

# International Caselaw Alert

New Caselaw on the European Insolvency Regulation and from countries having enacted UNCITRAL Model Law on Cross-Border Insolvency

In co-operation with INSOL Europe



**In this issue: Special Focus on Eastern Europe and „Second Level Forum Shopping“**

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*Restructuring and Insolvency Articles***Essential Aspects of the Romanian Insolvency Law**

Romania's accession to the European Union involved a long process of harmonizing the Romanian legal system by reference to the principles of the laws of the European Community in various fields and of the legal systems of the other Members of the European Union.

With specific reference to the insolvency field, the transformations were meant, on one hand, to amend the internal insolvency legislation in compliance with the legislation of the Member States, and on the other hand to ensure the direct applicability in Romania of the Community regulations on insolvency procedures.

The considerations below refer only to aspects related to the insolvency procedure in the internal Romanian law, as we are dealing with the comparatively recent amendment brought by an enactment entered into force on 20 July 2006, i.e. Law no. 85/2006 on insolvency procedure.

This article is not concerned with an analysis of the aspects related to the relations governed by international private law in the insolvency field. We only mention that these relations are governed by different regulations: Regulation no. 1346/2000 of the European Council (for the relations concerning Members of the European Union) and Law no. 637/2002 regulating the relations governed by international private law in the insolvency field (for the relations concerning non-member states).

**Purpose of the Law**

The modification of the domestic legal framework by the Law no. 85/2006 (the “**Law**”) envisaged two basic principles – the celerity of insolvency proceedings and a better protection of the creditors' interests through instruments made available to their representative bodies – the Creditors' Meeting and the Creditors' Committee.

In an effort to transpose such principles, the Law brought certain amendments to the former enactment (Law 64/1995):

Ioana Hrisafi



Ionut Serban

Tuca Zbarcea  
& Associates  
BGN Romania



- (a) the establishment of a new institution – the simplified (accelerated) procedure;
- (b) discharging the syndic judge of its administrative duties;
- (c) increasing the duties of the official receiver and of the liquidator;
- (d) increasing the role of the Creditors' Committee and the Creditors' Meeting, in view of ensuring a better protection of the creditors' interests;
- (e) facilitating the procedures of summoning, notification, convening and communication of various procedural deeds, by introducing the Insolvency Proceedings Bulletin.

## Participants in the Insolvency Proceedings

According to the Law, participants in the insolvency proceedings are:

- The syndic judge, having as main duties to issue the decision of opening the insolvency proceedings, to judge the contestations filed during the progress of the proceedings, to appoint the temporary official receiver or the temporary liquidator, until the appointment of the permanent one by the Creditors' Meeting, to cancel the debtor's right to conduct activities, to judge the applications for initiation of liability proceedings against the debtor's leaders etc;
- The special receiver appointed by the general meeting of the debtor's shareholders, whose duties are reduced after the debtor's right to conduct activities is cancelled, upon appointment of the official receiver. The special receiver represents the debtor's interests and may propose the reorganization plan, may file contestations and manage the debtor's activity;
- The official receiver elected by the Creditors' Meeting, in charge of fulfilling the actions relating to the insolvency proceedings, until the bankruptcy is ordered;
- The liquidator elected by the Creditors' Meeting, in charge of fulfilling the actions relating to the insolvency proceedings, after the bankruptcy is ordered;
- The Creditors' Meeting that may decide on any opportunity issue in connection with the progress of the liquidation proceedings;
- The Creditors' Committee (3 or 5 members elected from among the creditors, by the Creditors' Meeting) having, *inter alia*, the duty to analyze the liquidator's reports, the contestations filed against them, to draft its own reports proposing measures required to be taken during the progress of the proceedings etc.

## Opening of Proceedings

In order to open the proceedings, the insolvency has to be ascertained by the court of law, at the debtor's or creditor's/creditors' express request.

### Application filed by the debtor

The debtor has the obligation to file the application for opening the insolvency proceedings within 30 days after the date when such insolvency was ascertained; the failure to file such application may entail the initiation of criminal liability proceedings against the debtor (for the offence of fraudulent bankruptcy).

The debtor may file the application for opening the proceedings when it deems that its insolvency is imminent.

In event the debtor files application for opening the proceedings, the Law does not provide for a minimum amount of the debt as conditional upon the approval of the application filed by the debtor, as in case of applications filed by co-creditors.

The filing by a debtor, in bad faith, of an application for opening the proceedings entails the latter's liability for the prejudices caused. The filing by a debtor, in bad faith, of an application for opening the proceedings may be determined by the latter's intention to cause (at least) one of the following consequences: (i) procrastinating a forced execution procedure against a debtor's asset, (ii) avoiding payment of highly onerous interest and penalties<sup>1</sup>, (iii) suspending the trading of the issuing companies' shares between the date of procedure opening and the confirmation date of the reorganization plan.

