# INITIATION OF INSOLVENCY PROCEEDINGS AND ITS EFFECTS IN ROMANIAN LAW

Lecturer **Cristina COJOCARU**[1]

***Abstract***

*Under Romanian law, insolvency shall be initiated at the request of the persons entitled, usually the debtor or the creditor. After checking the fulfilment of the legal conditions, the syndic judge will order the opening of insolvency proceedings as well as the measures to be taken to know precisely the financial situation of the debtor, the causes that led to the situation of insolvency and the way forward, i.e. the general or simplified procedure. The judicial administrator draws up a report based on which the syndic judge shall decide either the continuation of the general procedure in order to observe the chances of recovery of the debtor on the basis of a reorganization plan or the transition to the simplified procedure: the bankruptcy procedure. In the first case – that of the general procedure – a reorganization plan will be applied, leading to the improvement of the debtor's activity and the payment of the debts to its creditors; in the second case, there are some steps that will lead to the liquidation of the debtor's estate to cover the claims of the creditors. Without claiming to analyses the topic extensively, the article aims to underline the most important aspects about entering the insolvency procedure.*

***Keywords:*** *Romanian business law, insolvency, insolvency proceedings, initiation of insolvency.*

***JEL Classification:*** K22

## 1. Introduction

Under Romanian Law, the legal provisions in this matter are showing a picture of the proceedings updated in accordance with the European regulations. After the year 1989, from a view in favour of the debtor to a view probably more the creditors-oriented, the legal framework has constantly change in Romania[2].

In the current Law no. 85/2014 ("the Law"), the insolvency proceedings are triggered with an application filed with the competent court – the tribunal – by the debtor, the creditors or other persons or institutions provided by law[3].

Immediately upon receipt of the request, the syndic judge will be appointed to resolve such a request.

The syndic judge will verify the application as regards the fulfilment of the conditions required by the law for the initiation of insolvency proceedings and will rule by an order or a decision and, according to the person who filed the application, the creditor or the debtor, the resolution is different.

## 2. The application filed by debtor

If the syndic judge finds that the debtor's request meets the requirements of the law, he shall issue an order to open the general procedure.

The syndic judge may also order the opening of the simplified procedure if several conditions are fulfilled: either the debtor has expressed his intention to enter into a simplified procedure, or he fails to submit the documents provided by the law within 10 days or he falls into certain categories provided by law.

If the opening of the general procedure is ordered, the syndic judge will appoint a judicial administrator and, if a simplified procedure starts, the judge will appoint a liquidator, who must carry

[1] Cristina Cojocaru – Department of Law, Bucharest University of Economic Studies, Romania, cristina.cojocaru@cig.ase.ro.

[2] For a comparative perspective, view Matthew Braham, Frank Steffen, *Voting rules in insolvency law: a simple-game theoretic approach*, „International Review of Law and Economics", Volume 22, Issue 4, December 2002.

[3] See Carpenaru D.St., Hotca M.-A., Nemes V., *Codul insolventei comentat*, Universul Juridic Publishing House, Bucharest, 2017, p. 20 et seq.; Tandareanu N., *Codul insolventei comentat. Vol.1: Art. 1-182*, Universul Juridic Publishing House, Bucharest, 2017, p. 32 et seq.

out the notifications provided by the law.

Following receiving the notification, the creditors entitled to file an opposition within 10 days upon its receipt, which is a mandatory time limit. Upon the introduction of an opposition, within 15 days, the syndic judge establishes a term, when any opposition filed will be resolved[4]. The syndic judge can find that the debtor is not in a state of insolvency, in which case he will admit the opposition and revoke the opening of the proceedings. If it is found that the debtor is in a state of insolvency. The syndic judge will reject the opposition.

### 3. The application filed by creditors

By receiving such a request, the syndic judge must check that the conditions required by the law are met and communicate the decision within 48 hours to the debtor.

By receiving such communication, the debtor must to make its position known within 10 days, either to challenge or to recognize the state of insolvency.

It should be noted that in order to protect the debtor against the possible abuse of the creditors, the law provides that the syndic judge may require the payment of a security of no more than 10% of the value of the claims within 5 days; if this security is not lodged, creditors' claims will be rejected.

When it is established that the debtor is in a state of insolvency, following the appeal of the debtor rejected and the opening of the general procedure ordered, the debtor will no longer be entitled to request judicial reorganization. In this case, the reorganization plan may only be proposed by the judicial administrator or by the creditors which hold together or separately at least 20% of the value of the claims.

If it is established that the debtor is not in a state of insolvency, the judgments will rule on his appeal and the creditor's request will be rejected.

Moreover, if the debtor does not challenge within the time limit the state of insolvency and wishes to reorganize his activity, the syndic judge will order the opening of the general procedure.

