

The Liability Regime in the Insolvency Procedure from Romania

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In any country, commercial business allows larger free movement for traders, but it also implies the fulfillment of certain obligations as well, because of the importance held by the values handled on the market and because of the necessity to keep in operation the economic system.

The implication of a trader in complex and continuous relations with several suppliers and creditors, on one hand, and with clients, on the other hand, involves continuous operation of the collection and payment mechanism. Should this mechanism is blocked due to the lack of liquidities at one link of this circuit, the business of many traders bonded through the series of their operations is threatened. Keeping in operation this mechanism in the commercial business is sometimes made with the price of eliminating from the circuit of the ones who, most often due to loss accumulation, are no longer able to continue payments¹.

The insolvency procedure is the mechanism that assures functional economy by leaving the market of companies which are no longer able to pay the exigible debts.

Commercial insolvency is a current reality in any business environment and more present in a market economy under development, as the Romanian one is, where insolvency appears as a result of natural causes, of legislative games and experiments, of short-term interests, or as a consequence of state's or managers' "outlawry" practices.

The insolvency law in Romania, although it suffered many changes, is not able to keep pace with the ingenuity of bad-faith traders. We make this assertion under the conditions that we refuse to believe that the lawmaker on purpose has not clearly established the liability regime of persons guilty of companies' entering into insolvency, allowing some influent persons to avoid the strictness of the law.

If we analyze the history of the procedure to incur liability in Romania, we may notice that an innovation when enacting Law no. 64/1995 regarding the procedure of reorganization and winding up, consisted in favoring the debtor, in the improvement of its personal status, by removing the infamous and punitive character the bankruptcy held in the Romanian Commercial Code.

In Romania bankruptcy represented in the past the "debtor's commercial catastrophe"², the ruin of his estate, the loss of

¹ R. Bufan, *Legal Reorganization and Bankruptcy*, Lumina Lex Publishing House, Bucharest, 2001, page 13.

² I.N. Fintescu, *Course on Commercial Law*, Bucharest, 1930, vol. III, page 93.

freedom and the elimination of the bankrupt from the commercial life and also commercial disqualification.

The bankrupt has been tied from his neck with a chain to the "infamy prop", in the middle of the borough and exposed to public disgrace.

Such penalties ceased in modern times, but the bankrupt's person continued to be subjected to strict measures.

The Romanian Commercial Code from 1887 also stated harsh regime for the bankrupt: the court has been entitled to order the arresting of the bankrupt when there existed "sufficient fraud clues", but such clues have been extensive, consisting even in the "disappearance or unjustifiable absence of trade books and the failure to submit the balance sheet". The bad-payer debtor might be charged with simple bankruptcy even in case of disproportional personal expenses or when commercial books have not been kept in accordance to the law.³

Apart from penal punishments, the bankrupt had to suffer a series of interdictions and the loss of political, civil and professional rights.

Gradually, in the countries of the Occidental Europe and due to the influence of the British law, the infamous and punitive character attenuated.

However, currently, the liability procedure in the insolvency procedure is properly stated by the French and Italian law, being established a series of measures to determine the trader to be diligent and correct in his trading: the arrest of the bankrupt, his entering into a special court book, the loss of his capacity to hold certain positions or to exert certain professions. The Romanian law related to insolvency is highly liberal and it favors the debtor.

This *de facto* status is also reflected in the conclusions drawn by the European Commission in its Report regarding the progresses recorded by Romania during 2004 in the process for ascension to the European Union, according to which the Romanian legal system does not state efficient mechanisms for economic operators to leave the market. As main causes for lack of efficiency have been identified the "complexity of the procedure, the non-uniform application of the laws in matter, the low protection creditors' enjoy of". The Romanian Government has set up as main objective of the Legislative Program and of the Strategy of Reforming the Judicial System the preparation of a law to redefine the proceedings of legal reorganization and bankruptcy.

This draft of the law regarding the insolvency procedure, which has been endorsed by the Romanian Government and that had to be discussed by the Romanian Parliament in October 2005, although

³ Ion Bacanu, Magazine of Commercial Law no. 1/1996, Lumina Lex Publishing House, Bucharest, page 10.

it brings several improvements as to the introduction of a simplified procedure, the establishing of bankruptcy-specialized divisions in courts, the extension of liabilities of the receiver in bankruptcy/liquidator, the extension of the role held by creditors' meeting and creditors' board, the reduction of the terms to prepare procedural documents, the simplification of the means to summon, notify and service, etc., it has not as major concern the clarification of the regime to incur personal liability.

