valorem* fee is charged. This notary fee is made up of at least two components: the 'fee for the notary's services' and a lump sum for the notary's expenses. The first component is calculated on a degressive scale according to the amount of the secured obligation. The second component is 40 per cent of the first.<sup>\*54</sup> The registration fee is additional to this notary fee.<sup>\*55</sup>

The extremely high notary costs make the creation of a charge considerably more expensive than anywhere else in the region.<sup>\*56</sup> It also seems to be disproportionate to apply the same notary fees for the notarisation of a mortgage contract (i.e., a contract creating a security right in immovable property) and a charge contract (i.e., a contract creating a security right in movable property). Expensive notarisation as a mandatory precondition to registration results in relatively low usage of non-possessory charges when compared to other countries (e.g., Slovakia, Romania, and Bulgaria).<sup>\*57</sup> To take a striking example, whereas approximately 65–75 per cent of registrations in a Canadian secured transactions register relate to motor vehicles<sup>\*58</sup>, the Hungarian charges register is not used at all to create charges over motor vehicles, except for fleet financing. Because of the high costs of the mandatory notarisation, automobile financiers use a title-based security device, the option to purchase, which is surrounded by much uncertainty and risk. If the vehicle is seized by a judgment creditor (often the tax authority), the option to purchase is of no value, since the financier obtains merely contractual rights by exercising the option to purchase. (To acquire ownership, the financier should also take possession, obviously impossible after seizure of the vehicle by the bailiff.) The finance and leasing industry claims to suffer a yearly loss of five billion HUF because of the expensive and cumbersome registration of charges forcing the industry to use alternative devices.<sup>\*59</sup>

<sup>54</sup> See decree No. 14/1991. (XI. 26.) of the Justice Minister on the remuneration of notaries. For instance, if the credit secured is an amount higher than HUF 5,000,000 (≈ € 21,000), but not higher than HUF 10,000,000 (≈ € 42,000), the notary is entitled to charge a fee of HUF 56,700 (≈ € 235) plus 0.5 per cent of the amount of the credit exceeding HUF 5,000,000. This is the 'fee for the notary's services' (*közjegyzői munkadíj*). 40 per cent of this is added as a lump sum for the notary's expenses. Thus the notarisation of a charge agreement securing a credit of HUF 10,000,000 (≈ € 42,000) costs HUF 114,380 (≈ € 474). These calculations are based on the exchange rates on 20 June 2008. The 'fee for the notary's services' can be doubled if the deed is drawn up in a foreign language, it can be halved if the notary prepares the deed on the basis of a draft provided by the parties without altering the draft.

<sup>55</sup> At present, the fee for registration is HUF 5000 (≈ € 19), the fee for search is HUF 1000 (≈ € 4).

<sup>56</sup> Hungary is the only country that is given a negative grading in respect of the costs of the creation of a mortgage as a result of the high notarial fees in the recent EBRD survey: *Mortgages in transition economies. The legal framework for mortgages and mortgage securities, 2007*. See <http://ebrd.com/pubs/legal/mit.pdf> (20.06.2008). Although this survey investigated the legal framework for security rights in immovables, the negative grading holds equally in respect of the costs of creation of security rights in movables.

<sup>57</sup> Since 2003, the number of new registrations has been declining year by year: 12,129 (2002), 10,760 (2003), 9,481 (2004), 9,085 (2005), 7,430 (2006).

<sup>58</sup> R. C. C. Cuming, *Should Canadian Jurisdictions Implement Certificate of Title Systems for Motor Vehicles?* Uniform Law Conference of Canada, Civil Law Section 2006, p. 11. Available at [http://www.ulcc.ca/en/poam2/Certificate\\_of\\_Title\\_for\\_Motor\\_Vehicles\\_En.pdf](http://www.ulcc.ca/en/poam2/Certificate_of_Title_for_Motor_Vehicles_En.pdf) (20.06.2008).

<sup>59</sup> The Hungarian Leasing Association has been urging the Ministry of Justice since 2006 to amend the law and enable the automobile financiers to take a charge over motor vehicles in a simple and inexpensive way. The original suggestion of the industry was to provide for the registration of charges over motor vehicles in the specialist register operated by a government agency pursuant to traffic legislation. The author of this article proposed instead a reform along the lines of Canadian law and the recommendations of the English Law Commission: registration in the charges register without mandatory notarisation of the charge contract, inclusion of the unique identification number of the vehicle in the record, possibility to search the register according to this identification number and disapplication of the rule according to which buyers in the ordinary course of business take free of a registered charge without having to search the register. The Leasing Association welcomed this alternative proposal and the Chamber of Notaries also seems to be prepared to make the online search of the register possible in the near future. For a brief summary of the Law Commission proposals see H. Beale, *Reform of the Law of Security Interests over Personal Property*. – J. Lowry, L. Mistelis (eds.). *Commercial Law: Perspectives and Practice (Essays in Honour of Sir Roy Goode)*. London 2006, 3.50.

