

# SIMULATED CONTRACTS BETWEEN THE OLD AND NEW CIVIL CODES OF ROMANIA

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## Abstract

*The world which gave birth to the New Civil Code is significantly different than the world of the 19<sup>th</sup> century of the Old Civil Code, as the development of social relationships has been tremendous in the last century, many more people participating actively in society and thus having more incentive to resort to the complex mechanism of simulation in order to mask their true intentions. Thus, the lawmaker of 2011 in Romania has been a lot more careful to describe the effects of simulation between the parties of the simulated contracts, especially in regard to the third parties who acted in good faith. In trying to protect these latter, five articles of the New Civil Code govern these complex relationships which stem, basically, from an instinctual tendency of humans to lie. Also, through-out the 150 years in which the Old Civil Code (inspired by the Napoleon Code of France of 1804) has been in force, tomes of legal literature tried to remedy its obvious deficiencies. In the New Civil Code these suggestions and conclusions, as well as many ideas which stem from court rulings have been assimilated into law. This short paper tries to give a short analysis on these changes and to glimpse at the way the legal professionals involved in interpreting the law will assimilate them.*

**Keywords:** *simulation, apparent contracts, sham contracts, effects of simulation, differences between the Old and New Civil Code*

## 1. Introduction

The Old Civil Code of Romania had a long live, approximatively 150 years, between 1865 and 2011, suffering under numerous types of regimes, from authoritarian monarchies to communist dictatorships.

Despite frequent attempts at adopting new Civil Codes<sup>1</sup>, the Napoleonian Civil Cod survived until 2011, when a New Civil Code came into force, in an attempt to further the social, cultural and legal development of Romania.

This New Civil Cod has been inspired by numerous other legislations, such as the Quebec Civil Code, the Italian Civil Code etc., the lawmaker trying to assimilate the best of all worlds in an attempt to solve the many legislative hurdles that Romania has had to face, especially after the fall of the communist regime.

Thus the New Civil Code came into force on the 1<sup>st</sup> of October, 2011, and it is a work of grand proportions, introducing many new institutions but also trying to be in line with traditions our country has had for centuries. This is why in a lot of areas, the New Civil Cod has assimilated the law literature and the jurisprudence of the Romanian courts, trying, and mostly succeeding, in making the Civil Code understandable to the layman and useful for the law professional.

The area of interest to us is regarding simulated contracts or simulation in general, which the Old Civil

Code described succinctly at art. 1.175. The New Civil code offers a much more comprehensive description of the institution at art. 1.289 – 1.293.

In this short paper we shall try to ascertain whether the New Civil Code is a change of paradigm or whether it is merely a change of form, a codification of the criticisms of the Old Civil Code.

## 2. Definition of the institution of simulation and general consequences

Before we try to analyze the differences between the two Codes we think it necessary to try to give a short definition on the institution of simulation and of the simulated contracts.

To simulate is nothing else than to lie about something, to present a distorted truth. Why would a person want to simulate an action? To gain some advantages, of course.

To simulate in contractual matters is nothing less than to elaborate a public contract, which is presented to the outside world as true and which contains an apparent agreement, whilst between the parties, a secret agreement is drawn, the true expression of their will, and which is adversely different than the apparent contract.

Thus, the simulation mechanism works with these concepts: apparent contract (public, but false, known generally to third parties, does not contain the true will

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<sup>1</sup> There have been a few attempts by the lawmaker to elaborate new Civil Codes, more in tune with the times: the Civil Code of 1940, the Civil Code of 1980, the Civil Code of 2004.

of the parties), concealed, hidden contract (contains the true will of the parties, the secret contract, known and producing effects only between the parties, generally not known by third parties) and general agreement to simulate – the simulation mechanism.<sup>2</sup>

Contractual parties usually resort to simulation to hide their true intentions, as these latter ones are either not permissible by law or would impede upon their desired goals. Simulation usually brings advantages. Indeed, parties usually resort to simulated contracts to try to gain some sort of advantage over third parties (creditors, successors) or try to circumvent the law<sup>3</sup>.

