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Do We Have Enough Rich People to Tax Them Out?

The de facto insolvency of Romania's budget pushes politicians to propose the reinstatement of progressive taxation on individuals' income.

Romania had until 2005 a system of progressive taxation on the income made by individuals, with rates ranging from 18% up to 40% of the net income (the intermediate rates being 23%, 28% and 34%). The income thresholds used in order to determine the application of the percentage of the income tax were in fact very low - for monthly income exceeding about 300 Euro – so it was actually very easy to reach the limit beyond which the tax would be of 40%. The introduction of the 16% flat tax in 2005 (which applied not only to individuals, but also to companies) revolutionized the whole system: not only that the budgetary revenues from the payment of the income tax increased at a fast pace (until Romania was hit by the economic crisis), but also the reduced taxation made Romania a more enticing destination for investment (and attracted criticism from Western Europe due to so-called "fiscal dumping").

Now, Romania is again facing difficult economic challenges. The IMF and domestic political factors advanced proposals to switch back to the progressive tax system, or, at least, to increase the rate of the flat tax. At first sight this makes sense – progressive taxation is the system of choice for most developed countries, and, in addition to that, why should we not tax more the rich people.

> "An equitable tax system should be designed having in mind the specific realities of our country and taking into account the experience which is already available here related to the functioning of both the progressive and the flat tax systems.

On the other hand, we should be careful to avoid a copy-paste of solutions which may work elsewhere, but may be not appropriate for Romania. An equitable tax system should be designed having in mind the specific →

realities of our country and should take into account the experience which is already available here related to the functioning of both the progressive and the flat tax systems. We shall therefore briefly examine below some of the arguments which are in favor of the preservation of the current flat tax system in Romania.

A Reasonable Flat Tax Is an Effective Mean to Improve Tax Collection

Let us take a look at the figures. According to Romania's National Statistics Institute, immediately prior to the introduction of the flat tax system (i.e. in 2004), income tax revenue totaled about 7.1 billion lei. In the first year of existence of the 16% flat tax, budget revenues in absolute figures (pertaining to income tax) declined with about 6% (which is remarkably low, since the previous progressive tax system reached easily the rate of 40%). After 2006 however, the collection of income tax revenue quickly increased, with growth rates ranging between 33% (in 2008) and 46% (in 2006), reaching a total revenue in absolute figures of 18.5 billion lei in 2009 (which is about three times the corresponding amount in 2004, when tax rates were significantly higher).

Part of its evolution can be attributed, naturally, to the growth of the GDP. However, this was clearly not the single factor (GDP has not increased with 30% or 40% in none of these years…). In fact one this growth of the income tax revenue results from the very achievement of one of the main purposes of establishing the flat tax, which was to bring income out from the shadows of the black market.

Romania Needs the Competitive Edge that Only the Flat Tax System Can Give

One of the favourite arguments of the supporters of the progressive tax is that this system has been in use for a considerable number of years in practically all economically developed countries. This in itself is not sufficient to justify the abolishment of the flat tax in a place like Romania, which is surrounded by countries which use a flat low tax system. The most notable example in that regard is Bulgaria, where the flat tax rate is even lower than Romania's, i.e. 10%; a few days ago Hungary announced also the intention to introduce for the following years an income flat tax at a rate of 16% and a tax cut for small and medium businesses.

In addition, we should not forget how Romania looks to both domestic and foreign investors: a place with crumbling infrastructure, poor governance, uncontrollable corruption, poor life quality, and unions marching in the streets. Romania clearly needs policy measures to compensate for these shortcomings (which show no sign of going away in the following years…); the existence of a relatively low flat tax is one of the most persuasive arguments that one might put on the table in order attract new investments here. Relinquish the flat tax in favor of the progressive tax – and nothing much will remain on our side (apart, maybe, from the dubious advantage of having one the lowest paid workforce in Europe…)

The Flat Tax Is More Equitable than the Progressive Tax

"From each according to its ability, to each according to its needs". Most of the Romanians would immediately recognize this famous slogan, which was very popular with communist propaganda (no surprise here, one of the guys who actually enjoyed saying this was Karl Marx). The argument for progressive taxation is that it is natural that the rich pay more taxes than the poor. Apart from the fact that the very basis of this argument is flawed (because the rich do not benefit more from the services financed from the state budget than the poor; in fact the very opposite might be true), the way the problem is presented is simply deceiving: under the flat tax system, the "rich" already pay more taxes. One person earning 100 lei per month will pays 16 lei in income tax. Its neighbor receiving a salary of 1000 lei per month, will pay ten times more, which is 160 lei. It is as simple as that.

The Costs to Manage the Flat Tax System Are Lower

One major advantage of the flat tax system is that it`s less prone to abuse or random →

application by the tax authorities. When you make 100 lei as income, you just know that you have to pay to the state 16% applied to that amount. On the other hand, an effective progressive tax system needs to be associated with legislation granting the possibility of tax deductions for certain expenses. This means unfortunately a more complicated legislation, entailing more bureaucracy and less predictability in the way the legislation will be interpreted and implemented.

The Flat Tax Rewards the Active Members of the Middle Class

Critics of the flat tax argue that this would be a system which would be beneficial mostly to the very rich. It is indeed a fact that the gap between the wealthiest and the poorest Romanians is widening, and that is frustrating for many individuals who came to feel that our country is not offering fair and equal chances to all. "Property is theft!" said once a 19th century French anarchist. "Big property is theft!" cries out now the Romanian media and public opinion, confronted with the unexplained and often unexplainable manner in which the immensely rich have amassed their fortune. While the accusation of theft might be true in at least some of the cases, the adequate remedy for stealing remains the appropriate and consistent enforcement of criminal law, and not an increase of the financial burden of all citizens via the establishment of a progressive tax system.

After 20 years or so of capitalism or so, Romania still lacks an authentic and well established middle class. The income flat tax encourages the active members of the middle class, incentivizing them to work harder and collect immediately and directly the reward of their efforts. We are still decades away economically and socially from the most advanced members of the EU. The only way to reduce this gap is to give to the most active and capable members of our society the motivation they need and deserve. Taxing them more is not going to do the trick…

A Few Conclusions

The return to the progressive tax system is simply not the right way to go for Romania. However, the economic crisis and the current condition of the public finances dictate tough measures; these days the Government proposed to the Parliament a cut in the public spending to be achieved by reductions with 25% of all salaries paid by the state institutions and 15% of the pensions. If these measures will stand the vote of the Parliament and the review of the Constitutional Court remains to be seen. Irrespective of the fate of these proposals, there are still things that ought to be done and that could be done by the Government in order to improve the condition of the public finances, such as to (and the list and inherently incomplete):

- Encourage employment by simplifying procedures related to the employment of personnel and the payment of salary-related taxes and contributions;
- Enhance the efficiency of spending of public money;
- Improve legislation on public acquisitions to ensure free competition, fair chances to all bidders, and the reduction of capital costs for the state budget;
- Encourage more domestic and foreign investment in production capacities;
- Ensure observance of the law – fight smuggling and "black" economy.

Last, but not least, we need an education system which should be able to instill a true entrepreneurial culture and dismiss the pernicious idea that state employment would be somehow safer and more beneficial than working in a private company...

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Focus

- Insolvency Proceedings in front of an European Union Court against a Romanian Company

Insolvency Proceedings in front of an European Union Court against a Romanian Company

The process of harmonizing general applicable commercial law principles governed by the internal legislation of the member states has been a critical issue since the early days of the European Union. The mere rationale behind such harmonization process was to ensure that different legal statues governing similar matters are adjusted, mutatis mutandis, in order to ensure a consistent approach of similar legal matters throughout all EU Countries.

> “ Insolvency raises many different and complex legal issues and although some may seem uncomplicated in a local context, they might become much more difficult to be dealt with in an international context.

In the current economic context, where business operations of EU companies often have cross-border effects, an important part of such process was the harmonization of the principles of insolvency. Reaching an agreement on insolvency proceedings was not an easy task and the time elapsed since the establishment of the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (also known as the “Brussels Convention”) until the harmonization of insolvency proceedings – that is 32 years, and this speaks for itself. Nevertheless, on 29 May 2000, the European Commission enacted Regulation No. 1346/2000 (the “Regulation”) on insolvency proceedings. According to the Treaty establishing the European Community[1], the Regulation is generally applicable for all EU Member States, without the necessity to be harmonized with the internal legislation of each Member State.

Why was such harmonization process needed? Not a difficult guess: insolvency raises so many different complex legal issues that while some may seem uncomplicated (and why not benign from a political perspective) in a local/national context, they might become much more difficult to be dealt with in an international context. There is no doubt that a bankruptcy procedure that is being →

1. Art. 249 of the Treaty establishing the European Community

opened and handled domestically is based on the fairness principle that all creditors (or at least those in the same category) must be treated equally. What is the situation when it comes to cross-border bankruptcy procedures? Is the equal treatment still a viable principle or is it more likely to meet certain resistance as well as practical and legal barriers? The purpose of the harmonization process was therefore to enable the conduct of cross-border insolvency procedures based on certain pre-agreed principles for ruling competing claims.