It could be argued that the excessive notary costs are justified or at least counterbalanced by the ‘executory force’ of a notarised deed: upon default by the debtor, the notarised deed allows the creditor to proceed immediately to judicial enforcement, without first having to reduce the secured claim to judgment. While this argument has its merits, it does not justify the mandatory requirement of a notarial deed as a precondition to registration. Secured creditors should be free to decide whether, under the circumstances of the particular transaction, a notarial deed is indispensable or not.<sup>\*60</sup>

During the consultations, the Chamber of Notaries argued that the mandatory notarisation also serves to protect the debtor against exploitative terms imposed upon the debtor by a rapacious creditor. However, according to the data collected by the Chamber of Notaries, about 95 per cent of the debtors against whose property charges are registered are legal persons, usually companies obtaining professional legal advice when preparing contracts and making decisions. Consultations also revealed that the notarial deeds are usually drawn up on the basis of carefully prepared draft agreements negotiated by the parties’ legal representatives and it is highly unlikely for a notary to require the alteration of the parties’ agreement. As far as natural persons granting charges are concerned, the provisions of the Civil Code on the avoidance of unfair contract terms provide adequate protection.

Finally, notaries also argued that the mandatory notarisation serves the purpose of verification of the contracting parties’ identity, since notaries have access to the state databases and are obliged to check the identification documents against the contents of these databases. First, this service does not justify the excessive costs of notarisation, and, second, modern technology (such as the electronic ID card already introduced in some European jurisdictions, such as Estonia) could provide an alternative to personal identification by a notary.

### 3.6. Paper-based document-filing instead of on-line notice-filing

The charges register is kept in electronic form by the Chamber of Notaries, but neither registration nor search is possible on-line. Both are possible only by going personally to the office of a notary. The registration can only take place on the basis of a notarised charge contract. The register is not publicly searchable via the website of the Chamber of Notaries,<sup>\*61</sup> but it is possible to conclude a contract with the Chamber of Notaries for direct electronic access for the purpose of making searches, provided that the necessary technical requirements are met and the fees for having access to the register are paid.

In summary, the current system of publicity does not allow for simple, fast, and inexpensive registration or access to the registered information. This is to a great extent because the Hungarian legislator of 1996–2000 misunderstood the nature and role of the charges register. This misunderstanding is still present among both lawyers and market participants, most of whom think of the charges register as if it were the equivalent of the land register for movables and disregard the basic differences between a title register and a secured transactions register. For instance, the ‘Concept Paper’ for the new civil code (2002) stated that “the authenticity<sup>\*62</sup> of the charges register has to be increased”.<sup>\*63</sup> The speakers at a conference organised by the Chamber of Notaries in February 2007 argued that the rules on the charges register should be brought into line with the rules of the land register. It may be hard to believe, but the leading lawyer of the Chamber of Notaries recommended abolition of the rule according to which transferees in the ordinary course of business obtain an overriding title, free of the non-possessory charge, without having to search the register. Even 11 years after the establishment of the charges register, it is still not commonly accepted that the charges register operates on the principle of negative publicity (or negative authenticity) and that the record in the register is not intended to

<sup>60</sup> The costs of obtaining a notarial deed with executory force seem to be high also in other countries of the region, but the notarisation of the charge contract is usually not a mandatory precondition to registration. See, e.g., K. Andova. *Das Mobiliarpfandrecht in Österreich, Ungarn, Tschechien und in der Slowakei*. Wien 2004, p. 221; B. Schönfelder. *Courts, Credit and Debt Collection in Post-communist Slovakia*. Notes about some understudied ingredients of a successful transition. – *Economic Annals* No. 167, October–December 2005, p. 7 ff.

<sup>61</sup> In other countries of Central and Eastern Europe, where a register for security rights in movables has been established, on-line search is possible, and in many countries also registration can take place on-line, at least for a limited group of registered users such as banks. The charges register operated by the Slovakian Chamber of Notaries permits free, electronic on-line search. See <http://www.notar.sk/dotnetnuke/aj/Liens/tabid/346/Default.aspx>. Also the database of the Romanian Archive of Security Interests in Movables can be searched by anyone for free via the Internet at <http://www.mj.romarhiva.ro>. In Montenegro, searches can be made through the Internet at <http://www.rzcg.cg.yu> and registered users (currently only lawyers of the Montenegro Bar and commercial banks) can also register charges on-line.

<sup>62</sup> ‘Authenticity’ (‘public faith’) means that public reliance on the contents of the land register is protected. The first reform of the CC provisions on the law of charge (1996) introduced the rule that the charges register is ‘authentic’, i.e., public reliance on the contents of the register is protected. The second reform (2000) limited the ‘authenticity’ of the charges register to the conclusion of the charge agreement, i.e., the register provides authentic evidence that a charge agreement was entered into by the parties. Of course, even this rule is pointless, because third parties are not interested in the existence of the charge agreement, but in the existence of the charge as a proprietary right.

<sup>63</sup> *Az új Polgári Törvénykönyv koncepciója és szabályozási tematikája* (Concept Paper of the new Civil Code). – *Magyar Közlöny, Különszám* (Official Gazette, Special Issue) 2003, p. 101 (in Hungarian).

provide positive proof of the existence of the charge. Even if these are recognised, they are often considered to be the result of bad legislation. Astonishingly, even banks consider the charges register to be a repository of authentic documents with the notaries as gatekeepers who should scrutinise the information submitted by the parties.<sup>64</sup> It must be admitted that Hungarian legal scholarship did a very bad job in educating the public about the role of the charges register and the nature of the non-possessory charge over movables.

