

# The Closing of the Insolvency Procedure



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***Abstract.** The achievement of the balance between the offer and the demand in a market economy makes that some merchants win and others lose. Losing in business is a normal risk, usually assumed by any merchant. But when the merchant records losses, the issue is of engaging his responsibility before all those that may be damaged due to his negative results. Faced to this reality, the commercial legislation, by way of the collective procedure, has tried to find the most adequate means to reduce up to the maximum the negative influences that the losses beared by a merchant may have on his creditors. According to this, from the new law of the collective procedure (Law no. 85/2006) there have been analyzed those cases of closing the procedure and their effects which raised already problems in practice and aroused interesting doctrinal controversies.*

**Key words:** insufficiency assets; judicial reorganization; bankruptcy; procedural costs; liquidation fund; retraction of the debtor.



The achievement of the balance between offer and demand in a market economy makes some merchants win and others lose. Losing in business is a normal, common risk, usually assumed by any merchant, even though he hopes that it will not happen to him. But when losses are not avoidable, the issue is engaging his responsibility before all those (business partners or mere creditors) who may be damaged due to his negative results. Thus, from its very beginning, by way of collective procedures (initially called bankruptcy), commercial law has concerned itself with finding the most adequate means of reducing the negative consequences that can be incurred by creditors through the losses suffered by the merchant.

During the past few years, there has been a trend in legislation change in many European states regarding collective procedures; this trend materialised in adopting

new legal regulations in some cases<sup>(1)</sup>. Consequently, the legislative instability that characterises collective procedures is not solely found in Romanian law<sup>(2)</sup>; it is most certainly determined by the fact that it requires a permanent adaptation of legal rules to economic reality.

In this respect, the French doctrine showed “*the law of collective procedures has become more and more complex over the years, without reaching satisfying results*”, because in the case of bankruptcy everybody loses. As such, in this field, “*there are no good laws, only some that are worse than others*”<sup>(3)</sup>.

In this regard, first and foremost, we recall the fact that in 2006 new legal rules were adopted in Romania with respect to commercial insolvency and bankruptcy, specifically Law no. 85/2006 regarding the insolvency procedure<sup>(4)</sup>.

This new law explicitly repealed the former law concerning judicial reorganisation and bankruptcy, Law no. 64/1995 as modified, and subsequently completed and republished. We assess that this new law represents a core change of the Romanian law regarding collective procedures, even though it still preserves some of the former legal rules (from Law no. 64/1995). We also have to mention that, shortly after it was adopted, some of the articles of Law no. 85/2006 were slightly<sup>(5)</sup> changed by OUG no. 86/2006 regarding the organisation of practitioners' activities in insolvency<sup>(6)</sup>.

The essential innovation brought on by Law no. 85/2006 is, as it can also be understood from its title, the gathering of all previous procedures regarding judicial reorganisation and bankruptcy into a single procedure so-called "insolvency procedure". Thus, by deciding to open the insolvency procedure, the syndic judge will decide either the beginning of the judicial reorganisation procedure under the hypothesis that a reorganisation plan is confirmed, or, on the contrary, to follow directly the bankruptcy procedure<sup>(7)</sup>.

Starting from this reality, in the present article we have set as goal, on one hand, to analyse some of the legal hypotheses in force that concern the closing of the insolvency procedure and, on the other hand, the effects of this decision.

## 1. The cases of closing the insolvency procedure

Insofar as the closing of the insolvency procedure is concerned, we have to mention from the very beginning that the new rules largely took over the previous legal provisions contained within Law no. 64/1995, with some modifications that do not necessarily represent a betterment of the normative frame, as we will show next.

As a fact, as in the previous regulation, Law no. 85/2006 stipulates in an unitary manner the cases of closing the insolvency procedure within the 8<sup>th</sup> Section of Chapter III.

Thus, according to the provisions of articles 131-134 of Law no. 85/2006, the insolvency procedure is closed in the following situations:

a) as a consequence of fulfilling all the payment obligations assumed in the reorganisation plan (art. 132 par.1);

b) if there are no assets in the debtor's patrimony, or if they are not sufficient to cover the procedural administrative costs, and no other creditor is willing to make available the necessary sums;

c) even before all assets in the debtor's patrimony are liquidated, if the claims were fully paid for, and all the associates of the legal person, or natural person respectively, ask for this within 30 days from the notification communicated by the liquidator. In this

situation assets which have not been liquidated will become common property of the associates or shareholders (art. 133);

d) if no claim was recorded against the debtor (art. 134, par. 1) and the procedure was opened at the debtor's request;

e) In case of bankruptcy, after closing all procedures regarding the liquidation and distribution of assets or funds out of the debtor's patrimony (art. 132, par. 2).