The Regulation provides the conditions for opening insolvency proceedings in matters of international private law. Furthermore, the Regulation applies to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator.

Considering the international applicability thereof, the Regulation stipulates clear rules related to the competence for opening insolvency proceedings. This ability is thus assigned to the courts of law from the Member State in which the debtor's center of main interest is located. Needless to say, the Regulation is applicable only in case the debtor's center of main interest is located within the European Community.

A company's center of main interest is presumed to be, unless proven otherwise, at the registered office thereof[2], but in certain cases, even if the registered office of the insolvent debtor is located in another State, the court may appraise the center of main interest according to other criteria as well, such as (i) financial, organizational or operational dependence, (ii) the continuous performance of the company's activity in another location than the one in which the registered office is located and (iii) the presence of the company`s assets on the territory of another State than the one of the company's registered office.

> "The Regulation states that the applicable law is the law of the State where insolvency proceedings are opened and it determines the conditions for the opening, conduct and closure thereof.

For the sake of example, in 2009, a French Court has opened insolvency proceedings against a Romanian company, considering that its center of main interest was located in France, although its registered office was in Romania. Such decision was grounded on the company's affiliation to, and dependence of, a French group of companies. The application for the opening of insolvency proceedings was filed by the insolvent companies themselves, thus proving to the Court their organizational and operational interdependence. The Court analyzed the file and ruled that it is competent to open the insolvency proceedings against the Romanian company.

The core feature of the procedure governed by the Regulation is the capacity to generate same effects in any other State of the European Union. Thus, these effects shall influence the operation of the insolvent company and its assets. One may state that the main insolvency proceedings generate extraterritorial effects, since the liquidator may exercise all the prerogatives provided by the law of the State where the proceedings were opened, in any other EU Member State.

From a procedural perspective – that is the law applicable to insolvency proceedings and the effects thereof – the Regulation states that the applicable law is the law of the State where insolvency proceedings were opened, and such law determines the conditions for the opening, conduct and closure thereof[3].

Generally, the main issue which concerns creditors of a company is the way they will recover their receivable and what would be the source for such recovery. In order to properly address such concern, one must firstly identify the nature of the insolvency proceedings performed under the Regulation as well as the debtor's ability to service its debt. →

2. Art. 3 paragraph (1) of the Regulation

3. Art. 4 paragraph (2) of the Regulation

As regards the recognition/enforcement of insolvency proceedings, the Regulation provides that any resolution to open insolvency proceedings issued by a Member State's competent court under the Regulation is recognized in all Member States as soon as it becomes effective in the State where proceedings were opened[4]. Thus, the resolution to open insolvency proceedings has the effects assigned to it under the law of the proceedings-opening State in any other EU Member State, with no further formalities, as long as no insolvency proceedings are opened by the other Member State. Moreover, from a procedural perspective, in order to be enforceable against third parties, it is necessary to publish the resolution for opening insolvency proceedings in the Member State where the debtor is headquartered.

As regards the legal means available to the creditors from an EU Member State to recover their receivables against the insolvent company, the Regulation provides several options which are detailed herein below.

Registration of the claim with the relevant court

As soon as insolvency proceedings are opened in a Member State, the competent court (or the liquidator appointed by the latter) shall promptly notify the creditors who have their residence, domicile or registered office in another Member State[5].

The notification shall specify, inter alia, the deadlines, the competent authority registering the creditor's claim, and so on. Furthermore, the notification shall specify the obligation of the secured or privileged creditors to register their claims. According to the Regulation, the notification shall be drafted in the official language of the opening State (the "Official Language"). For this purpose, a form bearing the heading "Invitation to lodge a claim. Time limits to be observed" shall be used. The claim shall be drafted in the Official Language or in one of the official languages of the opening State, bearing the heading "Lodgment of Claim". The creditor should attach copies of underlying documents, if any, and shall specify the nature of the receivable and the value thereof, as well as the existence of liens and/or security interests, including a list of the assets encumbered by such securities.

> "As regards the legal means available to the creditors from an EU Member State to recover their receivables against the insolvent company, the Regulation provides for several options.

Opening of secondary insolvency proceedings based on the local insolvency law

According to the Regulation, the opening of insolvency proceedings in an EU Member State further to identifying the center of main interest in the respective State does not hinder the opening of secondary insolvency proceedings governed by the law of the State on the territory of which such proceedings were opened. Nevertheless, the effects of secondary proceedings are limited to the debtor's assets located on the territory of the second State[6]. Thus, secondary insolvency proceedings may be requested by the liquidator appointed in the main proceedings and by any other person or authority empowered to request the opening of insolvency proceedings according to the law of the State on the territory of which the opening of secondary proceedings is requested[7].

In case of opening secondary proceedings, the liquidator in the main proceedings and the one in the secondary proceedings have the obligation to cooperate and inform each other on any matter which may be useful for the other proceeding, especially on the submission stage of the claims and verification thereof, as well as on all necessary measures →

4. Art. 16 paragraph (1) of the Regulation
5. Art. 40 of the Regulation
6. Art. 27 of the Regulation
7. Art. 29 of the Regulation

for completing the proceedings.

This second option is helpful for those creditors whose receivables are secured with the assets of the insolvent Company located in the relevant jurisdiction, because they may enforce the securities faster than in the main proceedings opened in another EU Member State. A major advantage of the secondary proceedings is that the creditor is familiar with the law applicable to the secondary proceedings, which implicitly leads to lower costs for representation before the syndic judge than those involved by the assistance in the main proceedings.

That said, we note, however, that such secondary procedure is not really helpful for unsecured creditors. Should the proceeds resulting from capitalizing assets in secondary proceedings be higher than the value of the receivables of the secured creditors, the balance shall be used to settle receivables registered in the main procedure.

To summarize the above, it appears that the Regulation provides certain protection to both creditors in the process of recovering their receivables (giving them the opportunity to capitalize the insolvent debtor's assets in the secondary proceedings) and the debtor itself, offering the opportunity to prove its ability to cure its financial status.

As regards the unification process, while such action seems to be rather difficult to implement (at least on short and medium term and with the notable exception of the general legal principles), the Regulation seems to be a significant starting point in the process of reaching an agreement among EU member states. This is mainly because it provides support to lawyers, liquidators and judges to become familiar with the heterogeneous solutions for a multitude of problems that cross-border bankruptcy raises. Although the EU is far from that stage where procedural unity can be achieved, it goes without saying that the Regulation is at least a major step towards mutual recognition of each country's insolvency institutions.

> "The Regulation seems to be a significant starting point in the process of reaching an agreement among EU member states.

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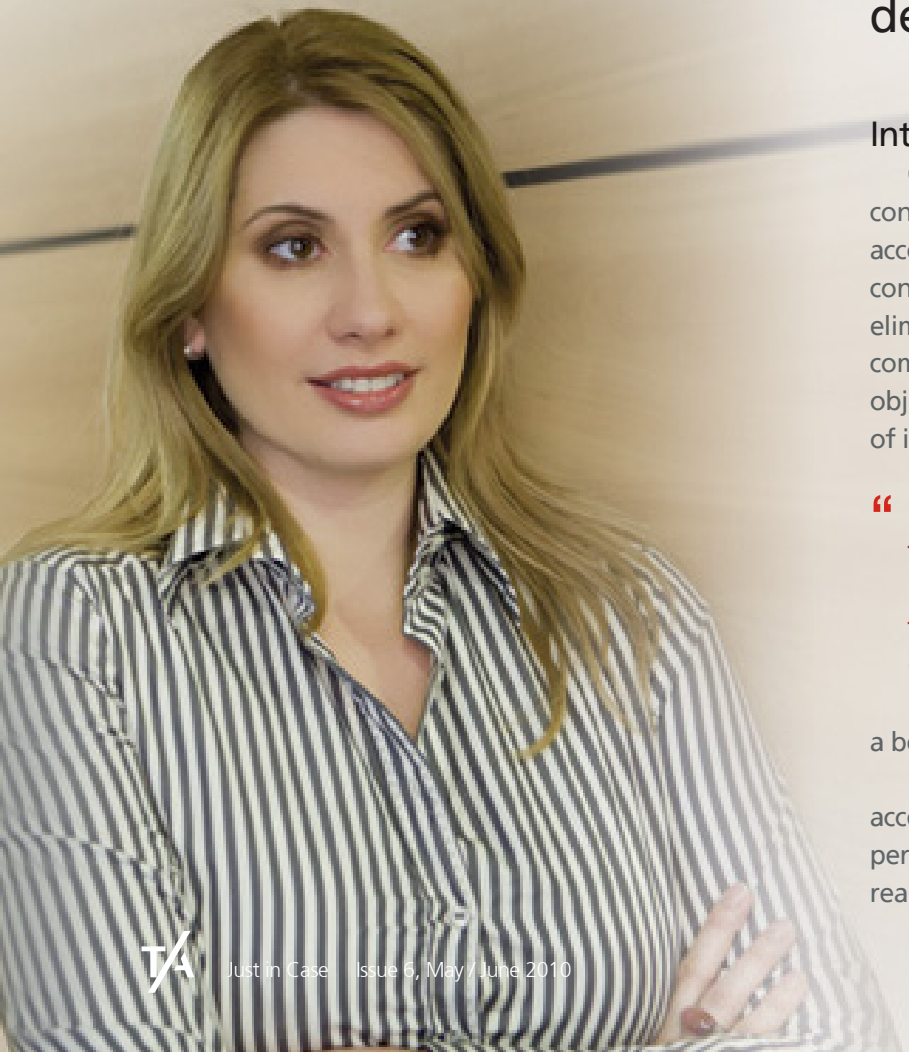
Case by Case

- Herding the Debtor out of the Woods
- Sale by OMV Petrom of its Petrochemicals Business Activity
- A Bird's-Eye View of Certain Controversial Aspects in Engineering Contracts

Herding the Debtor out of the Woods



Bucharest Court of Appeals quashes an award of opening insolvency procedures in spite of absence of debtor legal challenge in first instance.

