

GENERAL ASPECTS CONCERNING THE PRINCIPLES OF INSOLVENCY PROCEEDINGS

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Abstract: *Insolvency proceedings represent a special judicial procedure regulated by Law no.85/2014 on insolvency prevention and insolvency proceedings, also known as the Insolvency Code. This law has regulated distinctly the fundamental principles underlying its application. These principles are based on the recommendations of the World Bank and the International Monetary Fund, which have contributed substantially to the adoption of the project of this law. Due to the fact that Law no.85/2014 has stated expressly the principles underlying its enforcement, has included the concepts of insolvency of a group of companies and insolvency of entities with extraneous elements, the Insolvency Code is deemed as one of the most advanced legislations at EU level.*

Key words: *insolvency, proceedings, principle, debtor, creditor*

1. Introduction

The concept of *principle* is that fundamental element, that basic idea that underlies a scientific theory, a judicial system or a conduct norm.

At present Law no.85/2014 on insolvency prevention and insolvency proceedings is referred to in the usual language of both doctrinarians and practitioners as the *Insolvency Code*. The term *Insolvency Code* is used for the purpose of a simplified language and to establish the distinction from Law no.85/2006 on Insolvency Proceeding, Law no.85/2014 being a more complete and complex law, that, however, does not cover all fields of application, like the

insolvency of administrative-territorial units still covered by Government Emergency Ordinance (OUG) no.46/2013 concerning the financial crisis and the insolvency of administrative-territorial units and the insolvency of individuals, for which Romania has not yet adopted a norm. For details concerning the term Insolvency Code used for Law no.85/2014 see also the Decision of the Constitutional Court no.283/21 05 2014, according to which Law no.85/2014 „cannot be qualified as an Insolvency Code, considering its range of applicability.”

Law no.85/2014 is an ample act including judicial norms applicable to certain judicial rapports, with a specific regulatory field, namely the rules

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applicable in the prevention of insolvency (pre-insolvency) and insolvency.

This law was passed subsequently by Government Emergency Ordinance no.91/2013 on insolvency prevention and insolvency proceedings, which was declared unconstitutional by Decision no.447/29 10 2013 of the Constitutional Court. This norm preceding the Insolvency Code passed in this form in such a way as to accelerate the adopting of new regulations on insolvency prevention and insolvency, has caused considerable controversy in the literature[10], [13]

The Insolvency Code includes special judicial norms, hence *derogatory* from common law [18].

Thus art.342 par.1 of Law no.85/2014 stipulates: “if not contrary, the provisions of this law are completed by those of the Code of Civil Procedure and of the Civil Code”.

Art.1 par.1 of the New Civil Code [23] enumerates the sources of civil law, namely the law, practices and the *general principles of law*. Thus we note that for the first time the legislator of the New Civil Code has regulated the principles of law as being a source of law, without, however, enumerating them and including them in a legal regulation.

We consider that to the extent to which the Insolvency Code is completed by the provisions of the Civil Code, the general principles of law constitute a source of law also for the pre-insolvency proceedings or insolvency proceedings, if not contrary to the principles regulated by this special law. Thus, the principles expressly regulated by the Insolvency Code are special priority principles, and as their completion also the general principles of law represent sources of law, to the extent of their compatibility with the regulated object of this law.

Law no.85/2014 has not stated expressly that the principles enumerated in art.4 par.1 constitute a source of law, the

legislator stipulating that the provisions of this law *are based* on these principles. This yields the conclusion that the principles enumerated by the legislator are applied for the *interpretation* of the provisions of the Insolvency Code as well as for their *completion*, if not distinguished otherwise by law.

The necessity of adopting principles underlying the application of the Insolvency Code follows from the fact that the legislator cannot anticipate all practical situations that may arise under the rule of a certain provision.

Thus the literature [6] emphasizes that “the legislator cannot have the knowledge of all possible combinations of circumstances that may occur in future”.

The necessity of regulating the specific principles underlying the Insolvency Code originates, *in our opinion* in the very character of special law of this norm that entails a certain specialisation of all bodies applying these procedures or pre-insolvency and insolvency.

