THE STATE OF SOME OF THE DEBTOR'S LEGAL DOCUMENTS CLOSED THE "SUSPICIOUS PERIOD"

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Abstract

The "suspicious period" known by the doctrine is the period of time between 120 days and 3 years before the procedural initiation because it is assumed that the debtor, aware of the coming disaster, will try to diminish the negative effects of his bankruptcy by ousting fraudulently or by means of active ruinous measures or to decrease his liabilities in the creditors' detriment, making counter-performances, creating guarantees for non-priority receivable etc.

Key words: *suspicious period, debtor, bankruptcy*.

I. Preliminary considerations

The "suspicious period" known by the doctrine is the period of time between 120 days and 3 years before the procedural initiation because it is assumed that the debtor, aware of the coming disaster, will try: diminishing the negative effects of his bankruptcy by ousting fraudulently or by means of active ruinous measures, decreasing his passive in some of the creditors' detriment, making counter-performances, creating guarantees for non-priority receivable etc.[1]

In this case, Law 85/2006 regarding insolvency proceedings states that the receiver or the liquidator has the possibility of initiating actions for the cancellation of fraudulent documents closed by the debtor during this time, such actions being exempted from stamp duty, according to Article 77 of Law 85/2006.

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[1] Gh. Piperea, *Insolvency proceedings as a civil lawsuit* (Part IV), in "The Journal of Business Law", nr. 5/2007, p. 33.

Article 20 paragraph 1 letter h) of Law 85/2006 underlines the fact that the receiver is within his rights to initiate actions in order to annul the fraudulent documents closed by the debtor in the creditors' detriment as well as the nullification of patrimonial transfers, of commercial operations undertaken by the debtor, plus of the creation of guarantees allotted by him, susceptible of prejudicing the creditors' rights.

The passage presented above doesn't mention the fact that these documents must be prior to the procedural initiation, as it was mentioned by Article 79-80, independently interpreting the text and applying it in other situations than those presented in Article 79-80 being characterized as a threat[1].

In compliance with Article 79, these measures are implemented in cases of reorganization or liquidation, following a plan, as well as of bankruptcy, guided by the general and simplified form of the procedure. The actions necessary of enforcing the provisions of this section are brought by the receiver or liquidator and decided on by the bankruptcy judge[2]. *The initiation of these actions is optional, the right action having to be exercised within a year from the deadline established for the report's elaboration*[3]*, but no later than 18 months before the day the procedures are initiated, in accordance with Article 81 paragraph 1 of Law 85/2006.* When the receiver or the liquidator doesn't use the prerogative given by the law, the creditors committee can use them[4], a single creditor cannot initiate this kind of action[5].

[1] I. Turcu, S. Szabo, *The collective procedure in limited association (II), Paradoxes and traps in the insolvency proceedings*, in „The Journal of Commercial Law", nr. 3/2007, p. 18-19.

[2] I. Turcu, *Law of the insolvency proceedings, Article Comments*, Publishing CH Back, Bucharest, 2007, p. 309.

[3] According to Article 20 letter b) of Law 85/2006, one of the receiver's prerogatives is to check out the debtor's activity and to write a detailed *report* about the causes and circumstances that lead him to the state of bankruptcy, mentioning the people who might be at fault for this situation and the premises on which they will be held to answer judicially (...), as well as the real possibility of an effective reorganization of the debtor's business or of the reasons why this process can't be carried out and to send this report to the bankruptcy judge within the term decided by him that should not surpass 60 days from the day the receiver was appointed.

[4] With respect to Article 17 paragraph 1 letter f) of Law 85/2006, one of the creditors committee prerogatives is to initiate actions in canceling the asset transfers done by the debtor in the creditors' detriment, when such actions has not been initiated by the receiver or the liquidator; this provision is reviewed by Article 81 paragraph 2 of Law 85/2006.

[5] D. Dumbrăveanu, R. N. Catană, *Comparative law considerations over some of the legal documents closed in the suspicious period by the debtor during the insolvency*

II. Fraudulent acts closed by the debtor that are likely to be cancelled

Article 79 of Law 85/2006 stipulates that the receiver / liquidator can insert actions to the bankruptcy judge in order to nullify the fraudulent documents drawn by the debtor in the creditors' detriment during those three years before the procedural initiation.