Introduction

One of the greatest advantages of contemporaneous legal systems is the accessibility of legislation – texts of law are constantly aiming to become reader-friendly, eliminating professional lexis in favor of commonly used vocabulary. The obvious objective is knowledge: a society that is aware of its legal rights and responsibilities is, surely, a better society.

> “ In sports, the Olympics slogan goes, the essential is to take part. In the insolvency procedure, however, the essential is not to take part (Bernard Soinne).

In a limited number of instances, however, accessibility of legislation is one of the greatest perils that lie in waiting of an inexperienced reader. It creates the false perception that, because the text is comprehensible, so are its legal consequences; because descriptive legal notions are easy to understand, so is their potential association in complex judicial institutions. Few better examples can illustrate this conclusion than the legislation that surrounds insolvency proceedings, i.e. Law No. 85/2006 regarding insolvency proceedings.

Should the reader lack any legal background, a simple study of the text still allows an individual to grasp the fundamental principles that run an insolvency procedure. Alas, this is not enough: the insolvency law conceals so many intricacies, so many partial links to other pieces of commercial, civil or civil proceedings legislation that even the most experienced insolvency lawyer will be bold enough to call himself in full knowledge of the law’s application. It is therefore an ill-conceived initiative for a company to venture alone, or with little help from a legal advisor, into the →

realm of an insolvency tribunal. Dangers will lie ahead, and should the company fall prey, it will be a daunting task for any team of lawyers to rescue it and reinsert it into normal commercial life, as if nothing had happened.

The Facts

The debtor, a member company of an well-known Austrian group, had had a commercial dispute with its creditor, on basis of a contract of execution of works. It claimed that the execution of this contract on the part of the creditor was not in conformity with conventionally agreed standards, and therefore refused to acquit invoices totaling approximately EUR 65,000. Although negotiations took place between the two parties and significant commercial correspondence had occurred, at one point the creditor decided to request the Bucharest Tribunal to open insolvency proceedings against its contractual counterpart.

The debtor treated such request lightly: the sum in the invoices was insignificant in relation to the turnover of his business, financial data showed his ability to pay at any moment. His refusal was legitimate, he had contested and refused to sign all creditor-referred invoices, on basis of significant defects in the works provided. Why should he pay for the creditor's culpable errors, he asked? And, in any case, negotiations were still in place for a settlement, clearly allowing for the conclusion that the insolvency request was just a strategic mean of pressure appointed by the creditor.

In view of the negotiations that were continuously taking place, the debtor estimated that a settlement is bound to be reached in the next couple of months. As a result, he paid little attention to the insolvency subpoena received, and only showed up in Court at the first hearing to ask for a postponement, in order to hire a lawyer. It was normal, he argued, that he should benefit from the legal assistance of a professional, his right to defense alone ensures the success of his request.

> "The debtor paid little attention to creditor`s request to open insolvency proceedings against him.

Whatever advice he may have received until that date, the debtor was fast to regret it. Not only are requests for trial postponement treated with great severity in such trials, due to the legal principle of urgency that governs the whole insolvency legislation, but he had also omitted to file a written challenge to the creditor's request for insolvency in the imperative 10-days term from the moment he had received the copy of the request. The result was dramatic: the judge rejected the postponement request, approved the opening of insolvency procedures against the debtor, raised his administration rights, named a third-party official receiver to run the business of the company, and froze the debtor's bank accounts.

The debtor was shocked… this was a huge commercial blow to an honest business, ran by a reputable and well-known company, who had never had problems with the law. What will potential clients now say? How will he keep his current clients? How will he explain this to his bank, and what will happen to his significant current credit contract?

So it was in the aftermath of the Bucharest Tribunal's award that the debtor decided to request the help of Țuca Zbârcea & Asociații's litigation department, requesting a rapid legal remedy to all the damages he had suffered.

The Strategy

Our reader has already correctly guessed that the case at hand presented our team of lawyers with heavyweight legal obstacles. A challenge to the creditor's request was not filed in the 10-days term requested by the law, actually it was never filed before the issuance of an award. The debtor appeared to have done little to contest the presumption of insolvency that the creditor had placed upon him. How could the Tribunal's sentence be overturned?

An appeal on the merits was filed almost immediately. The first objective set by our insolvency lawyers team was the rapid, provisional suspension of the insolvency proceedings opened against the debtor until such appeal would be heard. →

However, this task alone was nothing short of a mountain to climb: because the insolvency law is a fast-paced one (the Romanian law-maker wanted to allow any guiltless creditor to urgently recover his receivable), insolvency awards cannot be suspended except for the situation when the debtor had filed a legal challenge to the creditor's request. A *prima facie* view over this text of law excluded any chance held by our client to obtain the desired suspension.

Nonetheless, in spite of the encompassing pessimist mood, our attorneys put together an ingenious strategy of defense, which argued that the rationale of the above stated legal restriction was to disqualify the passive debtor from benefiting of suspension privileges. It quoted relevant legal writings that showed that a passive debtor is a "silent" one, a debtor that does not manifest himself in any way towards the creditor's opening claim. In our case, the debtor did in fact expressly show his will to oppose the creditor's claims – if this was untrue, why would he want to hire a lawyer "to prepare his defense", as argued in his written postponement request?

Three weeks after the award of the Bucharest Tribunal, the debtor heard the first piece of good news: the Bucharest Court of Appeal agreed to provisionally suspend procedures until the judging of the appeal in the file. The insolvency status was raised, administration rights were recovered by the debtor, bank accounts were again at the company's hand. And now for the preparation of the final appeal in the case. With the assistance of our lawyers, rapid settlement was reached with the creditor, on condition that he filed a written request to the appeals court, acquiescing that his claims no longer hold an object. However, this alone could not suffice: there had been several prior cases in which the debtor had paid his debt to his original creditor in course of the appeal, nevertheless, insolvency proceedings were still upheld by the appeals courts. The explanation for this is that the insolvency procedure, once opened, becomes a collective one; the damaged party is not only represented by the initial creditors, but also by all the other existing creditors, including the bank. Until all such receivables are paid, the debtor is still considered to be in insolvency.

> "The insolvency law is a fast-paced one and insolvency awards cannot be suspended except for the situation in which the debtor had filed a legal challenge to the creditor`s request.

Consequently, a second list was submitted to the court, proving the healthy financial status of the debtor: bank accounts excerpts confirmed that the company held a turnover much in exceedance of the requested sum, public authorities records confirmed that the debtor had always been a timely payer of considerable sums to the state budget. It is not enough, our lawyers argued, that a creditor holds an outstanding receivable for the debtor to have to undergo insolvency procedures; if the company has a vigorous financial shape, the creditor will have to seek other ways to satisfying his claims.

In any case, the creditor did not make a solid case that his receivable was liquid and outstanding. His invoices had been contested by the debtor, objectively verifiable claims of non-conformity were made with regards to the works executed by the former.

Should all these lines of defense fail, it was still obvious that the debtor's fundamental right to defense was disregarded by the rejection of his postponement request. The imposition of such a serious sentence upon a debtor without even hearing his side of the story amounts to a violation of his most basic rights in the litigation proceedings.

Serious critiques had therefore been put in place against the Tribunal's award. But was this convincing enough? After all, a legal challenge had not been filed in term by the debtor: the first court only observed this, and acted in consequence. What could be wrong in such a conduct? Our team extensively argued that any insolvency proceedings appeal allowed the court to reinvestigate in full the facts of the case matter, so that the limitations imposed by the lack of a legal challenge were now obsolete. The jurisprudence controversy over this general theoretical matter was so high, that it had even became a subject of a past debate in the Chamber for an unitary jurisprudence of the Romanian Superior Judge Council. →

The Award

5 months after the opening of the insolvency procedures, a final award[1] was pronounced by the Bucharest Court of Appeals. In a not so often split decision, with one dissenting opinion, the Court irrevocably admitted the debtor's claims, and quashed the Tribunal's award of opening insolvency procedures.

