

EVOLUTION OF INSOLVENCY REGULATIONS IN ROMANIA

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Abstract: *The financial situation of a firm represents a knowledge that is necessary for all stakeholders because they all need to have information about the capacity of the entity to be profitable. The purpose of the study is to examine the evolution of insolvency regulation throughout the years by concentrating on the changes made in laws. The peculiarities of insolvency law influence the way in which the companies cope with their financial difficulties. The number of insolvent companies and the rate of insolvency are values that show the differences between countries and give the possibility to realize a comparison of the regulations in order to establish the aspects that need improvements.*

Key words: insolvency rate, insolvency law, Romania, Eastern Europe
JEL classification: G33, K41

INTRODUCTION

The financial crisis has caused more and more companies to be unable to pay their current debts. This is due to the lack of necessary amounts. In a situation like this, the only measure that it is able to determine the fate of such an undertaking is the *insolvency procedure*, which will be completed in the reorganization of the company or in the liquidation of this one and the payments of its debts.

Although the accounting of liquidation operations of a company is carried out following the principles of the financial accounting, the operation itself is one that presents a much higher complexity than the operations in the current accounting. The accounting related to the liquidation of a company has many particularities. Only when thinking about the causes that may determine a company to declare bankruptcy and liquidation, can we see the complexity of the phenomenon. The liquidator, as the person who will handle the management of the company in a liquidation procedure, must have extensive knowledge and skills, not only about accounting, but also about law, especially the commercial law. Only a specialist in the field may organize the liquidation operations, so that by carrying it, the rights of the debtor and those of the company's creditors are secured.

Through liquidation it is desired *to obtain the best solution for the ending of the contractual relations in which a debtor is involved.*

Having that in mind, since the adoption of the first regulations in the field, Law no. 64/1995 on judicial reorganization and bankruptcy, a long time has passed and we may consider that insolvency is no longer a new area of research in Romania. This area has grown over the pass years and, although it had a relatively late start, it has adapted to the Romanian economy.

However, even in the context of major changes, *insolvency is a relatively new term in Romania, compared to other EU countries.*

Insolvency and bankruptcy are still dishonourable estates for debtors in Romania. They are willing to do everything they can to be relieved by this situation. In fact, insolvency is the one that allows a debtor to defend its property and business. Even when the state conducts multiple actions to recover its debts, insolvency provides this option.

Insolvency and bankruptcy are actually recovery solutions. However, the efficiency of these procedures will strongly depend on the moment when declaring insolvency or bankruptcy proceedings and on the entity that introduced in court the request for opening of the procedure. Although Law no. 64/1995 was repealed by Law no. 85/2006 regarding the insolvency procedure and the latter had suffered several changes and additions, the proceeding has a few points that can be improved in order to cover the deficiencies of the current application. Anyhow, law enforcement under the current economic condition is very important.

The areas that over the time have been the most vulnerable to bankruptcy proved to be: wholesale and distribution, retail and construction.

Trade was mainly affected in the past years by the consumers' orientation to supermarkets, while the construction sector had difficulties due to drastic reduction in demand, stoppage of projects and suspension of ongoing investments due to lack of funds and the occurrence of problems in process of the recovery of debts from the partners.

1. INSOLVENCY IN NUMBERS

The number of bankruptcies achieved in 2010 in Romania had an 18% increase, compared to 2009.

