INSOLVENCY VERSUS BANKRUPTCY: ADVANTAGES AND DISADVANTAGES OF THE PROCEDURE

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Abstract
The analysis of the development of the phenomenon in Romania has the role to highlight the trend that has been followed by the number of organisational entities that have been affected by the insolvency phenomenon in Romania, the distribution by counties and regions of the number of insolvency cases as well as the activity sectors that have been most affected by this phenomenon. At the same time, in order to provide an overall picture regarding the size of the insolvency phenomenon in Romania, organisational entities with extremely high turnovers have been given as examples, (legal entities) entities which, since 2008 up to the present moment, have been crossing one of the stages of the insolvency procedure. Some of them have been applied the simplified insolvency procedure, since they didn't have the possibility to reorganise, and others, fewer in number, have used insolvency as a „rescue boat", following the general insolvency procedure and entering a reorganisation process, in the attempt to avoid bankruptcy.

Key Words: *Insolvency, bankruptcy, debtor, creditor, collective insolvency procedure, judicial reorganisation.*

Introduction

From a legal point of view, insolvency is regulated by the Law no. 85/2006 – the law regarding insolvency and bankruptcy, consolidated in 2010. This law replaces Law no. 64/1995 regarding the procedure for judicial reorganisation and bankruptcy and it represented the introduction of a unitary regulation in this matter. At the same time, the close-out operations of enterprises are also included by the Law no. 31/1990[1] regarding trading companies, with subsequent modifications and amendments. The insolvency procedure is also applied in an appropriate manner to the economical groups of interest (EGIs) as associative forms with legal personality and patrimonial purpose, regardless of whether they do or do not have the quality of merchant[2].

Content

The insolvency procedure represents the collective procedure aiming at the "forced" recovery of debts from a debtor which is in the position of not being able to handle his debts, under the supervision of a syndic judge. Insolvency has become, especially since the economic and financial crisis has taken over the world, a phenomenon which affected a lot of companies, both outside the Romanian borders as well as within the country. Insolvency can be viewed from two angles, with both a positive as well as a negative side. The advantages that the use of this debt recovery method might have are emphasized on the one hand, both for the debtor as well as for the creditors, and the relevant negative aspects, through the abuses that might derive once this procedure has been commenced, on the other hand.

Art.2 of the law[3] stipulates that "the purpose of this law is the setting up of a collective procedure for the covering of the liabilities of the debtor which is in insolvency. The collective

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[1] Art. 252-272 of Law no. 31/1990 regarding trading companies, republished with subsequent modifications and amendments – Law no. 76/2012.

[2] *The Manual of Good Practice in Insolvency*, „Support for the improvement and implementation of the legislation and jurisprudence in terms of bankruptcy", Consortium managed by PricewaterhouseCoopers, under the coordination of Prof. dr. Turcu Ioan.

[3] Law no.85/2006 - Law regarding the insolvency procedure, amended in 2010.

procedure is defined by the law[4], as being "the procedure through which the known creditors participate together at the monitoring and recovery of their debts, in compliance with the modalities stipulated by the legislation in force". The purpose of the procedure does not have the same significance for all those involved. The purpose of the debtor is reached when the latter has managed to redress and continue its normal activity. The interest of creditors is to maintain a business partnership with the debtor.[5]

The difference between the two notions, bankruptcy and insolvency, which are often presented as synonyms, is given by the fact that a debtor which is in insolvency has the possibility, if certain conditions, which are expressly stipulated by the law, are met, to enter an activity reorganisation phase, based on a reorganisation plan[6] approved by creditors and confirmed by the syndic judge.

If so reorganized business is profitable and allows payment of all claims, according to the terms and conditions set forth in the plan, the debtor gets out of insolvency, keeps its legal status and its activity is to continue without intervention of the judicial administrator or bankruptcy judge. If the reorganized activity does not comply with the plan, the debtor is out of the reorganization phase and gets into bankruptcy status. Bankruptcy, in the classical meaning of the word, had two precise purposes, complementary and tightly related to one another; an immediate purpose – constant in ensuring the payment of the creditors and the punishment of the bankrupt debtor, as well as a mediate one – which had as a purpose the reclamation of the commercial environments.[7]

At this point the debtor business goes under the judicial liquidator's command that will do the property assessment and recovery following to pay debts from the amounts so collected. After completion of the sale of goods, the debtor will be removed from the register where it's registered and therefore will cease to exist.

