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CALL OPTIONS AS SECURITY FROM THE PERSPECTIVE OF HUNGARIAN LAW

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Although the currently effective Hungarian Civil Code does not name a call option as security, it does not prohibit the use of a call option as security either. The first question this raises, therefore, is whether Hungarian law permits the use of a call option as security? Naturally, this then creates more questions. For example, if the answer to the first question is in the affirmative, are there any mandatory provisions of the Civil Code with which the agreement on the establishment of a call option as security must comply? Can the validity of such an agreement be challenged on the grounds of containing services and considerations that are overly disproportionate?

Over the last few years there have been a number of debates on the nature of a call option used as security, some reaching the highest levels of judicature. While the Supreme Court of Hungary has not issued any binding general guidelines on call option as security, several articles have been published by high-ranking judges and one of the five courts of appeal in the country even published a civil law opinion on the issue (Civil Law Opinion no 1/2008 of the Court of Appeal of Szeged). Below, we briefly discuss the most important features of a call option used as security in light of the civil law opinion. Then we also touch upon whether an agreement on the establishment of a call option as security can be challenged on the grounds of containing services and considerations that are overly disproportionate.

The civil law opinion of the Court of Appeal of Szeged states that a call option can be used as security. It reasoned that just because a call option is used as security, it does not automatically render the agreement on the establishment of the call option null and void. As an owner can dispose with his own assets, he may therefore also give an asset as security to the creditor. The court of appeal adds that when it comes to establishing a call option as security, the agreement must comply with certain mandatory provisions of the Civil Code (i.e. the call option as security may not be exercised in order to circumvent the mandatory provisions applicable to pledge). Thus, argues the court of appeal, a provision pursuant to which the creditor may unilaterally acquire the ownership title to the encumbered asset before the due date of the claims in the event that the debtor fails to fulfil his obligations is null and void. At the same time, if the creditor is relieved from the obligation to settle accounts with the debtor as regards the difference between the value of the encumbered asset and the amount of the outstanding claim, the establishment of call option as security is null and void.

A further question is how the creditor is required to settle accounts. If a call option is used as security, the creditor may satisfy his claim (principal amount and interest) out of the amount received as a sales price for the asset encumbered with a call option. It is essential that the creditor does not receive more than he is entitled to. If there is a provision in the agreement on establishing a call option as security pursuant to which the creditor may acquire the asset

at a purchase price equal to the amount of loan resulting in the creditor acquiring also the difference between the purchase price and the actual value of the asset, such provision is null and void. This is because no unjustified enrichment may occur on the creditor's side.

The court of appeal makes it clear that in order for the agreement to be valid, the purchase price has to be determined with regard to the market value of the asset. There is no need to determine the value of the asset (i.e. the purchase price); it is also satisfactory to determine the purchase price by using a formula, a specific method for calculating the actual market value of the asset that will be equal to the purchase price.

One of the consequences of a void agreement is the obligation to restore the original state, i.e. the state as if the agreement had not been concluded. There is an alternative to this, namely, if the reason for invalidity (i.e. the unlawful method of calculating the purchase price) can be eliminated, the court can render the agreement on the establishment of call option as security valid. In this case, if a call option is established on some real estate, the call option agreement will qualify as a mortgage agreement and the court may order the registration of the mortgage with the land registry. In the absence of this court action, satisfaction through a void security is null and void.

Another question is whether an agreement on the establishment of a call option as security may be challenged on grounds that the services and considerations as stipulated in the agreement are overly disproportionate. The civil law opinion is silent on this issue and there is currently no prevailing judicial practice on this. There are two different opinions. Some high-ranking judges are of the view that a call option agreement may be challenged on said grounds. In this case, the asset's market value as of the conclusion of the call option agreement is to be taken into account. Others say that the validity of the call option agreement may not be challenged on said grounds and that it is only the purchase agreement (i.e. the agreement taking effect after the exercise of the call option by the creditor) may be challenged. In this case, the asset's market value as of the date of exercise of the call option is to be taken into account. As there is currently no relevant judicial practice on this, the issue of challenging the call option agreement or the purchase agreement is for the judge chairing the case to decide.

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The contents of this article are intended to provide only a general overview of the subject matter. Specialist advice should be sought for specific matters. Queries relating to this article should be addressed to the author at:

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