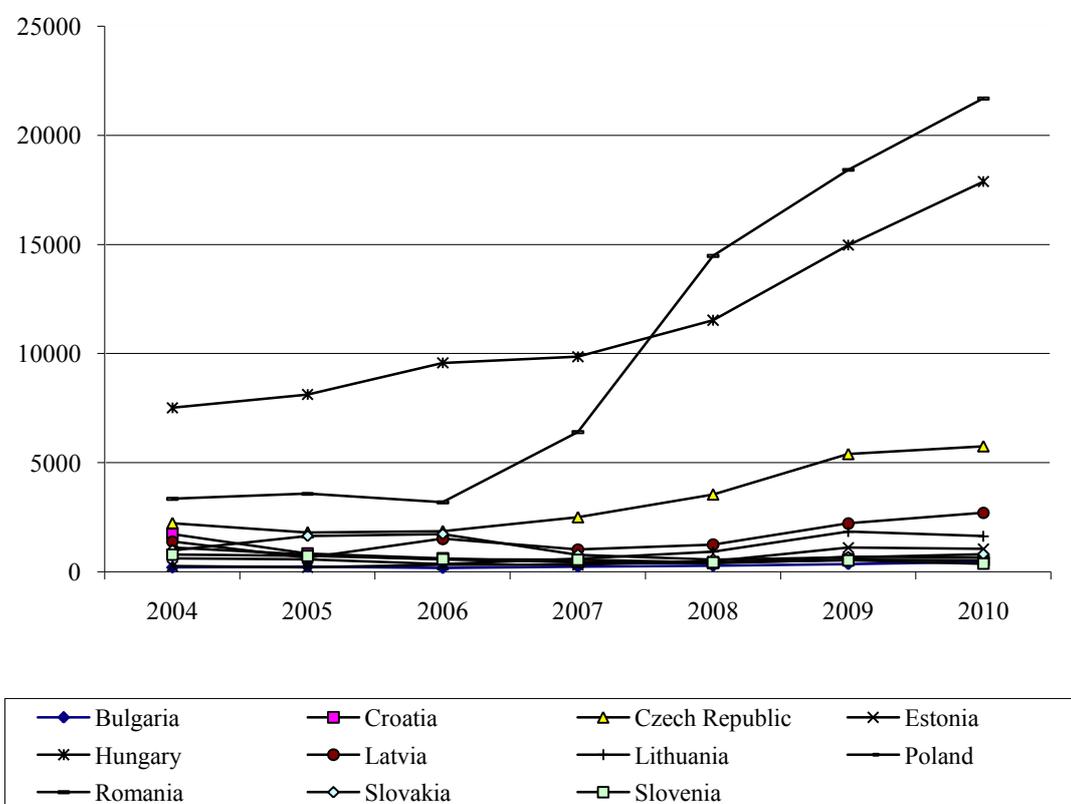
According to Coface Romania, at the ending of 2010, 10 377 firms were in general insolvency procedure and 5 104 firms and 702 companies were insolvent. Moreover, 5.482 companies were in bankruptcy, and 27 in judicial reorganization, leading to a total of 21.692 companies in various stages of insolvency proceedings.

However, these numbers reflect better the position of Romania, if we were to compare them to other countries. In this sense, we developed a comparison with the eastern European countries.

Data for the countries from Eastern Europe included in this study was provided by Coface Central Europe Holding AG.

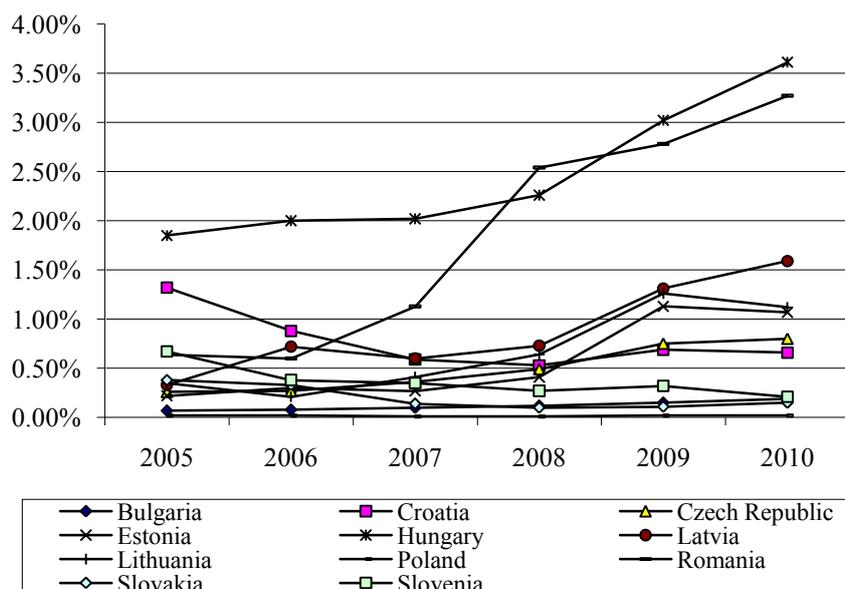
Just by looking at the number of insolvent companies in Eastern Europe we can see that Romania is not in a good position. And with the numbers from 2010 this situation has not changed. Since 2008, Romania is the country with the highest number of companies that are in a state of insolvency. This aspect would not be a negative one if it would be in correspondence with a low insolvency rate as it is in France.