Thus, according to art.342 of Law no.85/2014 the provisions of this law are completed by those of the Civil Code and of the Code of Civil Procedure, if not contradictory.

The bodies enforcing insolvency proceedings, namely the legal administrator, the liquidator, the syndic judge and the courts of law, in fulfilling their legal tasks need to interpret any provision of the Insolvency Code or to replace their absence when required by the given practical situation *in the spirit of the principles* described by the legislator in art.4 of Law no.85/2014.

It can be asserted that the principles underlying the provisions of this special law contribute to the achievement of the *purposes* of these procedures, being adopted in view of the uniform interpretation of the provisions of the Insolvency Code [8].

Insolvency represents the state of a debtor's patrimony characterised by the insufficiency of available funds for payment of uncontested, liquid and enforceable claims. Based on this definition in the literature [19] insolvency is analysed according to the aspect of the debtor entering a *state of cessation of payments*.

The debtor's state of insolvency need not be confused with the same debtor's *insolvability*, these being distinctive notions [1].

Thus insolvability refers to the liabilities exceeding the assets of a patrimony. The concept of insolvability concerns the state of the debtor's patrimony related to its contents consisting of patrimonial assets and liabilities.

Consequently the state of insolvency does not represent an imbalance between the debtors' assets and liabilities, but the situation when in a given period of time the debtor's financial resources are not sufficient for payment of the due debts, unrelated to the patrimonial assets to liabilities ratio.

Insolvency knows two forms, namely evident or presumed insolvency and imminent insolvency - Art.3 par.1 no.1 lit. a of Law no.85/2006 on the insolvency proceedings, published in Official Journal no.359/21 04 2006, refers to "insolvency is presumed as evident ...", art.5 par.1 no.29 lit.a of Law no.85/2014 on insolvency prevention and insolvency proceedings, published in Official Journal no.466/25 06 2014 refers to "the debtor's insolvency is presumed ...", without adding the term "evident".

Presumed insolvency refers to the state of the debtor's patrimony when after 60 days from the due date [14] the debtor has not paid their debts towards one or more creditors. *Imminent* insolvency refers to the state of the debtor's patrimony when it is proved that the debtor will not be able to

pay the collectable debts on the due date, from the financial resources available at that due date.

Pre-insolvency represents the *state of financial distress of a business* [3] when its dynamics of managerial and economic viability potential is decreasing, but whose holder satisfies or is capable of satisfying its collectible obligations.

The literature [11] analyses the state of financial distress of a business [17] in relation to legal provisions from other fields, like European Union legislation [24] on state aid that refers to the concept of financial distress of a business, without however defining it; legislation on capital markets from the perspective of financial distress risk; legislation on competition in relation to the concept of group of companies, etc.

Although in practice it is difficult to distinguish the state of financial distress from that of insolvency, (particularly from that of imminent insolvency), especially in situations of pre-insolvency when the business is capable of but not actually satisfying its obligations, these two states need be addressed differently and are regulated by distinctive juridical norms.

Hence the conclusion that the state of financial distress or the state of insolvency need be determined with maximum accuracy so that the debtor makes the correct choices in relation to the protection offered by the special judicial norms applicable to such proceedings [15].

The *purpose* of any pre-insolvency or insolvency proceedings is to institute *collective proceedings* such as to cover the liabilities of the insolvent debtor.

In this sense art.2 of Law no.85/2014 on insolvency prevention and insolvency proceedings establishes the purpose of this law as being the "institution of collective proceedings for covering the debtor's liabilities, *while granting, when possible, the chance of redressing their assets*".

Until the coming into force of Law no. 85/2014 on 30 06 2014, pre-insolvency proceedings were governed by Law no.381/2009 concerning the introduction of the preventive concordat (settlement) and ad-hoc mandate.

According to art.2 of Law no.381/2009 “the purpose of this law is *saving* the distressed business, in view of allowing continuation of its activity, keeping the jobs and covering the claims incumbent upon the debtor by means of amiable renegotiation of the receivables or of the conditions thereof, or by a preventive concordat (settlement).”

Art.2 of Law no.85/2006 on insolvency proceedings also provides: “the purpose of this law is the institution of collective proceedings for covering the insolvent debtor’s liabilities”.