Among the advantages that entails entering insolvency proceedings and which must be known, here are some of them:

- Continue to work even if the payment due dates of some debts were exceeded;
- Application of simplification measures related to the reverse charge in terms of value added tax ;
- Stopping the flow effect of any interest, penalties or pecuniary damages for delay in performance of obligations to unsecured debts, meaning that the debts of the company freeze since the moment when insolvency id declared;
- Termination of any foreclosure proceedings since declaring insolvency, that any action of a creditor within the meaning of the debtor foreclosure is suspended;
- Recovery of any claims of the debtor against third parties is done without payment of duty stamp.
- Existence of these benefits involves also the possibility of abuses in the procedure application:
- The possibility of requesting the opening of proceedings to be filed not only by creditors but also by the debtor can lead to abuses such as, outsourcing a large chunk of assets under property, in order to avoid payment, this being done in bad faith by the debtor.

With all these advantages for the debtor which result from application of the insolvency procedure in accordance with regulations in force, Romanian companies (as borrowers) are sceptical

[4] Law no.85/2006 - Law regarding the insolvency procedure, amended in 2010, art.3. par. 3.

[5] Turcu Ion, *Tratat de insolventa*, Ed. C.H.Beck, 2006, pg.294.

[6] The article "Will the Law no. 85/2006 regarding the insolvency procedure manage to provide the appropriate framework for the efficient reorganisation of companies in difficulty?", Eng. Speranța Munteanu, UNPRL member, lawyer Nicoleta Mihai, UNPRL member, published in the PHOENIX insolvency magazine, no. 16-17, April - September 2006.

[7] Birchall Ana, *Procedura insolventei- Reorganizarea judiciara si procedura falimentului- Note de curs*, Ed. Universul Juridic, 2007, pg. 27.

when requesting the insolvency procedure as a saving solution in difficult situations caused by lack of liquidity (cash)

Although they have liquidity problems, the main reasons that make companies not to declare their insolvency are:

- the shareholders of the company (as debtor) are those who lose money when it become insolvent because there is no profit and no dividend receipts, and if they decide to sell the company assets, they are sold under market price;
- experience shows that in Romania a very small percentage of firms that become insolvent managed to avoid bankruptcy eventually.

It is believed that entry into insolvency is a fact that affects the company's image, especially if it has a certain position in the market. Actual or potential customers can be influenced in a negative way, meaning that they reduce their expressions of interest for the products / services of the company. Therefore, it appears that insolvency is an area of which should have knowledge about not only the stakeholders (companies administrators, managers, insolvency practitioners, other stakeholders), but the general public in their capacity as clients (actual / potential) or employees, etc.

The legislation regarding bankruptcy, whose purpose is to regulate the condition of certain individual companies, cannot act in an efficient manner when a large part of the economy is facing major financial difficulties. For this reason, a distinction is made between the individual bankruptcy and the systemic bankruptcy. When a single company goes bankrupt, it is presumed that the company in question has committed a mistake (excessive debts, scarce management etc.) which has not been committed by other companies. In exchange, when there are several companies that cannot pay their debts, the mistake is no longer an individual one, but it is related to the system. The moment that a single company goes bankrupt, there is a wide range of offers for other management teams, but when a large part of the companies which are on the brink of going bankrupt, it is practically impossible to replace all the management teams. In addition, when there is a financial and economical crisis within the system, it is very difficult to establish what is the net value of a company, as well as to assess many of the financial outstanding debts, because some of the assets of the company which is basically going bankrupt, can be debts towards other companies which have also stated that they are about to go bankrupt or find themselves in the position of not being able to repay the debts in question. The macroeconomic effects of the systemic bankruptcy are extremely notable: mass unemployment, problems related to financial flows for the banking system, creating a vicious circle that also incorporates the limitation of production and eventually the decrease in economic growth and the acceleration of recession, respectively. As far as the size of the insolvency phenomenon is concerned within the Romanian organizational entities, it has known a consistent increase starting with the year 2008, which is a year that also marks the beginning of the manifestation of the effects of the financial and economical crisis, both at world as well as at national level.

