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NEW INSOLVENCY CODE

The highly expected law regarding the insolvency proceedings, Law 85/2014, was released June 25, in Official Gazette no. 466/2014 and has entered into force on Saturday, 28.06.2014.

As part of the "Romanian Judicial Reform Project" started in 2006, the new Insolvency Code is an important step in modernizing the Romanian legislation, in one line with the codes adopted in previous years (The Civil Code in October 2011, The Civil procedural code in February 2013, The Criminal Codes in early 2014).

Thereby, we can now say that most parts of the legal system in Romania have been refreshed and updated with the European legislation. Remains to be seen how the law practitioners but also the civil society will deal with this avalanche of new regulations, with obvious benefits but also with a lot of doubts that must be clarified in day to day business.

Insolvency in Romania is a hot topic, as every year about 25.000 companies declare insolvent. During the last 2 years and 4 months, there were 65.283 companies insolvent, according to the official information from the National Trade Registry. At this level, Romania is the country with the highest rate of insolvencies, exceeding Poland and Hungary.

One of the main reasons for this high number is the economic crisis which still can be felt in Romania but also the fiscal burden and overwhelming bureaucracy. It should also not be neglected how easy it is in Romania to start a company, especially limited liability companies, where the shareholders take almost no risk (Please see our Guidelines in this regard) nor the fact the state itself is one of the biggest bad payers that cause bankruptcy to many companies.

Coming back to the new insolvency code, the law has improved the procedure in court, by establishing shorter and stricter deadlines or by establishing harsher penalties for participants, but unfortunately, there are no actual benefits for unsecured creditors (most of our foreign clients hold this position).

In any proceedings, be it bankruptcy, foreclosure or re-administration, unsecured creditors remain last among those who need to receive their money and usually the creditors receive nothing, a fact often confirmed even by the president of the National Union of Insolvency Practitioners of Romania. Therefore, we advise our clients to choose carefully their business partners and to take **measures to guarantee the debts**.

Not last, we should mention that the legislator intended more, to bring together in a single code all regulations on insolvency which were split in dozens of laws than to revolutionize the procedure itself.

As for the novelties, the most important ones introduced by the new legislation can be summarized as follows:

- For the first time the fundamental **principles** of insolvency procedures were introduced;
- The **private creditor test**, introduced by the Court of Justice of the European Union in Case C-73/11 P, especially applied to state aid issues related to reducing the budgetary claims, was also regulated by Romanian law;
- Super **priority principle** was introduced as rights of certain creditors of a bankrupt debtor to receive payment before others that would seem to have superior claims to money or assets; typically granted when a creditor provides much-needed financing after the filing of the bankruptcy petition;
- Introducing the **insolvency of group of companies**, Romania being among the first European countries who included this provision in the law; group of companies being defined as two or more companies interconnected by control and / or ownership of qualifying holdings;
- The new law substantially alters the insolvency provisions relating to **collective redundancies**. Consistent with the Court of Justice of the European Union (Joined Cases C-235/10–C-239/10), the new law refers to the procedure foreseen by the Labor Code in case of collective redundancies. According to previous regulations, termination of individual employment contract could be done urgent by the judicial administrator, without the need attending collective dismissal procedure.

- The law regulates and gives great importance to the instruments **prevention of insolvency**:
  - the **ad-hoc mandate** - confidential procedure commenced by the debtor, whereby an ad-hoc mediator chosen from insolvency practitioners and designated by the court, negotiates agreements with one or more creditors, within a maximum of 90 days;
  - **preventive agreement** – agreement between the debtor in financial difficulty and creditors holding at least 75% of the uncontested claims approved by the bankruptcy judge, the contract by which the debtor proposes a recovery plan and the debtor's creditors agree to support the efforts to overcome the economic difficulties;
- Regarding the opening of the insolvency procedure and the procedure in court, the new law establishes:
  - a creditor shall be entitled to request the opening of insolvency proceedings if its claim against the debtor's assets is due more than 60 days and not more than 90 days, as it was stipulated in the old law;
  - a new limit starting at 40.000 RON for both creditors and debtor, in order to open the insolvency proceedings. The old law provided a minimum limit of 45.000 RON only for the creditor;
  - employees may require the opening of the insolvency procedure if the amount to be recovered is more than six gross average salaries per employee;
  - the claim will be judged by the Tribunal in the first instance and by the Court of Appeal in the second instance. Its decision is final;
  - new procedural terms are set by the law: i) 7 days (in the old law the term was 10 days) in order to make an appeal against the decision in the first instance. ii) the duration of the observation procedure was limited up to 1 year with possibility of extension, for justified reasons (the old law did not provide a term of the observation period); iii) a term of 60 days to pay the current debts, born during the insolvency proceedings, with the creditor's possibility to ask the commencement of the bankruptcy if the current debts are not paid in the given period;
- The reorganization plan:
  - duration of the plan may not exceed three years;
  - modification of the plan, including its extension can be done anytime during the reorganization procedure without exceeding a total maximum of four years from initial confirmation;

- the plan is approved if the majority of the creditors' categories approve the plan and if at least 30% of the total receivables vote for it (the old law did not provide this double majority);
- the creditors are split into categories: wages; budgetary creditors; secured creditors; unsecured creditors, essential creditors (unsecured creditors who provide services, supplies, materials or utilities without which the debtor can not perform business and that can not be replaced by any other supplier)

- The law introduced explicit provisions on the treatment of leasing contracts and receivables from leasing contracts;
- As novelty the liability of special administrator, appointed by shareholders for breach of the limitations of law, was introduced;

The new law applies only for the upcoming insolvency procedures, started after 28.06.2014. The procedures started under the rule of the old law 85/2006, will continue to be judged accordingly.

Summing up, from my point of view, the benefits of the new law are only minor. The most welcomed change is the setting of the debt limit also for the debtor from 40.000 RON to 45.000 RON in order to open the insolvency. In this way abusive claims from debtors could be limited. As well, the new double majority required in order to approve the reorganization plan comes in support of creditors, especially unsecured creditors, since this category has usually the highest percentage of the total receivables.

In conclusion, it is legitimate to say that the new insolvency code is a step forward, although only a small step, in stopping abusive insolvencies and hopefully in accelerating the procedures in court.

Important! The new insolvency code does not foresee any provisions relating to personal insolvency. The legislator released last year a project regarding this subject but due to a strong lobby from banks and credit institutions, the government signed a Memorandum of Understandings with FMI by which the Romanian authorities have pledged not to promote some legislative initiatives, such as the draft law of personal insolvency, until the law clarifies arrangements for compensation to bank creditors.

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