In order to attain the goal established by the European Commission, we think that an essential element in solving the chapter "The low protection the creditors benefit of" is to establish the legal instruments required to incur the liability of individuals guilty of debtor's entering into the insolvency procedure.

The acceleration of the insolvency procedure in order the ineffective companies leave the market cannot be made without norms that establish the ones who are guilty, the penalties and the means to recover debts.

It is obvious that the reform of justice cannot be put into practice if it shall not be corroborated with the introduction of harsh norms to control corruption. When these sensitive problems shall be brought to an end, this shall mean a positive indication in the improvement of Romania's image in the eyes of the European Economic Community.

As to the inexistence of efficient methods to assure the establishing of the guilty persons, the incurring of liability, the establishing of penalties and of the means to recover the prejudice the figures are relevant: in last 15 years, large financial evasions have prejudiced Romania's budget with about 25 billion euros, of them 8 billion euros are the result of the bankruptcy of banks.

In the top of the bank frauds from Romania appears Bancorex, where its purposely entering into bankruptcy brought 2 billion dollar prejudice. Unbelievable, the bank's manager executed 2 1/2 year imprisonment for illegal granting of cars and after he left prison, the court ordered retroactive payment of his salary as bank president.

As to Dacia Felix Bank, its manager has been convicted in Switzerland for 10 million dollar prejudice and in Romania for 300 million dollar prejudice he has not been convicted.

The Romania Discount Bank and the Investment and Development Bank have eased pockets and accounts of 25 million euros. Convicted to imprisonment has been only the president of the first bank, who after one year of imprisonment has been freed.

In this famous bank bankruptcies from Romania are dealt huge amounts of money, the guilty ones cannot be found and the prejudice is recovered in proportion of maximum 15-20%.

If we look to the evolution of the procedure to incur liability after 1995, at a first glance, it seems to be changed, but in fact, we notice that these are just readjustments or additions determined by major changes in the other chapters of the law. Obviously, the placement of Chapter IV of Law no. 64/1995 - chapter that focuses on incurring personal liability - in the middle ground of the lawmaker's preoccupations has generated and still generates many controversies among theoreticians and practitioners, first of all due to its inefficiency at the practical level of the application of its provisions.

The only legal norm upon which liability of members of management bodies can be incurred is the one stated in art. 137 of Law no. 64/1995 related to the procedure of judicial reorganization and bankruptcy, which currently states following:

"(1) The bankruptcy referee may order that a part of the debtor's liabilities - legal entity that forced into insolvency - be borne by the members of the management boards, administrators, managers, auditors and by any other person, who contributed to this condition for one of the following acts:

a) have used the goods or credits of the legal entity in own benefit or in the benefit of a third party;

b) have traded in their own interest, under the cover of the legal entity;

c) have ordered, in their own interest, the continuation of a business that obviously has led the legal entity in default;

d) have kept fictitious accounting records, have led to the disappearance of accounting documents or have not kept accounting books in accordance to the law;

e) have misappropriated or hidden part from the assets of the legal entity or have increased, in fictitious manner, its liabilities;

f) have used ruining means to raise funds to the legal entity, in order to postpone its default;

g) in the prior month to the default they have paid or have made to be paid preferentially a creditor, by harming other creditors.

(2) The application of provisions of paragraph (1) does not remove the application of the penal law for acts that represent offences".

Through this clause, the lawmaker aims to protect creditors against illicit acts committed by the representatives of the debtor company, making them available the action to incur the liability of persons guilty of company's forcing into insolvency. This action allows the creditors who have not received their debt after reclaiming the goods from the assets to obtain higher amounts of money through debt enforcement in case of persons who have contributed to the debtor's insolvency. We shall analyze further the manner to apply this operation and several issues that arise.

If we analyze the abstract content of illicit acts stated in clause 137, paragraph (1) of Law no. 64/1995, we notice that the terms used by the lawmaker hold general character, this allowing that several actual contents be absorbed by the limitative cases provided by the insolvency law. However, we notice from practice that the company's insolvency status may be also caused by other illicit acts, which are not stated by the law or that are impossible to be assimilated with the ones that belong to the limitative cases that have been stated.

In practice, there are not few the situations when the receiver in bankruptcy/liquidator through his own business report or the judge through the judgment to incur liability, convinced by the contribution of some persons to the company's forcing into commercial insolvency, but being limited by the legal wording, "forcedly" frame some actual acts within the express and limitative cases stated in clause 137 of Law no. 64/1995. Our opinion is that this solution, although moral, is not legal.

