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THE STATE OF HUNGARIAN INSOLVENCY LAW

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Some Non-Technical Observations on the Occasion of the New York Law School Symposium on Bankruptcy and Corporate Development in Emerging Nations

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As an invited "observer" of the Sixth Annual Ernst C. Stiefel Symposium at the New York Law School, I was besieged with a number of extraordinarily pleasant tasks: to visit New York City on a beautiful spring weekend, while tornadoes were ripping Northwest Arkansas asunder.[1] And to do so with a generous scholarship from the sponsoring agency. And to listen to stimulating discussions, led by smart and experienced scholars, judges and practitioners. And to be attended by smart and eager NYLS law students, and to discover that at least some of them, like I, and notwithstanding the present symposium, honestly find American Indian law to be at least as fascinating as comparative bankruptcy law, as hard as that may be to believe.[2] And, apropos of this essay, to be granted a few pages in the *Journal of International and Comparative Law* to make these "observations" about the presentations in *general and Hungarian insolvency law in particular.*

My "observations" shall be five.

1. Hungary "emerged" as a nation in 896 A.D., but never mind. We all know what the organizers mean.

2. My first lengthy stay in Budapest was in the spring of 1992, on sabbatical from the University of Arkansas, and teaching at the

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1. Sometimes even writing footnotes is a pleasant task. *See Death from the Sky*, N.Y. DAILY NEWS, April 23, 1996, at 4, or, less dramatically, *Tornadoes Leave 4 Dead in Western Arkansas, N.Y. TIMES, April 23, 1996, at 14.*

2. Perhaps a future Ernst C. Stiefel Symposium will compare the laws of the various nations regarding their indigenous inhabitants. Or even better, perhaps it will compare the laws of the various Indian tribes regarding the European-American inhabitants of their reservations.

Külkereskedelmi Foiskola, an undergraduate business school of good reputation. About half-way through my stay, I met an American, newly M.B.A.'d from Columbia, who was in town to advise Hungarian businesses on some nifty western idea, franchising, I think. I asked her what she thought so far. "I like it here," she said, "but I wish the Hungarians weren't so pessimistic."

She had discovered for herself half of a familiar observation about Hungarians: they are both uncommonly hospitable and uncommonly pessimistic, so, when you visit Budapest you should expect to be invited into many homes, but don't expect to have a good time. I gave my usual snappy retort, something about their having chosen the losing side of every international conflict since the 14th century. That will wear a country down.

But I began to think more seriously about her observation as I rode the Metro to work the next day, and those thoughts are relevant still, in April, 1996, at the present symposium: Perhaps Hungarians have some things to be pessimistic about. Since the 1989 changes, unemployment has moved well into the double digits. Crime has increased; drugs have made it across once-tight borders. Budapest now has subway sleepers and graffiti vandals, beggars who pester the busy and skinheads who harass the innocent. Sex shops grace previously picturesque shopping districts. Inflation makes the Metro expensive and turns pensions into pittances. The infrastructure is crumbling and business bankruptcies are pending.

If a list like this of the downside of democracy makes Hungarians pessimistic about the "new" Hungary, it makes a Westerner realize how we have come to accept such developments as the natural, even necessary, consequences of modern life. Except for inflation, which has been under control for some time in the U.S., the list above contains little that an American would regard as exceptional. Well, unemployment as high as 10% would be extraordinary if it were the national rate, though in some locales the rate is that high now. Even a 10% national rate would likely cause no upheaval beyond a switch from one of our comfortable political parties to another. And as far as the other factors go, well some of us worry some of the time about some of them, and people from places like Fayetteville, Arkansas, still express wonder and even shock when we visit places like New York, but on the whole, I think, our response to the concern expressed by Hungarians over the "new" Hungary is, "well, what exactly did you *think* free market democracy was all about?"

And, in turn, when we express concern that they are returning the former communists to power, their response is, "Yes? And what did you expect? That we *like* the grand principle of free speech as exercised by

graffiti artists, panhandlers and skinheads? That rampant insolvency is *our* particular cup of legal tea?"[3]

3. Which brings me to the dissolution of the New York Law School. I learned of this non-event before the first panel sat, as I sipped my coffee in the hallway of the very much undissolved New York Law School, reading the history of the sponsoring institution.

Times were tough for NYLS after World War II, not least, one suspects, on the financial side. The school sought permission from the New York courts to dissolve.

Permission denied.[4]

It is, of course, not a unique occurrence that a privately owned entity be denied the opportunity to cease performing what is seen as a public service. The Greyhound insolvency raised similar issues.[5] But, while not unique, in the U.S. the situation is at least unusual. In the "emerging nations" of our discussion—at least those, like Hungary, "emerging" from socialism—however, the question goes to the heart of the insolvency phenomena: what businesses are too important to be allowed to fail? It was a theory of socialism, of course, that all the businesses running were worth running.[6] The theory is now gone—or, at least, on hold—and it is not the case that all vital businesses are state-owned, at least when one defines "vital" from the risk-averse mind-set of many formerly socialist businesspersons.

