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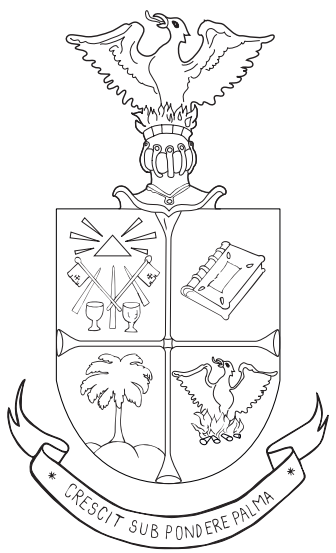

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Economic Analysis of Several Issues Related to the Enforcement of Civil Judgments in Hungary

Introductory remarks

Any legal instrument might serve multiple purposes, first and foremost its societal purpose in general. Within this framework, we can subdivide this category (without thorough classification) into classes of societal importance, such as the need for the survival of a group (such as ensuring water and the food supply); other physical needs (e.g. defence) or, for example, the demographic needs of a society; or simple mundane activities that facilitate the pursuit of happiness for each citizen. These needs of a society are embedded in legal instruments that ensure their application. However, underlying this, there exists a fundamental rational issue: what makes it possible and useful for citizens to cooperate in order to form a functioning society? It is in their self-interest to join their productive capabilities into a working economic system that provides for the common functions of their joint enterprise: society and the state itself. This is the economic system, which works as an exchange market for the activities of individuals, however useful or simply joyous they may be, all contributing to the reality of a working society.

The importance of the economic system must not be underestimated, as we are intimately and personally familiar with the rise and fall of the communist economic system, and the dangers of exaggerated collectivism. Hence, we now mainly see societies working in the framework of more or less social capitalism, based on the operation of self-interest, which is a factor in the welfare of the individuals and due to the invisible hand of society at large. Naturally, the functions of the state (as the organ of society), once classical – namely national defence, protection of citizens from each other, the regulation of lawful behaviour and adjudicating disputes – are on the rise, and new functions and new roles arise that are incorporated by the state, such as welfare measures. However, all these activities are made possible by a well-functioning economic system. The lack of an economic incentive often renders desirable goals unattainable. For our purpose, we therefore assert that economic feasibility is a necessity for the proper operation of the law, and it is also true of the adjudication of disputes in a broad sense. It does not mean that this basic function of the state must operate for profit; for example, the utility of national defence is verified by the lack of war;

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in other words, we do not have an army for aggressive warring, but for avoiding it.

Applying this analogy to the adjudication of disputes, it must be maintained for achieving peace in the country; legal peace, which is in itself the bedrock of an orderly society, providing framework for citizens to pursue their own objectives. Hence, economic logic may convince us to uphold institutions that are particularly in contradiction with the self-interest of a person (why would I, who have never been before a court, pay for the salary of judges), but, seen as a whole system, they provide invaluable services (I pay my share of taxes, because it upholds the legal order, in which I may pursue my activities in peace).

Does this mean that the legal system is completely exempt from the economic logic, then? On the contrary! Laws and even litigation operate under the umbrella of economic logic, even though sometimes we need to see a wider picture for this reality to appear. In this paper I will reiterate well-established notions of law and economics and apply them to the particular field of enforcing civil judgments. I also analyse special regulations that are intended to enhance the enforcement of judgments, most importantly the incentive of the bailiff to conduct a fair procedure. I also examine information disparity and its effect on the necessity of commencing an enforcement procedure. My aim – besides generating a debate on the issue – is to prove the economic feasibility of the present rules and highlight those that may be problematic.

1. Pacta sunt servanda. This Roman law rule is almost holy scripture for lawyers, especially those in the civil law area. *Alterium non laedere.* Or if so, the damage must be compensated for: this seems to be an everlasting order, which has been enforced in a broader or narrower sense for millennia. They are legal orders and moral theses at the same time, and further moral theses might become legally recognised, such as in the legal nullification of contracts in violation of the *bona fidei* principle. While law was a field of practical knowledge for thousands of years, lately it is subjected to rationality: it is a fair expectation that the law, the whole legal system, shall abide by the rules of formal logic and be subject – beyond social needs – to those logical rules, the origins of which can be traced back to ancient times, but which have made their own special development in other areas of social sciences, amongst them, economic science. If law abides by rationality, should it abide by rationality in its economic sense?

Economic analysis of law is a discipline over 60 year old,[2] which has sprung out from the cooperation of economic and legal scholars in the United States; today it is applied not only to the civil law area, but also to criminal law, and administrative law.