The limitation by the law of illicit acts upon which creditors are allowed to prepare applications to incur personal liability has determined them to find ingenious solutions to reason their applications.

By virtue of the prejudice that exist in the creditors' assets, should there have not been incident the provisions of clause 137 of Law no. 64/1995, they have requested to incur liability on the persons guilty for debtor's forcing insolvency by offering the reasons of "wrong management", "faulty management" or "management error".

Taking into account that in Romania professional management standards are not legally stated, no appraisal can be made in this respect. There is no actual legal content of professional management or of the minimal one, useful to sentence on this reason.

Some creditors, due to the legal limitation of the actions upon which they may request the bankruptcy referee to incur liability, invoke the position as administrator based on the theory of mandate as basis for the liability.

Our opinion is that in current wording, liability that may be incurred by the members of debtor's management bodies, as well as with by persons who "contributed" in debtor's forcing into insolvency is a special one, limited to illicit acts enumerated by the law, and the simple status as administrator corroborated with the existence of a prejudice against creditors cannot lead to incur liability when lacking the performance of an illicit act incriminated by clause 137 of Law no. 64/1995.

To perform the aim of the insolvency law, the "debt payment to creditors", these should hold the possibility to claim the reparation of the produced prejudice for any illicit act that contributed to insolvency. Otherwise, bad-faith traders are encouraged to commit illicit acts that are not stated by the

law, commisive or omissive acts which cannot incur personal liability.

Another issue we face with in Romania is the refusal of debtor's management bodies to work together with the receiver in bankruptcy/liquidator and implicitly to deliver the accounting books of the debtor company.

In order to prepare the report regarding the causes and motives that led the company to force into insolvency, in which he has to give opinions upon the persons guilty of this condition, the receiver in bankruptcy/liquidator has to analyze the company's accounting books. Should these books are not submitted none of the express and limitative acts enumerated in clause 137 of Law no. 64/1955 cannot be evidenced.

Although the insolvency law stated initially for failure to deliver the accounting books pecuniary sanction, which subsequently has been transformed in penal sanction, from practice it is noticed that the method is inefficient.

Practically, currently there is no real and efficient method to exert pressure on the debtor's management bodies to submit the accounting books. Furthermore, should the representatives of the debtor company show that due to several grounds they do no longer held the company's accounting books, a pecuniary sanction is applied, most of the times very low compared to the amount of the debts.

Under the conditions that the receiver in bankruptcy/liquidator is held impossible to prove the illicit acts, the guilty one becomes protected by the law and we may assert that "we suffer of too much democracy".

From the practice of Romanian law courts, we notice the orientation of bankruptcy referees to order the incurring of personal liability of debtor's representatives on grounds of clause 137, paragraph (1), letter d of Law no. 64/1995, when these refuse to submit the company's accounting books, although this illicit act is not stated by the insolvency law.

Our opinion is that judges held courageous and constructive approach when they assimilated the act of failing to submit the accounting books with the provisions of clause 137, paragraph (1), letter d "failure to keep accounting books in accordance to the law". This solution is undoubtedly moral - it assures the legal frame for creditors to recover the prejudice caused by the company's forcing into commercial insolvency.

A method that may contribute to the edification of this phenomenon is in our opinion the express incrimination of this act in clause 137, paragraph 1 of Law no. 64/9955, as well as the introduction in the wording of the insolvency law of the presumption related to the causality relation between the failure to submit the accounting books and the forcing into insolvency of the debtor company. In this way the burden of the

proof shall be reversed - the debtor being the one who has to prove the contrary, opportunity with which he would be motivated to work together with the receiver in bankruptcy/liquidator and to deliver the company's accounting books.

This proposal exists in the draft of the new insolvency law as the completion of clause 137, letter d with the mention "debtor's failure to submit the accounting books", which creates a relative presumption of failure to keep accounting books in accordance to the law and of the causality relation between this act and the entering of the company in default.

A last issue we approach is connected to the person of the members of the debtor company management bodies.

First of all, we notice the willful exemplificative character of the enumeration of persons that may represent the object of an action to incur liability, to leave open the possibility to add other positions that come out from the status as member of a management body.⁴

Unfortunately, the Romanian law does not state minimum requirements of commercial knowledge for persons involved in running and managing a commercial company.

There are not few the circumstances when the administrators of debtor companies do not hold the slightest idea about responsibilities and obligations incumbent to them by their position. There are persons who do not hold minimum instruction and education required to manage a business, there are persons who do not hold the notion of commercial risk, and, when risk appears, its management becomes an insurmountable problem.