There are three types of simulated contracts:

- a) simulation by interposing another person as contractual party – this type of simulations is usually used by parties who, by law<sup>4</sup> or by private norm, cannot have a contractual relationship regarding a certain right. A “strawman” thus is inserted within the “equation” in order to seem that the right has been passed not to its true successor according to the will of the parties, but to the strawman. The secret contract, however, expresses the fact that the respective right has been passed to its true successor.
- b) Simulation by changing the nature of the contract or of some its components – this type of simulation usually entails the concealment of a type of contract which is either not permissible by law or which is detrimental to the interests of the parties. For example, a donation contract of a house is simulated to be a lease contract, in order to hide the property right of the real buyer from his creditors. In this fashion, property of the house is apparently withheld by the donor, while in manifesting their true intent, the parties, through the secret agreement, acknowledged that property of the house shall be transferred to the other party. Parties can also simulate only some aspects of the contract regarding the price, conditions etc., harming the interest of certain third parties.<sup>5</sup>
- c) Simulation by fictitious contract. The parties who want to evade their creditors usually hide their intentions through the use of simulation in which they fictitiously relent ownership of a certain right in favor of another person, while, in reality, retaining ownership through the means of the true agreement as part of the simulation. This true agreement entails that ownership has not passed to the other party, but has stayed with the initial owner.

Now that we have briefly shown the types of simulations which the law literature has elaborated through-out the history of Romanian and Continental law, we ought to state that the Romanian lawmaker did not choose to sanction this complex operation with nullity, but had a rather more tolerant approach – **inopposability**. Indeed, other legislations have been a lot harsher towards the operation. For example, Hungarian law does not tolerate such lies and sanctions the operation with nullity, this nullity having effect on third parties as well. Spanish law, also, sanctions the apparent contract with nullity. German and Austrian lawmakers have also not been tolerant of this operation.

Inopposability means that while the true will of the parties, as expressed in the secret, but true contract produces consequences between the parties, it cannot produce consequences in regard to third parties, with the exception of the situations in which the true will of the parties creates advantages for the third party.

This sanction of inopposability also means that neither the apparent contract, nor the hidden one are null and void. The true will of the parties produces consequences only between them, whilst only the apparent, but deceitful, contract produces consequences before third parties.

This is the main effect of simulation in the Romanian legislation: only the false and simulated will of the parties produces consequences in regard to third parties.

The reader can easily imagine that this complex sanction applied to the simulation operation will have complex consequences, as well, in regard to third parties who might be interested in using the concealed contract for their own interests.

### 3. Simulated contracts in the Old and New Civil Code. Differences. Effects and consequences.

The Old Civil Code contained merely one article concerning the complex mechanism of simulation: art. 1.175 which entailed that the secret contract that modified a public contract produces consequences only in regard to the contractual parties and their personal successors, but cannot produce consequences in regard to other persons.

Thus, from this succinct article spawned a myriad of interpretations from the professional law literature as well as from the Romanian courts. In principle these effects have been in accordance with the interpretations given by the French courts and the French law

<sup>2</sup> A. Menyhard, E. Veress, *New civil Codes in Hungary and Romania*, ed. Springer, 2017, p. 169, published on Google books.

<sup>3</sup> F. Baias, “Simulația – Studiu de doctrină și jurisprudență”, ed. Rosetti, Bucharest, 2003, p. 163.

<sup>4</sup> In the Romanian legal system judges cannot buy certain rights which are pending judgement, and thus, having this special status and interdiction, judges usually refer to simulation through the participation of a “strawman” who buys the respective right, while the true agreement states that ownership of the right will not be the strawman’s but the true contractual party, the judge – at. 1.653 Romanian Civil Code. In this case, the entire simulation will be null and void according to the New Civil Code which copies the old provisions of the Old Civil Code.

<sup>5</sup> Fiscal simulations, unfortunately, are quite common in Romania, as parties usually try to conceal the true price of the transaction from the state in order to pay less taxes. While the Romanian lawmaker has, in general, been quite tolerant of simulated contacts, in this case the contract is null and void, as the state has to have leverage over people who try to skimp on taxes.

literature, as the Old Civil Code was thoroughly inspired from the French Code of 1804.

The New Civil Code tries to delve more thoroughly into the matters of simulation through the use of five articles: art. 1.289 – art. 1.293 C.civ.

Whatever the changes may have been, the definition, in principle, of the mechanism and the effects of simulation have remained the same: the secret contract can only produce effects between the parties of the simulation, and cannot produce effects against third parties.<sup>6</sup>

Thus, the New Civil Code has retained the tolerant approach towards the act of simulating, not choosing the powerful sanctions other lawmakers chose (the entire operation being null and void), like in the Hungarian legislation.

In justifying this decision, the Romanian lawmaker expressed that the tolerant tradition of the Romanian people is incompatible with harsh sanctions such as nullity. The Romanian lawmaker expressed that this sanction can only be applied when law explicitly forbids the parties to resort to contractual simulations. In other words, the law has to sanction the simulation mechanism *per se*, otherwise it will be permissible in the Romanian legislation.

