A lawyer's-eye view of FX loan battles

Dr. Szilvia Drimál of Drimál Law Office has been representing borrowers who said they were saddled with unbearable foreign-exchange loans. She talks about the legal battles of the last few years and the impact of new legislation.

ZSUZSA SZABÓ

Dr. Szilvia Drimál.

Q How have the legislative changes on FX loans reshaped the legal industry?

A: In no way. Lawyers are seeking the legal breaches, those legal arguments on the basis of which FX-loan agreements may be contested even after the recent legislative changes. The volume of FX-loan lawsuits is not such that it could cause a real reshaping of the market.

Q Many law firms have received requests from unsatisfied borrowers about the expensive consequences of exchange-rate fluctuations in recent years. The borrowers sought restitution from the banks and the banks sought to defend against compensating clients. Which side has your law firm has taken, and why?

A: Those law firms that represented the state or the banks in the legal actions came from a small group. All the other law firms have the possibility to be contacted by desperate debtors who need help and advice to solve their problems caused by FX loans. I am one of these attorneys.

Q Can banks be held responsible regarding highly increased expensive foreign-currency mortgages?

A: Banks are financial service companies and are traditionally expected to be in the possession of special financial knowledge and instruments needed to manage risks, which are hardly foreseeable conditions, and decide if a loan applicant is acceptable, or a financial product is ready to be marketed. In the case of FX loans, the problem is that the CHF/HUF exchange rates increased substantially, to an unforeseeable extent. Who should be responsible for that increase? Who should bear the damages of that? Why did banks not calculate with this possibility? The banks have a professional responsibility for the present situation. Hungarian society expected that the banks should shoulder that responsibility by themselves, or by court decisions, or by the new legal acts. It is not what happened. Now banks have to return to their clients only that money collected in an evidently dishonest way. All the exchange rate risks are still taken by the customers, although in most cases they were not aware of the level of risk that they were bearing.

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Q In your view, has the latest law on the mandatory conversion of FX loans into HUF loans at current market rates brought a solution for the borrowers, or can further lawsuits be expected on this issue?

A: No, it hasn't: As I have already mentioned, the main problem with FX-loans is the extreme exchange rate. The latest laws obliged the customers to bear all the damages deriving from exchange rate changes until the date of conversion on the rates of November 7, 2014. In most cases it means that the debtors now owe the banks 150-200% as much money as they effectively received from the bank 5-10 years ago, although they paid the installments meanwhile.

Borrowers and law firms are looking for possibilities to fight against the conversion of FX loans, as it is socially unfair and the burden on the customers is simply unbearable. People will lose their homes. Lawsuits can only be started on the basis of the law. In this case the law is unfair. I am not sure that further lawsuits are the instruments to resolve these problems.

Q Before the changes in the law, there was a lack of precedent and limited legal coverage for borrowers in these cases. How were law firms able to help?

A: Before the recent legal amendments, attorneys referred to the unlawful regulations of the loan contracts and asked for the cancellation of the invalid contract articles in lawsuits. Application of the law developed in that way. Developments created the basis of the recent legislation. But legal development did not have enough time to resolve all the unlawfulness. Legislation simply did not consider some important questions, including the responsibility for the exchange rate changes and the related risk management.

The new legislation changed the legal circumstances and by turning the FX-loans into HUF loans at a defined rate declared that the responsibility for the exchange rate changes should be entirely held by the customer. The new acts amended the loan contracts by the power of the law, without the need of the approval of the contractual parties. It is the law. Attorneys and courts apply the law. So probably everyone feels that the situation is not correct; there is no real help on a legal basis.

Q To what extent have the requests for legal advice services increased in these last couple of years?

A: As the exchange rate worsened for debtors, more of them asked for legal advice. The extent depended on the law firm specializing itself in the very special field of FX-loan contract law. There are/were law firms which took some hundreds of legal actions against banks based on a common template of statement of claim. But it is really not general; most law firms gave advice to their clients and brought lawsuits only if the clients had no other option.

Q Regarding suing banks under FX loan agreements, how many successful lawsuits resulted from your company?

A: I usually did not bring lawsuits against banks. I carried out negotiations with them, and I described our objections in a letter informing them what they could

expect if they sued my client. If a bank initiates the lawsuit, it – and not my client – must advance the expenses and the bank has to prove its statements, not my client – this is important. In the cases where I notified the bank of our objections, none of the banks took any kind of legal action against my clients or their guarantors or the owners of the mortgaged real estate. Most of my clients chose that way instead of suing.