### 3.7. Lack of a general extension of charge to proceeds of disposition

The right of the chargee to follow the charged asset in the hands of a transferee is considerably limited by the rule according to which buyers in the ordinary course of business acquire an overriding title to tangible movable assets free of a non-possessory charge. Also to counterbalance this limitation, the charge should extend to whatever proceeds are received by the grantor upon disposition of the charged assets. However, Hungarian law takes a narrow view of the proceeds that take the place of the original collateral: the charge extends to a payment under an insurance policy, damages recovered from a third party, or other value received for the depreciation in value or destruction of the charged asset, but not to proceeds of disposition. Of course, the parties may agree that a charge is to carry through to any proceeds of disposition, but problems may arise in practice (e.g., upon the commingling of money), as Hungarian law does not have tracing rules to identify the proceeds of the original collateral.

### 3.8. Enforcement: The creditor's remedies upon the debtor's default

The enforcement methods should be made less formalistic and more flexible in order to reduce costs and delay. The remedy of acceptance of the collateral in full or partial satisfaction of the secured claim should be introduced with appropriate safeguards for the debtor and third parties.

### 3.9. Lack of consumer protection rules

Finally, greater flexibility should be counterbalanced by consumer protection rules whenever necessary, such as by restricting the consumers' ability to encumber their future property or by a mandatory requirement of public sale as a method of enforcement.

## 4. The virtues and vices of the bill on the new civil code

The structure of the provisions on charge is essentially the same in the Expert Draft and the bill on the new civil code. In both of them, the rules are divided into 10 chapters, covering the following:

- I. Creation of the charge
- II. The secured obligation
- III. The object of the charge
- IV. Pre-default rights and obligations of the parties
- V. Charge granted by a third party (i.e., by a person different from the debtor of the secured obligation)
- VI. Security trustee
- VII. Charges register
- VIII. Priority of charges
- IX. Enforcement of the charge
- X. Termination of the charge

<sup>64</sup> In the consultation process, the Banking Federation preferred retaining the present system of document-filing — coupled with the lowering of notary fees — to the introduction of on-line notice-filing. To understand this position, one should know that Hungarian banks do not trust the agreements on extrajudicial enforcement, because they fear that uncooperative debtors might prevent the creditor from taking possession of the encumbered assets. Therefore they regularly require the chargor to sign a notarial deed that enables the creditor to initiate judicial enforcement proceeding without previous judgment. To put it briefly, banks do not consider document-filing to be a particular burden, since notarisation of the charge contract requires appearance before a notary anyway.

In addition to these chapters, comprising the title on charge, the bill contains two further titles, one on enterprise charge and another on the so-called independent (non-accessory) charge. The Expert Draft recommends restricting the scope of an all-asset security right to movables and abolishing the independent charge altogether.

A significant portion of the provisions on charge is identical in the academic and the official draft. Still, there are considerable differences, most notably in respect of the treatment of title-based security devices and the system of registration of security rights in movables. This part of the paper provides a comparison of the solutions adopted by the various drafts, focusing on the Expert Draft and the final Ministry of Justice draft, which became the Bill on the new civil code.<sup>\*65</sup>

## 4.1. Effectiveness as between the parties

The Expert Draft contains a provision on the *inter partes* effectiveness of a charge contract.<sup>\*66</sup> According to this provision, the legal effects of a charge contract are twofold: On the one hand, the contract creates an obligation on the part of the grantor to transfer possession of the asset to the creditor or to give a declaration of consent to the registration of the charge. On the other hand, the parties to a charge contract have the same rights and duties between themselves as the chargor and the chargee, but these rights and duties cannot be enforced against third parties in the absence of dispossession or registration.

Thereby the Expert Draft recognises the *inter partes* enforceability of unperfected security rights. However, a clear distinction between creation and perfection (third-party effectiveness) throughout the draft would have been preferable. In contrast, the Ministry of Justice's drafts — including the Bill — do not clarify the legal effects of a charge contract not accompanied by dispossession or registration.

## 4.2. Quasi-securities

The proper treatment of title finance has been one of the most debated issues of the re-codification. The Commission Draft included a prohibition of title-based (or fiduciary) security agreements<sup>\*67</sup>, whereas the Expert Draft and the First Ministry Draft opted for a statutory re-characterisation of *quasi*-securities as charge agreements.<sup>\*68</sup> This approach resembles the device of a 'presumption of hypothec' as had been recommended by the Civil Code Revision Office of Québec in 1978.<sup>\*69</sup> For example, a transfer of ownership or an assignment for purposes of security would not be void, but would be given the effect of a charge contract. Similarly, the grant of an option to purchase by way of security would be converted into a charge contract. Without dispossession or registration, the charge contract would not create any right *in rem*, yet the creditor may still be able to enforce the charge and realise the collateral in the absence of competing third parties.