A happy end that took 5 months of extensive research and litigation by our attorneys, a meticulous and long-lasting work of evidence preparation and, more importantly, a fundamental decision of jurisprudence should not only be interpreted as a happy end. It is also a word of caution for companies traveling in the tough realm of the financial crisis, much akin to the cautions that rangers present to their tourists: best practice is to seek the professional help of a connaisseur before trespassing the dark woods of insolvency tribunals, not only when one cannot find his way out.

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1. Decision No. 2566/22.03.2010 of the Bucharest Court of Appeals, VIth Commercial Division

Sale by OMV Petrom of its Petrochemicals Business Activity

Further to its privatization, OMV Petrom, the largest company in Romania, underwent several processes of disposal of non-core businesses through outsourcings or sale of the concerned non-core businesses.

The sale of the petrochemicals business carried out on Arpechim Piteşti industrial site has been by far the most complicated of such processes. Over two and half years had passed between the go-live and the closing. Its implementation gave headaches to lawyers, business consultants and, last but not least, to the parties to the transaction. And the story could continue….

The Business

Arpechim Piteşti industrial site has been designed from its establishment as a place where integrated crude oil refining and petrochemicals businesses were carried out. This situation created several synergies between the two activities, including a common utilities' network, shared services or licenses that were covering both activities. The petrochemicals business is largely depending on the feedstock produced in the refinery located on the same industrial site and delivers almost its entire production of ethylene and propylene to Oltchim, a State-owned chemicals company located in Râmnicu Vâlcea.

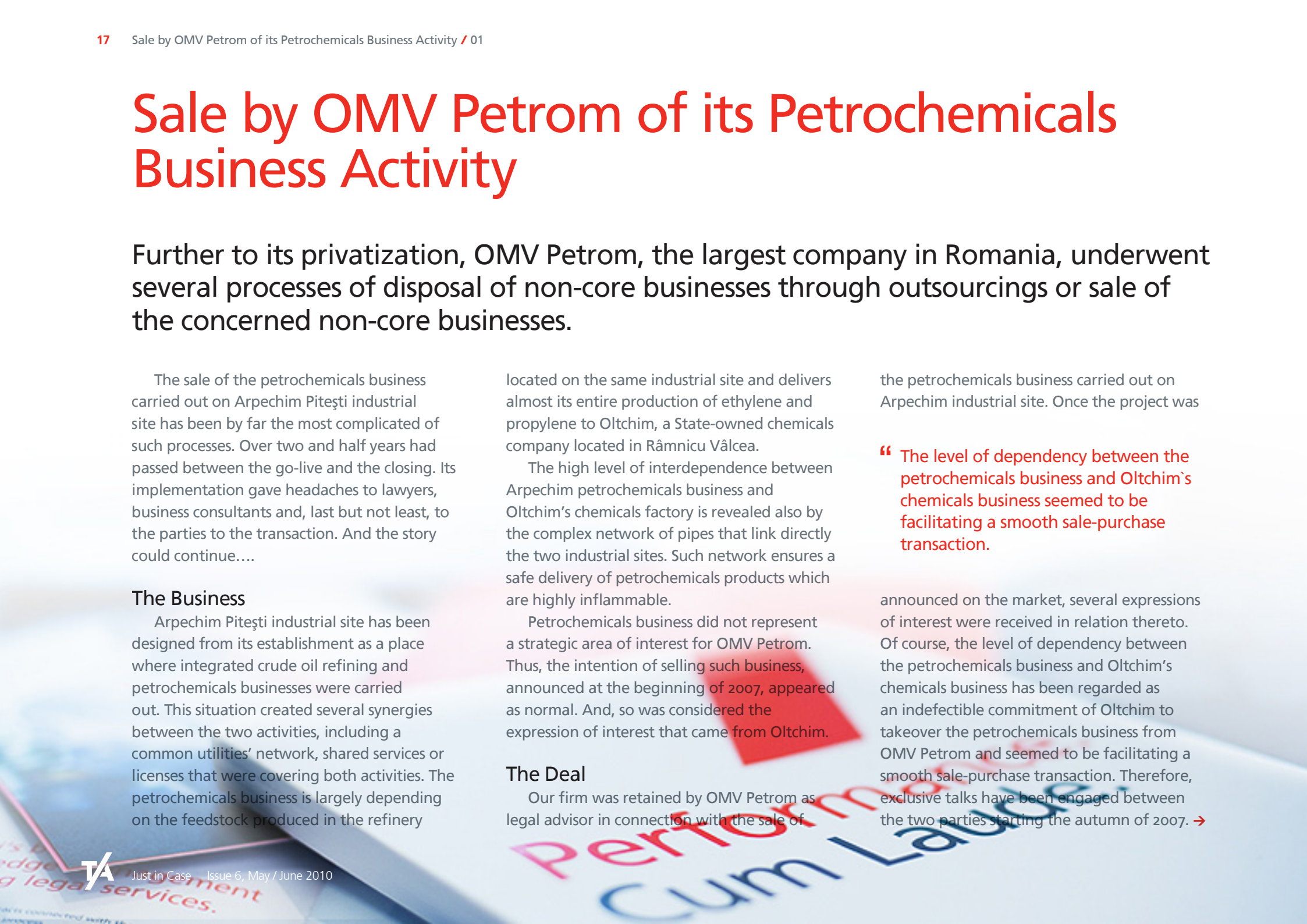
The high level of interdependence between Arpechim petrochemicals business and Oltchim's chemicals factory is revealed also by the complex network of pipes that link directly the two industrial sites. Such network ensures a safe delivery of petrochemicals products which are highly inflammable.

Petrochemicals business did not represent a strategic area of interest for OMV Petrom. Thus, the intention of selling such business, announced at the beginning of 2007, appeared as normal. And, so was considered the expression of interest that came from Oltchim.

The Deal

Our firm was retained by OMV Petrom as legal advisor in connection with the sale of the petrochemicals business carried out on Arpechim industrial site. Once the project was announced on the market, several expressions of interest were received in relation thereto. Of course, the level of dependency between the petrochemicals business and Oltchim's chemicals business has been regarded as an indefectible commitment of Oltchim to takeover the petrochemicals business from OMV Petrom and seemed to be facilitating a smooth sale-purchase transaction. Therefore, exclusive talks have been engaged between the two parties starting the autumn of 2007. →

> "The level of dependency between the petrochemicals business and Oltchim`s chemicals business seemed to be facilitating a smooth sale-purchase transaction.



What at first seemed simple and straightforward turned into a winding path of decisions and a few dead ends. Moreover, as the recession started to take its toll on many of the business investment plans in Romania, the entire project was put into question and, with the recession intensifying and business projections turning more pessimistic, the talks between the seller and the buyer eventually reached an impasse in the second half of 2008. In the economic turmoil, Oltchim had found difficulties to secure finance for the acquisition itself, and also for the working capital and for the repayment of an historical debt towards OMV Petrom related to the supplies of ethylene and propylene made to Oltchim in a total amount of approximately 25 million Euros.

The project slowdown had an important consequence on the transaction structuring. Before such moment, the parties envisaged a sale and purchase of a running business. Two contractual options were explored in this respect, i.e. a contribution in kind or direct sale of the petrochemicals assets to a special purpose vehicle with the subsequent sale of the shares thereof from OMV Petrom to Oltchim and a straightforward business transfer agreement between the two companies. Eventually, none of these options was implemented and OMV Petrom decided to shut down the business in October 2008 to cut additional losses.

The transaction structure had to be reconsidered once a revival of Oltchim's interest in acquiring the business appeared at the beginning of 2009. Finally, the parties decided to go for a direct sale of assets accompanied by the transfer of the dedicated employees and certain complex agreements concerning the separation of the petrochemicals business from the crude oil refining one, the guaranteeing of the repayment of the historical debt and the allocation of the environmental liabilities in connection with the petrochemicals industrial site.

The Challenges

Many challenges had to be overcome before the closing of the transaction.

First of all, Oltchim made substantial efforts to obtain acquisition finance which in most of the cases were unsuccessful. But the most important of all these challenges, concerned the contemplated State aid which the Romanian State intended to grant through the issue of a state guarantee of up to 80% of a loan of approximately 60 million Euros, which Oltchim had to obtain from the financial markets. Severe criticism to this measure from the German group PCC, the minority shareholder of Oltchim, eventually determined the European Commission to investigate the matter and forced the purchaser to find alternative financing.

Secondly, OMV Petrom had requested a sustainable solution from the purchaser in order to guarantee the repayment of the historical debt and the future deliveries of feedstock to the petrochemicals business. Otherwise, OMV Petrom would have increased its financial exposure vis-à-vis Oltchim in a troubled period for the whole petrochemicals industry. Again, the legal team involved by Țuca Zbârcea & Asociații came with several valuable legal solutions in order to ensure the level of comfort which OMV Petrom wanted and to balance the parties' interests in the transaction.