Q What about the whole "legal market" specialized in FX loan agreement cases? How did those cases go?

A: Generally only a small part of the lawsuits of debtors initiated by law firms were successful, but these successes developed the application of the law, so they were important successes. The new law suspended all these lawsuits; they could continue in these weeks, after receiving the bank settlements from the debtors, but in completely new legal circumstances.

Q Has the increased activity from FX loan cases driven up demand, and prices for local law firms?

A: Not at all: As I have already mentioned, law firms working for banks and the state are few, most attorneys work for the debtors. Debtors are usually in a very bad financial situation, so they are not able to pay high legal fees; often they are not even able to pay the general legal fees. To work on these cases it is necessary to create low fixed prices according to the type of case (legal advice, writing letters, lawsuits).

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Q Concerning legal advice and bringing a lawsuit in an FX case, what kinds of legal costs are borrowers facing?

A: The first meeting – looking over the documents, checking the possible legal avenues – usually costs HUF 10,000-30,000. Representation in a lawsuit is about HUF 100,000-200,000 at Budapest law firms in these cases.

EXPERT OPINION

New trends in construction contracts

The contractors are still generally punished under the commonly used contracting mechanisms in Hungary instead of being motivated, although in Western Europe contractual clauses facilitating the cooperation of the contractors are already widely applied – as highlighted in the sector specific summary of KCG Partners Law Firm.

Although in the last year the construction sector, by reaching an annual 26.7% increase, has performed well from a quantitative perspective, the sector specific contractual safety is still below the EU level. According to the summary of KCG Partners Law Firm, one of the reasons for this difference is that contract templates are still commonly applied and several times reapplied in the sector, and such contracts primarily punish the non-contractual performance of the contractor instead of motivating good performance. Since construction investments may typically be carried out only under the cooperation of several contractors specialized in different sectors, well-functioning contractual mechanisms tailored to the given project would be crucial to interconnect the contractors' work and support their cooperation.

"Traditional Hungarian construction contracts usually apply different provisions for the performance of each contractor instead of handling the works in an interrelated way. This is an absolutely obsolete, inefficient structure which generates complex legal disputes if difficulties arise," outlines Eszter Kamocsay-Berta, managing partner of the KCG Partners Law Firm.

It is a frequent mistake that instead of looking for an immediate solution, the parties postpone the resolution of their dispute to a later date, so that the possible disputes do not obstruct the construction process. This strategy is however wrong, since this is why the impact of the non-contractual performance on completion time and budget cannot be recognized in due time.

In such cases the contractors face the sanctions regulated by the construction contracts, like late performance penalties, or penalties for defective performance, or even deductions for defects by construction closing. It occurs in numerous cases that the rights and obligations negotiated at the closing of the project turn into financial and settlement disputes, or worse, terminate in court.

Investors and contractors could certainly also do a lot to establish a contractual system that ensures the successful completion of an investment. Thus, in addition to the traditional contractual securities (such as phased payments of contractor's fee upon reaching the milestones set out in the time schedule, good performance retentions, good performance guarantees or penalties), other forward-looking instruments could have an enhanced role during the construction period.

These instruments are for example the "real-time" project management method, the key points of which are the continuous communication and the active contract management. The real-time project management instruments enable the immediate, continuous and safe recording of the events of the construction process, the immediate access to the recorded data from anywhere with more equipment enabled. Such instruments may also show the possible impact of a proposed additional work on the construction schedule and on the investment costs.

KCG Partners' experience is that incentive schemes are getting more and more popular worldwide, whereby instead of imposing penalties, "benefits" are offered in the case of the successful execution of the projects. Incentive mechanisms show that the communication and cooperation between the contractors is essential for the successful completion of the project.

In Western Europe, the idea of joint risk-sharing is already an established practice. In this case the motivating factors for the parties for the increased cooperation are the shares obtained, in a portion determined before, from the savings achieved during the construction, or, on the contrary, bearing the possible losses jointly. Establishing a bonus framework is also a commonly used motivation tool, from which the contractors can also benefit from the successful implementation of the completed investment.

Last but not least, the contractors can be motivated for continuous and outstanding performance if they may share the social appreciation, the "glory" derived from a major investment and their firm names can be mentioned in connection with the investment. Unfortunately major investors usually limit this possibility by strict regulations, and they do not consider that publicity may have a huge incentive force that inspires better performance.