The Expert Draft extended the scope of re-characterisation to cover also retention of title agreements to secure the purchase price and those lease transactions that are economically indistinguishable from conditional sales ('disguised sales'). The title retained by the lessor is re-characterised as a security right if a) the lessee acquires or has an option to acquire the ownership of the leased goods for no additional consideration or for nominal additional consideration at the end of the lease or b) the term of the lease is equal to or longer than the remaining useful life of the goods.<sup>\*70</sup>

The Expert Draft also provides for the superpriority of acquisition financiers' charges (purchase money security rights): title-retaining sellers and finance lessors — whose retained title is given the effect of a charge — have priority over other chargees if they register their charge prior to the buyer's/lessee's taking possession of the goods and notify other creditors with a registered charge over the same goods. The Expert Draft extends this superpriority also to lenders who advance credit to enable buyers to acquire goods.<sup>\*71</sup>

The Second Ministry Draft, of February 2008, reversed the policy decision to treat all transactions performing a security function equally. The re-characterisation rule was dropped. The Bill neither prohibits nor re-

<sup>65</sup> Hereinafter: the Bill.

<sup>66</sup> Expert Draft § 4:104.

<sup>67</sup> Commission Draft § 5:383: "A contract for the transfer or retention of title, the transfer or retention of a claim or a right by way of security is null and void, unless there is an express statutory provision to the contrary." This is similar to, although broader in scope than the approach of the Dutch Civil Code in article 3:84 (3).

<sup>68</sup> Expert Draft §§ 4:106–107, First Ministry Draft § 4:100. The First Ministry Draft applied the recharacterisation rule only to transfer of ownership by way of security, assignment by way of security and the grant of an option to purchase by way of security, but not to retention of title and finance lease.

<sup>69</sup> See, e.g., M. Boodman, R. Macdonald. How Far is Article 9 of the Uniform Commercial Code Exportable? A Return to Sources? – Canadian Business Law Journal 1996 (27), pp. 249, 256.

<sup>70</sup> Expert Draft § 4:107.

<sup>71</sup> Expert Draft § 4:144.

characterises title-based security devices. It is silent on some *quasi*-securities, such as security transfer of ownership and security assignment. The rights of title-retaining sellers and finance lessors are regulated, but they are not considered to be security rights at all.<sup>\*72</sup>

However, one title-based security device received express recognition in the Bill: the option to purchase granted by way of security. According to the Bill, the grant of an option to purchase for security purposes is valid only if a) granted in a notarial deed or in a deed countersigned by an attorney, b) registered in the land register or the charges register, and c) containing statement of the value of the asset according to expert opinion given not earlier than six months from the date of the grant of the option. The option to purchase entitles its holder to create a contract of sale by unilateral declaration, subject to a duty to account to the debtor ('seller') for any surplus calculated on the basis of an expert opinion given at the time of the exercise of the option to purchase.<sup>\*73</sup> These rules are unsound from a dogmatic point of view (e.g., the registration requirement as a condition for the validity of the contract) and do not clarify a number of essential issues (what kind of obligations may be secured; what the requirements are in respect of the identification of the secured obligation and the encumbered assets in the contract; what the pre-default rights and obligations of the parties are, if any; whether it is an accessory right that is terminated, for example, by the discharge of the secured obligation, etc.). Nor will the holder of the option to purchase be able to follow the asset into the hands of third parties. At least there is no provision to that effect in the Bill.<sup>\*74</sup>

An alternative to full-fledged functionalism could have been to apply only the publicity requirement to *quasi*-securities (i.e., to include them within the registration scheme) while leaving their contractual and proprietary nature otherwise unaltered.<sup>\*75</sup> However, this solution was rejected as well, for no apparent reason (although the system of document-filing would be unsuitable for at least some forms of *quasi*-security and — as shall be explained later — the Ministry of Justice refused to adopt a system of notice-filing).

### 4.3. Receivables financing

Both the Expert Draft and the Bill propose extension of the registration requirement to charges over receivables. In fact, all of the drafts contained this proposal, and this was one of the few issues on which all consultees agreed.

It was the understanding of the Hungarian Banking Federation that the publicity of security rights in receivables is also a requirement from the viewpoint of the new European capital adequacy regime applicable to credit institutions. Under the new regulatory framework based on the Basel II Accord, collateralised transactions have to fulfil a number of criteria in order to qualify as a credit risk mitigation technique. One of these criteria is the legal certainty of the collateral, since collateral can effectively mitigate risk only if the relevant legal mechanisms ensure that the lender has clear rights to the collateral. As the registration system permits prospective creditors to discover already existing security rights and enables the secured party to obtain priority over third parties, publicity has been considered to be an element of legal certainty by all stakeholders in the consultation process.

By contrast, none of the drafts recommends extending the scope of registration to outright assignments — i.e., transfers of receivables. The Expert Draft recommended the re-characterisation of security assignments as charge agreements, with registration required to achieve third-party effectiveness. The Bill does not require the publication of either security or outright assignments. Rather, it turns a blind eye to the facts that security assignments perform the same economic function as charges and that it is often very difficult to distinguish between outright transfers, on the one hand, and security transfers and charges, on the other. The Bill fails to recognise that the publicity of all three types of transactions could improve the ability to obtain credit on the security of receivables.

To promote receivables financing transactions and thereby to increase the availability of credit, both the Expert Draft and the Bill provide for the override of contractual anti-assignment clauses: contractual restrictions on the transferability of receivables are null and void.<sup>\*76</sup> The Bill also expressly provides that contract clauses

<sup>72</sup> The provisions on sale and leasing treat the title-retaining seller and the finance lessor as owner.

<sup>73</sup> Bill § 5:373. This article is contained in the Book on the Law of Obligations (Book V), following the rules on suretyship and independent guarantee.