Fraudulent documents are those acts performed with ill-will, with the intent of harming someone else's right[1]. There is a double end of such acts:

- the harm brought upon the creditors' rights or the elusion of the law;
- the debtor's acquiring of profit for himself or for someone else.

The fraud is committed in two ways:

- regularly, with the help of a third-party;
- by the debtor himself, acting alone[2].

According to Article 80 paragraph 1 of Law 85/2006, the receiver or the liquidator can bring actions to the judge, their aim being the cancellation of the patrimonial right establishment or transfer to third-parties and the restitution of goods that were handed over, as well as the value of other services accomplished by the debtor through a series of acts of which we shall soon discuss.

Gratuitous asset transfers

The provisions of Article 80 paragraph 1 of Law 85/2006 refers to all gratuitous asset transfers of both mobile and immobile nature[3] executed by the debtor during the 3 years before the procedural initiation, thus creating an *exception*: *humanitarian sponsorship*.

These legal provisions are to be applied to: all donations (including disguised gifts and disguised donations), debt remittance, the abandonment of a right without counter-performance, legal transactions, setting up dowries and real and personal bonds agreed by the debtor[4].

The gratuitous character of the act is no subject of debate when it comes to authentic donations which are legally agreed on on the day of approval or when it comes to an approved gift. On the other hand, nullity

proceedings, in „Pandectele Române", nr. 4/2006.
[1] I. Turcu, *op. cit.*, p. 310.
[2] *Ibid.*, p. 311.
[3] *Ibid.*, p. 316.
[4] I. Turcu, *op. cit.*, p. 316-317.

equally takes effect on: indirect donations, partition donations, unbalanced donations, being disadvantageous for the debtor[1].

It is questionable whether even the patronage or the commadate is part of the category drafted by Article 80 paragraph 1 letter a), as well as any other documents which apparently are only gratuitous; in reality it's about a kind of interested legal instrument[2].

Commercial procedures where the debtor clearly surpasses the received service

The content of Article 80 paragraph 1 letter b) takes into account the commercial procedures that took place 3 years before the procedural initiation. These procedures are not only objective acts of trade, but also procedures concerning the immobile goods found within a goodwill[3].

Subjectively, it is about the unbalanced services that uncover the ill-will of the contractors. The bench trial will have to determine the scale of the unbalance, linking it to the date when the contract was closed[4].

In order to achieve the operation's cancellation, under the provisions of Article 80 paragraph 1 letter b), it is necessary that some *conditions* must be carried out:

- the existence and the extent of obligations must be known by the contractors (fr. – *commutatif*). In this case, the doctrine assessed that contracts with an aleatory character, which are "difficult to rate"[5], should not be cut off from the effects of Article 79-80 of Law 85/2006, this rating being decided by the bankruptcy judge.
- the obvious imbalance must be in the debtor's detriment;
- the counter-performance of the other party must clearly be unbalanced to the obligations entered by the debtor in the operation[6].

Theses acts shall be considered fraudulent toward the creditors – being related to the rebuttable presumption of fraud (*iuris tantum*) – and injurious until proven otherwise and if the counter-proof isn't administered

[1] D. Dumbrăveanu, R. N. Catană.
[2] A. Avram, *The insolvency proceedings. General section*, Hamangiu, Bucharest, 2008, p. 185.
[3] D. Dumbrăveanu, R. N. Catană.
[4] *Ibid.*, p. 10.
[5] *Ibid.*, p. 11.
[6] I. Turcu, *op. cit.*, p. 317.

by the parties, these acts shall be annulled[1].

The documents closed during the suspicious period, having the parties' intention involved in this in concealing goods from the creditors' pursuit or of harming someone else's rights

This kind of documents, likely of being nullified, are different in the way that all the parties involvement in this (debtor, creditor) have acted with the *intention* of harming the creditors through hiding a good that is part of a group of goods sought under lenders' general pledge; so the ware-about of a *fraudulent scheme* between the debtor and his partners is imperative[2].

Instruments of ownership transfer toward a creditor made within 120 days before the procedural initiation, if the amount of money that was about to be received by the creditor, in case of the debtor's insolvency, is smaller that the amount written in the transfer instrument

To be susceptible of cancellation, we have to be in possession of an ownership transfer document closed during the suspicious period (120 days before the procedural initiation), the transfer's objective being a total or partial extinction of a debt between the debtor and his creditor, a debt created before those 120 days and *the effect of the ownership transfer has to be the growth of the sum which the creditor would receive it in case of bankruptcy, at the loss of the other creditors*[3].

