NEW REGULATIONS REGARDING INSOLVENCY IN ROMANIA AND SOME OBSERVATIONS ON THEIR DEFICIENCIES

Daniela Popa, Assist. Prof., PhD, "Romanian-German" University of Sibiu

Abstract: Insolvency is the inability of a debtor to pay their debt. There are many comments already made on the new Insolvency Code. It is absolutely normal to be so, while we are put in front of an important instrument involved in predictability and efficient function of the market economy. Insolvency and bankruptcy regulate market economy through cleansing the "bad" companies and protect the creditors. So now in Romania there are no contestants of the necessity of a good and clear law for insolvency and other procedures used for regulate these cases. But there are some essential zones in the actual code which are not succeed to solve the old issues and to truly improve and better the old law. In this paper, we will concentrate over two major inaccuracies of the new law, which are in our opinion, feckless and even counterproductive in regard to the principles of market economy, even thou the reasons for applying them are rightful: the curtailment of the span for the reorganization plan and the other the allowance for budget and public institutions to coerce the payments within insolvency procedure.

Keywords: insolvency, debtor, cash flow, lack of liquidity, bankruptcy.

1. INTRODUCTION

Insolvency is the inability of a debtor to pay their debt (Boyd, Ellison, 2007). A business can be cash-flow insolvent but balance-sheet solvent if it holds market liquidity assets, particularly against short term debt that it cannot immediately realize if called upon to do so. Conversely, a business can have negative net assets showing on its balance sheet but still be cash-flow solvent if ongoing revenue is able to meet debt obligations, and thus avoid default: for instance, if it holds long term debt. Some large companies operate permanently in this state.

The principal focus of modern insolvency legislation and business debt restructuring practices no longer rests on the liquidation and elimination of insolvent entities but on the remodelling of the financial and organizational structure of debtors experiencing financial distress so as to permit the rehabilitation and continuation of their business. This is known as business turnaround or business recovery. In some jurisdictions, it is an offence under the insolvency laws for a corporation to continue in business while insolvent. In others (like the United States), the business may continue under a declared protective arrangement while alternative options to achieve recovery are worked out. Increasingly, legislatures have favoured alternatives to winding up companies for good. It can be grounds for a civil action, or even an offence, to continue to pay some creditors in preference to other creditors once a state of insolvency is reached.

Debt restructurings are typically handled by professional insolvency and restructuring practitioners, and are usually less expensive and a preferable alternative to bankruptcy. Debt

restructuring is a process that allows a private or public company - or a sovereign entity - facing cash flow problems and financial distress, to reduce and renegotiate its delinquent debts in order to improve or restore liquidity and rehabilitate so that it can continue its operations.

As Romania have acquired second place in UE for the number of companies in insolvency compared to the number of active firms at 6.44%, (Serbia had 7.61%) the new regulations are in big demand. Romania had almost 40% from the total amount of insolvencies in Central and Eastern Europe.

2. REGULATIONS AND DEFINITIONS OF INSOLVENCY ABROAD

Insolvency regimes around the world have evolved in very different ways, with laws focusing on different strategies for dealing with the insolvent corporate. The outcome of an insolvent restructuring can be very different depending on the laws of the state in which the insolvency proceeding is run, and may cases different stakeholders in a company may hold the advantage in different jurisdictions.(Swanson, Marshall, Lokey, Norley, 2008)

In Australia Corporate insolvency is governed by the Corporations Act 2001 (Cth). Companies can be put into Voluntary Administration, Creditors Voluntary Liquidation & Court Liquidation. Secured creditors with registered charges are able to appoint Receivers and Receivers & Managers depending on their charge.

In Canada, bankruptcy and insolvency are generally regulated by the Bankruptcy and Insolvency Act. An alternative regime is available to larger companies (or affiliated groups) under the Companies' Creditors Arrangements Act, where total debts exceed $5 million.

In South Africa, owners of businesses that had at any stage traded insolvency (i.e. that had balance-sheet insolvency) become personally liable for the business' debts. Trading insolvency is often regarded as normal business practice in South Africa, as long as the business is able to fulfil its debt obligations when they fall due.

Under Swiss law, insolvency or foreclosure may lead to the seizure and auctioning off of assets (generally in the case of private individuals) or to bankruptcy proceedings (generally in the case of registered commercial entities).

