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The Opening of the Insolvency Procedure: Theory v Practice

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The exit from the market of debtors, who no longer deal with maturing payments, is legally regulated in most countries around the world. The first modern regulation of the insolvency procedure in Romania is found in 1995 and it suffers to date many modifications meant to keep the insolvency procedure in direct connection with the socio-economic reality. The special attention paid by insolvency lawmaker, but also its continued development over 20 years, would require a clear procedure for all parties involved. The opening of insolvency proceedings is accessible to debtors who recognise their financial difficulty, but also to creditors under certain conditions expressly lay down by the Insolvency Law. Although the legal text in a first reading seems to be lacking in ambiguous interpretations, its application in practice has raised a number of difficulties, quantified in completely different jurisprudence. The unit of jurisprudence in legal matters is an imperative of any state. The lack of consistency of judicial practice generates an undesirable phenomenon, the insecurity of the legal circuit translated into the decline of the Romanian citizens' confidence in the act of justice. The law must have the same meaning for all.

Keywords: *International Treaties; Human Rights; Islamic Court; Aceh; Indonesia*

Introduction

Let us imagine a spider web built in a tree. Although it seems solid, the cobweb reinforced in several points crossing each other is far from being indestructible. It must withstand natural phenomena such as rain, wind or mankind/animal intervention. The web can be destroyed to a lesser or greater degree, the time of remaking it being prorated to its destruction degree but various factors such as the size of the spider, its ability and rapidity when building the web, and its social activity are essential, too.

The size of spiders varies; the smallest is *Patu digua* of 0.37 mm and the biggest - *Theraphosa blondi* of 90 mm. Small-size spiders spend less time building the web and as a paradox, their cobweb is very big as compared to their own size. The big spiders, although investing a lot of time in weaving their web, do not display the same performance as the small ones considering the spider/web size ratio. And speaking of the cobweb size, I must mention the social spiders named *Anelosimus eximius*, which live in colonies up to 50,000 individuals. In 2007, in Texas, in the Tawakoni natural reserve, a huge spider web of approximately 180 meters was discovered[1].

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[1]Information available on https://ro.wikipedia.org/wiki/P%C4%83ianjen

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I have stated that the spider's social activity influences the building/ repairing of the web because males have specific complex rituals of courtship, which they perform for a greater purpose than reproduction, that being for preventing that the females eat them after mating.

Taking that information to the business world, one will find many resemblances. The business world is made up of several entities, which act on the market and are interconnected by the business they unfold. Failure of a business can be generated by external factors independent of the manner in which the business was ran, such as the competition or the law amendments, as well as by internal factors that are closely connected to the abilities and professionalism of the company's management bodies. A skilful manager will protect the company against the intervention of disrupting external or internal factors, thus rendering the risks minimal. The same as for the spiders, if the social activity distracts the manager's attention, a plain unfavourable situation corroborated with the passive character of the decision makers can lead to the dissolution of the company.

Similar to the behaviour adopted by social spiders, one can find gradually more often business organized under the form of the economic concern group, made up of several individual entities particularly meant to mitigate the shock caused on the market by the intervention of different factors.

In a perfect ecosystem, there would be a cobweb that after being built would help the spider during its entire life, without the web having to be rebuilt, but perfection is a utopia. The same stands for the perfect business network.

The Insolvency Procedure in Romania

In general, the business environment is going through continuous formation and transformation. Some players are successful, while others fail. There must be a balance between the players entering and exiting the market. By adequate laws, the entry of new players on the market is facilitated, as well as the exit of those that failed in paying their debts when due.

As early as 1995, the Romanian Parliament acknowledged the importance of the Law of insolvency, as well as the need for an adequate legal framework to be in place for facilitating the recovery of the creditors' receivables by means of granting a recovery opportunity of the debtor's business or winding up its wealth when the business reorganization would no longer be possible.