Figure 1 - Evolution of number of insolvent companies in Eastern Europe (2004-2010)



As we can see from Figure 2, the insolvency rate has high values (over 2,5% in the last three years). In 2008 Romania had the highest insolvency rate from the compared countries.

Figure 2 - Evolution of insolvency rate in Eastern Europe (2004-2010)



Romanian insolvency rates are usually lower than the ones for Hungary, but we can expect worst future situations for Romanian companies. This is because the evolution of the number of insolvent companies and the evolution of insolvency rate show a higher total variation for the period 2004-2010. This would be translated into higher percentages of variation in the next few years.

2. EVOLUTION OF THE INSOLVENCY LAW IN ROMANIA

Currently, the legal framework regarding the insolvency of companies in Romania is essentially defined by Law no. 85/2006 regarding the insolvency procedure, which sets the rules to apply when a company is unable to pay its liabilities. Another act that regulates on the insolvency state is Law no. 31/1990 regarding companies. The latter establishes rules for the dissolution of companies in a separate chapter (Title VI, Chapter I, "Dissolution of companies", art. 227 – art. 237) and the liquidation of companies in a separate title (Title VII "Liquidation of companies", art. 252 - art. 270).

2.1 Romania until 1989

The regulation of bankruptcy was made gradually in Romania. The term “bankruptcy” appeared for the first time in the Romanian legislation in 1817, in the Carafea Code and then in the

Calimachi Code. Both of them handled for the first time the problem of “falit bancrutar”. In 1840 Romania adopted the first comprehensive law of bankruptcy, “Condica pentru Comercia”, that mostly was a translation of the previously dispositions on bankruptcy of the French Commercial Code (Onofrei, 2007).

The Romanian Commercial Code, adopted in 1887 on the Italian Commercial Code model, presented the bankruptcy institution in Paper III, entitled "About bankruptcy". According to this act, the bankruptcy represented an enforcement procedure on the property of a trader. The establishment of bankruptcy was done either at the request of debtors or creditors, either ex officio, and the procedure is done with the involvement of courts, a syndic judge and the creditors.

During the period of “social realism” (1947-1989), due to states’ control on a company's accounting system, the law regarding bankruptcy was not implemented, although it remained in force.

2.2 Insolvency law over the past 20 years

1990 and the new political system led to the adoption of Companies law and the need to apply the Romanian Commercial Code on dissolution and liquidation.

Thus, the reforms that occurred after the events of December 1989 brought new elements to this area, although the reorganization and bankruptcy law (Law no. 64/1995) appeared only in 1995.

The introducing of the Law no. 64/1995 regarding judicial reorganization and bankruptcy actually represented the introducing of a new legislation in this field in Romania. This law replaced the Commercial Code orders on bankruptcy.

This law was modified multiple times, through different normative acts. Thus, reorganization and bankruptcy procedure has changed continuously. Changes were made at short periods of time (almost every year).