Turkish insolvency law is regulated by Enforcement and Bankruptcy Law (Code No: 2004, Original Name: *İcra ve İflas Kanunu*). Main concept of the insolvency law is very similar to Swiss and German insolvency laws. Enforcement methods are realizing pledged property, seizure of assets and bankruptcy.

In the United Kingdom, the term bankruptcy is reserved for individuals. A company which is insolvent may be put into liquidation (sometimes referred to as winding-up). The directors and shareholders can instigate the liquidation process without court involvement by a shareholder resolution and the appointment of a licensed Insolvency Practitioner as liquidator. However, the liquidation will not be effective legally without the convening of a meeting of creditors who have the opportunity to appoint a liquidator of their own choice. This process is known as creditor's voluntary liquidation, as opposed to member's voluntary liquidation which is for solvent companies. Alternatively, a creditor can petition the court for a winding-up order which, if granted, will place the company into what is called compulsory

liquidation or winding up by the court. The liquidator realises the assets of the company and distributes funds realised to creditors according to their priorities, after the deduction of costs. In the case of Sole Trader Insolvency, the insolvency options include Individual Voluntary Arrangements and Bankruptcy.

It can be a civil and even a criminal offence for directors to allow a company to continue to trade whilst insolvent. However, two new insolvency procedures were introduced by the Insolvency Act 1986 which aims to provide time for the rescue of a company or, at least, its business.

In addition to the above-mentioned corporate insolvency procedures, a creditor holding security over an asset of the company may have the power to appoint an insolvency practitioner as administrative receiver or, in Scotland, receiver. The process, latterly known as administrative receivership or, in Scotland, receivership, has existed for many years and has often resulted in a successful rescue of a company's business via a sale, but not of the company itself. Since the introduction of the collective insolvency procedure of Administration in 1986, the legislators have decided to set a shelf life on the administrative receivership or, in Scotland, receivership procedure and it is no longer possible to appoint an administrative receiver or, in Scotland, receiver under security created after 15 September 2003.

The United States has established insolvency regimes which aim to protect the insolvent individual or company from the creditors, and balance their respective interests. For example, see Chapter 11, Title 11, in United States' Code. However, some state courts have begun to find individual corporate officers and directors liable for driving a company deeper into bankruptcy, under the legal theory of "*deepening insolvency*."(Thompson, 2010)

In determining whether a gift or a payment to a creditor is an unlawful preference, the date of the insolvency, rather than the date of the legally declared bankruptcy, will usually be the primary consideration.

3. REGULATIONS AND DEFINITIONS OF INSOLVENCY IN ROMANIA

Until 2014, insolvency in Romania was regulated by Law 85/2006 regarding insolvency procedures, Article 3, as such: *Insolvency is that state of debtor's patrimony characterized by lack and availability of pecuniary funds for payment of doubtless, liquid and due debts, as such:*

(a) Debtor insolvency is presumed when after 90 days from expiration it will not paid his debt; the assumption is relative;

(b) Debtor insolvency is imminent when is proved that debtor cannot pay at expiration the due debts with the fund allowable at due term.

From 25 October 2013 insolvency was intended to be regulated by a new law, OUG 91/2013 named *"Insolvency Code"*. This new code was created as a weapon against fiscal evasion and to discourage local companies to use insolvency as a method of fiscal evasion and creditors' cheating. Modifications proposed made short difference between a good will player and a bad one, and so giving additional difficulties for earnest companies which have real financial problems from economic context or some other objective factors.

In the new regulations, insolvency is defined both in terms of cash flow and in terms of balance sheet in the Romanian Insolvency Code 2013, Section 1, Article 4 which reads in part:

"*29.- Insolvency is that state of debtor's patrimony characterized by lack and availability of pecuniary funds for payment of doubtless, liquid and due debts, as such:*

(a) Debtor insolvency is presumed when after 60 days from expiration it will not paid his debt; the assumption is relative;

(b) Debtor insolvency is imminent when is proved that debtor cannot pay at expiration the due debts with the fund allowable at due term".

Both definitions are similar, with only a small restriction regarding the number of days to expiration date. We think that limitation was accepted in order to preserve the losses incurred by non payment for the creditors.