So, one would think that the insolvency courts of our "emerging nations" will regularly have to wrestle with the problem presented to the New York Supreme Court in the *New York Law School* case, perhaps leading to the same result: "No. You may not fail."

4. The morning panel on bankruptcy spent some considerable time talking about priorities and, in particular, the priorities given to the employees of a failing business. I was left with the impression that the panelists thought that the problem was not of great concern in U.S. bankruptcies, perhaps because of protective labor laws. (This impression

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3. *See* Clarke Thomas, Editorial, *Hungary's Lighter Shade of Red: Why Does a Nation Pursuing Capitalism Elect Communists? Because it's a Free Country*, PITTSBURGH POST-GAZETTE, September 6, 1995, at A17.

4. Application of New York Law School, 68 N.Y.S.2d 838 (N.Y. Sup. Ct., 1946).

5. *See, e.g.*, Frank Swoboda & Martha M. Hamilton, *Greyhound Woes May Lead to the End of the Line*, WASHINGTON POST, June 7, 1990, at E1.

6. *See generally* KARL MARX, CAPITAL (Ben Fowkes trans., 1976). Even this theory was limited in practice, and there was a pre-1989 statute for the orderly winding up of the affairs of failing or obsolete state enterprises. (The very idea of including in this footnote a citation to a now-repealed Hungarian insolvency statute is too bizarre to contemplate.)

may be counteracted by the panelists' more circumspect written presentations found elsewhere in this *Journal*.) Thus was presented a stark contrast with the insolvency laws of "emerging nations" which, we were told, tend to be quite protective of wages and benefits.

From an Arkansas perspective, the contrast is even starker than the panelists painted. The Jones Truck Lines bankruptcy is probably small change from a New York perspective, but for Arkansas, it's a big deal. And recently the bankruptcy judge in that case ordered the Teamster's Union pension fund to disgorge $5,743,491.61 in pre-bankruptcy contributions as non-ordinary course preferences.[7] Plus interest.[8] Theoretically, the drivers, who went unpaid during the final weeks prior to JTL's petition, will receive some of that money as pay-outs on their priority wage claims. But it is hard to find many "theorists" connected to the case; the bankruptcy cognoscenti seem to presume that most of the recovery will go to pay lawyers, not truck drivers.

Which leads to this question to the panel in absentia: is such a result even contemplatable in your country?

5. In my consumer bankruptcy seminar this semester we have been discussing the interplay of insolvency and crime. The Thursday before the symposium, the discussion was in the context of proceedings against the debtor under Arkansas's hot check laws.[9] Here: Debtor writes a bad check, then petitions in bankruptcy. Post-petition, the prosecutor demands payment or else. Debtor pays the prosecutor, who takes a bite for himself and then pays the creditor who took the check. The trustee tries to recover the money from the prosecutor. What result?

This hypothetical[10] raises for me two questions of broad social policy, both of which were before the morning panel. The first of these matters is the increasing tendency that we have seen in the U.S. of late to criminalize the civil side of debt collection. Hot check prosecutions, especially when backed by restitution orders, have put a private debt

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7. Jones Truck Lines, Inc. v. Central States, Southeast and Southwest Areas Pension Fund (*In re* Jones Truck Lines, Inc.), 196 B.R. 483 (Bankr. W.D. Ark., September 27, 1995.), *aff'd.*, Civil No. 96-5040 (W.D. Ark., July 17, 1996).

8. *In re* Jones Truck Lines, Inc., Civil No. 96-5040, at 10 (W.D. Ark., July 17, 1996) (referring to Bankruptcy Court Order entered on December 20, 1995).

9. ARK. CODE ANN. §§ 5-37-301 to 5-37-307 (Michie 1987).

10. *See* Complaint to Recover Unauthorized Post Petition Transfer, *In Re* Twin City Builders (Complaint No. 96-7001) (Bankr. W.D. Ark., April 15, 1996). The trustee voluntarily withdrew this complaint in light of the *Seminole Tribe* case, discussed below in the text.

collector or two out of business in Arkansas. More notorious is the jailing of "deadbeat dads" (and occasionally moms).[11]

When I first came to Arkansas fifteen years ago, I moved into Madison County. Now, my county—a small, rural one, some distance east of campus—is not considered, shall we say, a monument to legal enlightenment, and one quirk that was often pointed to in confirmation of this is that the Madison County sheriff kind of collects the rent. Surely, it is not a crime to be late with the rent, but if once it is a crime to kite a check innocently, what comes next?[12]

Apparently, from the panelists, this criminalization of insolvency is common in the "emerging nations," and, perhaps, here is a place where we are following their lead.

The other broad social policy that is at work in the hot check hypothetical is sovereign immunity, for the trustee must sue the prosecutor in order to recover the post-petition transfer. And, in fact, smack in the middle of our discussion of the problem, the U.S. Supreme Court decided a case that would seem to make § 106 of the Bankruptcy Code unconstitutional.[13] That section, recently amended and expanded by Congress, is the broad waiver of sovereign immunity that relegates the government *qua* creditor to the role of merely another player in the debtor's bankruptcy.