The Romanian legal framework on bankruptcy procedure has improved significantly following the adoption of Law no. 85/2006 regarding the insolvency procedure, which took effect after the publication in the Official Gazette on 21 July 2006 (“new law”). This new law, which replaced Law no. 64/1995 on judicial reorganization and bankruptcy, lays down new mechanisms to shorten the proceedings, in order to accelerate the reorganization of those in financial difficulties (judicial reorganization procedure), or to end their existence and save the creditors rights (through bankruptcy procedure).

The new law states that the parties involved in insolvency proceedings are called in court, whether it is a judicial reorganization or bankruptcy. The summons is published in the Bulletin of insolvency proceedings. This bulletin is a procedural tool introduced by the new law to avoid common shortcomings of citation procedure provided in the Civil Code. Based on the principles of the new law, once the summons is published in the Bulletin, the citation procedure is considered properly made and the judge may continue with the case. The benefits of the intermediation made by this bulletin are highlighted mainly when a large number of creditors have to participate and also when the procedure requests the summoning of each party to all hearings. As such, many unwanted delays that could occur, to the detriment of the interests of creditors, are removed through a rapid resolution of the case.

Another novelty brought by the new bankruptcy law is the simplified procedure. The simplified procedure can be applied to certain categories of debtors (for example, when debtors that do not have any assets, when debtor's administrator cannot be found or when the debtor has declared its intention to enter directly into bankruptcy and be removed from the companies register). Under the simplified procedure, a debtor shall be regarded as being bankrupt, without the possibility of a judicial reorganization (which is normally the first stage of insolvency proceedings). The new law significantly increased the competence of the creditors and also the syndic judge's duties. For example, it is noted that the syndic judge may control the procedural facts only in legally terms rather than taking into account the opportunity of activities (especially when it comes to the control of the judicial administrator or the liquidator's activity).

In addition, the judges can no longer certify the sale contracts regarding the lands or buildings owned by the debtor, which are concluded by judicial liquidator through public auctions. Such contracts are subject to authentication by a public notary.

Law no. 85/2006 brought other novelties like: the impossibility of reorganization of a debtor whose appeal on the state of insolvency was rejected; the protection of the debtor who requested the procedure, giving him the possibility of reorganization; the introduction of penal sanctions for the offense of simple bankruptcy (failure to submit an application for the opening of insolvency proceedings on time); the use of any method for the sale of goods if it has the creditor's approval; organizing specialized departments for the tribunals; undertaking the liquidation fund by UNPIR (National Union of Insolvency Practitioners In Romania), harmonization with the European regulations; the possibility of a creditor to request the insolvency of a debtor, if he has a claim of just 10 000 RON, instead of 30 000 RON.

CONCLUSIONS

During the transition period, insolvency was related to restructuring and privatization. The two processes, made state enterprises enter into competition with the market ones, calling for responsibility of management to make decisions that maximized the benefits. Currently there is a tendency to favour liquidation, on the expense of judicial reorganization. This situation may change if the legal system would become more efficient, and administrators and syndic judges would have more powers. These premises would provide greater confidence in the judicial reorganization. However, the reorganization should not be applied to companies that are not likely to become viable. An effective insolvency process provides an effective exit mechanism for non-viable businesses and a solution to recover the viable ones. Stiglitz has defined as a central role of bankruptcy institution in the modern capitalist economies the encouragement of reorganizations, considering that a company is more valuable having activity than if its operations are closed (Stiglitz, 2009). However, European insolvency laws are orientated to bankruptcy (Couwenberg, 2001).

Even with the new regulations, in Romania, there are still gaps in their implementation process. An unconsolidated legal system, a commercial legislation often ambiguous, an involvement of the State which excluded the public sector from the bankruptcy proceedings and increasing state aid favours a difficult bankruptcy procedure. State aid should be directed to encouraging neglected areas, namely research and development or training.

Therefore, as important as the definition of insolvency legislation is, a greater importance has the need to improve the implementation of the legal system.

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