2 Coase and Calabresi infra compiled the fundamental articles that initiated the thought experiment in this direction. See: Ronald Coase: *The Problem of Social Cost*, Journal of Law and Economics, 1960 3:1-44.; Guido Calabresi: *Some Thoughts on Risk Distribution and the Law of Torts*, Yale Law Journal, 1961 70:499-553. One other authority on the topic, author of several fundamental books and articles and former chief circuit judge in the 7th District Court of the USA is Richard A. Posner, see e.g. *Economic Analysis of Law*, Boston: Little Brown, 1973.

[3] Beside the wide range of international literature, numerous Hungarian authors have written on this subject.[4] Textbooks cover the basic legal and economic theories, with special regard to property and contractual issues in particular,[5] and devote a smaller but important portion of their contribution to the assertion of claims, mainly in civil judicial procedure. However, I have yet to find a comprehensive contribution in the literature regarding the actual enforcement of civil verdicts; to the issue of coercive measures related to civil claims upheld by the court; and how these rules fit into the general system of economic theory. This paper discusses that topic and endeavours to set these rules into a new framework with the hope of generating a debate on the topic.

2. According to a Hungarian author on the law of enforcement of civil claims, Ignác Frank, "It is futile to hold a tribunal, should the enforcement of the verdict not follow." Though our doctrine of civil procedure separated the issues of enforcement from the Code of Civil Procedure and although the right to enforce a decision is not automatically part of the legally binding effect of a verdict, his statement can be intuitively proved with the assumption of the contrary. Should the judgment of a court for the final settlement of the parties' dispute be rendered a dead letter, and should the parties not be affected by its actual emergence, the judicial procedure would lose the very element that provides for the restoration of peace under the law. The very fact that a dispute arose between the parties or the judicial protection of rights was necessary for other reasons is the proof that peace under the law needs to be preserved, since at least one party challenges civil order and the other party considers this important enough to plead for legal protection. Hence, the institutionalisation of enforcement is a necessary element of any legal order – should anyone call it into question.

3. For a lawyer, it is the content of the norm that is relevant; the fulfilment of any obligation shall be viewed through the prism of whether a deed is prescribed or prohibited in a norm. Economic analysis of the law has no such presupposition (while other, sometimes simplifying presuppositions in accordance with its field of science exist). Quite the reverse, it has a deeper theoretical insight, that legal relationships have several options dependent upon the choice of a rational actor and, when it comes to a decision, their welfare must be the primary concern. Hence the deduction with persuasive mathematical and logical apparatus, that *pacta sunt servanda* – axiomatic for a lawyer – might not apply in every case from the economist's point of view; there are cases where the logical and economic decision is to terminate or even break the

3 Marianna Nagy: *The Application of Rational Choice Theory in the Study of the Administrative Enforcement of Law*, ELTE ÁJK Annales 2010.

4 Ld. pl.: Attila Harmathy - András Sajó (szerk.): *A jog gazdasági elemzése*, KGJ, Budapest, 1984.; Attila Menyhárd: *A kötbérről és a foglalóról*, in: A Polgári Jogot Oktatók XXII. és XXIV. Országos Találkozójának Válogatott Tanulmányai, Novotni Alapítvány, Miskolc, 2018, 67-78.; Ákos Szalai: *A magyar szerződési jog gazdasági elemzése*, L'harmattan, Budapest, 2013.; Béla Pokol: *Posner gazdasági jogelmélete*, JESZ 2000/3. szám

5 Robert Cooter-Thomas Ulen: Jog és közgazdaságtan, Budapest, 2014.

contract. During this rational sequential decision process or simultaneous gameplay – with simplification – the laws of welfare economics shall apply; where parties seek to maximise their utility. This might be modified by the economic theories such as introducing social utility. Within this framework of decision-making process, norms, whether ethical or legal, appear as only one factor among others and not expected to override the economic logic that is presented e.g. in Pareto-optimum on the individual or social scale.

Here we refer to the two schools in the economics of law, namely the normative school and the other one, analysing the efficiency of particular legal institutions. While normative analysis aims to create a norm that best fits an economic rationale, analysis of particular legal institutions endeavours to show the dynamics of incentives and disincentives within a set framework of legal regulations. This short essay begins with several normative aspects and then sets off to analyse concrete legal regulations and their beneficial or disadvantageous nature.