The Romanian law also does not state any sanction or interdiction as to persons who have incurred personal liability in a bankruptcy file. Despite the fact that the Romanian insolvency law is mostly taken over from the French model, the Romanian lawmaker has not regarded as necessary to put into practice the procedure of prohibiting business management, administration or control.

This legislative gap allows persons found guilty of company bankruptcy to develop in parallel, without any restriction, business having the same scope of business, in another company. There are not few the cases when even during the administration of the bankruptcy procedure, these persons establish another companies, with same profile, and continue undisturbed their business under another name.

Another method that is often found consists in establishing two companies, A and B, by the same persons. In company A is employed staff that in fact works for company B, staff for which budgetary obligations are not paid. There are contracted credits which are not returned by company A and monies are used by

⁴ I. Turcu, Bankruptcy – Current Procedure, Lumina Lex Publishing House, Bucharest, 2005, page 474

company B. Goods or merchandise are purchased and these are not paid to the suppliers, and are further sold, undervalued or under the market price, to company B. Practically, even from the beginning company A is predestinated to bankruptcy, and company B, managed by same persons, develops illegally.

This fact is possible due to the lack of legal norms to professionally punish the persons who, through incompetence, negligence or by willful misconduct have forced a company into insolvency.

It is our opinion, that against this contradictory situation there have to be taken immediate actions, i.e. the courts have to be given the legal instrument upon which the persons found guilty of producing irreparable prejudices to creditors be punished by prohibiting them to manage, administrate and control the commercial business of any form of a company that develops economic activity in Romania.

Of course, the measure to prohibit the management, administration or control of the commercial business has to contain a series of actions established to state distinct sanctions for distinct degrees of culpability.

In this way, the court shall have the opportunity to size the punishment to the particular status of the individual, having as consequence the protection of the public against the errors that have been committed.

The basis of these norms to be introduced also in the Romanian legislation is to make aware the liable persons of the need to provide protection to the interests of other participants in the commercial process - stockholders, creditors, employees.

It is our opinion that the application of this procedure would represent a real weapon against incompetent members of the management bodies, as well as against the fraudulent ones.

Also in this respect, we may refer to the inexistence in the Romanian law of proceedings regarding the bankruptcy of private persons. Over 190,000 private persons currently have debts in the payments related to consumption, mortgaging or real-estate contracted credits. Over 28,000 Romanians have due payments for credits contracted in more than 2 banks. The due payments of private persons amount about 45 million euros.

The conclusion of this paper is that the liability regime in the Romanian insolvency procedure has to be made harsher. It is unconceivable its current status of inefficiency and the full libertinism of the debtor.

Innovations brought to the insolvency law through its multiple amendments led to the excessive favoring of the debtor, fact that may be put under question in the social-economic conditions existing in Romania.

In the current insolvency law we do not find any infamous or punitive measure that may be compared with the ones that have

existed in the regulations of the Romanian Commercial Code or with the ones that currently exist in other legislations, such the French or the Italian one.

Limitations and restrictions that exist in Law no. 64/1995 aim proper administration and preservation of debtor's estate, holding a patrimonial character and these do not aim infamous or punitive effects that may subsist after the completion of the insolvency procedure.⁵

The draft of the new insolvency law, which aims to be a new insolvency code, despite the fact that it brings substantial changes to eliminate with celerity from the market the companies without performances, does not include large measures to aggravate the liability of the members of the debtor's management bodies.

The timid amendment that has been chosen by the lawmaker in this field - the introduction of the act of debtor's failure to submit the accounting books in the illicit acts meant to incur personal liability - although praiseworthy, it is not capable to solve the "weak point" found by the European Commission - "the low protection that creditors benefit of".

It is our opinion that the attainment of the objective imposed by the European Commission it is urgently needed to make harsher the liability regime in the Romanian insolvency procedure, which in our opinion may be attained through:

- the assurance by the lawmaker of proper legal instruments and by their use by the bankruptcy referee to settle the applications to incur liability in distinct manner, as to the fact that the persons involved are incompetent or fraudulent;
- the extension of the range of illicit acts upon which creditors are entitled to submit applications to incur liability;
- the popularization of sentences and punishments in order to use their educative and preventive role towards traders;
- the introduction of measures capable to professionally punish the persons who have contributed to the attainment by the debtor of the insolvency status: the prohibition to develop certain businesses, the prohibition to hold management positions, and the most severe one, the prohibition to develop any commercial business. The period during these sanctions should be active shall rest with the court, which has to establish the seriousness of the illicit acts that have been committed.

⁵ Ion Bacanu, *op. cit.*, page 13