The law prohibits the filing of an application for reorganization (in essence, one of the forms in which the proceedings may be carried out) with respect to the debtor which was previously subject to a reorganization procedure sometime during the preceding 5 years. The regulation is confusing in this respect; however, the overall opinion is that the prohibition would exclusively relate to the right to file the application, not to the carrying out of the reorganization procedure by the debtor undertaking such procedure pursuant to an application filed by the creditors.

### Application filed by the creditor

In order to approve such an application, the Law provides for two conditions: **(i)** the receivable, whose recovery is pursued, should be certain, liquid and payable up to a minimum amount of RON 10,000<sup>2</sup> and **(ii)** more than 30 days have passed from the date when the receivable became due and payable.

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<sup>1</sup> The law provides that, after the opening of the proceedings, no interest, increase, penalty can accrue to the receivable occurring prior to the opening of the proceedings.

<sup>2</sup> For employees – 6 average salaries per economy.

## **Consequences due to the Approval of the Application for Opening the Proceedings**

In case of fulfillment of the legal requirements, the syndic judge shall approve the application for opening the proceedings, initiating **(i)** either the simplified proceedings, **(ii)** or the general proceedings.

### **Simplified proceedings**

The simplified proceedings involve the opening directly by the debtor of bankruptcy proceedings (liquidation of the assets for the purpose of covering liabilities). In this case, it is appreciated that there are no real chances that the debtor's activity be redressed.

The simplified proceedings apply whenever: (a) the debtor expressly manifested its intention to apply such proceedings, (b) the debtor did not file the documents requested by the syndic judge, regarding the company's activity, (c) the debtor falls within certain categories expressly and restrictively listed by Law: natural person traders, family associations, companies having no assets in their patrimony, companies whose headquarters do not exist or cannot be identified, companies whose director cannot be found.

### **General Proceedings**

The steps of the general proceedings are:

#### **Appointment of the official receiver**

The official receiver shall supervise the entire progress of the proceedings. At the opening of the proceedings, the official receiver shall notify both the debtor, to file all the documents concerning the company activity, and the company creditors.

#### **Notification of creditors**

The purpose of this action is to provide creditors with the opportunity of recovering their receivables by filing an application for registration with the creditors' list. Furthermore, creditors may lodge a challenge against the opening of the insolvency proceedings, which is to be settled by the syndic judge.

After registration of all receivables, the official receiver shall prepare the preliminary table of receivables, which shall be submitted to the syndic judge for approval.

#### **Suspension of certain proceedings**

As a direct consequence of the proceedings opening: (a) the statutes of limitation, (b) the delay interests, penalties and interest, (c) the trading of the shares belonging to the company in debt, (d) the judicial and extrajudicial proceedings for recovering the receivables from the debtor or by selling its assets, are suspended.

Exceptions from the rule concerning the suspension of the delay interests, penalties and interest [letter (b) above]: the secured receivables are recorded in the table according to the value of the securities, provided that they do not exceed the aggregate amount of the secured receivables. Upon distribution of the security price, the secured creditor shall be entitled to calculate the interest and penalties (accessories) until the sale of the asset, should the selling price be higher than the initially estimated value.

Exceptions from the rule concerning the suspension of all judicial proceedings against the debtor [letter (d) above]: a creditor of a receivable secured by means of a mortgage, pledge or other security interest in personal property or lien may request the syndic judge to cancel suspension, in view of immediate sale of the asset forming the object of the security.

The application for the cancellation of the suspension measure, having as consequence the immediate capitalization of the secured asset, may be accepted only in one of the following two cases:

- (i) the value of the secured asset is fully covered by the total value of the receivable, provided that (a) the assets making the object of the security would not be determinant for the success of the proposed reorganization plan, (b) the respective assets would not be part of a operating unit if their sale would decrease the value of remaining assets;
- (ii) if there is no appropriate protection of the secured asset, because (a) the value of the secured asset risks to decrease, (b) the value of the secured part of an inferior receivable risks to decrease, further to the accumulation of interests, increases and penalties or (c) the secured asset is not insured against the risk of loss or damage.

In the last case, the syndic judge may reject the application on the cancellation of the asset sale suspension, if the official receiver or the debtor propose asset protection measures, such as:

- periodical payments in favor of the creditor in order to cover the decrease of the security value, the secured part of an inferior receivable, in order to realize the interests and penalties;
- establishment of an additional real or personal security, or the replacement of the secured asset with another asset.

### **Cancellation of the administration right**

The syndic judge may order the cancellation of the debtor's administration right, in which case all acts, legal operations and payments made by the debtor must be performed through the official receiver.