The constant concern displayed by the Romanian Parliament for correlating the laws to the economic reality was proven by the passing of Law no. 85/2014 on the procedures of preventing the insolvency and the insolvency, also named the New Code of Insolvency. Even now, the Romanian Ministry of Justice is unfolding a project for improving the legal provisions for the insolvency domain, together with the National Union of Insolvency Practitioners of Romania.

The business environment of Romania is clearly affected by the insolvency of economic entities, which leave the market without having met their obligations. The commercial security, which can be summarised in the creditor's confidence to receive payments when due, is strongly affected. A business entering the

insolvency procedure indirectly affects the entire network in which it was included: its partners, customers, suppliers, and employees. Because of that, in the specialty literature the insolvency was compared to an *epidemics*[2] spreading rapidly in the business environment.

The amplification of the insolvency phenomenon can be seen in the statistical data published by the National Trade Registry Office of Romania, that being the number of companies that became insolvent[3], which increased during the first quarter of year 2018 by 19.31% by comparison to the similar period of year 2017. For understanding the whole picture of the Romanian business environment, one must mention that during January-March 2018 5,725 companies suspended their activity (42.98% increase by comparison to the same period of year 2017) and 9,793 companies winded up (60.83% increase by comparison to the same period of year 2017)[4].

De lege lata (in the existing law), the insolvency notion is legally defined in article 5 paragraph (1) item 29 of Law no. 85/2014: "the state of the debtor's patrimony which is characterised by the insufficient available funds for paying the certain, liquid and payable debts."

The Law of Insolvency no. 85/2014 mainly ensures that the debtor be granted the opportunity to recover by using the business reorganization procedure, but it also sets out the conditions for the debtor exiting the market if it would fail to mend its business – the bankruptcy procedure. One must state that, even if the law of insolvency seems a protection granted particularly to the debtor that was unable to meet the obligations it has accepted when due, it is balanced by the rights granted to the creditors within the same procedure, which pursue the recovering of uncollected receivables.

Unfortunately, although the law comprises solid principles and rules that facilitate the business reorganization, it is minimally used in practice because company managers use the protection provided by the law of insolvency only when the financial situation is irremediably compromised and the activity can no longer by reorganised, thus that the bankruptcy procedure must be initiated.

Opening the Insolvency Procedure – Theory

The purpose of Law no. 85/2014 set out in article 2 is "creating a collective procedure for covering the debtor's liabilities" while granting, when possible, the opportunity to recover its activity.

The possibility to use the insolvency procedure is open to the debtor and to the creditors, but the conditions vary. The coverage of the law of insolvency from the point of view of its subjects in connection to which it can be applied is very broad and refers to all professionals, except for those involved in liberal professions and those for which special provisions are stipulated for the status of

[2]Schiau (2001) at VI.
[3]Ministry of Justice - National Trade Register Office.
[4]All that statistical information are available under the form of monthly tables on the website of the National Trade Registry Office of Romania, www.onrc.ro

their insolvency, such as insurance companies, banks, territorial administrative bodies or education facilities.

The law stipulates two types of procedures: a general one, in which the possibility of the debtor to recover must be analysed, and a simplified one, much shorter as regards the procedure terms, which implies only unfolding some operations for the debtor leaving the market and erasing it from the records of the Trade Registry. The simplified procedure will apply only to the debtors that do not hold any assets in their patrimony, their memorandum of association or accounting documents cannot be found, the director cannot be found, the registered office no longer exists or the address declared to the Trade Registry Office is no longer the registered office.

If a debtor finds, according to its accounting documents, that the moneys it has are insufficient for paying the debts that became certain payable and eligible over 60 days[5] before, it is bound for in 30-day time[6] to go before the court of law and submit a request for going through the insolvency procedure. It must be stated that prior to the Insolvency Code (Law no. 85/ 2014) entering in force, the conditions described above sufficed for substantiating the opening of the insolvency procedure. After the Insolvency Code entered in force, the threshold value[7] for opening the insolvency procedure was set for the debtor, too.

Following the analysis of the company recovery possibilities, the debtor will decide whether opening the simplified procedure, which would lead to deleting the legal person from records, or the general procedure within which the debtor's reorganization could be considered, the end being its reintegration on the market, must be initiated.