Then, considering the cessation of the petrochemicals business by OMV Petrom in 2008, there were various positions which had to be reconciled with regard to this matter, i.e. the purchaser's need for staff once the business it is taken over, the burden of the salary costs between the cessation of the business and the closing of the transaction and, of course, the social pressure which came from the employees themselves.

> "As the recession started to take its toll on many of the business investment plans in Romania, the entire project was put into question.

It goes without saying that the difficulties inherent to the factual separation of the two businesses performed on the same industrial site gave serious headaches to all the people involved in the project, from technical experts to lawyers. →

...And the Implementation

Throughout the implementation of the project, our team faced a number of legal difficulties, ensuing mostly from the challenges mentioned above but also from external pressures posed by the economic and financial crisis.

Under the circumstances, our lawyers` task became even more daunting as we had to find the adequate means to ensure a successful outcome for the project under the new market conditions.

The asset transfer agreement included the general provisions related to the transaction structure, the conditions precedent, the completion mechanisms and the liability of the parties while the implementation of the thorny matters has been tackled in separate contractual instruments. The sale of the fixed assets has been made at a symbolic price of 1 Euro which found its rationale in the loss making history of the petrochemicals business and in the obsolete condition of the installations. The actual value of the transaction price, which amounted to approximately EUR 12 million, came from the working capital which was sold together with the fixed assets. Due to this price structure, the representations and warranties of the seller have been limited to the maximum extent permitted by the Romanian law.

The separation of the two business involved a multidisciplinary team of lawyers and included various mechanisms such as the allotment of the plots of land where the industrial installations are located, the novation of several contracts from the seller to

> “ The separation of the two business involved a multidisciplinary team of lawyers and included various mechanisms.

the purchaser, the reduction of the scope of work of certain frame contracts concluded by the seller for both businesses, the conclusion of a framework agreement purported to ensure both parties with the utilities and services necessary to the parties to run their business after completion and the allocation of the environmental liabilities related to the industrial site.

Among these mechanisms, the framework services and utilities agreement required an innovative and legally sound approach in order to ensure a balance between the parties' interests. The process of attaining this goal has been made even more difficult by the high number of regulations which had to be taken into account in the determination of the most viable approaches. Also, our law firm offered to the seller various legal solutions to preserve its rights on the installations and infrastructure which were deemed essential for its future operation of the refinery business on the industrial site. To this end, sophisticated contractual mechanisms were prepared in order to ensure the preservation by the seller of ownership or special rights over essential installations providing utilities to both parties, over the pipes, railway and electrical networks infrastructure (e.g. conditional sale purchase agreements, buy-back mechanisms, creation of access rights, outsourcing of utilities to an external partner supplying both parties, etc.).

The framework services and utilities agreement along with the agreement concerning future deliveries of feedstock between the parties add a substantial value to the transaction as the estimated turnover ensuing from these contracts amounts to millions of EUR monthly.

Industrial sites used to be constantly under the eye watch of the environmental authorities. Therefore, the transfer and/or sharing of environmental liabilities related to the transferred business received a significant attention during the transaction. The contractual instruments prepared in this respect covered essential aspects such as the conditional transfer of the carbon allowances allocated to the transferred installations by the Romanian State based on the Kyoto Protocol only for the purchaser's effective emissions of greenhouse gases into the atmosphere to be made after the restart the business and the back-to-back transfer to the purchaser of the compensations offered by the Romanian state to the OMV AG (the purchaser of the majority stake in OMV Petrom) on the occasion of the privatization in relation to the environmental losses to be ascertained in connection with →

pollution events which have their origins before the privatization.

Another cornerstone aspect of the transaction was represented by the purchaser's possibilities of guaranteeing the repayment of the historical debt towards OMV Petrom. Țuca Zbârcea & Asociații proposed a groundbreaking guaranteeing mechanism, implemented for the first time in Romania, which consisted in the creation of an escrow mechanism whereby the carbon allowances allocated to the purchaser by the Romanian State based on the Kyoto Protocol (either in relation to its own chemical plants or taken over together with the acquired business) were put into a dedicated account and were to be released to the parties according to the compliance by the purchaser with the repayment schedule and with its level of effective emissions of greenhouse gases into the atmosphere.

Our law firm acted as escrow agent based on the provisions of the Romanian legislation concerning the lawyer's profession which allow law firms to perform fiduciary activities for their clients. This solution finally removed one of the show-stoppers in the seller's position, i.e. the inability of the purchaser to come with sustainable guarantees in connection with the debt restructuring.

Against a background of some very active trade unions, the parties have also carefully assessed the impact of the transaction on the employees' rights. The task has been even tougher due to the question whether the legislation concerning the protection of the employees in case of transfer of undertakings is applicable after the lapse, between the cessation of business by one firm and its resumption by another firm, of a period of time in which the concerned installations had ceased to operate.

In the case at hand, OMV Petrom had initiated the procedure for collective dismissals of the employees which could have resulted in the effective lay-off of the employees before the closing of the transaction. Such decision was based on economic grounds and came in a moment when the conclusion of the transaction documents was doubtful. The case-law of the European Court of Justice offered us solid arguments to consider that the temporary closure of an undertaking and the resulting absence of staff at the time of the transfer do not of themselves preclude the possibility that there has been a transfer of an undertaking. Eventually, the employees dedicated to the petrochemicals business have been transferred to Oltchim before the lapse of their dismissal notices and strictly in accordance with the provisions of the domestic and EU legislation concerning the protection of employees in case of transfer of undertakings. Our legal team has ensured a smooth implementation of the transfer of employees based on various experiences in similar processes.

In December 2009, OMV Petrom and Oltchim reached an agreement and in January 2010 the transaction was successfully completed further to the satisfaction of the conditions precedent provided in such agreement (including the approval of the economic concentration by the Competition Council).

> "Our legal team has ensured a smooth implementation of the transfer of employees based on various experiences in similar processes.

Given the high dependence between the now separated crude oil refining and petrochemicals businesses, the contractual instruments prepared in connection with this transaction have to be "time resistant" in order to ensure the smooth running and cooperation between the two businesses. And, in a certain way, this transaction leaves us the impression that it is a story without an end.

The core team from Țuca Zbârcea & Asociații which assisted OMV Petrom in this transaction included Cornel Popa, Partner and coordinator of the project; Cristian Radu, Managing Associate and Patricia Enache, Senior Associate.

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The Wrong End of the Cat. A Bird`s-Eye View of Certain Controversial Aspects in Engineering Contracts

A man who carries a cat by the tail learns something he can learn in no other way (Mark Twain).

Bit(e)s of the Story

Regrettably, opportunities to grab the figurative cat's wrong end present themselves more often and in a less predictable manner than they ought to (and, for sure, more frequently than any animal protection foundation would be prepared to accept).

With the benefit of hindsight, after a case was litigated, the parties involved often take the time to question their behavior and the way the contract which had eventually led to the quarrel had been prepared.

This article just does that – its origins lay in one arbitration in which we have acted in the recent years, and has just ended a couple of months ago.

The case was truly complicated, involving extremely diverse legal and technical issues. We have not set us our objective to tell the whole story of the case, but only to attempt to uncover part of its teachings, which might be relevant for the future (and, with a little imagination from your side, might help you know how to proceed with cats…).

We have selected three main items for discussion within this article: (i) contractor's liability under an engineering contract for defects in the design of the works provided; (ii) the proper form to amend a written engineering contract, and (iii) the applicability of penalty clauses in cases in which the contractual term for the fulfillment of the main obligation is extended.

> "This article`s origins lay in one arbitration in which we have acted in the recent years, and has just ended a couple of months ago.

Before discussing these issues, we shall start by providing a brief presentation of the background of the arbitration, which will be limited however only to those aspects which →

might be helpful to understand the analysis of the legal issues mentioned above.

The parties to the dispute (to be referred to as "Employer" and "Contractor") concluded a contract for the refurbishment of a power plant (the "Contract"), whose original expected lifetime of 30 years was about to expire. The contractual documentation provided that one essential element for the Employer was that the refurbished plant would have a new 30-year lifetime period.

The Contract was a "turn-key" agreement, in the sense that the Contractor had the obligation to design and perform the refurbishment works. The Contractor also warranted that the works and any part thereof shall be free from defects in the design, engineering, materials and workmanship.

The parties stipulated a defect liability period of 24 months, commencing at the date of completion of the works (i.e. the date of the issuance of the so-called provisional acceptance certificate). For any defects found during the defect liability period, the Contractor was required to remedy the defect at its own cost and any damage to the works caused by such defect.

Moreover, if the remedy works necessitated the stoppage of at least one unit of the hydropower plant, there was a liquidated damages clause (penalty clause), requiring Contractor to pay 0.15% of the contract price of the relevant hydro-unit per each day of stoppage.

Sometime after the completion of the works, but, in any event, after the expiry of the initial defect liability period, the parties discovered certain cracks on one element of the refurbished hydro-units. In order to eliminate the cracks, the Contractor performed extensive repair works (which triggered the stoppage of certain hydro-units), and also changed the design of the hydro-units. Since the parties could not agree whether the Contractor remained responsible for the occurrence of the cracks even if those were discovered after the lapse of the original defect liability period, they had to resort to arbitration. While the Employer sought to obtain damages for the loss sustained due to the stoppage of the hydro-units, Contractor asked to be reimbursed for the costs entailed by the repairs performed at the units, after the alleged expiry of the defect liability period.