<sup>74</sup> The option to purchase is opposable against third party acquirers only if the option relates to immovables or registered tangibles and the option is registered in the land register or the appropriate specialist register. See Bill § 5:190 and § 5:195 (5).

<sup>75</sup> Louise Gullifer draws attention to this possibility in her article *Quasi-security Interests: Functionalism and the Incidents of Security* — I. Davies (ed.). *Issues in International Commercial Law*. Ashgate 2005, pp. 3, 10. This approach has been followed in the second stage of secured transactions law reform in Lithuania. See A. Smaliukas. *Reform of Laws on Security Interests in Lithuania: Convergence of Legal Concepts*. — I. Davies (ed.). *Issues in International Commercial Law*. Ashgate 2005, p. 31 ff. and A. Smaliukas. *Reform of security over movable property in Lithuania: the second stage*. Available at <http://www.ebrd.com/pubs/legal/lit041d.pdf> (20.06.2008).

<sup>76</sup> Expert Draft § 5:177 (3), Bill § 5:168 (4).

prohibiting or limiting the creation of a charge over the receivables shall be of no effect.<sup>\*77</sup> Under these rules, the assignment of the receivable or the creation of a charge over the receivable — despite a contractual restriction — does not even constitute a breach of contract as between the debtor and the assignor/chargor. The Commission Draft of 2006 provided only for the ineffectiveness of such clauses as against the assignee, but not as between the assignor and the debtor of the receivable. However, this solution was not considered to be sufficient to stop the widespread practice on the part of large customers of inserting in their purchase orders a clause prohibiting the supplier from assigning his right to payment under the supply contract.<sup>\*78</sup> Creditors would still be deterred from assigning or charging the receivable for fear of liability in damages for breach of contract.

#### 4.4. Charges register

One of the main differences between the Expert Draft and the Bill is the approach taken with respect to the charges register. Whereas both the Commission Draft of 2006 and the Expert Draft of 2008 propose to modernise the charges register by switching to on-line notice-filing, the drafts of the Ministry of Justice — including the Bill — retain the status quo: document-filing by personal appearance in the office of a notary.

The Expert Draft contains detailed rules on on-line registration. Instead of the present system of document-filing with extensive particulars of the charge to be registered, it recommends that only the essential data (the name and details of the chargor and the chargee, along with description of the encumbered assets) should be filed by completing a form on-screen (on a government website). The parties may also include in the notice the maximum amount of the secured obligation, but this is not mandatory.

In response to concerns about wrongful filings ('bogus filings'), the Expert Draft requires also the consent of the grantor to be given on-line. Only enrolled users would be able to register a charge or give consent to a registration. Both natural and legal persons could enrol as users, and legal persons could also submit the particulars of natural persons entitled to register charges or consent to registrations on their behalf. In addition to prior enrolment as a user, the draft envisages personal identification before each registration or consent to registration. This could take place by various techniques, such as by implementing an electronic ID card scheme as can be found in Estonia.<sup>\*79</sup>

#### 4.5. Security trustee

Both the Expert Draft and the Bill empower the chargee(s) to appoint a person (the security trustee or charge manager) to exercise all the rights of the chargee(s) arising under the charge except for the right to transfer the secured obligation. This new role is intended to facilitate syndicated lending, where the loan is extended by a group of creditors and the charge is granted for the benefit of all of them. The rules are inspired by those laid down in article 16 of the EBRD Model Law on Secured Transactions. The charge manager may be one of the chargees or a third party. The appointment is effective against third parties from the date of registration in the appropriate register. If a security trustee is registered, the chargees themselves do not need to be registered. Upon any transfer by a chargee of the secured obligation extending to the charge, the powers and obligations of the security trustee continue and the security trustee acts also for the benefit of the new chargeholder.<sup>\*80</sup>

#### 4.6. Extension of the charge over a receivable to any personal or property rights securing the receivable

The current Civil Code provides that the assignee of a receivable automatically has the benefit of a suretyship or a charge that secures the payment of the receivable, but no similar rule can be found among the provisions on charge. The Expert Draft and the Bill apply the same rule to a charge over a receivable: the chargee automatically has the benefit of a suretyship or a charge that secures the payment of the receivable.<sup>\*81</sup>

<sup>77</sup> Bill § 4:105 (6).

<sup>78</sup> As the suppliers often depend upon the orders from these large customers, non-assignment clauses are usually imposed upon the weaker party by the party with the stronger bargaining power.

<sup>79</sup> See <http://www.id.ee> (20.06.2008).

<sup>80</sup> In 2007, a new provision has been added to the French Civil Code with the same purpose. Article 2328-1 CC enables the secured creditors to appoint a person to hold the security interest for their benefit, particularly to act for their benefit in the course of the registration and the enforcement of the security interest: "Toute sûreté réelle peut être inscrite, gérée et réalisée pour le compte des créanciers de l'obligation garantie par une personne qu'ils désignent à cette fin dans l'acte qui constate cette obligation."

<sup>81</sup> Expert Draft § 4:165 (1), Bill § 4:152 (1).

The drafts also clarify that where the receivable is secured by an independent guarantee, the charge does not extend to the right to draw under the independent guarantee. It extends only to the proceeds under the independent guarantee.\*<sup>82</sup>

## 4.7. Enforcement: The creditor's remedies upon the debtor's default

Under current Hungarian law, a chargee is entitled *ex lege* (without the need for an express agreement with the chargor) only to judicial enforcement. Out-of-court disposition of the collateral is possible only if the debtor expressly agreed to this prior to the default, in written form.