The debtor's request must bear its legal representative's signature and if it requests that the simplified procedure be initiated, it must also submit the decision of the general meeting of shareholders.

For the syndic judge allowing the debtor's insolvency request, several documents must be attached. They are expressly provisioned in article 66 paragraph (5) and article 67 paragraph (1) of Law no. 85/2014.

The documents that must be attached to the request of opening the procedure, which the debtor would submit are

- *proof of notifying the competent tax body on its intention to open the insolvency procedure (article 66 paragraph 1 and article 67 paragraph 1 letter m);*
- *last annual financial statement, trial balance for the previous month to the date of registering the petition of opening the procedure (article 67 paragraph 1 letter a);*

[5]Article 5 paragraph (1) item 29 of Law no. 85/2014 defines the insolvency notion
[6]Article 66 paragraph 1 of Law no. 85/2014
[7]Article 5 paragraph (1) item 72 of Law no. 85/2014 defines the threshold value applicable to opening the insolvency procedure.

- *list of the debtor's assets with the amendments in the advertising registries for those having liens, list of bank accounts where funds are transacted (article 67 paragraph 1 letter b);*
- *list of creditors (article 67 paragraph 1 letter c);*
- *list of payments and asset transfers made 6 months prior to opening the procedure (article 67 paragraph 1 letter d);*
- *profit and loss account (article 67 paragraph 1 letter e);*
- *list of members of the economic concern group (article 67 paragraph 1 letter f);*
- *declaration indicating the intent to open the simplified procedure or the general procedure (article 67 paragraph 1 letter g);*
- *brief description of the reorganization manners (article 67 paragraph 1 letter h);*
- *notarised statement or attorney at law certified declaration indicating that the debtor has not undergone the reorganization procedure 5 years prior to submitting that request (article 67 paragraph 1 letter i);*
- *notarised statement or attorney at law certified declaration indicating that during the 5-year period prior to submitting the request, the business owners and the debtor's enforcement bodies have not been finally convicted for a series of intentional offences against assets, of corruption, forging documents, tax evasion, money laundering, etc. (article 67 paragraph 1 letter j);*
- *certificate of being accepted for trading on a regulated stock market or other issued financial instruments (article 67 paragraph 1 letter k);*
- *a declaration certifying the debtor's membership to a group of companies (article 67 paragraph 1 letter l);*
- *decision of the General Meeting of Shareholders on agreeing the opening of the simplified procedure (article 66 paragraph 5).*
- *In the absence of the relevant documents the syndic judge will reject the request on opening the insolvency procedure. Naturally, when one does not want to begin the company reorganization, the following documents must not be submitted: declaration on the reorganization manner and notarised statements.*

Summing up, it can be noticed that the debtor must go through an easy prior procedure for opening the insolvency procedure, that being previously notifying the competent tax bodies (proof of notice being the document requested for opening the procedure), submitting some accounting documents or some lists directly deriving from the accounting documents, drafting some plain statements and a notarised declaration.

If the request will be accompanied by those documents and bear an adequate stamp, the syndic judge will issue a conclusion on opening the general or the simplified procedure. The creditors of the debtor can oppose in writing the conclusion on opening the insolvency procedure in 10-day time of receiving the notice from the insolvency practitioner temporarily designated to administer the procedure.

If there is an incident engendering the debtor's assets, the syndic judge can order the urgent interruption of any approaches of enforcing the debtor's assets until the time when the decision on opening the insolvency procedure is issued.

The main effects of beginning the insolvency procedure fall on the patrimony and they are interrupting the judicial and extrajudicial actions, interrupting all ancillary amounts from accruing, interrupting the statute of limitation period, closing the existing bank accounts and opening the sole insolvency bank account. There are also non-patrimony effects, such as withdrawing the debtor's right to manage the company, promoting the company's insolvency situation, binding the debtor to supply the data and information requested in connection to its activity. The existence of some patrimony effects that could protect the patrimony of the company facing financial difficulties should persuade the honest debtors to use that procedure. In fact, although the debtors meet the legal conditions for lodging the petition of beginning the insolvency procedure, meaning they have debts over Lei 40,000, which were payable for over 60 days, they remain passive and bind the creditors wanting to recover their receivables to lodge that petition.