We believe that this approach is a pragmatic one, as the lawmaker could see that the effects on innocent third parties could be terribly harsh if the simulation would be null and void. Also the Romanian lawmaker accepted that simulations are not necessarily a heinous crime, but rather an adaptation of contractual parties to certain situations.<sup>7</sup>

Also, in principle, to hide the true nature of the contract, either in regard to its clauses, or in regard to certain aspects, or even its own fictitiousness, it not always fraudulent, the simulation can actually have quite noble aspirations. For example, a person wishes to gratify another person who has proven himself to excel in his field of study, but wants to retain his anonymity – the anonymous philanthropist. In this instance, he will have interest in resorting to the simulation mechanism, hiding himself before a “strawman”.

Thus, the New Civil Code has maintained the legality of simulation, in principle, the lawmaker sanctioning the operation only in special cases or situations.

In the Romanian legal system, the simulation is considered to be neutral - it does not have a certain positive or negative meaning. The mechanism of simulation cannot validate a certain invalid contract and, *viceversa*, cannot invalidate a valid agreement<sup>8</sup>.

In our discussion about the differences between the Old Civil Code and New Civil Code, at art. 1.289, the New Civil Code, after decades of conflict between different law authors and between the law literature and courts, concluded that the secret, but true contract must not honor the mandatory conditions of validity regarding form. Thus, the real contract must only honor the substantial requirements, as all contracts do. In other words, in the case of simulation, the simple and valid will of the parties is enough to form the contract, irrespective of special mandatory conditions concerning form.<sup>9</sup>

This is an extremely important mention in the new legislation, putting an end to all debate regarding this subject and positioning the Romanian legislations as one of the most tolerant legislations in Europe.

Even the Italian legislation which inspired the Romanian simulation legislation has stricter provisions in regard to this matter, requiring the true contract between the parties to adhere to the legal provisions regarding substance as well as form.

For example, if two parties – A and B – want to conceal their true will of donating a product from A in favor of B, they can resort to the simulation mechanism and enter into a sham, apparent agreement of sale. The parties are incentivized to choose a sale agreement as it has many advantages: the heirs of the donor cannot contest the legality of the sale if their reserve is reduced, B's creditors lose the ability to claim the amount that was the price of the product etc.

According to art. 813 C.civ., the donation is subject to special form requirements - all donations should hold the authentic form.

But, this donation being a part of the simulation mechanism, being the true, but hidden contract, does not have to abide by the special form requirements and thus the parties, just through their will, can legally wrap the donation contract into a sale contract.

Secondly, articles 1.290 and 1.291 are new introductions into the Romanian civil legislation, showing how the simulation mechanism can harm the interests of third parties: objective successors (persons who acquired assets from the parties of the simulation) and creditors.

These two articles are the innovations of the Romanian lawmaker in the New Civil Code and they mainly transpose into law the conclusions of the Romanian courts as well as the law literature.

Art. 1.290 stipulates that the secret contract cannot be enforced by the contractual parties, their personal and objective successors<sup>10</sup>, nor by the creditors of the apparent seller against third parties

<sup>6</sup> F. Baias, art. 1.289 and the following in “*Noul Cod civil. Comentariu pe articole*”, ed. CH Beck, Bucharest, 2012.

<sup>7</sup> See also, regarding the Old Civil Code - C. Hamangiu, I. Rosetti – Bălănescu, Al. Băicoianu, “*Tratat de Drept Civil Român*”, ed. Ciomei, Bucharest, 1928, p. 853.

<sup>8</sup> G. Chivu, “*Simulația în teoria și practica dreptului civil*”, ed. Argonaut, Cluj-Napoca, 2001, p. 36

<sup>9</sup> F. Baias & other authors, “*Noul Cod civil. Comentariu pe articole*”, ed. CH Beck, Bucharest, 2012, the analysis at art. 1.289 C.civ.

<sup>10</sup> The personal successor is the universal successor of a party, the person who continues the personality of the defunct after the event of his demise. The personal successor is the general heir of all rights of obligations. The objective successor, on the other hand, is the person that

who, in good faith, have gained rights from the apparent acquirer. The secret agreement is effective between the parties of the simulation.

This article is a summary or a conclusion of 100 years of terrible ordeal concerning the effects of the mechanism of simulation and gives the ultimate favor to the third party – the possibility of ignoring the true will of the parties captured in the true contract, and giving them the benefit of basing their decision on the apparent, but sham, contract.

This is a great benefit, in general, for third parties, as they usually gained rights or assets from an apparent acquirer exactly because, having knowledge only of the apparent contract, they, in good faith, considered the apparent owner to be the true one.