### **Submission of the report by the official receiver**

After it has reviewed all company's documents and has drafted the preliminary table of receivables, the official receiver shall submit a report mentioning: (i) the preliminary table, containing all the receivables registered against the debtor, their type and the preference rights arising from the nature and securities accompanying the receivable, (ii) official receiver's recommendation on the drafting of a reorganization plan or, as the case may be, the commencement of bankruptcy proceedings.

The Report may be contested before the syndic judge. After the settlement of contestations, the final table of receivables shall be drafted.

Since the entire procedure is directed towards covering the liabilities, we shall further review the possibility of re-launching the business of the debtor company by applying a reorganization plan or, if this is no longer possible, the assets shall be liquidated under bankruptcy proceedings.

### **Proposal of a reorganization plan**

The reorganization plan may be proposed: (i) by the debtor, (ii) by the official receiver or (iii) by the company's creditors which hold together at least 20% of the total value of receivables.

The reorganization plan must be voted by the Creditors' Meeting and then confirmed by the syndic judge. After the plan has been confirmed, the debtor's activity shall be organized in accordance with the plan. The creditors' receivables and rights may be amended as provided by the plan.

### **Bankruptcy**

If: (i) the debtor does not comply with the provisions from the reorganization plan, (ii) the plan is not confirmed by the creditors' meeting or the syndic judge, (iii) the simplified procedure has been carried out, the debtor shall undergo bankruptcy, which involves the change of the assets making the debtor's wealth into money, in order to cover the liabilities.

At this stage, a liquidator shall be appointed. The liquidator shall notify all creditors on the opening of bankruptcy proceedings and the opening of liquidation proceedings.

The creditors the receivables of which were created after the opening of the proceedings may request the registration of these receivables. After the registration and verification thereof, the final consolidated table shall be drafted, and the debtor's assets shall be inventoried and sealed.

## **Liquidation of assets**

The liquidation of the debtor's assets is exclusively incumbent to the liquidator, under the control of the syndic judge.

The liquidator shall hire, on the debtor's behalf, an evaluator to assess the debtor's assets in accordance with the international evaluation standards.

The sale method for immoveable assets (public tender, direct negotiation or a combination of these two) shall be approved by the General Creditors' Meeting on the basis of the liquidator's proposal and the recommendation of the Creditors' Committee.

When the immoveable is sold by direct negotiation, it is possible to accept a better offer to the sale price resulting further to direct negotiation. Even in case the Creditors' Meeting approved the proposal on the direct sale of the respective immovable assets, the sale may only be made, under the sanction of absolute nullity, after the expiry of a term of 30 days as of the date of the last publication of the better offer. Triggering a better offer by publishing a notice in the newspaper in this respect shall be made in order to maximize the debtor's wealth, therefore, if a better offer is notified during the 30 days, the sale may no longer be made, and the premises of another direct negotiation are thus created.

## **Preference order at the distribution of the price further to the sale of assets encumbered by real securities**

The price distribution order is as follows:

- expenses related to the sale of the respective assets;
- receivables of the secured creditors, plus interests and penalties. Real securities mentioned by the Law are mortgages, pledges, other movable securities and retention rights.

The possible part of the receivable encumbered by a real security which was not fully realized through the sale of the encumbered asset shall become an unsecured receivable, competing against the other receivables from its category.

A secured creditor may participate in the distribution of any amount which precedes the sale of the respective encumbered asset. However, the Law does not mention the order of such distribution, but it may be presumed that this is the usual preference order.

## **Usual preference order**

In case of liquidation of assets on which no real securities were established the Law provides the following preference order:



- expenses related to the insolvency proceedings;
- salaries and other receivables arising from labor relations;
- credits, with related interests and expenses, granted by credit institutions after the opening of proceedings, as well as the receivables resulting from the debtor's continued operation after the opening of proceedings;
- budgetary receivables;
- receivables due to third parties having obligations of care, underage allowances;
- receivables determined by the syndic judge for the care of the individual debtor and his family;
- banking credits, with the related expenses and interests, receivables resulting from product deliveries, service provisions or other works, rents;
- unsecured receivables;
- subordinated receivables, in the following preference order: (i) receivables of shareholders holding at least 10% of the share capital and (ii) receivables arising from gratuitous acts.

The creditors from the same category shall be satisfied *pro rata*, and those from the inferior categories only after the full satisfaction of preferred securities.

### **Closing the proceedings**

In case the full liquidation of the debtor's assets is found, even if the receivables were paid only partially, the syndic judge shall order the close of proceedings.

### **Liability of the debtor's management**

This liability may be engaged in case the debtor's directors or auditors or other persons fraudulently determined the debtor's insolvency.