However, if it appears from the debtor's statement that he has been subject to reorganisation during the last 5 years or he falls within the categories provided by art. 38 of the Law (like the professional sole traders registered at the Trade Register, family enterprises, or debtors for which the managers are unknown or the accountancy documents may not be found, etc.), the opening of the simplified procedure shall be ruled.

### 4. Information on the state of the debtor in insolvency

Once the decision to initiate the procedure is final, any act issued by the debtor and any correspondence issued by the debtor, the judicial administrator or the liquidator, will necessarily carry information in Romanian, English and French on the status of the debtor with the terms*: în insolvenţă, in insolvency, en procedure collective*.

After entering into the judicial reorganization or bankruptcy procedure, the debtor's documents and correspondence shall bear the following mentions*: în reorganizare judiciară, in judicial reorganization, en redressement,* respectively: *în faliment, in bankruptcy, en fallite.*

If the debtor in one of these situations fails to fulfil his information obligations for damages caused to third parties in good faith by acts concluded with the debtor in insolvency, the liability in such cases rests solely with the persons who have concluded the acts as legal representatives of the debtor.

[4] See also I.C.C.J., Decision no. 16/2018; I.C.C.J., Decision no. 44/2016; I.C.C.J., Decision no. 1444/2015 , I.C.C.J., Decision no. 1445/2015, I.C.C.J., Decision no. 1306/2015; I.C.C.J., Decision no. 1305/2015,, I.C.C.J., Decision no. 1083/2015,, I.C.C.J., Decision no. 787/2015**.**

### 5. The obligation of the debtor to provide the necessary information for the conduct of the procedure

In order to carry out the insolvency proceedings, the debtor is obliged, regardless of whether he or a creditor has requested the insolvency, to submit to the file for the syndic judge the information on the company. The data and information reach the judicial administrator and the liquidator, including the list of payments and patrimonial transfers performed during the 120 days prior to the opening of the proceedings.

In the event that the debtor does not submit the required documents in the simplified procedure, the liquidator will reconstitute them at the debtor's expense. The debtor's failure to comply with the law is sanctioned with the payment of judicial fines. The refusal of the debtor natural person or legal representative of the debtor to make available to the syndic judge, the judicial administrator or the liquidator the required documents or the obstruction in bad faith to the reconstitution of the documents, constitutes an offense and is also punished.

### 6. The effects of opening insolvency proceedings

Such effects concern only the debtor's patrimony: its rights and obligations, but also the rights of third parties regarding the recovery of claims on the debtor[5].

*i. Loss by the debtor of the right to manage his wealth*. In principle, the opening of the proceedings cancels, by law, the right of the debtor to administer[6], *i.e.* to manage his activity, to administer or dispose of his assets, unless he has declared, under the law, the intention to go through reorganization.

Therefore, all acts, transactions or payments made by the debtor after the opening of proceedings are void, except the case of acts concluded during the observation period or those authorized by the syndic judge.

It should be noted that this effect does not lead to the debtor's loss of his right to property but only that he can no longer manage it, this right being exercised by the judicial administrator or the liquidator respectively under the law.

If the debtor has expressed his intention to undergo reorganization, he does not lose his right of administration. Also, in this case the syndic judge may order that this right be lifted in whole or in part if he considers that the appointment of a judicial administrator is necessary.

In addition, if the creditors or the judicial administrator finds continuous losses from the debtor's assets or the real lack of a viable recovery plan, they may request the lifting of the debtor's right of administration.

The debtor's right of administration ceases to be lawful at the time when the bankruptcy proceedings commences; from this date, he will only be able to perform liquidation operations.

In all cases of removal, the debtor's right of administration, the syndic judge will order all banks where the debtor has or may have accounts, to dispose of them only by order from the judicial administrator or the liquidator, respectively.

*ii. Suspending of judicial and extrajudicial actions for the satisfying of claims on the debtor's or debtor's assets.* According to the Law, any individual judicial or extrajudicial action prior to the commencement of the proceedings, which is aimed at achieving claims on the debtor or his assets, shall be suspended from the date of the initiation of the proceedings. This suspensive effect is taking place from the date of the decision to open the procedure and not from the date of the application.

The same effect of suspension will also arise with regard to enforcement proceedings against the debtor. In practice, any prosecution on the debtor is suspended and all these apply by the effect of the law without the need for any decision in this respect.

In order to ensure the effect of the suspension, the syndic judge, once the proceedings initiate,

[5] For the effects on employees, please see N. Stef, *Bankruptcy and the difficulty of firing*, „International Review of Law and Economics", Volume 54, June 2018.
[6] See also I.C.C.J., Decision no. 16/2018.

will communicate this measure to the court at the debtor's headquarters as well as to the banks where the debtor has opened accounts.