Seminole Tribe is a case in which the Court continued its major reworking of the structure of "Our Federalism," holding that Congress is without the power to waive state sovereign immunity under its pre-Eleventh Amendment enumerated powers. In that case the power was found in the Indian Commerce Clause, but the case would appear to have sweeping effect beyond the narrow Indian law question that was directly at issue.[14] In the Constitution, the Bankruptcy Clause lies nearby the Indian Commerce Clause,[15] and the Seventh Circuit will soon confirm that § 106 is unconstitutional, or I'll be surprised.[16]

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11. *See Deadbeat Dad Agrees to Pay*, UPI, Dec. 7, 1995, *available in* LEXIS, Nexis Library, UPI File.

12. It is a crime to kite a check to pay the rent, that is, to write a check for the rent, hoping to beat the check to the bank with one's pay, ARK. CODE ANN. § 5-37-307 (Michie 1987).

13. Seminole Tribe of Florida v. Florida, 116 S. Ct. 1114 (1996).

14. In fact, it is my judgment that *Seminole Tribe* will never be considered a major Indian law case.

15. The Indian Commerce clause is in U.S. CONST. art. I, § 8, cl. 3. The Bankruptcy clause comes next in U.S. CONST. art. I, § 8, cl. 4.

16. *See In re* Merchants Grain, Inc., 59 F.3d 630 (7th Cir. 1995), *cert. granted, vacated,*

In countries where the government is a more vigorous participant in the economy than ours is, the question of the government's role as creditor in a private enterprise's insolvency proceedings will be an active one, and was raised during the morning session of the symposium. In federalist systems like ours, where the national courts control the insolvency proceedings but where the inferior sovereigns are creditors, the question takes on the ramifications of important political theory; as always in federal republics, the question is whether, and how if at all, the center will control the provinces.[17] In non-federalist systems, the question is less complex, but still alive. I'm not certain that our Court or Congress has worked it out correctly and I will be interested in how other countries address the sovereign immunity question.

Those are my "observations." A thought in conclusion: "Travel narrows," said Morris Zapp in David Lodge's novel, *Changing Places*.[18] And, indeed, one suspects that, as the countries we studied at the symposium "emerge," there are those travelling and preaching the law who are narrowed by their experiences; who see what they expect to see; who attempt to transfer from home entire bodies of business and law—from our affection for franchises to our abhorrence of preferences—that may, or may not apply; who forget the legitimate frustrations of people "emerging" into misfortunes—be they graffiti or corporate insolvency—that we take for granted.

More formally than Zapp, but to the same effect, are the comments of Richard Rubenstein, another who sees a connection between American Indian law and the topic of this symposium, broadly considered:

> More often than not, efforts to "civilize" a new frontier by molding it in the image of purportedly more advanced and humane political order subserve the interests of elites aiming at domination, not conflict resolution. Well-meaning missionaries

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remanded in light of Seminole Tribe *sub nom.* Ohio Agric. Commodity Depositors Fund v. Mahern, 116 S.Ct. 1411 (mem.) (1996). *See* Light v. State Bar of California (*In re* Light), 1996 U.S. App. Lexis 16575 (9th Cir. 1996) (*per curiam*) (unpublished). If the very idea of an unpublished opinion holding a statute of Congress unconstitutional is too much for you, as it is for me. *See* Sacred Heart Hospital v. Pennsylvania Dept. of Pub. Wel. (*In re* Sacred Heart Hospital), 1997 U.S. Dist. Lexis 514 (E.D. Pa. 1997); Koehler v. Iowa College Student Aid Comm. (*In re* Koehler), 1997 Bankr. Lexis 9 (Bankr. D. Minn. 1997), and cases cited *id.* at n.8.

17. You might see in this regard, Judith Resnik, *Dependent Sovereigns: Indian Tribes, States, and the Federal Courts*, 56 U. CHI. L. REV. 671 (1989).

18. DAVID LODGE, CHANGING PLACES 42 (Penguin Books 1992) (1975).

> to the East [i.e. to the former Soviet Bloc] would do well to consider "how the West was won." What was the point, after all, of teaching Native Americans to read the Scriptures? What relationship did the Holy Bible or Blackstone's *Commentaries* bear to the wild scramble for wealth and power proceeding at the same time on the same virgin territory? What role did "training in democracy" play in assisting powerful outside interests to acquire the assets, control the natural resources, and dominate the markets of undeveloped American lands?[19]

The Sixth Annual Ernst C. Stiefel Symposium largely spared us the preaching of bankruptcy and corporate missionaries. Rather, savvy practitioners, principled jurists and rigorous scholars introduced us to the intricacies of the laws of their jurisdictions, where increasingly businesses are organized to meet the needs of economic development, and, increasingly too, businesses fail to make it in a modern credit economy. I for one am thankful for the opportunity to attend and for my understanding to be broadened, Zapp to the contrary notwithstanding.

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19. Richard E. Rubenstein, *Dispute Resolution on the Eastern Frontier: Some Questions for Modern Missionaries*, 8 NEGOTIATION J. 205, 206 (1992).