4. Legal order extends to the whole of society and regulates issues that are not assessed in monetary terms, rather on an emotional level. For example, our family law regulates the parental custody rights, which can hardly be monetised at first glance; nevertheless, their enforcement must indisputably be part of our laws. The theory of utility – that is to be maximised by the individual – is a very powerful tool, since it explains why parental custody is also a valued right that is sometimes fought to the bitter end, even though its monetary value is hardly expressible. Even though I try to avoid those areas where a claim is not monetary then, based on the previous remark, these claims also may be subjected to this economic prism, since the utility-maximising citizen will allocate value-bearing assets (time, energy, money etc.) to have these claims enforced in their favour.

5. Enforcing monetary claims and the economic analysis of their legal background are considerably easier to analyse than adjudicating in family law cases or those where the value of human dignity is at issue. Since we face financial claims here, their value is easier to determine, both from the point of view of the parties and other participants in the enforcement. The main parties to the transaction are the creditor and the debtor and, for the sake of expediency, we assume the existence of an enforceable decision. However, the ways of obtaining an enforceable decision are very different. Typically, the right to enforcement shall be based upon a non-appealable, final judicial decision, that contains one or more obligations on the losing party and the time-limit for voluntary completion has passed without effect.[6] These are important in our analysis because, if we consider the dynamics of the whole transaction in economic terms, we have passed almost the whole decision tree that is usually analysed in the legal economic literature. The parties concluded a contract, whereby they assessed each others' capability and willingness to comply (wrongly, as the dispute proves); however,

6 General preconditions of enforceability in the Act LIII of 1994 on Judicial Enforcement (hereinafter: Vht.) §13.

the relevant legal facts show that fulfilment did not take place, upon which the party defaulted against – after having assessed their costs and chances of winning – reacted by claiming their rights before the court (setting aside other summary procedures for the moment). In the civil procedure, that is a sequential gameplay according to the economic analysis of law, the set of facts were ascertained, to which the judge rendered a sentence obliging the losing party in the court of first instance and on appeal, second instance.[7] The legal economic concept of perfect damages is of less importance to us now (it is important from the perspective of being an incentive or disincentive in deciding whether to sue); it is enough to presume that the creditor rests assured with the sentence that is now enforceable using coercive forces of the state, if necessary.

There is a similar decision tree present for the minor pecuniary claims not exceeding an amount of HUF 5 million (cca. EUR 14,000), where there is a mandatory order for payment procedure before the public notary. According to the statistics, a small minority of the cases turn into the time and money-consuming litigation before the courts upon the debtor's statement of opposition. Its result is, however, the same: the final order for payment is enforceable as the final sentence of the court. A third typical enforceable document is an authenticated document from the public notary, which very cost-effectively avoids the litigation or order for payment procedure and offers a direct route to enforcement, provided that strict conditions are met. Our analysis does not cover the assessment of costs and the chances of those decisions as necessary steps for producing an enforceable document; however it is remarkable that, according to the rule on costs of procedure, the Hungarian rules, in accordance with European and British law, order the loser to pay the costs of the prevailing party (loser pays principle). Therefore, the costs of obtaining a judgment shall be added to the successful claim; in other words, the obligation to reimburse of costs is an important incentive to settle, because the parties may reduce their losses if, having assessed the true costs of losing the lawsuit, settle in due course, where they even might split the costs.

6. The costs of claim enforcement are proportional to the volume of the claim. According to the thesis of the economic analysis of law, if the number of violations of rights increase or if the costs of litigating the claims decrease, the numbers of suits will rise and, correspondingly, enforcement cases will increase, too (although to a lesser extent, due to the possibility of negative judgement and voluntary compliance). It is consistent with reason that, together with the rise in the volume of litigation, the coercive enforcement of judgments will rise, and also, assuming same base of enforceable decisions, any decrease in the costs of the enforcement procedure will increase the number of enforcement procedures initiated. The same base means the same volume of enforceable documents (final judgment, order for payment, authenticated document), where the higher costs of enforcement might deter even the prevailing party to initiate the actual enforcement. Particularly so, if even the

7 I neglect the economic analysis of these steps, as they are extensively covered by Cooter and Ulen, Robert Cooter-Thomas Ulen: Law and Economics (6th ed.), Addison-Wesley, 382-453.

costs of enforcement have a high chance of not being reimbursed, in which cases the judgment stays dead paper.