In this way, once the procedure starts, any individual prosecution by the creditors is no longer possible and the recovery of any of these claims is only possible under the joint procedure.

Exceptionally, in the cases provided by art. 39 of the Law, the creditor holding a mortgage-backed claim, pledge or other security, or a right of retention, may request the syndic judge to lift the suspension of actions in respect of the claim and the immediate capitalization of the asset which is subject to the security.

The syndic judge may lift the suspension when the value of the object of the guarantee is covered by the total amount of the claims and the parts of claims secured by that object. However, it is worth mentioning that the asset under the guarantee should not be very important or significant for the reorganization plan. In addition, if that asset is part of a whole, by selling it, the value of the remaining should not be diminished.

*iii. Suspending the prescription period on actions for claims against the debtor*. The measure is necessary in order to protect the holders of the shares which have been suspended and as such, from the commencement of the proceedings, the prescription of the actions for the settlement of the claims against the debtor is also suspended[7].

*iv. Suspending the accumulation of interest, increases and penalties*. The Law stipulates that no interest, increase, penalty, or expense may be added to claims incurred prior to the opening of the proceedings.

It should be noted that this suspension concerns only the penalty interest and not the regular one, and at the same time the guaranteed receivables are excluded, which will be included in the final list up to the value of the valuation guarantee

*v. Suspending the trading on the regulated markets of the shares issued by the debtor*. Another consequence of the opening of insolvency proceedings is the suspension of the trading on the capital markets of the shares issued by the debtor joint stock company.

This suspension will come into force with the notification of the National Commission of Real Estate on the opening of insolvency proceedings and is valid until the date of the confirmation of the reorganization plan.

When this commission receives the communication of the debtor's bankruptcy, its shares are withdrawn from the regulated market on which they are traded.

## 7. Legal acts concluded by the debtor in the period preceding the opening of insolvency proceedings

When determining the legal status of these acts[8], the lawmaker considered the purpose in which these acts were concluded and their consequences on the debtor's patrimony.

Regarding most of these legal acts there is a strong suspicion that they have been concluded with the intention of defrauding creditors, therefore the law establishes certain periods prior to the opening of the proceedings, periods during which the concluded acts are subject to analysis and appreciation of their merits and legality.

These terms are different depending on the nature of the legal acts under scrutiny: 3 years, 2 years and 120 days.

*a. Legal acts made fraudulently*. It concerns any fraudulent legal act that the debtor has concluded for the creditor's loss within 3 years prior to the opening of the proceedings and which, at the request of the judicial administrator or the liquidator, the syndic judge may cancel.

It concerns the sanction of cancelling the fraudulent legal act, not its revocation, because there

[7] See also, Decision no. 636/2018 of Bucharest Court of Appeal.

[8] See also, Decision no. 2301/2018 of Bucharest Court of Appeal, Decision no. 2302/2018 of Bucharest Court of Appeal, Decision no. 2180/2018 of Bucharest Court of Appeal, Decision no. 2082/2018 of Bucharest Court of Appeal, Decision no. 1994/2018 of Bucharest Court of Appeal, Decision no. 2008/2018 of Bucharest Court of Appeal, Decision no. 1876/2018 of Bucharest Court of Appeal, Decision no. 1742/2018 of Bucharest Court of Appeal.

is a close link between the fraud and the debtor's state of insolvency.

The action for annulment of fraudulent legal acts shall be filed by the judicial administrator or the liquidator within one year from the expiry of the time set for drafting the report of the judicial administrator, but not later than 18 months from the date of the opening of the procedure. The two terms have different legal meanings: the one-year term is a limitation period and the 18-month period is mandatory time limit.

If the judicial administrator or liquidator respectively does not file such a request, the application may be submitted by the creditors' committee.

The request shall be lodged against the debtor, represented by the special administrator as the case may be.

It is worth mentioning that fraud at the expense of creditors is presumed once the act is concluded within the period set by law. This presumption is preserved even when the debtor through abuse of procedural rights delays the moment of the opening of the proceedings in order to expire the limitation period for the action for annulment.

The effect of the annulment of the legal acts concerned is that of depriving them of their effects under the common law.

*b. Legal acts subject to the sanction of annulment*

(i) Acts of transfer, free of charge – such acts are detrimental to the creditors, and therefore all these acts concluded during the three years preceding the opening of the proceedings are subject to cancellation. In this case, the law does not require the bad faith condition of the recipient.

Acts concluded for sponsorship for humanitarian purposes are excluded.

Also, in case of legal acts in which the performances of parties are imbalanced, if the legal act concluded within three years prior to the opening of the proceedings is obviously disadvantageous to the debtor, it is subject to cancellation.