The establishment or the completion of security interests

Often, the debtor, faced with the prospect of imminent bankruptcy, will try to avoid the creditor's civil action by giving him a security interest with one of his goods. In this way the debtor will sever the equal status between creditors, as long as he does not have any other interests through the masked delay of his insolvency and by doing so, giving priority to one out of

[1] A. Avram, *op. cit.*, p. 186.
[2] I. Turcu, *op. cit.*, p. 322.
[3] I. Turcu, *op. cit.*, p. 322. In the French jurisprudence, this text found its use in cases of payment releases when, in stead of the owed sum, the debtor offered merchandise or materials or he offered another apartment, different from the one mentioned in the contract still not carried out, but he paid in full, (…) and in the American jurisprudence, the text also applies to the payments done by the debtor through bills (promissory notes, checks).

many of his creditors[1].

Article 80 paragraph 1 letter e) of the law mentioned-above speaks of the cancellation of the establishment or of the completion of a security interest, for a receivable that was unsecured[2], in those 120 days before the procedural initiation – as a result, we can deduce the *precedence of the creditor's receivable*; this precedence scores the lack of any of the debtor's legal interest for the establishment or completion of a security interest attached to such a receivable.

The doctrine assessed that *a collateral established in the suspicious period in order to guarantee both a previous debt and a present or future debt isn't annulled, except for the case when the collateral guarantees a previous debt, as the collaterals for future debts will not be attacked by nullity*[3].

The legal provisions, regulated by Law 99/1999, are applied to: pledges, mortgage agreements and also to executional mortgages, when the receivable, initially unsecured, is later acquiring a security interest[4].

The prepayment of outstanding debts

According to Article 80 paragraph 1 letter f), *the prepayment of outstanding debts, done within 120 days before the procedural initiation, is susceptible of cancellation in case its deadline had been determined for a date subsequent to the initiation.*

This legal text *is also applied to the receivables that were not formed in the day when they were effectively been discharged, not to mention the payments performed in the suspicious period through the legal mechanism of debt assignment*[5]*, of perfect or imperfect delegation* by which the debtor appoints one of his own debtors to pay one of his lenders. Payment release by which the debtor is providing to his creditor is also attacked by means of nullity, a payment which the creditor agreed on receiving a service different

[1] D. Dumbrăveanu, R. N. Catană.
[2] In compliance with Article 3 point 13 of Law 85/2006, the *unsecured creditors* are the debtor's creditors who do not constitute collaterals toward the debtor's patrimony and who do not have privileges accompanied by retention rights, whose receivables are up to date on the time of the procedural initiation, as well as new receivables related to current activities in the probationary period.
[3] D. Dumbrăveanu, R. N. Catană.
[4] I. Turcu, *op. cit.*, p. 326.
[5] I. Turcu, *op. cit.*, p. 327.

from the service owed[1].

Cash payments are the exceptions, payments done via bank transfer or currency script bills (bill of exchange, promissory note, check – if the endorser's receivable toward the drawer has a valid existence)[2] through any payment methods accepted by commercial usances (the remittance in current accounts, the use of credit cards[3]).

Both legal compensation and judicial compensation are not hit by nullity, with the exceptional case in which the legal compensation would come out from a disguised fictional process into a payment release[4]. In the same time, the nullity becomes effective for conventional compensations that are based on the parties' agreement, becoming easely confused with a mutual payment release[5].

The transferring acts or the entering of obligations fulfilled by the debtor in 2 years time before the procedural initiation, with the intent of hiding / delaying the state of bankruptcy or to fraud a natural or artificial person to which he was bound at the time of performing the transferring of certain operations with financial derivatives, together with the fulfillment of a netting ("bilateral netting agreement") achieved on the basis of a qualified financial contract

According to Article 3 paragraph 31, *qualified financial contract* means any contract seeking operations with financial derivatives achieved in regulated, assimilated or well-understanding markets, as to how they are regulated.