The *fundamental principles of insolvency prevention and insolvency proceedings* [20] were first regulated by Law no.85/2014.

Thus art.4 par.1 no.2 of this law establishes one of its principles namely granting the debtors a *chance of efficient and affective redressing of the business* by means of either insolvency prevention or judicial reorganisation proceedings [5], [16], [22].

Both pre-insolvency and insolvency require a triple approach, from the economic, juridical and social perspectives.

These approaches, harmonized and combined need to ensure attainment of the aim of any pre-insolvency or insolvency proceedings.

The *economic approach* to the aim of insolvency proceedings entails that by covering the insolvent debtor’s liabilities, *i.e.* by paying the receivables due to the debtor’s creditor, the commercial capital, the credit, respectively, is returned to the commercial circuit.

The *judicial approach* to the aim of insolvency proceedings entails that by covering the insolvent debtor’s liabilities the debtor’s obligations to its creditors are completely or partially settled, payment being a means of fulfilling civil obligations.

The *social approach* to the aim of insolvency proceedings refers to the possibility granted to honest debtors to reorganize their activity and thus returning them to the economic and social environment.

The purpose of pre-insolvency and insolvency proceedings was defined by the legislator at art.2 of Law no.85/2014 and consists in “establishing collective proceedings in view of covering the debtor’s liabilities, while granting, where possible, a chance for the rehabilitation of the debtor’s business”.

Art.2 of Law no.85/2006 on Insolvency Proceedings provided that “the purpose of this law is to establish collective proceedings for covering the insolvent debtor’s liabilities”.

Regarding Law no.85/2006 that was abrogated by Law no.85/2014, it needs to be pointed out that the former had only regulated insolvency proceedings, while Law no.381/2009 concerning the introduction of the preventive concordat (settlement) and ad-hoc mandate also regulated pre-insolvency proceedings.

Art.2 of Law no.381/2009 that was abrogated by Law no.85/2014 provided that: “the purpose of this law is *saving* the distressed business, in view of allowing its continuation, keeping the jobs and covering the claims incumbent upon the debtor by means of amiable renegotiation of the receivables or of the conditions thereof, or by a preventive concordat (settlement)”.

Thus the legislator has circumstantiated the purpose of insolvency prevention and insolvency proceedings, unlike the

legislator of Law no.85/2006, and has added the possibility of granting a chance of rehabilitation of the debtor's business as a common purpose for both pre-insolvency and insolvency proceedings.

Law no.85/2014 has stipulated for the first time, specific principles that govern the application of this law in its regulatory field.

These principles need to be observed by all bodies that apply both insolvency prevention and insolvency proceedings [21].

Further on, all participants in such proceedings, like the debtor, the debtor's creditors, the special administrator, etc. need to complete all the specific deeds and operations of such proceedings, in the spirit of these principles.

Like any principle of law, these principles too are designed to complete the special provisions of this special law, where the latter do not provide or lend themselves to interpretation.

Regarding the *function* to be ensured by the principles established in the Insolvency Code the opinion [7] was voiced, that this is an *integrating* function, and that the necessity of decreeing these principles follows from the logical unity of legal order, as insolvency does not constitute an exception in this matter".

The previous laws that had regulated this field, namely: bankruptcy (the Commercial Code), judiciary reorganisation and bankruptcy (Law no.64/1995 concerning judiciary reorganisations proceedings and bankruptcy) and insolvency (Law no.85/2006) did not include provisions to establish the principles governing these proceedings.

The literature [4], [9], [13], [14], [17], previous to the passing of Law no.85/2014 had evoked certain principles governing these special proceedings, based on a general analysis of the provisions included by the norms previously passed in this

matter. Thus the following were evoked [2] as principles of insolvency proceedings: the principle of insolvency proceedings celerity, the principle of insolvency proceedings collectivity, the principle of judiciary reorganisation pre-eminence and the principle of maximising the debtor's assets.

The principles established by Law no.85/2014 were based on the World Bank principles, the Principle of European Insolvency Law and the UNCITRAL Legislative Guide on Insolvency Law.