It was the litigation procedure, for which the following equation was created by legal economists, according to FC (filing cost) = EVC (estimated value of claim),[8] and the equilibrium represents the point at which the decision of the rational decision maker turns. With lower filing costs, they will file the claim; at a higher rate they revise their filing intentions and abandon their claim. I point out that, if the claimant creditor loses their claim completely [EVC=0] that counts as a failure in the functioning of the claim-enforcement system, a 100% failure with respect to the actual claim. According to the legal economists, the aim of the legislator should be to minimise the costs of litigation together with minimising the costs of systemic failures. The function where FC>EVC also shows that the system of claim enforcement certainly creates failure (at least in an economic sense).

7. This equation might be referred to the execution procedure itself. If we assume the same volume of enforceable decisions (which might be an unfounded assumption, since the will to litigate a claim will respond to the efficiency of execution, especially if it declines), than we might accept FCe (filing cost of enforcement) = EVeC (estimated value of enforced claim)[9] as an equilibrium. Under that range, filing for execution is irrational, whereas over this point it is irrational to forego it.

The Hungarian rules of judicial enforcement, especially those on costs[10], provide for proportionality, with a low and high threshold of costs. The lowest threshold of fee payable to the court bailiff is HUF 9,000; the highest must not exceed HUF 1,000,000; between the two amounts the fee corresponds to the value of the claim to be enforced. There are further elements of costs, some *pro rata* to the value of the case (namely the flat rate cost of 50% of the above-mentioned fee, added to it); other elements are itemised (such as an hourly fee based on site visits and travel costs). There are the so-called flat costs of the chamber, which are based on the Section 34/A of the Vht. and due after successful enforcement; HUF 1,000 up to a HUF 400,000 claim value; over this, 1% of the claim value without an upper threshold. A further element of the costs is the incentive to the bailiff, the enforcement premium, which is only due as a proportion of the debt successfully recovered, of 8% up to HUF 5,000,000,HUF 400,000 between HUF 5,000,000 and 10,000,000 and 6% of the sum above HUF 5,000,000, finally above HUF 10,000,000 enforcement HUF 700,000 and 3% of the portion above HUF 10,000,000 shall be due as enforcement premium.[11] This

8 Az EVC equals to the total value of the claim multiplied with the chance of successful litigation (V*p, where p≤1)

9 EVeC-t equals the total value of the claim multiplied by the chance of successful enforcement (V*p, where p≤1)

10 35/2015. (XI. 10.) IM decree on the Costs of the Judicial enforcement procedure (hereinafter: Dsz.)

11 See. Dsz. 14-16. §§, where there are several exclusions from the main rule. For example, costs

premium is clearly an incentive for the court bailiff to attend to his work carefully, while it also can be viewed as sharing the risk between the creditor and the bailiff.

For the creditor, this clear set of cost rules facilitates the calculation of the left side of the equation, namely the evaluation of the FCe (filing cost of enforcement), since these costs are fixed by law (just like the costs of the public notaries and judicial procedures). Those cost elements that are proportional to the value of the claim, are connected to successful execution, thus they do not burden the creditor in advance and so there is no need to take them into consideration from the creditor's point of view. The other side of the equation is the estimated value of the enforced claim (EVeC), which equals the total value of the enforced claim (plus interest and other accessories) multiplied by the chance of successful enforcement. Calculating this side is not a trivial exercise, since the creditor might well lack the proper information.

8. The lack of willingness to comply on the debtor's side is proved by the deadline for voluntary completion elapsing without success. The remaining question concerns the capability to comply. However, the legal order does not entitle the creditor to gather information from various databases (information available from official public records); however, authorised persons in are able to review the financial status of the debtor but only after the execution procedure has commenced. That means that the creditor may only calculate their real chances – receiving the information gathered by the bailiff – only after the enforcement procedure has commenced. This informational asymmetry (and also lack of means to comply) is assuaged by those *in rem* (such as mortgage) or *in personam* (a guarantor) if given in the contract, but even in this case, the danger of there being insufficient funds is still possible.

According to my thesis, the legal system – based on understandable data protection principles – does not support a creditor with an independent data-collection permit in order to assess their chances of recovering the debt; their information asymmetry – if they did not defend themselves during the transaction with the abovementioned guarantees – will only be alleviated during the enforcement procedure. However, the lack of information could be eased on the part of creditor with a partial procedure, where – assuming a final judicial decision, still before filing for enforcement and with proper legal guarantees – the court bailiff, upon request and for an appropriate fee, would be able to retrieve information on the debtor and provide it to the creditor. That would set them in a position where the chances of success could be evaluated properly and a debt beyond reasonable hope of recovery would lead to the enforcement procedure being abandoned[12] Even though this is a loss on the part of the creditor, they would avoid incurring the advancement of further (flat) costs that would remain her burden in the event of an unsuccessful execution. At societal level, these decisions

are reduced by the discount given to the debtor who voluntarily vacates his house that was sold on auction (as provided by Vht. 154/A-154/B. §§).