The creditor entitled to request the beginning of the insolvency procedure[8] is the company whose receivables on the debtor's patrimony are certain, liquid and payable for over 60 days. Certain receivables means receivables that derive from the receivable action itself, or even from other documents, even if they are not authenticated, issued by the debtor or acknowledged by it. The creditor will be able to request that the insolvency procedure be initiated only if, after setting off their mutual debts, no matter their type, the amount owed surpasses the threshold of Lei 40,000.

After the creditor has lodged its petition, the syndic judge will decide whether the conditions mentioned above were met and will order that the insolvency procedure be began or will reject the action on opening the insolvency procedure. If the receivables of the creditor who requested the insolvency procedure are paid until the date of closing the debates, the syndic judge will reject that petition as having no grounds[9].

Opening the Insolvency Procedure – Practice

Although the text of the law seems clear and straightforward, when first read, applying the legal norms mentioned above into practice has led to various difficulties and to an irregular jurisprudence.

The first issue I have found is that the debtor does not observe the due date until when it is bound to lodge a petition to begin the insolvency procedure. Article 66 paragraph (1) of Law no. 85/2014 stipulates "the debtor facing insolvency is bound to submit a petition to the court of law for having the provisions of this law applied to it in maximum 30 days of the date when the insolvency began."

[8]The definition of the creditor entitled to request that the insolvency procedure be initiated is given in article 5 item 20 of Law no. 85/2014

[9]The rule is set out in article 72 paragraph 5 of Law no. 85/2014.

If the debtors observed that legal norm, the commercial security would enhance and the contractual partners' trust would increase. However, it does not happen so.

Any legal advisor knows that the punishment is included in the legal norms as the part setting out the consequences that derive from not observing that norm in the circumstances set out by its assumption, as well as the possible approaches the competent authorities might implement against the subject of law that breached the law.

The law of insolvency does not provision any punishment for not observing that provision, although it does indicate that the debtor is bound to submit the petition in 30-day time of the date when the insolvency began. Lacking any punishment that would persuade the insolvent debtor to observe the term imposed by law has led and is still leading to negative effects in the business world, the commercial security being thus challenged. The Romanian debtors do not begin the insolvency procedure when financial difficulties appear and the activity might be reorganised and that is shown by the high number of bankruptcy procedures, over 95% of the total number of insolvency procedures of Romania.

When solving the matter indicated above, in connection to the regulations that will be issued, my opinion is that, while considering the obligation to lodge the insolvency petition in 30-day time of the insolvency, a severe punishment must be set out, prorated to the damages brought to the commercial security, such as refusing to allow the interrupting of all ancillary amounts from accruing.

The second matter I am approaching refers to applying and observing article 67 paragraph 1 letter a of Law no. 85/2014, which requires to the debtor to attach to the petition the last financial statement and the trial balance for the month prior to the date when the petition to being the insolvency was registered.

Even when the petition to begin the insolvency procedure was lodged by the creditor, the debtor is bound to submit to the case file in 10-day time, the relevant documents, among which the summary financial statements[10].

In practice, there are many situations when the debtor, without having any regard for the importance of the insolvency practitioner analysing its current financial situation, submits next to the petition to begin the insolvency procedure the last balance sheet registered with the finance administration, which is not the balance sheet of the financial period prior to lodging the petition to begin the insolvency procedure.