Made public by Finance Ministry in September, as a project, was lately (October 2) comprise in government agenda as law project and at the end of the day was approved and announced as an urgent ordinance. And that was so urgent because lately budget incomes were low, and one of the reasons being fiscal evasion allowed in some cases by the old insolvency procedure. The government thought that companies were inclined to enter the procedure to avoid taxes. As a result, the Constitutional Court squashed as unconstitutional this ordinance, by its Decision 447/29.10.2013, and for the moment Romanians Insolvency courts function within the old law 85/2006. For now it is a strong will to bring before the public a new insolvency law, but there are some strong political debate and opposition against it.

This paper is concentrate on the changes brought by the ordinance, as we strongly believe that these will be maintained in the new regulations, wherever it will be issued.

The new law (we do not comment of introduction of a new ***law*** through an urgent ordinance, while it is a common practice in Romanian government, not to allow the Parliament to vote for a law, and instead to manage generally fiscal incomes by ordinance) due to apply from 25 October 2013 abbreviate the maximum reorganization length from three years to only one year. But it not gives solutions for diminishing the abuse or frauds achieved in observation period.

The observation period in length of 2 or 3 years allows some frauds as: suboptimal businesses, no payment of taxes, unfair deals with selected clients and suppliers, unfair methods in the rest of the industry while others operate and pay taxes normally.

Still, the shape of the new law publication arose multiple question marks as: reduction of the reorganization term and most of all the enforced selling of actives during the procedure.

About a week ago the Parlament aproved a new insolvency law which transpose *2001/24/CE Parlamentary of Europe Directive of 2001* regarding reorganisation and liquidation for credit institutions.

3. ANALYSING SOME FLAWS AND INCONSISTENCIES OF PROPOSED LAW

There are many comments already made on the new Insolvency Code. It is absolutely normal to be so, while we are put in front of an important instrument involved in predictability and efficient function of the market economy. Yes, insolvency and bankruptcy regulate market economy through cleansing the "*bad*" companies and protect the creditors.

So now in Romania there are no contestants of the necessity of a good and clear law for insolvency and other procedures used for regulate these cases. But there are some essential zones in the actual code which are not succeed to solve the old issues and to truly improve and better the old law. We will concentrate over two major inaccuracies of the new law, which are in our opinion, feckless and even counterproductive in regard to the principles of market economy, even thou the reasons for applying them are rightful.

The first is curtailment of the span for the reorganization plan and the other the allowance for budget and public institutions to coerce the payments within insolvency procedure.

But before proceeding we like to emphasise the first principle of the construction of the law, which in our opinion include a misunderstanding of the principles based on the foundation of insolvency regulations in European Union, „*Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*" established by World Bank. The eighth principle of this regulation refers to "allow a chance of efficient recovery to ***viable*** debtors".

First principle of the Romanian code is referring at "*to allow **honest** debtors an efficient and effective recovery using prevention insolvency procedures or reorganization procedures*".

This difference in approach reverberates on the full text of the code and truly and inefficiently stakes the solution for the debtors in debt or the business debt restructuration. Accordingly, viability is tested and the restructuration possible only when, by continuing business, recovery receivable indicator for the creditors is bigger or equal to the bankrupt indicator for recovery debt.

Undoubtedly debtor's honesty is important and impliedly weights in forming creditors' assumption to sustain or not a restructuration proposal. But the code did not state a definition for the debtor honesty and even international practice do not give a test or a methodology to measure the level of trustworthiness from which a debtor could became restructured.

More so, if the debtor's business is feasible (viable) but the management is not reliable, the new code allows creditors and judicial administrator to restructure that business, by proposing a reorganization plan in which the business is put off the initial management control.

We believe that this aspect is essential because (as in the case of former regulation) if there were stated a requirement of debtor's viability as a recovery condition it would bring an improvement of the procedure. If judicial administrator confirmed not only a possibility of recovery, but also an obligation for him to argument the recommendation of acceptance the debtor in observation phase using specific tests and analysis. If this condition had exist in the code, it would brought to a custom or practice or the debtor intended to reorganize to early prepare such argumentation in order not to enter bankruptcy.