This article aims to highlight both aspects regarding the insolvency procedure. One is related to the reorganization of organizational entities and one to their bankruptcy. Until 2006, when it was introduced Law 85/2006 related to insolvency and bankruptcy proceedings in Romania, the provisions of Law 64/1995 on the judicial reorganization and bankruptcy have applied. This law, according to several authors, insolvency practitioners (lawyers, engineers, and economists) had many shortcomings, which led to inconsistent enforcement of laws because allowed many interpretations. The tendency, at a European level as well as at an international level is to modify the legislation regarding the bankruptcy and insolvency procedure, in the sense of encouraging the judicial reorganisation process[8]. This was happening also in the other European countries and therefore the European Union asked to introduce a material to be applied uniform in this area. As a result, during

[8] Birchall Ana, *Procedura insolventei - Reorganizarea judiciara si procedura falimentului - Note de curs*, Ed. Universul Juridic 2007, pg. 190.

July 2004-April 2006 in Romania was developed the PHARE project, Support for improvement and implementation of legislation and case law regarding bankruptcy", involving the Ministry of Justice consultant experts who met within a consortium led by PricewaterhouseCoopers Management Consultants Ltd, which has led to appearance of Law 85/2006 on insolvency, having the role to improve the legal and institutional framework of the material.

Thus, the main conclusions that can be drawn may relate, on one hand to the changes in law made by the new law of insolvency, which were highlighted in the hereby paper, and on the other hand was considered presentation of the insolvency proceedings stages, especially by highlighting the possibility offered by law regarding reorganization.

In this paper we have shown that, legally, Law 85/2006 introduces several novelties in terms of:

- Introduction of a simplified procedure applicable only for certain categories of subjects ;
- Redefining the role of the bankruptcy judge, meaning that he only deals with the legality of acts and operations and doesn't question their opportunity;
- Increasing the role of the meeting of creditors and the creditors' committee;
- Increasing the responsibilities of judicial administrator / liquidator;
- Reducing the time to perform procedural acts, simplifying the procedures for citation, communication, notification by launching the Insolvency Bulletin[9];
- Strengthening the efficiency of reorganization procedure.

If the entry of companies on the market is made increasingly easier, taking measures to simplify their access, at least in terms of bureaucracy, of how to proceed, the law on bankruptcy responds to the need of companies to exit as rapid as possible out of the market. However, it is noted that the market exit of a company is not an easy process; it takes from a few months (or a year) to several years. The streamlining of the insolvency procedure is conditioned by the quickness of the procedural stages. The duration between the registration of the introductive request and the decision regarding the initiation of the procedure, gets out of control and its unjustified extension can provide the opportunity to elude the creditors' rights through deeds of the debtor, which could actually be irreversible.[10] However, in light of the new regulations, it is highlighted more and more the possibility of reorganizing those companies struggling with payment of due debts from funds available on the due date. In Romania, according to statistics, successful reorganizations have a very low percentage, most of open plan ending in failure or bankruptcy proceedings.

In the old legislation the reorganization costs were high and involved execution over long periods of time; for example, from the appeal action until the opening of insolvency proceedings had to undergo a period of 6 months, while the current legislation stipulates that immediately after opening procedure one will know whether it will enter the general procedure or the simplified procedure. Insolvency procedure involves also some accounting transactions made under Law 82/1991 on accounting.