The World Bank principles [27] represent a wide-range action instrument meant to support countries that work on improving their legislative framework, in order to achieve an increasingly competitive legal system in commerce, an increasingly safe and predictable investment environment in view of ensuring economic growth.

These principles are grouped in 4 chapters: Legal Framework for Creditor Rights, Risk Management and Corporate Workout, Legal Framework for Insolvency and Institutional & Regulatory Frameworks.

The Principles of European Insolvency Law were decreed by a group of experts of the International Insolvency Institute. These experts showed that the principles are structured into 14 chapters and include rules representing the essence of the European insolvency proceedings, reflecting the characteristics of the EU member state legislations.

Thus these principles include rules for insolvency proceedings in general, insolvency bodies and participants, the effects of initiating insolvency proceedings, the competences and remuneration of the insolvency practitioner, the treatment of the creditors' claims, the situation of the debtor's employees, the judicial regime of deeds closed by the debtor, the judicial regime of the creditors' guarantees, the debtor's

reorganisation, the debtor's administration, the liquidation of the debtor's assets and the closing of the proceedings.

The purpose of these principles as stated by the group of experts is to adopt, in future, a European Insolvency Code.

The UNCITRAL Legislative Guide on Insolvency Law [26] includes a selection of governing principles and objectives to be reflected in any national legislation on insolvency.

The guide has 4 parts, the first two, adopted in 2004 referring to the establishing and decreeing of the main objectives and structure of insolvency proceedings, as well as the principles governing it.

The third part of the guide was adopted in 2010 and refers to the insolvency of a group of companies.

The fourth part of the guide was adopted in 2014 and refers to the responsibility of the executive bodies of companies facing imminent insolvency.

The recommended principles[28] were decreed such as to be taken into consideration when implementing insolvency legislation: inducing a certain degree of confidence on the relevant marketplace in order to promote stability and economic development; maximisation of the debtor's fortune and of the value of the debtor's assets; maintaining a balance between bankruptcy and reorganisation; ensuring a fair treatment of all creditors of the same category; ensuring the efficient initiation of insolvency procedures within a reasonable term; creation of a judicial regime that ensures an equitable distribution of funds among the creditors; ensuring a predictable and transparent legislation; recognition of the creditors' rights and establishing clear rules for all the categories of creditors participating in the insolvency proceedings; establishing a legal framework for cross-border insolvency.

The principles underlying Law no.85/2014 are regulated at art.4, as follows:

a) maximisation of the degree of utilisation of the assets and of recovery of the claims;

b) granting the debtors a chance of efficient rehabilitation of their business, either by means of insolvency prevention proceedings or by judicial reorganisation proceedings;

c) ensuring efficient proceedings, including adequate mechanisms for communication and unfolding of the proceedings, within a useful and reasonable timeframe, in an objective and impartial manner at a minimum cost;

d) ensuring equal treatment to the creditors of equal rank;

e) ensuring a high degree of transparency and predictability of the proceedings;

f) recognition of the existing claims of the creditors and respecting the order of priority of the receivables, based on a set of clearly determined and uniformly applicable rules;

g) limiting the credit risk and the systemic risk associated to the transactions, by means of financial instruments derived by recognition of immediately collectible compensation in the case of insolvency or of prevention proceedings of the insolvency of a co-contractor, thus reducing the credit risk to a net amount owed between the parties or even to zero, when financial guarantees were transferred in view of covering the net exposure.

h) ensuring the access to financing sources in insolvency prevention proceedings during the observation and reorganisation period, creating an adequate regime for the protection of these claims;

i) underpinning the approval vote of the reorganisation plan by clear criteria, ensuring the equal treatment of all creditors of the same rank, the recognition of the compared priorities and the

acceptance of a majority decision, while the other creditors are to be offered payments equal to or greater than they would receive in case of bankruptcy;

j) favouring in insolvency prevention procedures of the amicable negotiation/renegotiation of claims and of the closing of a preventive concordat;

k) efficient utilisation of the assets in due time;

l) in the case of a group of companies, coordination of the insolvency proceedings such as to ensure an integrated approach;

m) management of insolvency prevention and insolvency proceedings by insolvency practitioners and conducting these under the control of the court of law.

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