Both the Expert Draft and the Bill give the following out-of-court remedies to the chargee without requiring a pre-default agreement: a) disposition of the collateral by the chargee, b) acquisition of title to the charged asset (in other words, acceptance of the charged asset) in full or partial satisfaction of the secured claim, and c) collection or enforcement of the charged claim. The rules are fairly similar to those in Part 6 ('Default') of article 9 UCC.

The secured creditor is required to act according to the standards of commercial reasonableness when disposing of the collateral extrajudicially, taking into account the interests of the debtor, the chargor (if different from the debtor), and any other chargees with a right vested in the same asset. The extension of the requirement of commercial reasonableness to all aspects of all out-of-court dispositions is an innovation; the current Civil Code refers to this standard only in the case of charges over financial collateral. The Expert Draft and the Bill also provide for a rebuttable presumption that the disposition was made in a commercially reasonable manner if the disposition was made a) at a price current in any regulated market (such as stock exchanges) at the time of disposition or b) in conformity with the usual commercial practices among dealers in the type of property that was the subject of the disposition.

Appropriation as a special remedy in the case of possessory charges over financial collateral is, of course, retained. This remedy is regulated as an exceptional form of acquisition of title to the charged asset in full or partial satisfaction of the secured claim, where the creditor does not have to present a proposal and the consent of the debtor or third parties is not required. The creditor is, in essence, only required to account for any surplus, taking into account the value of the collateral at the time of enforcement.\*<sup>83</sup>

## 4.8. Consumer protection

Both the Expert Draft and the Bill recommend introduction of consumer protection rules into the law of charge — in the context of the creation and the enforcement of the charge. The relevant provisions are identical in the two drafts.\*<sup>84</sup>

A charge contract will qualify as a consumer charge contract if a) the chargor is a natural person, b) the object of the charge is an asset primarily used for purposes outside the scope of the chargor's business or professional activity, and c) the secured obligation arises from a contract that the chargor concluded outside the scope of its business or professional activity.

In the context of creation, the drafts seek to prevent excessive consumer borrowing by requiring the consumer charge contract a) to contain a specific description of the encumbered asset(s) and b) to stipulate the maximum amount of the secured obligation. A consumer charge contract that fails to meet these requirements is null and void. To protect consumers from overindebtedness, the drafts also provide that consumers cannot charge their future property, except when it is the secured loan that enables the consumer to acquire the future asset.

In the context of enforcement, the restrictions are twofold: a) the chargee is not entitled to accept the collateral in full or partial satisfaction of the secured obligation (he is required to dispose of the encumbered asset),

<sup>82</sup> Expert Draft § 4:165 (2) and § 4:117 (7), Bill § 4:152 (2) and § 4:108 (7).

<sup>83</sup> 'Appropriation' (within the meaning of the financial collateral directive) is defined by Professor George L. Gretton as a method "whereby the creditor enforces by taking absolute title to the collateral". See G. L. Gretton. *Financial Collateral and the Fundamentals of Secured Transactions*. – *Edinburgh Law Review* 2006 (10) 2, pp. 209, 231. In fact, the creditor may have acquired absolute title well before the enforcement, through the commingling of fungible goods. As Professor Alfons Bürge explains: "beim *pignus irregulare* bei der Pfandverwertung immer nur um ein Aufrechnen oder Abrechnen gehen kann, da das Eigentum bereits früher übergegangen ist und sich die Schuld auf die Leistung von Sachen gleicher Art, Güte und Menge beschränkt". See A. Bürge. *Das römische Recht und das Drama der Umsetzung der Richtlinie über die Finanzsicherheiten in das deutsche BGB*. – R. Waldburger, Ch. M. Baer, U. Nobel, B. Bernet (eds.). *Wirtschaftsrecht zu Beginn des 21. Jahrhunderts*, FS Peter Nobel, Bern 2005, pp. 495, 512. The essence of *pignus irregulare* is very clearly formulated in article 1851 of the Italian Civil Code.

<sup>84</sup> Bill § 4:97, § 4:138, Expert Draft § 4:103, § 4:151.

and b) the disposition may take place only by a public sale, except as otherwise provided by the parties in a written agreement entered into after default.

## 4.9. Charge over financial collateral

Ever since its adoption in 1959, the Civil Code has contained rules on a special security right with two distinctive features: it can subsist only over money (tangible or intangible)<sup>\*85</sup> and securities (certificated or uncertificated), and it confers on the creditor a right of appropriation upon the debtor's default. Although it is created by a security agreement and transfer of possession to the creditor, it is regulated separately from the provisions on possessory charge (pledge). It even has its own distinct name (*óvadék*). These rules were amended in 2004 by the statute implementing the EC financial collateral directive.

The Bill integrates the rules on this special form of security right into the general scheme of the law of charge, with special rules whenever necessary. Special rules have been added in the chapters on creation, pre-default rights, priority, and enforcement.