This is the typical sanction of simulation: the true will of the parties shall not take effect against third parties who acted in good faith.

Also, worth mentioning is the fact that the Romanian lawmaker stipulated the notion of “good faith” or “good will”, an idea previously only present in law literature or court rulings.

In general, in the case of simulation, a third party is of good faith when this party is rightfully ignorant of the true contract, of the true will of the parties and, acting upon this good will, enters into agreements with the apparent owner of a specific right.

Good faith also implies that the third party entering into agreement with the apparent owner checked all public registries ensuring that the party he contracts with is the true owner of the right. For example, if the third party acquires a house, then he must check the land registry in order to ensure that the seller is the true proprietor of the house. If he acquires the house from another person than that shown in the land registry, then he may be considered to have bought the house “in bad faith”.

Moreover, art. 1.291 of the New Civil Code, regulates the relationships between the simulation parties and the creditors, as well as between the creditors themselves.

Art. 1.291 par. 1 of the New Civil Code stipulates that the secret contract is not effective against the creditors of the apparent acquirer who, in good faith, registered their foreclosure proceedings in the land registry or obtained a seizure of the asset object of the simulation.

It must be noted that this norm is not necessarily groundbreaking in the general regulation of the contract simulation, but it is a novelty addition as it clearly offers the inopposability solution only with certain conditions: to be given this huge benefit, the creditor of the apparent acquirer must uphold some special conditions. He must have registered the foreclosure proceedings in the land registry or obtained a seizure of the asset object of the simulation.

If these special requirements are not met, then the secret contract will be effective against the creditor of

the apparent acquirer, and thus he will not be able to hide under the “cape” of inopposability. This norm is a faithful copy of the Italian provisions who offer the same solution in this case.

The main victims of the simulation are not, usually, the creditors of the apparent acquirer, but they have an incentive to begin foreclosure proceedings against their debtor, seeing that he has gained new assets from the apparent seller.

However, these creditors are not preferred by art. 1.291, unless the very special conditions presented above are met. Otherwise, if they did not obtain a judicial seizure of the asset or they have not registered the foreclosure, then they will be have to bear the effects of the true contract.

If the creditor of the apparent acquirer is not the true victim of the simulation mechanism, then who is this true victim?

Finally, we reached an important point in which the modern Romanian lawmaker chose a different path than the legislator of 1865: art. 1.291 par. 2 New Civil Code stipulates that if the creditor of the apparent acquirer comes into conflict with the creditor of the apparent seller, the latter will have prevalence, as, in our opinion, he is most of the time the real target of the simulation, the reason why the parties resorted to this complex scheme: in order to reduce the number of assets the creditor can use to satisfy his claim.

However, there is one condition: that the claim of the creditor of the apparent seller is previous to the claim of the creditor of the apparent acquirer.

If the claim of the creditor of the apparent seller was born after the claim of the creditor of the apparent acquirer, then there is no reason to protect the first, as he has become creditor knowing full well the assets that his debtor had.

In this latter case, the creditor of the apparent acquirer will prevail over the creditor of the apparent seller, as the second one fights against a loss and the first fights for enrichment. Time and time again the Romanian legislator has considered that between fighting against loss and fighting for enrichment, the first one will always prevail.

The solution chose by the Romanian legislator in the New Civil Code is again in tune with the Italian Civil Code, at art. 1.416, being also a 180 degree turn from the court rulings and the law literature of the Old Civil Code.

We think that this solution is just and is a welcome improvement.

Finally, at art. 1.292 of the New Civil Code, the legislator stipulated that proof of simulation can be made between parties only through the means put forth by normal contractual law, with the exception of the illicit simulation, when parties can use any and all means of proof. Proof of the simulation can be made by third parties through any means.

#### 4. Conclusion

Contract simulation is a complex mechanism, tolerated to a certain degree in Romanian legislation, under the Old Civil Code, as under the New Civil Code.

However, the New Civil Code has departed from some old opinions of the Romanian courts or of the Romanian law literature and chose new remedies to try to bring order between the conflicting interests of the simulation parties as well as the third parties.

The New Civil Code is, without a doubt, an improvement concerning the regulation of simulated

contracts, offering concrete stipulations and being careful not to harm the interests of third parties who acted in good faith, a lot more than the stipulations of the Old Civil Code.

This is natural, as the world which gave birth to the New Civil Code is significantly different that the world of the 19<sup>th</sup> century, of the Old Civil Code, the development of social relationships has been tremendous in the last century, many more participating actively in social activities and thus having more incentive to resort to the complex mechanism of simulation.

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