The activity of the insolvency practitioner implies analysing the economic activity of the debtor for at least 2 years prior to the date when the insolvency procedure began. That review is particularly important because two vital reports for the insolvency procedure are grounded on it (report on the continuity of the observation period or beginning the simplified procedure regulated by article 92 paragraph (1) and the report that must state the persons that contributed to the debtor's insolvency state, which is regulated by article 97 paragraph (1)). It sets

[10]Article 82 of Law no. 85/2014: "the debtor is bound to make available to the receiver/ liquidator […] information and documents deemed necessary in connection to its activity and wealth."

out the need to lodge some lawsuits[11] for annulling the fraudulent documents or operations that the debtor made while damaging the creditors' rights, during the two years before the insolvency procedure was began. Next, the report on the causes and circumstances of the insolvency procedure grounds the need to lodge the petition for determining the patrimony personal liability of the persons that contributed to the debtor's insolvency, according to article 169 of Law no. 85/2014[12].

As long as the debtor is allowed to lodge a petition for beginning the insolvency procedure by attaching "old" summarizing financial documents, while disregarding article 67 paragraph 1 letter a, which expressly requests attaching to the petition to begin the procedure the last financial statement and the trial balance for the month prior to the date when that petition was registered, it is obvious that the documents submitted have no economic or legal significance. The conclusions of the insolvency practitioner would thus be drafted only formally, without having any reliability.

In the file no. 1776/115/2017 of the Caras Severin Court of Law, upon a creditor's request, the insolvency procedure was began and the only accounting documents that were found were those of 2009-2011, according to which the accounting books were reviewed. Naturally, there could not be any action for annulment concerning only the operations made during the 2 years prior to the date when the insolvency procedure had been initiated or debating on the request to determine the personal patrimonial liability.

As long as only the syndic judge is authorised to check such documents attached to the petition of beginning the insolvency procedure, my opinion is that such a review should not be only formal, strictly referring to checking the document named balance sheet. The period to which the documents attached by the debtor must be checked as well. On the contrary, the entire insolvency procedure would be led beginning with assumptions that are no longer real.

The third matter is construing article 72 paragraphs 5 and 6, corroborated with the provisions of article 84 paragraph (1) of Law no. 85/2014, which allow the debtor to pay the receivables requested by the creditor asking to open the insolvency procedure until the debates close. When the syndic judge would find that the receivables were paid, he would reject the petition of beginning the procedure and if he would find that the payment was not made until the debates close, he would decide on beginning the insolvency procedure. Article 84 paragraph (1) provisions that all documents, operations and payments made by the debtor after the date of beginning the procedure are null de jure, except for those authorised by the syndic judge or endorsed by the receiver.

The decisions made by the syndic judge are enforceable and can be challenged only by lodging an appeal. The appeal, as a challenging manner, will

[11]The action for annulment is provisioned in Law no. 85/2014, Tile II, Chapter I, Section 5, article 117 and the next.

[12]Article 169 of Law no. 85/2014 sets out the conditions and deeds, which when proven, can lead to binding the members of the debtor's management bodies to pay the debtor's obligations by using their own wealth.

begin a judicial inspection on the decision made by the syndic judge in the first instance court.

By means of this legal text, the debtor coming before the court of law for beginning the insolvency procedure stands another chance to meet the obligations it has accepted before the plaintiff creditor until the debates on the merits of the case close.

In the file no. 847/115/2015[13] on the case list of the Caras Severin Court of Law, the syndic judge found that the creditor held certain, liquid and payable receivables of Lei 202,058 against the debtor, that the condition on the threshold value was met, and that the receivables should have been paid for over 60 days. Given that all legal conditions were met, he ordered that the insolvency procedure be initiated in connection to the debtor G.E. SRL. The debtor G.E. SRL lodged an appeal against the decision of the syndic judge, and the Timisoara Court of Appeal[14] allowed the debtor's appeal, rejected the petition to begin the insolvency procedure and bound the creditor to pay Lei 3,097 as court expenses considering that until the date when the appeal was solved, the debtor had paid all of the debtor's receivables and in the accounting and financial period corresponding to year 2014, it had registered a profit of Lei 485,389.