The chapter on creation provides a special definition of transfer of possession in respect of intangible money and book-entry securities.<sup>\*86</sup> This means that the concept of possession is broadened, instead of the introduction of a new concept, such as 'control'.<sup>\*87</sup> The methods by which a creditor can obtain possession of bank money or book-entry securities are the following: a) transfer to the creditor's account; b) transfer to an account (sub-account) in the name of the debtor, blocked in favour of the creditor; c) control agreement; and d) automatically upon conclusion of the charge contract, if the secured creditor is the depositary bank or the intermediary. All of these mechanisms are deemed to effect a transfer of possession for the purposes of creating a charge over bank money or securities. The control agreement is defined as a tripartite agreement between the account holder, the creditor, and the depositary bank (in respect of bank money) or the intermediary (in respect of securities), pursuant to which a) the depositary bank or the intermediary is not permitted to comply with any instructions given by the account holder without having received the consent of the creditor and/or b) the depositary bank or the intermediary is obliged to comply with any instructions given by the creditor without any further consent of the account holder.<sup>\*88</sup>

The chapter on pre-default rights contains a provision on irregular pledge, which implements the rules of the financial collateral directive on the creditor's right of use and disposition.

The chapter on priorities includes a rule according to which a possessory charge (pledge) over money or securities credited to an account has priority over a non-possessory, registered charge over the same assets. This is the 'Hungarian translation' of the UCC rule that gives priority to the secured creditor who has control over another secured creditor who perfects by other means.

The chapter on enforcement empowers the creditor to enforce a possessory charge over money or securities by appropriation — i.e., without sale — by retaining as much of the collateral as is necessary to discharge the secured obligation.<sup>\*89</sup> The creditor is, of course, under an obligation to account for any surplus.

The Expert Draft adopts substantially identical rules, with only minor differences, stemming from a different conceptualisation of the transfer of incorporeal money.

<sup>85</sup> The term used to refer to intangible money (in both the CC in force and the drafts of the new CC) is 'claim based on a bank account'. This is similar to the term of the UNCITRAL Legislative Guide on Secured Transactions: 'right to payment of funds credited to a bank account'. In the course of the re-codification, there has been some discussion about the appropriate legal characterisation of intangible money. It has been proposed to characterize incorporeal bank money as a 'chose in possession' instead of a 'chose in action' (First Ministry Draft § 4:13), but this proposal was eventually rejected.

<sup>86</sup> Bill § 4:101.

<sup>87</sup> The concept of 'control' originates from article 8 of the UCC. It is used by the EC financial collateral directive in article 2, paragraph 2 and in recital No. 9, the directive defines the concept of 'provision' by reference to possession and control. The concept will probably be used as an equivalent of 'possession' for intangibles by the Principles of European Law – Proprietary Security Rights in Movable Assets, prepared by the Study Group on a European Civil Code. According to the Official Commentary to § 8-106 of the Uniform Commercial Code: "A principal purpose of the 'control' concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices." None of the drafts of the new civil code attempted to introduce a similar new concept into Hungarian law.

<sup>88</sup> This definition of 'control agreement' is modelled upon the definition of the UNIDROIT Draft Convention on Substantive Rules regarding Intermediated Securities. The second part of the definition is identical to the definition in the UNCITRAL Legislative Guide on Secured Transactions.

<sup>89</sup> If the securities do not have an objective market value, the chargee is not entitled to enforce the charge by appropriation.

## 4.10. Enterprise charge

The Commission Draft and the Expert Draft proposed to abolish the enterprise charge as a distinct security right. Two arguments were put forward to support this proposal: 1) A charge created by registration in the charges register may cover all the movable assets of the debtor (except those for which a specialist title register exists), including after-acquired assets. The only advantage of retaining the enterprise charge as a distinct security right would be that it could also cover — present and after-acquired — immovables and registered movables of the debtor. However, immovables and registered movables in the patrimony of the debtor are not safely ‘allocated’ to the secured creditor by an enterprise charge, since holders of subsequent mortgages and charges registered in specialist registers have priority over the holder of the enterprise charge. Therefore secured creditors always take separate mortgages and charges over immovables and registered movables in addition to an enterprise charge. This practice suggests that there would be no harm in restricting the scope of charges created by registration in the charges register to non-registered movables.<sup>\*90</sup> 2) The special enforcement method provided for in § 266 of the Civil Code — i.e., the sale of the enterprise as a whole (as a going concern) — should lead to a collective proceeding involving all the creditors of the debtor, and any difference from an insolvency proceeding would be hardly justifiable.<sup>\*91</sup>

In fact, there was no significant opposition among consultees to the abolition of the enterprise charge. It was only the Chamber of Notaries that insisted on retaining this institution, arguing that, although a creditor regularly takes separate mortgages over immovables and separate charges over registered movables that are already present in the debtor’s patrimony at the time of the creation of the enterprise charge, the enterprise charge captures also after-acquired immovables and registered movables (although priority may be obtained by another creditor). The Ministry of Justice accepted this argument, and the Bill contains a separate title on the enterprise charge. However, the rules depart from the existing law on two points: i) they permit an enterprise charge to be granted over the whole or **any part** of the patrimony of the enterprise — i.e., the requirement that the object of an enterprise charge be either the whole or **an economically independent unit** of the enterprise is to be abolished — and ii) the provision on enforcement “with the preservation of the unity of the enterprise” is omitted.<sup>\*92</sup>

## 5. Conclusions

Undoubtedly, the wholesale review of Hungarian civil law has yielded some fruits for the law of charges. If the Bill on the new civil code is enacted, this branch of the law will be better structured, conceptually clearer, and more streamlined than the provisions of the current Civil Code. The Bill also innovates in several important respects. It proposes introduction of a number of useful new legal concepts and techniques, such as the consumer charge contract, the control agreement, the merely consensual creation (in UCC parlance, automatic perfection) of a charge over financial collateral in favour of the depositary bank or the intermediary, the right of the chargee(s) to appoint a security trustee, the availability of extrajudicial remedies by virtue of law (*ex lege*), commercial reasonableness as a general post-default standard of conduct, and the new remedy of acceptance of the collateral in full or partial satisfaction of the secured obligation.