(ii) Legal acts concluded for the purpose of circumventing goods from the pursuit of creditors - it concerns the acts concluded during the three years preceding the opening of proceedings, with the intent of the parties to evade goods from the pursuit of creditors, or to damage their interests in any way.

The legal acts regarding the extinguishing of the debtor's debts are acts concluded during the 120 days prior to the commencement of proceedings whereby one or more assets have been transferred to a creditor for the purpose of extinguishing a past debt or for his benefit if the amount that the creditor could obtain in case of bankruptcy of the debtor is less than the value of the act of transfer.

(iii) Legal acts regarding the establishment of real guarantees - this category covers legal acts concluded during the 120 days prior to the opening of the proceedings and which constitute a real guarantee for an unsecured claim.

(iv) Legal acts regarding the debtor's early payments - it concerns the legal acts concluded during the 120 days prior to the opening of the proceedings and which provides for early payments for debts which matured at a later date following the opening of the procedure.

(v) Legal acts of transfer or assumption of obligations made with the intention of concealing or delaying the debtor's state of insolvency – they concern acts concluded within two years prior to the opening of the proceedings, by means of which the debtor seeks to hide its real status at the expense of the creditors.

Legal acts by which debts of the debtor are extinguished, actual collateral or anticipated payments of the debtor are made, if they are made in good faith in an agreement with creditors as a result of negotiations for the debtor's debt restructuring are exempted from cancellation.

(vi) The following acts concluded during the three years prior to the opening of the proceedings may also be cancelled:

- an act concluded by the debtor with a limited partner or associate holding at least 20% of the company's shares, or, as the case may be, of the voting rights in the general meeting of the associates when the debtor is the limited company concerned, ie a general partnership or a limited liability company;

- an act concluded with a member or manager, when the debtor is a group of economic interest;
- with a shareholder holding at least 20% of the debtor's shares or, as the case may be, voting rights in the general meeting of shareholders when the debtor is the same joint-stock company;
- with an administrator, director or member of the Supervisory Body of the debtor, cooperative society, joint stock company or agricultural, as the case may be;
- with any legal or natural person having a dominant position on the debtor or its business;
- with a co-owner on a common good.

If these documents were drawn up to the detriment of the creditors, they are subject to cancellation, with the justification that, owing to their position, the persons with whom the acts in question were concluded could have information about the debtor's status, even on the possibility of insolvency.

With regard to these acts, fraud is presumed, presuming to be a relative one, and therefore can be overturned by the debtor; it does not extend to the sub-buyer third party or the sub-buyer.

The right to an action for annulment shall be subject to a limitation period of one year from the expiry of the time limit for the preparation of the report of the judicial administrator.

The nullity of these acts has the effect of their retroactive cancellation, with the return of the parties' performances, with the exception of the third-party bad faith acquirer who loses the right to his claim or the good resulted from the reinstatement of the previous situation.

If the act was free of charge, the third-party acquirer will return the asset in its current state and in its absence shall return the difference in value with which he got enriched. If there was bad faith, he will return the whole value as well as the fruits gained from it.

In the case of sub-buyers, they will return the asset only if they have not paid the corresponding value of the good and knew or ought to have known that the transfer is susceptible to being cancelled.

## 8. Conclusions

Summing up the legal provisions, the company's insolvency proceedings may be initiated at the request of the debtor or creditor with the purpose to cover the insolvency debtor's liability by paying the claims of the creditors. Consequently, the procedure itself has the role of ensuring the protection of the interests of the creditors. This procedure therefore opens at the request of certain persons and takes place before the syndic judge who decides on all the necessary acts to carry it out.

Once this procedure has been initiated, some measures will be taken to know exactly the situation of the debtor, the provision of the necessary documents, and to inform those concerned, including third parties, of the opening of the proceedings.

Measures are taken so that the acts committed by defrauding the creditors be cancelled and assets or values that had been alienated are reintroduced in the insolvency estate in order to ensure proper payment of creditors. The management of the debtor's assets at the moment of the opening of the procedure is performed by the judicial administrator or by the liquidator under the control of the syndic judge.

## Bibliography

1. Braham M., Steffen F., *Voting rules in insolvency law: a simple-game theoretic approach*, „International Review of Law and Economics", Volume 22, Issue 4, December 2002, pp 421-442.
2. Carpenaru D. St., Hotca M.-A., Nemes V., *Codul insolventei comentat*, Universul Juridic Publishing House, Bucharest, 2017.
3. Stef N., *Bankruptcy and the difficulty of firing*, „International Review of Law and Economics", Volume 54, June 2018, pp. 85-94.
4. Tandareanu N., *Codul insolventei comentat. Vol.1: Art. 1-182*, Universul Juridic Publishing House, Bucharest, 2017.