When it comes to *netting* (*"bilateral netting procedure"*)**,** this one *seeks only qualified financial contracts and one of the moments of executing these operations moreover represents the approach of one of the contractors to the insolvency proceedings*. In compliance with Article 3 paragraph 33, these operations imply: the ceasing of qualified financial contracts and / or the acceleration of the parties / the fulfillment of obligations; the calculation or estimation of the compensation value; the conversion into a single currency of the compensation value; compensation till acquiring a net amount; the entry of the net amount, as the case may be, as a right of the

[1] D. Dumbrăveanu, R. N. Catană.
[2] I. Turcu, *op. cit.*, p. 327.
[3] D. Dumbrăveanu, R. N. Catană.
[4] *Ibid.*
[5] L. Pop, *The general theory of obligations*, Lumina Lex, Bucharest, 1998, p. 492-493.

party participating in the procedure, in other words even as a receivable of his contractor[1].

The bilateral netting agreement (*netting agreement*) is any kind of agreement or clause of a qualified financial contract between two parties, which specifies a netting of certain payments, discharging obligations or bringing into effect of present or future rights or having a connection with one or more qualified financial contracts (master netting agreement); in addition, any master netting agreement between two parties indicating the netting involving two or more master agreements, with any subsequent guarantee agreement (pledge, indemnity bond, personal guarantee etc.) or in connection with one or more master netting agreements.

III. Operations ended three years before the procedural initiation, likely to be annulled, with the recovery of services, if these are made in the creditors' detriment

According to Article 80 of Law 85/2006, it is about operations that were undertaken by people that are in legal relationships with the debtor:

- with a limited partner or with an associate that has at least 20% of the company's capital or of the suffrage in the G.M.S. (General Meeting of Shareholders) when the debtor is the limited partnership in question, it is an agricultural company, a general partnership, a limited liability company;
- with a member or manager, when the debtor is an economic interest group[2];
- with a shareholder who has at least 20% of the debtor's shares or of the G.M.S. 's suffrage, when the debtor is a corporation;
- with an manager, executive or a member of the debtor's State supervisors, a cooperative company, a cooperation, a limited liability company or an agricultural company;
- with any other natural or artificial person that has a dominant position towards his debtor or of his activity;
- with a joint holder concerning a common asset.

In all these situations it is assumed that these harmful operations to

[1] http://www.dreptonline.com/domenii/drept-comercial/compensarea-bilateral-net ting.html, accessed in 01.02.2009.

[2] For details regarding the economic interest group, see Monica Ionaș-Sălăgean, *The economic interest groups: cui prodest?*, in „Revista de drept comercial" nr. 8/2007, p. 78.

the creditors' interests were possible due to the abusive attitude of the interested person who, in same time, had benefited from the his social status and of the information he had access to concerning a potential trigger of the procedure, in order to obtain an unjustly benefit for himself, in the creditors' detriment[1].

The action for annulment initiated by the receiver or the liquidator in the previous cases will aim at recovering services, with the object of protecting the creditors' rights.

IV. The action for annulment

The insolvency law establishes a period of maximum 3 years previous to the commencement of the insolvency proceedings and until we reach that point we can go back in time to create an action for annulment with the intention of supplementing the debtor's patrimony with the alienated assets or with their counter-value[2].

The doctrine frequently made a comparison between the action for annulment and the Paulian action (*the aside action*). Both actions have a tendency of quelling the debtor's fraud[3].

There are a lot of distinct elements involving the two actions:

- the action for annulment generates positive effects for all creditors, whilst the Paulian action can help the creditor or the creditors only when they have brought the action with a particularity. This explains why the person who inserts the second action can exercise a right that is personal and particular[4];
- the action for annulment inclines not only on penalizing the fraud, but also on rebalancing the creditors' chances; by means of this action, intangible documents can be cancelled, like payments or partitions[5];
- the action for annulment aims at documents closed during the suspicious period, whereas the Paulian action allows the act of attacking the documents closed before the above-mentioned period;
- the Paulian action implies the third-party's fraudulent scheme and it leads to unenforceability of agreements towards the creditors at their

[1] I. Turcu, *op. cit.*, p. 329.
[2] Gh. Piperea, *op. cit.*, p. 33.
[3] D. Dumbrăveanu, R. N. Catană.
[4] L. Pop, *op. cit.*, p. 421.
[5] I. Turcu, *op. cit.*, p. 311.

own expense, whereas the action for annulment lies on the presumption of fraud sanctioned by the special procedure[1]. The task of proving the existence of fraud was exempted by setting a rebuttable presumption (Article 85 paragraphs 3-4) which acts only against the debtor[2]. This presumption can be removed by the debtor, after all, it being a rebuttable presumption[3].