A too long length of insolvency procedures seen lately has multiple causes which deserve a disjointed analysis. As such even the modalities of malfeasance of recovery given by law. By analysing the code with the law 85/2006 in perspective of curtailment, the procedure duration it is issued just one significant amendment: the reduction of the length of reorganization plan from three years to just one year. The efficiency of such amendment is quite debatable, for two reasons:

1. The number of approved reorganizations or ongoing (as per cent of total insolvency procedures) in any moment in time was never more than 10% , which means that from costs incurred by the state for the procedure point of view an important decrease could not contribute by the diminishing the reorganization period.
2. The second reason is based on the fact that once accepted, the reorganization plan is supposed to be in the best behalf and concern of the creditors, for debt collection. If this aspect were true, as it happens in more experienced jurisdiction (Great Britain, France, Germany or United States) the time length of the plan should not be restricted. In such jurisdictions the time length is even over ten years or more.

Meanwhile, the code should contain precise legal purviews regarding testing and monitoring the reorganization plan for earnestness and feasibility and not least, the importance of the vote mechanism for the creditors and not the plan temporal property.

Still it cannot be ignored debtor's tendency of abusing legal purviews and to prolong unjustified procedure length, which is a reality in the Romanian insolvency picture. This is not happening during the implementing reorganization plan, but more so in observation period (between the opening of general insolvency procedure and the approval / denial of the restructuration plan, followed by appointed judge confirmation). From this point of view a temporal limitation from which the plan should be laid and approved by creditors not more then six to nine months and some restrictions regarding rigorous observance of the debtor's activity during observation period as for efficient operational activity which not affect creditors' position from debt recovery point of view. It is worth to underline that based on the experience gained in business restructure a one year period is absolutely insufficient even in the case of low gravity business' restructuration. Even the Insolvency Code provides for the pre-insolvency procedure (known as preventive concordat – pre-insolvency procedures for safeguarding distressed undertakings) a 24 months period for implementation of the plan, with a possibility of lengthening with another six months (meaning two and a halt times more than duration of the reorganization plan).

Law no. 381/2009 provided for two optional procedures for safeguarding the distressed undertakings. The new regulation gives the debtors the opportunity to safeguard their activity resorting to mechanisms and amiable procedures of renegotiating their debts or their conditions, outside the judicial insolvency procedure and, as such, to avoid the initiation of the insolvency procedure, as regulated by Insolvency Law no. 85/2006.

The second big flaw which will negatively impact on recovery chances for companies in financial trouble (and in insolvency state) is the right to budget institutions to enforced sell

of assets, while in insolvency and during the reorganization period (forbidden by old regulations).

And this stipulation constitutes a major aberration from the principle unanimously accepted that in insolvency all creditors in the same category are equal. It is obvious the cause for introducing this stipulation: until now the law had given no protection for current creditors (with receivables born in the period of the procedure), as for no right for them to participate as entitled creditors and even no certain protection for the recovery of their debt. This situation was created after the amendments made for Law 85/2006 and not corrected by the new code and is referred to the fact that receivables born during the procedure are not clearly handled and there were no clear purview to oblige debtor, over the sanction of bankruptcy, to pay them in terms as commercial documents stipulate.

Due to the fact that all the inconsistencies we spoke about will incur over the insolvency procedure efficiency, we expect that those aspects and other negative aspects to be corrected before the application of these regulations.

4. ELEMENTS OF IMPROVEMENT FOR THE NEW LAW

In May 2014, there will be another law, approved by parliament and we like to emphasize some elements of novelty and improvement for these regulations.

First, there is some equilibrium created between debtor's and creditor's interests by limiting the easiness of issuing a reorganization plan and the tendencies of manipulation those procedures against creditors. The new advantages offered by the new law are:

- ✓ Voting for the ***reorganization plan*** through a majority of debts in 30% of total amount of debt, along with remaining conditions for debt categories. Even if the reorganization plan is flaw it still be possible to return to final table of debt even if those debts were diminished or denied. In other words, only the success of reorganization plan will bring debts liquidation. The recovered amount of money will be paid *pro rata* to all debtors from cash surplus after payment of current debts and the use of working capital.
- ✓ Special protection for ***current debts*** born in the observation period will be much easier to be paid (after the approval of judicial administrator and the judge). Not paying those debts could bring directly liquidation, even in the observation period.
- ✓ Limitation for one year of ***observation procedure*** while before due to the long observation period had been situation in which big current debts could accumulate and then the real chance for an effective reorganization were null.
- ✓ The protection for ***guaranteed debts*** grew stronger: for example in leasing contracts, the creditor is greatly protected against property transfer and in these cases theirs claim have a preferred cause (legal mortgage).
- ✓ Protection for the ***financing*** during the procedure (fresh money) by issuing a priority clause for those willing to finance a company in distress.
- ✓ Among other new regulations there is one regarding the ***liability for the special administrator***. All decisions against procedures rules are void, but there are new personal accountabilities for infringing the rules.

- ✓ As always, ***budgetary debtors*** are in advantage: for current debts unpaid in 60 days, ANAF could require bankruptcy. Even more while private creditors have only 45 days to depose liability request, ANAF have 60 days for that. More so, ANAF will receive in advance an application for opening the insolvency, while the application in court is not valid without the evidence of ANAF deposal.

5. CONCLUSIONS

The principal focus of modern insolvency legislation and business debt restructuring practices no longer rests on the liquidation and elimination of insolvent entities but on the remodelling of the financial and organizational structure of debtors experiencing financial distress so as to permit the rehabilitation and continuation of their business.

Debt restructurings are typically handled by professional insolvency and restructuring practitioners, and are usually less expensive and a preferable alternative to bankruptcy. Debt restructuring is a process that allows a private or public company - or a sovereign entity - facing cash flow problems and financial distress, to reduce and renegotiate its delinquent debts in order to improve or restore liquidity and rehabilitate so that it can continue its operations.

Insolvency regimes around the world have evolved in very different ways, with laws focusing on different strategies for dealing with the insolvent corporate. The outcome of an insolvent restructuring can be very different depending on the laws of the state in which the insolvency proceeding is run, and it may cases different stakeholders in a company may hold the advantage in different jurisdiction.

The new law for Romanian insolvency due to apply from May 2014 abbreviates the maximum reorganization length from three years to only one year. But it not gives solutions for diminishing the abuse or frauds achieved in observation period. The observation period in length of 2 or 3 years allows some frauds as: suboptimal businesses, no payment of taxes, unfair deals with selected clients and suppliers, unfair methods in the rest of the industry while others operate and pay taxes normally. Still, the shape of the new law publication arose multiple question marks as: reduction of the reorganization term and most of all the enforced selling of actives during the procedure.

The new law tries to solve some ancient problems, but it not succeeded properly. There are some essential zones in the actual code which are not succeeding to solve the old issues and to truly improve and better the old law. We will concentrate over two major inaccuracies of the new law, which are in our opinion, feckless and even counterproductive in regard to the principles of market economy, even thou the reasons for applying them are rightful.

The first is curtailment of the span for the reorganization plan and the other the allowance for budget and public institutions to coerce the payments within insolvency procedure. A too long length of insolvency procedures seen lately has multiple causes which deserve a disjointed analysis. As such even the modalities of malfeasance of recovery given by law. By analysing the code with the law 85/2006 in perspective of curtailment the procedure duration ensued just one significant amendment: the reduction of the length of reorganization plan from three years to just one year.

A temporal limitation from which the plan should be laid and approved by creditors not more than six to nine months and some restrictions regarding rigorous observance of the debtor's activity during observation period as for efficient operational activity which not affect creditors' position from debt recovery point of view. It is worth to underline that based on the experience gained in business restructure a one year period is absolutely insufficient even in the case of low gravity business' restructuration. Even the Insolvency Code provides for the pre-insolvency procedure (known as concordat preventive) a 24 months period for implementation of the plan, with a possibility of lengthening with another six months (meaning two and a half times more than duration of the reorganization plan).

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Romania have acquired second place in UE for the number of companies in insolvency compared to the number of active firms at 6.44%, (Serbia had 7.61%) and had almost 40% from the total amount of insolvencies in Central and Eastern Europe. So the new regulations are in great demand.

We hopefully conclude that in given time and circumstances the legislator will emend all the flaws and inconsistencies for this Code, in recognition of the fact that it is a major mean to fight for cleansing the market economy and to ensure a better protection for the debtor and creditors.

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