During the procedure, business liquidation is performed based on the ongoing activity principle, the entire period of liquidation being considered as a financial year, as witnessed by the fact that both financial statements are prepared to initiate the procedure, which take data from the last financial statements prepared and submitted by the debtor, and final situations are prepared, for closing. So, insolvency is the procedure to discover another „World" different from the ordinary, in the sense that the concepts involved are not known, in most cases, but only by qualified persons trained in the field.

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[9] Publication edited by the National Trade Register Office, which has as a purpose "the publishing of subpoenas, summons, notifications and communication notification of procedural documents performed by the courts of law, the judicial administrator and the liquidator„ - Art. 29 of Law 85/2006 regarding the insolvency procedure.

[10] Turcu Ion, *Tratat de insolventa*, Ed. C.H.Beck, 2006, pg. 299.

Insolvency proceedings may be used as a lifeline if the debtor denounces insolvency himself, in order to "freeze" time and do so that creditors will not to exert pressure on recovering their payments. This paper has offered an overview of the insolvencies situation in Romania, since the economic and financial crisis broke-up until 2011, statistics pointing the upward trend of the number of cases that were affected by the insolvency, the boom being recorded starting with 2008 and 2009, but also the sectors (fields of activity) most affected by this phenomenon. Also, it was found in statistics on firms with high business turnover in Romania that they are also the entities with most chances to avoid bankruptcy, as stage of insolvency proceeding.

They have goods in company assets and have a real opportunity to reorganize by restructuring the business or by selling some assets, based on a reorganization plan phased over several years (maximum three years as per insolvency law). For the business environment the purpose is achieved if the judicial procedure is transparent and predictable.[11]

As practice has shown, most reorganization plans fail, especially for small and medium businesses from the level of development activity point of view, and creditors, for the duration of the procedure, cannot recover claims. In these cases, insolvency is a method to save only the debtor, the creditor paying, in exchange, the price of the fact that he gave what is natural and necessary in any business, namely trade credit. From this perspective, there is attempt to find a way that insolvency to become a real escape way from the bankruptcy and not just a way to delay the proceedings, which can affect even the creditors who because they have accounts receivable may lack cash and, in their turn, can be threatened into insolvency by their business partners who can no longer collect money owed for the work done. We can say that insolvency and bankruptcy are two distinct notions which have a common goal: performance of the payment, meaning the execution of the obligations which have been assumed by means of a contract. That being in difficulty affects all contractual relationships in which it is involved together with its creditors, so that the legislator comes to its aid and does not consider it to be a "*fallitus ergo fraudator"*. Therefore, it can be said that the objective of this law is to set up concrete criteria for operation and treatment towards the insolvent debtor. The general dispositions of this law regulate the effects of the economic phenomenon, regulations belonging to the laws regarding trading companies, labour legislation, taxation etc.

Conclusions

In this paper, I approached insolvency and bankruptcy viewed from two angles, with positive and negative parts.

On the one hand, it highlights the advantages it has appealing this debts recovery procedure for both the debtor and creditors, and on the other hand it highlights the negative aspects highlighted by the abuse that may arise with the opening of proceedings. In conclusion it can be said that the difficulties that a company may encounter can be a serious threat, which can be completed either by recovery of the company (the recovery term is found in the French law of 1985 as well as the Romanian law 503/2004 regarding recovery and bankruptcy of insurance companies)[12] or its bankruptcy and therefore exit from the market.

But these difficulties can disrupt and other economic actors and can get into a vicious circle, therefore it was necessary to improve legislation to shorten development time and reduce costs of the procedure. For the purposes of effective exercise of pleadings, based on the principle of celerity enunciated by the law, it is especially recommended, the high qualification of persons involved in the procedure and of organs applying the procedure.

I also believe that in business, as in life, we need to show fair play, to consider „ the rules of the game "and recognize what we did wrong in order not to affect other people, being allowed to do

[11] Turcu Ion, *Tratat de insolventa*, Ed. C.H.Beck, 2006, pg.294.
[12] Turcu Ion, *Tratat de insolventa*, Ed. C.H.Beck, 2006, pg 295.

anything concerning ourselves, because each answers for the deeds done, good or bad, but without prejudice to other.

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