Time Limitations for the Liability for Defects of Design

As a matter of principle, under Romanian law, in services contracts there is a warranty period of one year after the delivery of the work (three years in matters related to construction contracts)[1]. Again as a principle, the contracting parties are allowed to establish different warranty periods. The parties' freedom to contract in respect of warranty periods against hidden defects is limited however by special rules applicable in the field of construction of buildings and of consumer protection.

The designer of a building (as well as other entities in charge with the construction works and the supply of material incorporated in the building) is going to be responsible for

> " Under Romanian law, in services contracts there is a warranty period of one year after the delivery of the work.

any hidden defects revealed during a 10-year period after the reception of the works, and throughout the lifetime of the building for defects of the structure of the building, resulting from the failure to observe the design and execution norms applicable at the time of the erection of the building.

Under the consumer protection legislation, sellers will be responsible for the remedy or the replacement of malfunctioning products due to hidden defects occurred within the average utilization period of the good sold.

There is no similar legislation in the field of engineering works, even though many of those could be more important financially →

1. Article No. 11 of Decree No. 167/1958 on extinctive prescription

and economically than the construction of buildings. In the absence of effective protection offered by the legislation, the beneficiary of works needs practically to use all its negotiating skills to obtain satisfactory contractual terms from its counter-party. *Ergo, caveat utilitor!*

Our era is dominated by passion for consumption and speed. We are surrounded by goods which will be obsolete in a few years and – if crisis forbids us - would be replaced by better ones, having, of course, shinier looks. Therefore for most of the occasions, why should we care? A warranty period of one, two or three years should be in most instances acceptable.

Not our case here though… what the Employer wished to obtain from the Contractor was a new, more efficient and resilient hydropower plant, whose estimated lifetime should have been of about 30 years after the works completion. In the case which inspired this article, the contractually agreed defect liability period was 24 months after the provisional acceptance of the works.

The question is what happens in the event in which the Employer discovers, say, after 36 months, that there existed a flaw in the design (of which even the Contractor may have not been aware, but, still, it could have avoided by the exercise of its professional diligence) which is so serious that impedes the normal operation of the asset.

In a rigid interpretation of most of the contracts relating to engineering works, the employer is left completely at its own devices, and will have to pay for repairs by himself (unless it can obtain some form of insurance). The estimated lifetime of – say – 30 years would be regarded as a mere "design guidance" or other similar words with equally metaphorical significance and bearing no legal connotation.

> "The question is what happens when a serious flaw in the design is discovered which impedes the normal operation of the asset.

A contractor may design a plant to last free of defects just for the defect liability period and, if defects break out after that period, really get away with it (it will be fair to say though that a contractor may not flee completely unharmed even in the event of a belated discover of defects; for the past, yes, its damage would be mainly of reputational nature, rather than legal, but for the future the effects might be catastrophic - a designer or a constructor with a bad record is not something that you would wish to have as your partner…).

For several good reasons – we think - we cannot fully support in all cases the strict interpretation that the existence of a defect liability period should be applied to such effect that the liability of a contractor will be excluded for defects of design which are discovered after the expiry of defect of liability.

First, defects of designs are more serious than problems which are due to workmanship or to materials used. Even if they might be discovered after a long time of operation, they existed prior to the expiry of defect liability period, prior to completion, and of course prior to the commencement of works. The defect was there as soon as the pencil fell besides the drawing board (or immediately after the last touch of the keyboard or of the mouse). That being said, at least under certain contracts, it may be argued (or not, subject to contract's wording) that the discovery of the defects is by itself, irrelevant, since the defect (and possibly the consequences thereof) existed during the defect liability period – and that would be sufficient to entail contractor's liability.

Second, the existence of a defect liability period should not be used by any of the parties in a way that would defeat the main purpose of the contract. If the objective of an employer is to obtain – such as in our case – a new hydropower plant with a lifetime of 30 years, well, this what the Contractor should aim to provide. In other words, the question to be asked is whether the works, as designed by the Contractor, are capable of being operated for exactly or at least for approx. 30 years without major interruptions, with due regard to normal wear and tear, and subject to the observance by the Employer of the specifications for a normal use of the hydro-units. →

Formal Requirements to Amend the Contract

During the performance of the Contract, the parties met frequently and signed routinely at the end of each session so-called "minutes of meetings", which documented the topics they discussed and outlined planning of future actions. One of the issues raised in the arbitration proceedings was whether these minutes might or might not have amended the Contract.

According to the terms expressly agreed by the parties, the only way to amend the Contract was by written instruments, dated, expressly referring to the Contract and signed by duly authorized representative of each party. During the performance of the Contract, the parties concluded several addenda which they called "amendments", to each being assigned consecutive numbers.

In the more strict interpretation, which was advanced by one of the parties, all amendments to the Contract, in order to be valid, should have followed the precise steps taken by the parties when they concluded the formal "amendments". The fact that a minute of meeting included wording which would lead to the variation of the Contract only meant, according to this position, that the parties envisaged the possible conclusion of a formal amendment in the future.

However, in the end, a less formalistic view was the one which prevailed: under Romanian law, in general, contracts are formed and amended through the mere consent of the parties, with no need for a special form. In the context of the arbitration, it was however essential for the tribunal the fact that it was established that the parties had used on other occasions the minutes of meeting as a method to amend the Contract. Moreover, the minutes of meeting, being a written document, complied with the formal requirements set forth by the Contract for the amendment thereof.

The Penalty Clause – Applicable Only to the Initial Obligations of the Contract?

The penalty clause included in the agreement was applicable in the case of stoppages in the operation of the refurbished hydro-units during the defect liability period. Since the arbitrators found that the initial defect liability period had been extended, at least in respect of certain of the hydro-units, the question was whether the penalty clause continued to apply during the extended defect liability period.

At first sight, the answer is quite obvious: yes. Traditionally, amendments to a certain clause of a contract leave the other clauses untouched (unless there is specific wording which affect these other clauses as well). If the parties chose to extend the defect liability period they must have done so with a purpose – which was to continue the application of the contractual rules established for the initial defect liability period. There was no need to re-affirm all clauses which were linked to the continued defect liability period.

The tribunal indirectly recognized this, as it upheld that the Contractor continued to be under an obligation to make good at its own cost any defect found in the extended defect liability period.

Absent any indication given by the parties, one should not be allowed to conclude that the extension of the defect liability period had the effect of prolonging just part of the obligations linked with its existence. They either are all extended, too, or none of them are.

> "The question was whether the penalty clause continued to apply during the extended defect liability period.

Surprisingly, the tribunal did not take this view. It mainly argued that the penalty clause had a "punitive" nature (not correct, because under Romanian law *punitive damages* are not recognized as valid legal concept; on the contrary, penalty clause have the function of assessing the *genuine damage* sustained by the creditor), and as such requires a restrictive interpretation in the sense that the penalty clause will not apply to the principal obligation that was extended unless the parties expressly and explicitly agreed that the penalty clause should also continue to apply. →

It is still too early to say whether this approach of penalty clauses is going to breakthrough the mainstream interpretation of Romanian law on this matter. Until there will be sufficient case law to tell one way or the other, the advice from the lawyer is simple: if you extend the duration of the performance of certain obligations under a contract (for example, a delivery obligation), the breach of which is sanctioned with the payment of a penalty clause, then it will be best practice to state somewhere in a contract amendment (or, more broadly put, in a document accepted by the other party) that the penalty clause will continue to apply, notwithstanding the expiry of the original deadline set for contract performance.

Your Checklist

Brief as this summary may be (which will be surprising for any person having been involved in the actual arbitration case, which was by far more complex than the issues briefly discussed above), is still the appropriate time to summarize a few do's and don'ts:

- Determine what is the appropriate warranty period for the works performed under a contract (to be recalled that it will be unlikely to assert successfully claims for defects after the expiry of the contractual warranty period);
- Attempt to obtain contractual terms which are at least as favorable as those offered by the Contractor (or Contractor's group) to other partners;
- Ask what are the consequences of defects: (i) contractor performs repairs at its own cost; (ii) will Contractor pay also damages for the lack of use of the works?;
- Understand which event counts for the effectiveness of the liability attached to the defect liability period: (i) the *existence* of defects; (ii) the *occurrence* of defects or (iii) the *discovery* of defects;
- Clarify the distinction between warranty for defects and functional guarantees (the latter contemplates the achievement of certain technical parameters regarding the operation of the works after completion);
- Determine whether it will be practically possible to enforce the liability clause: (i) will the contractor have sufficient assets to meet liability claims? (ii) is there any satisfactory security in place? (performance bond issued by a bank, parent company guarantee, withholdings applied to payments under the contract, etc.);
- It's not just about writing the contract… (i) … but also about the way it is performed; (ii) practice might "make" the contract – parties' consistent practice could serve as a tool for the interpretation of the contract or, as the case may be, as evidence of amending the contract; (iii) technical verifications prior to issuing the acceptance certificates should be as thoroughly made as technically possible;
- Don't forget about insurance – this might be a nice way for both parties to place the risks on somebody else's shoulders…

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News and Views

- Insolvency: Current Procedural Shortcomings
- Preventative Composition Law vs. Insolvency Law

Insolvency: Current Procedural Shortcomings

While 5 to 10 years ago insolvency proceedings were an incidental issue on the courts' agenda, lately the initiatives to initiate bankruptcy proceedings have become more and more often, and economic, financial or social implications - greater and greater, obviously due to the global economic crisis and the local economic realities.