The holders of the action for annulment

The action for annulment can be brought by *the receiver or by the liquidator* within one year in which a report has to be drafted (Article 20 paragraph 1 letter b), but no later than 18 months before the procedural initiation.

The creditors committee can bring the action to the bankruptcy judge if the receiver / liquidator won't do it.

Assuming that the cancellation of fraudulent documents, of established or transferred rights is likely to affect the debtor, the doctrine started *questioning the procedural status of the debtor (claimant or defendant) who uses this action*.

Because the receiver/liquidator has the quality of legal representative of the debtor, when they initiate the action, the debtor gains the status of claimant. Talking about alleged fraudulent documents, such a conclusion would be wrong because the debtor is considered the guilty party and considering the end of the action in question (the restoration of the debtor's patrimony, diminished by means of fraudulent ousting done by him during the suspicious period), this would be in contradiction with the debtor's interests.

As a conclusion, the debtor is the defendant of this action, being summoned by the special administrator, the situation of being summoned as a witness recurring to the debtor and as the case may be, to his contractor (Article 85 paragraph 6)[4].

[1] D. Dumbrăveanu, R. N. Catană.

[2] I. Turcu, *op. cit.*, p. 312.

[3] According to Article 85 paragraph 4, the fraud presumption is maintained, even if, in case of abuse of procedural laws, the debtor adjourned the moment of the procedural initiation so that the terms of Article 79-80 would no longer be valid.

[4] Gh. Piperea, *op. cit.*, p. 33.

The nullity exception

In compliance with Article 82 of the law mentioned above: *a request for canceling a patrimonial transfer performed by the debtor, in the normal course of his current business, is not possible*. Given that in this section the object of the actions for annulment is the debtor's juristic acts prior to the procedural initiation, then this should mean that they had in mind the current normal activity before the initiation[1].

The nullity's effects on the third-party purchaser

Article 83 paragraph 1 of Law 85/2006 states that in an annulled patrimonial transfer the third-party purchaser *will have to return the transferred good or, if the good still exists, its value determined on the day it was transferred by the debtor back to his property*. So, it's about a restoration in kind or by equivalent.

If the third-party purchaser accepted a transfer in good-will and without the intention of thwarting, delaying or cheating the creditors of the debtor and he returned to the debtor's property the good or its price that was transferred to him by the debtor, the first will have a same-value claim against the property[2], effectively becoming a lender of the of both his debtor and the debtor's property, alongside others and his claim must be accepted, even if it's delayed toward the deadline linked to the claim assertion[3].

We would also add that the gratuitous third-party purchaser of good faith shall return the goods in their state and if they are gone, he will have to pay back the difference value from which he has enriched himself.

[1] A. Avram, *op. cit.*, p. 204-205. The insolvency law even refers to the debtor's current activity after the procedural initiation, according to Article 3 paragraph 14 and Article 49, both of the same law and it consists of those acts of merchants and financial operations suggested to be executed by the debtor during the probationary period, in the normal rate of his trade, like: the continuation of the work he contracted on, in relation to the scope of activity, the execution of cashing operations and related payments, granting financing of working capital in current limits. *The current activity foreseen for the probationary period* doesn't suggest a usual activity because, after the procedural initiation, even when the insolvency influences the debtor, his activity will no longer be seen as a regular one, in regular conditions.

[2] The amount of the receivable of the third-party purchaser equals the good's value determined on the day of the transfer and so, the claim of having the receivable updated is unfounded. See I. Turcu, *op. cit.*, p. 340.

[3] I. Turcu, *op. cit.*, p. 339.

The gratuitous third-party purchaser of ill-will (his status must be proven) will return, in all cases, the whole value he had received, as well as the collected fruits or their equivalent value.

The nullity effects on subsequent documents

The receiver/liquidator or the creditors committee can bring an action on reclaiming from the subsequent owner the good or the value of the good transferred by the debtor, on two conditions:

- the subsequent owner has not paid the good's real price;
- the subsequent owner knew or he should have known the fact that the first transfer is likely to be canceled.

A rebuttable presumption of circumstance cognition discussed earlier is established when the subsequent owner is husband/wife, relative or in-law of the debtor reaching fourth grade included (Article 84 paragraph 2 of Law 85/2006).