However, the Bill also suffers from major flaws. The most important shortcoming of the Bill is its failure to implement an integrated and functional approach to replace the current fragmented and formalistic approach. Further, the Bill misses the opportunity to substitute a scheme of on-line notice-filing for the current system of paper-based document-filing.

The failure to handle the issue of *quasi*-securities in a consistent way means that the current situation of legal uncertainty will persist and the existing practice of creating a charge and a title-based security device at the same time over the same assets to secure the same obligation will continue. Neither transaction costs nor the amount of litigation will be reduced thereby.

The failure to modernise the charges register does not contribute to the competitiveness of the Hungarian legal framework in view of the advanced Internet-based registers operating in other countries of the region. The Bill,

<sup>90</sup> In its consultative report of 2004, the Law Commission for England and Wales also suggested that charges over assets for which there is a specialist mortgage register, for example land, registered ships, aircraft and certain types of intellectual property, should be outside the notice-filing scheme. See Company Security Interests. A consultative report. Law Commission Consultation Paper No. 176, p. 25 *ff.* Available at [http://www.lawcom.gov.uk/docs/cp176\\_final\\_version.pdf](http://www.lawcom.gov.uk/docs/cp176_final_version.pdf) (18.08.2008).

<sup>91</sup> For some time, subordinate legislation was planned to enact detailed rules along the lines of the EBRD Model Law for Secured Transactions (see article 25 on enterprise charge administration). Subsequent to a consultation in 2004, this plan was abandoned, as the conclusion was reached that an enforcement by the sale of the enterprise as a whole should take into account the interests of all the creditors and that can be achieved in a collective insolvency proceeding. The Drafts also referred to the Enterprise Act 2002 of the United Kingdom, which restricted the institution of administrative receivership to certain exceptional situations.

<sup>92</sup> These amendments represent a return to the first reform of secured transactions law in 1996.

if enacted in its present form, is going to compel the Chamber of Notaries to enable free on-line search of the register and will also abolish notarisation as a mandatory precondition to registration. However, registration will continue to take place by personal appearance before a notary instead of by filing a simple notice on-line. In fact, the more substantial issue of *quasi*-securities and the more technical matter of registration are closely linked: a cumbersome registration procedure precludes the extension of the registration scheme to title retention (at least if related to inventory supplied on short-term credit) and outright sales of receivables.

The Expert Draft offered solutions for both of these issues, in line with the recommendations of the latest international project aiming at the harmonisation of secured transactions law, the UNCITRAL Legislative Guide on Secured Transactions.<sup>93</sup> However, vigorous opposition was staged against the proposed solutions by the two stakeholders with the most significant influence over the drafting of this part of the Bill in the last phase of the codification, the Hungarian Chamber of Notaries and the Hungarian Banking Federation. The former asserted that notice-filing would disrupt public confidence in the reliability of the charges register, and the latter argued that the functional approach is an unnecessary restriction of freedom of contract.

To summarise, the Bill represents a significant simplification and an improvement of the current legislation, but it will achieve much more a fine-tuning than a radical change of the Hungarian law of proprietary security rights. Attachment to the status quo and particularist interests impeded the implementation of some of the core principles of a modern secured transactions law. Nevertheless, the codification exercise generated useful debate, and it brought forward new ideas and critical thoughts on the adequacy and efficacy of the existing legislative framework. Hungarian lawyers have been granted the opportunity to become familiar with the achievements of foreign law reforms and the recommendations of international projects aimed at the harmonisation of secured transactions law.<sup>94</sup> One can only hope that the unsettled debates and the divergences of the various drafts will provide food for further reflection and that the process will bear fruit in the coming years.

<sup>93</sup> In many respects, the proposed solutions were also similar to the reform proposals of the English Law Commission. As far as it can be predicted, the Study Group on a European Civil Code will also come to similar conclusions in its Principles of Proprietary Security Rights in Movable Assets to be published in 2009.

<sup>94</sup> On the invitation of the Ministry of Justice, Harry C. Sigman, member of the Drafting Committee that revised article 9 UCC held two lectures in Budapest, where he presented the US law of secured transactions. In late 2006, a three-day international seminar was hosted by the Ministry, where internationally renowned experts (Spiros Bazinas, Hugh Beale, Angel Carrasco Perera, Neil B. Cohen, Eric Dirix, Ulrich Drobnig, Dimitri Houtcieff, Eva-Maria Kieninger, Roderick A. Macdonald, Harry C. Sigman, Catherine Walsh) expressed their views on the draft provisions on the law of charges as contained in the Commission Draft. The author is indebted to all the participants of this seminar for their useful remarks and suggestions.