Generally, we are speaking of companies that are in a very critical economical situation, extremely close to "metastasis". Although, at this point, we may talk about a certain "culture of insolvency" amongst traders, the request for the protection provided by the law comes however, in most of the cases, when it is already too late. The self-confidence given by a position hardly obtained, drives the persons in key positions to attempt rope walking at high altitudes and without a security net – bank loans obtained with a questionable documentation, loss-generating offsets or personal indebtedness - all, in fact, just useless pit stops towards the unavoidable bankruptcy, or even worse, towards the breaking of the entire personal fortune built up in years of hard work. The correct management is a forecast-based management, and managerial skills may be proved in crisis situations, as well. What is important is that one understands and feels the "smell" of problems, and when prospects are dark, has the power to make the radical, nevertheless correct, decision, even if the notion "insolvency" sends cold shivers in first instance.

> "Laws were passed in hesitation, amendments were not always most suitable, and the experience gathered by other jurisdictions was not used in any way whatsoever.

Nevertheless, we have to admit that the insolvency legislation in Romania had a rather unfortunate development. Laws were passed in hesitation, amendments were not always most suitable, and the experience gathered by other jurisdictions or even before the war was not used in any way whatsoever, although, even now, it holds the answers to many of current questions. From a procedure in the interest of the creditors, it turned into a procedure at their discretion, which is acceptable up to the point when such power tends to breach the legal norms, due to financial reasons. →

During the inter-war period, the Syndic Judge was handling the insolvency proceedings himself, fulfilling tasks which are now incumbent upon the insolvency practitioner. In our time, the practitioner should have to be a real advocate of the justice, and be able to impartially enforce legal authorities, in an individual range of action, independent from any action of the debtor or creditor.

We deem that it is fundamentally wrong to consider that an inhomogeneous consortium of creditors with many, yet contrary, and only in theory unitary interests, may impartially assess, better than a judge – that is by definition an impartial arbitrator – whether a certain practitioner meets the professional criteria required to handle a certain proceeding. In order to survive under the current legislative and factual conditions, the insolvency practitioner turned into a rope walker. The rope he is walking on is lax and narrow, considering that the threat of being reassigned from the case hangs upon him like the sword of Damocles, as long as he fails to satisfy the priority interests of the mighty majority creditor, even if they are contradictory to the interests of the other creditors on the creditors list, and even to the legal authorities.

We shall include in this category the claim of secured creditors of having their securities reassessed at the value of the credit, even if, by their fault, they overestimated the assets upon granting the facility to be able to report higher crediting; or the claim of collecting, even after the initiation of the joint proceedings, the return on certain contractual assignments which, only at this point, reached their maturity, thus removing the distribution order provided by the Insolvency Law. Referring to budgetary creditors, we shall emphasize the abuse whereby the Ministry of Finance, acting through its relevant authorities, files bankruptcy applications against certain debtors which have, in their turn, amounts to recover from the very State budget. In our opinion, in such a situation, declaring the application inadmissible shall have to be permitted through a legal authority expressly providing this settlement fashion. It is inconceivable and against moral principles that the very person causing the insolvency state of the debtor has the legal means to initiate the proceedings provided under the Insolvency Law.

Granting tremendous powers to majority creditors led to situations in which the lowest fee represented the defining aspect upon the confirmation of a practitioner throughout the procedure, professional competence or logistic capability of handling complex proceedings being thus removed. The occurrence of unfair competition practices was thus a natural consequence of all the above. As the insolvency practitioner is a profit-making entity, each such practitioner, as per his morality endowment, started creating "financing sources" likely to support the expenses required to administer certain well-known companies, by outsourcing certain services whose costs escape the creditors' detection. However, surprisingly, even the important creditors, present in numerous insolvency procedures, fail to realize that, most of the times, all "related" expenses exceed by far the insolvency practitioner's fee and do not attempt to stop such harmful practices.

In conclusion, this new, yet important procedure in the current economic conditions could be substantially improved. However, the sine qua non condition for a quality amendment would be a debate attempted by professionals, either practitioners, judges, or specialized lawyers, and not a mere reproduction of other States' legislations and enactments, which are, most of the times, not applicable to the local specific.

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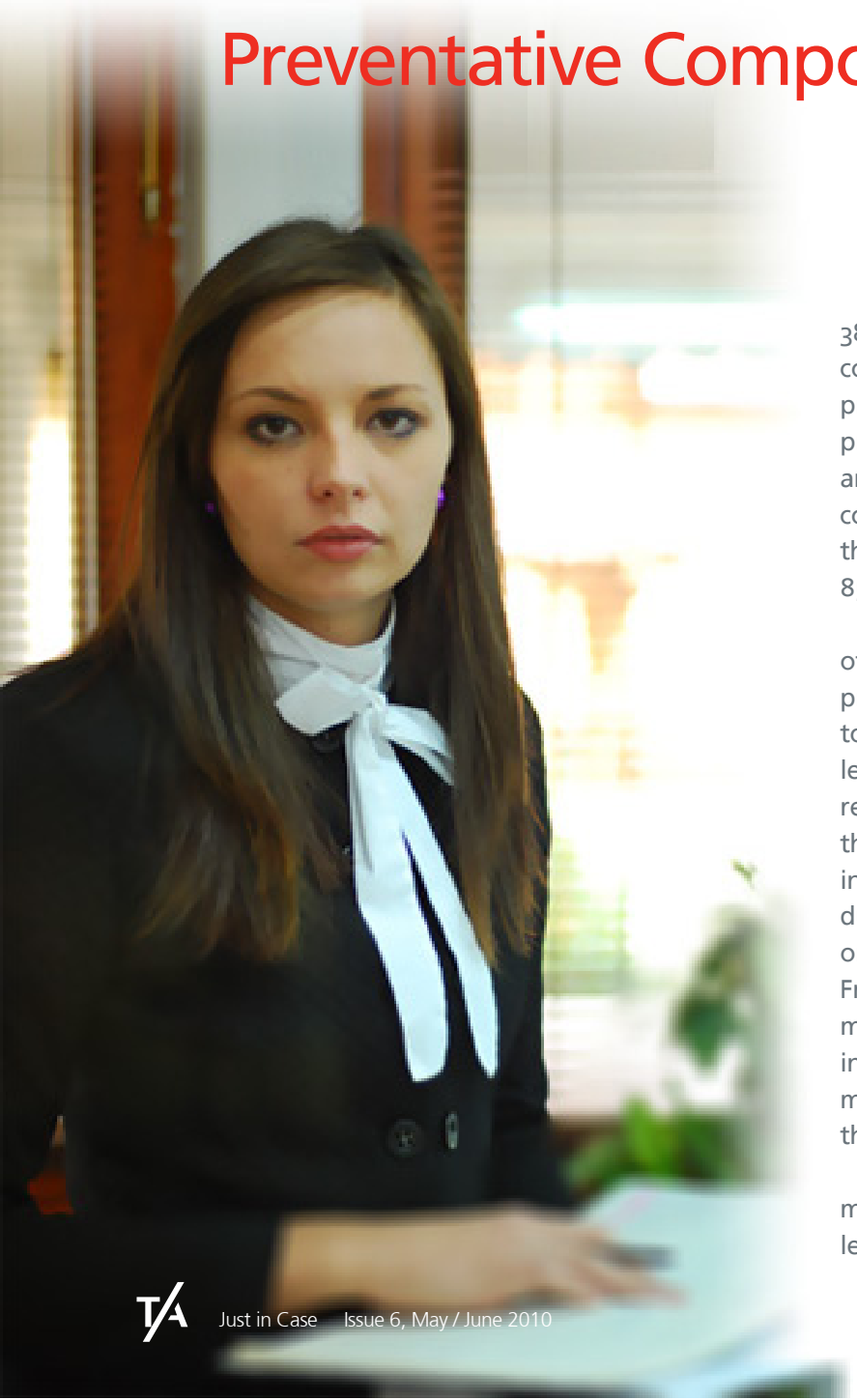


Preventative Composition Law vs. Insolvency Law

The Preventative Composition Law No. 381/2009 (the "Preventative Composition Law") comes in response to the European legislation, providing original alternatives to the insolvency proceedings. This legal authority originally and much more permissively regulates the company's restructuring options, other than those provided under the Insolvency Law No. 85/2006 (the "Insolvency Law").