A similar situation is found in the file no. 5480/115/2016[15] on the case list of the Caras Severin Court of Law. The syndic judge found that there were overdue invoices totally amounting to Lei 65,274 out of which, during the trial on the merits of the case, Lei 5,000 were paid, but he believed that the conditions for opening the insolvency procedure in connection to S. S.R.L. were met because the receivables were certain, liquid and payable for over 60 days and over the value imposed by law of Lei 40,000. The debtor S. SRL lodged an appeal; the judicial inspection court[16] allowed the debtor's appeal and annulled the decision that was challenged because all the receivables had been paid until the date of solving the appeal.

Although the Law of insolvency expressly provisions that the procedure can be initiated in connection to the debtor that during the trial on the merits had not paid the receivables, the cases presented above substantiate the possibility of paying the debts during the judging of the appeal. It must be said that the Law of insolvency is a special law, which deviates from the common law.

I believe that the freedom granted to the debtors of paying the receivables to the plaintiff creditors after the procedure was initiated contradicts the provisions of article 84 paragraph (1) of Law no. 85/2014, which set out the de jure nullity of any payment made after the insolvency procedure was initiated, which the syndic judge had not authorised or the receiver had not endorsed. That situation has led,

[13]Civil decision no. 347/JS/June 11, 2015 issued for File no. 847/115/2015 of the Caras Severin Court of Law, unpublished.

[14]Civil decision no. 1023/November 12, 2015 issued for File no. 847/115/2015 of the Timisoara Court of Appeal, unpublished.

[15]Civil decision no. 405/JS/December 8, 2016 issued for the file no. 5480/115/2016 of the Caras Severin Court of Law, unpublished.

[16]Civil decision no. 155/A/March 1, 2017 issued for the file no. 5480/115/2016 of the Timisoara Court of Appeal, unpublished.

as indicated in the first case, in the case of the creditor suing the debtor, while meeting all conditions for beginning the insolvency procedure, and the judicial inspection court believing that it was its fault because the debtor had paid its receivables.

In our opinion, after the insolvency procedure is initiated in the file on the merits of the case, the judicial inspection court can no longer consider subsequent payments made to the plaintiff creditor, given that they are de jure null. After the insolvency procedure was initiated, the judicial inspection court should only consider the situation submitted to the syndic judge because the insolvency procedure is collective and regards the entire body of creditors, having strict rules on the priority of payments made to the creditors and punishing the payments made to some creditors while disregarding others. Considering the patrimony and non-patrimony effects on the debtor's wealth, the date of beginning the insolvency procedure by the syndic judge is deemed T0 for interrupting the judicial and extrajudicial actions, interrupting the ancillary amounts from accruing, interrupting the statute of limitation, a matter that entitles me to believe that it applies to the payments made by the debtor without having the syndic judge's authorization or the receiver's endorsement, too.

As indicated above, the decision of the syndic judge to begin the insolvency procedure is enforceable, thus that the procedure follows its path, the preliminary receivables list being drafted until the appeal is judged; such a list refers to all creditors that have receivables to collect from the debtor. Even if the judicial inspection court will consider the payment made after the insolvency procedure was initiated, I believe that it cannot order that the petition be rejected just because the debtor paid the receivables to the creditor that lodged it, as long as the insolvency file comprises other creditors, too, which have lodged a petition to declare the receivables. For assessing whether the debtor is facing an insolvency situation after the date when the procedure was initiated by the syndic judge, it is my belief that the inspection court should look at the bigger picture, meaning it should check whether all creditors that requested that their receivables be paid by the insolvency procedure have received their money from the debtor.

Conclusion: Theory versus Practice

The law of insolvency of Romania is modern, the Parliament displaying a comprehensive insight on the manner in which the insolvency of the professionals affects the business environment. If the professionals can easily enter the market, the rehabilitation of those that can surpass the financial difficulties or the leaving of those that failed in meeting their obligations from the business environment is strictly controlled. Nevertheless, the law of insolvency is far from being perfect. The interpretation of the law in practice varies, thus leading to an irregular jurisprudence.

More important than the various interpretations of the legal norms concerning the insolvency area by the law practitioners, we believe it to be a priority to

educate the business environment so as it does not see insolvency as a stigma, but as an opportunity to recover granted to the debtors facing financial difficulties.

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