12 With thanks to Dr. Sándor Sz. Szabó attorney at law for this remark.

would appear as a gain in the form of unpaid procedural costs,[13] also remarking that enforcement institutions would not gain this income but would also not have to take the procedural steps and the work going with them. However, there are other structural perspectives that make the decision on commencing the enforcement procedure unilateral. The debtor may be interested in – as evidenced by the lack of voluntary fulfilment – hiding their assets, thereby excluding them from the execution. If the data on their financial positions had to be retrieved before the commencement of the procedure – of which action he must be informed of due to data protection principles – it would serve to warn him and avoid *mala fidei* actions. Since securing assets for coercive measures may only rest upon enforcement procedures that have commenced and be performed by authorised persons (namely court bailiffs), the simultaneous nature of retrieving information and commencing coercive measures seem unavoidable.

There are other factors that support the initiation of an enforcement procedure, most eminently financial and accounting considerations. Should the management of a corporate creditor neglect their fiduciary duty by failing to enforce a claim, it might render the management having civil liability, even criminal liability in a form infidel or neglectful management, a criminal offence with further preconditions. On the accounting side, any claim may only be written off as uncollectable if the enforcement procedure delivered that result. These factors increase the right side of the equation [EVeC], increasing the justification for commencing an enforcement procedure. It is clear that dismissing or easing these requirements would reduce the volume of enforcement. However, this decrease would also be a failure of the enforcement system,[14] provided that a final judicial decision remains unenforced, and contradicting our thesis on the use of execution in maintaining the legal order of society.

9. Up to this point we did not mention the systemic background to enforcement. The Hungarian system relies heavily on commercial incentives to make its enforcement efficient. Before 1994, judicial enforcement was part of the judicial organisation and the actors were employed by the courts. Their job was poorly regulated, due to the completely different approach to judicial enforcement under the socialist regime, which remained mainly unchanged until 1994.

As one of the last Acts of the first freely elected Parliament, it passed Act LIII of 1994 on Judicial Enforcement, which introduced a two-prong system. A body of so-called County-Court bailiffs remained in the employment of the court – this part of the organisation was responsible for the enforcement of mainly state dues and costs, such as unpaid criminal costs, court fees etc. Their efficiency did not rise in terms of successfully enforced cases.

Another body was founded, the independent court bailiffs, later organised into

13 Procedural costs are always transactional costs, increasing the total costs of a transaction without furthering its real merit.

14 See Point 6., by analogy to the EVC=0 case, in this cast EVeC=0, totaling a 100% failure.

a chamber (Magyar Bírósági Végrehajtói Kamara). An independent court bailiff applies for a post at a particular local court, is appointed by the Minister for Justice, and works in a given area of competence but as an entrepreneur, at his own financial risk. His fees and costs are determined by the law and recovered from the debtor or rarely from the creditor. He is strongly incentivised by his position to rationalise the performance of his office and, for a successful procedure, there is the above-mentioned enforcement premium, which holds the promise of profit for his activities. This part of the organisation has greatly improved enforcement in terms of recovered debts. The economic motor behind this was bailiffs' well-guarded self-interest; they hold state powers, therefore must be strongly controlled, but they also have to be incentivised – that is the for-profit operation of the office. In my opinion, it is a balanced system, which contributes to my thesis supra, that the efficiency of the enforcement system corresponds to the health of the legal system: should enforcement be systemically inefficient, the rule of law will ultimately suffer.

Concluding remarks

We have shown in this paper that the enforcement of civil judgment, seldom subject to economic analysis of law, is also governed by the theoretical notions of that area of research. Even for matters of emotional importance, these enforcement laws must be applied. The well-developed equations related to civil litigation may be duly modified to enhance our understanding of this particular area of civil procedure. We have shown how cost-benefit analysis works in deciding whether to commence the enforcement procedure, and also uncovered the information disparity that might lead to either under- or over-enforcement (in terms of initiated procedures). We also have shown that this disparity, the lack of information on the side of the creditor, might only be overridden with official assistance from a bailiff, who can lawfully collect the data necessary for a proper decision. This work must therefore be rewarded, no real incentive in terms of reducing enforcement costs might be given to decrease the number of total procedures. We concluded with remarks on the enforcement institutions and the systemic incentives that helped enhance their efficiency. We hope that, based upon our present work, further writings will clarify the relationship between the law and the economics of enforcement.