The insolvency practitioner has the position of mediator throughout the composition proceedings, which position is not new to a specialist in the field and, under this legal authority, is provided with an express regulation, and, most of all, is released from the rigid framework of insolvency. Thus, the insolvency practitioner no longer performs its duties by strictly enforcing the law, but also on the basis of a mandate given by the client. From this standpoint, the law shall permit a much faster settlement of the firms and offices in the insolvency market, the latter becoming more dynamic and acquiring, at the same time, the real attributes of a market.

The position of the conciliators is much more gradated, as the courts interfere a lot less in the mediation/settlement of disputes. The key word brought by this procedure is thus amicability.

A brief presentation of the most relevant distinctions between the two proceedings follows herein below.

Initiation of the proceedings

Insolvency may be initiated at the request of either the debtor, or one of its creditors, in compliance with the provisions of Art. 6 of the Insolvency Law.

Composition may be initiated at the request of the debtor only.

Publication of proceedings

The Insolvency Law requires that the initiation of the proceedings be published in the Insolvency Proceedings Register and notified in a widely circulated newspaper. In addition, Art. 45 of the Insolvency Law provides the obligation that each and every act issued by the debtor shall specify "undergoing insolvency" in three languages.

The composition proceedings require confidentiality with respect to its performance, and such nature is explicitly provided under the law. Thus, problem settlement is aimed without creating unwanted pressure on the →

debtor's activity, giving it the possibility to avoid obstacles generated by the publicity of the financial problems it is facing.

Enforcement and receivable collection proceedings

Art. 36 of the Insolvency Law provides that all enforcement measures against the debtor shall be *de jure* suspended.

During the insolvency proceedings, creditors which failed to get registered on the Table of creditors, or whose receivables failed to be included in the turnaround plan, shall lose every possibility to recover the receivables accrued prior to the proceedings.

The Composition Law may result in the suspension of enforcements against the company subject to the turnaround plan, only if the composition agreement is signed by the creditors holding at least 80% of the total accepted and unchallenged receivables. In addition, mention should be made that the Composition Law does not exclude the possibility of obtaining a writ of enforcement against the debtor, even during the implementation of the turnaround plan.

During the composition proceedings, the creditors failing to execute the agreement shall not lose the right to recover their receivables, and may thus, threat the debtor at any time. Throughout a ratified composition, the debtor temporarily "gets away" from the creditors failing to execute the agreement, i.e. throughout the implementation of the turnaround plan; subsequently, this suspension is removed.

Business plan implementation term

Throughout the insolvency proceedings, the business plan is called "reorganization plan" and may be proposed for a maximum term of 3 years with the possibility of a 1-year extension, however, subject to the same requirement of obtaining the favorable vote of the creditors.

Throughout the composition proceedings, the business plan is called "turnaround plan" and is enforceable for a term of 18 months with the possibility of a 6-month extension, subject to obtaining the favorable vote of the creditors.

> "During the insolvency proceedings, creditors which failed to get registered on the Table of creditors, or whose receivables failed to be included in the turnaround plan, shall lose every possibility to recover the receivables accrued prior to the proceedings.

Plan voting

Throughout the insolvency proceedings, the favorable vote on the plan entails multiple conditions, and, first of all, a differentiation among creditors by classes. Should the plan not be approved, the debtor shall go into bankruptcy proceedings.

The composition proceedings make no differentiation by classes of creditors, and the only condition required is to obtain a favorable vote from the creditors holding 60% of the total receivables, and 80% for the ratification of the composition, respectively. The negative vote of the creditors does not decisively influence the prospects of the debtor, which may file a new negotiation offer within 30 days.

Reduction of receivables

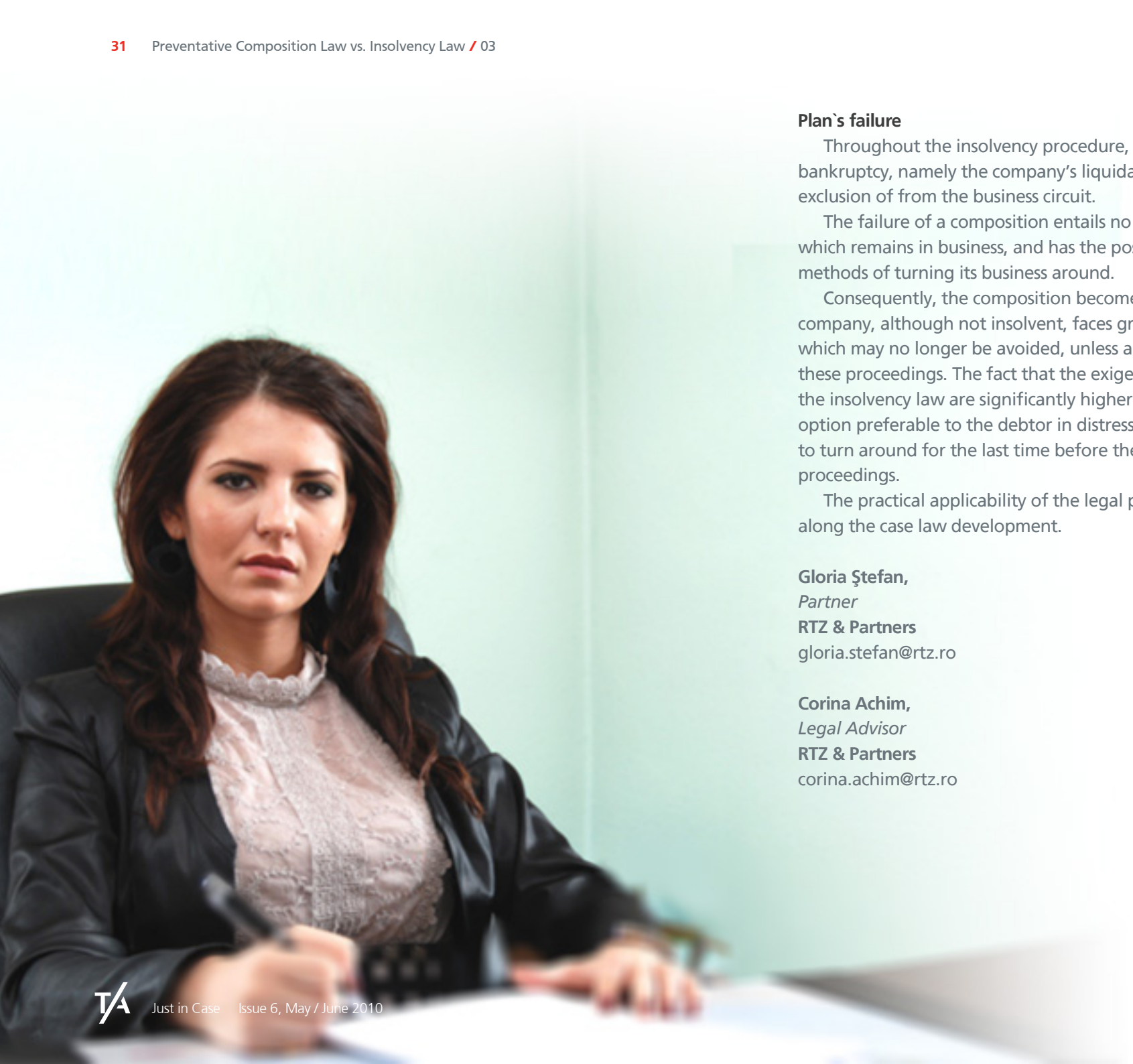
The Insolvency Law provides the possibility of creating a class of disadvantaged creditors, whose receivables may be actually reduced to zero, through the reorganization plan.

The Composition Law allows for a reduction of up to 50% of the total receivables held by the creditor, upon the consent of such.

The successful implementation of the proposed plan

By virtue of the Insolvency Law, a successful reorganization entails the payment of all debtor's debts, as provided under the plan, with the consequence of closing the proceedings, maintaining the debtor in business and relieving it from any obligations.

A successful composition takes place when the debts have been paid according to the turnaround plan, the consequence of this fact being the closing of the proceedings, which entitles the creditors not executing the composition agreement, to resume or initiate, as the case may be, the enforcement formalities against the debtor. →



Plan`s failure

Throughout the insolvency procedure, the plan's failure means bankruptcy, namely the company's liquidation, deregistration and exclusion of from the business circuit.

The failure of a composition entails no negative effect on the debtor, which remains in business, and has the possibility to search for other methods of turning its business around.

Consequently, the composition becomes necessary when the company, although not insolvent, faces greater and greater difficulties, which may no longer be avoided, unless all creditors are drawn into these proceedings. The fact that the exigencies and requirements of the insolvency law are significantly higher renders the composition option preferable to the debtor in distress, which is thus attempting to turn around for the last time before the initiation of the insolvency proceedings.

The practical applicability of the legal provisions is to be observed along the case law development.

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/ **The materials included herein are prepared for the general information of our clients and other interested persons. They are not and should not be regarded as legal advice.**

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