From our perspective, some of the hypotheses of closing the insolvency procedure which are stipulated by the new law require several remarks that we will refer to in the next paragraphs, while others do not lead to interpretation practical application problems.

First, we will mention the situation regulated by art. 131 of Law no. 85/2006, which refers to the closing of the insolvency procedure during any of its phases: "*if there are no assets in the debtor's patrimony or if they are sufficient to cover the procedural administrative costs, and no other creditor is willing to make available the necessary sums*". Through this provision, the Romanian legislator<sup>(8)</sup> took into consideration the hypotheses under which the procedure cannot continue due to the lack of funds necessary to cover administrative costs, costs incurred through procedure deployment respectively, including the remuneration of the administrator or of the judicial liquidator. In other words, it concerns the cases in which either there are no assets in the debtor's patrimony, or the existing assets are not sufficient to fund the procedural costs, and no other creditor is willing to make available the necessary funds.

We consider this case of closing the procedure has to be judged with respect to the provisions of art. 4 par. 4 of Law no. 85/2006 according to which, in the situation when there are no available funds in the debtor's patrimony, the procedural costs will be supported by the liquidation fund, managed by the National Union of Insolvency Practitioners in Romania.

Moreover, based on the opinion belonging to the judicial doctrine<sup>(9)</sup>, we can conclude that there is a discrepancy between the two texts mentioned above, so that the hypothesis of closing the procedure stipulated by art. 131 cannot ever be applied in reality because, as there are no funds in the debtor's patrimony, the procedural costs are supported by the liquidation fund.

We agree that such an opinion cannot be received since the text of art. 4 par. 4 of Law no. 85/2006 stipulates, by any means, that the liquidation fund will be resorted to "*in case there are no available funds in the debtor's account*", which is the case when there is no money to cover the procedural costs, even though there may be assets in the debtor's patrimony which can be liquidated<sup>(10)</sup>. In other words, art. 4 par. 4 becomes applicable only in situations

in which there are sufficient assets in the debtor's patrimony to be liquidated but, temporarily, there are no funds to cover the procedural costs.

As a consequence, if we corroborate the provisions of art. 4 with those of art. 131 of Law no. 85/2006 it results that the hypothesis of closing the insolvency procedure as regulated by this text concerns those situations in which, after having liquidated the existing assets in the debtor's patrimony, the conclusion is that procedural costs cannot be covered, and thus it is inappropriate to resort to the liquidation fund, and the procedure has to be closed. It is obvious that in this case the main goal of the insolvency procedure – the payment of creditors – cannot be achieved due to debtor's insufficient assets and, as a result, no procedural cost is justified.

A similar case is the hypothesis of closing the bankruptcy procedure stipulated by art. 133 letter a) of Law no. 85/2006 – where claims have been fully paid without being necessary to liquidate all assets in the debtor's patrimony. Of course, this situation is exceptional, even very rare, because if all the debts can be paid, it means the debtor is always capable of recovery. In this case, it is the judicial reorganisation procedure that will be opened, and not the bankruptcy procedure.

This case of closing the bankruptcy procedure was similarly stipulated by the previous regulation, by art. 132 of Law no. 64/1995, respectively. Under the former regulation, the following question was raised: what is the debtor's future in the situation in which the procedure is closed because the claims have been fully paid? The question was raised as a result of the fact that the law did not stipulate in this case the necessity to erase the debtor as a legal person. In consequence, he can continue his existence.

Thus, it was decided within judicial practice that *“in the situation regulated by art. 132 of Law no. 64/1995, if the syndic judge does not decide to erase the debtor and he still has assets, he can continue his activity because the objective of the law has been achieved”*.<sup>(11)</sup>

Instead of that, the doctrine of that time<sup>(12)</sup> underlined that it is not compulsory that under this hypothesis the debtor continues his existence and activity. In this way, if the assets left after all debts' payment is not enough to continue the activity, the debtor - legal person can *“opt to apply the provisions of Law no. 31/1990 for the dissolution and liquidation of the company”*. We consider, however, that the solution of continuation of the existence and activity of the debtor, although economically fair, was not fully correct as long as, according to art. 106 par. 2 of Law no. 64/1995 as republished with the subsequent changes and addenda, the syndic judge pronounced the dissolution of the debtor-legal person through the decision of opening the bankruptcy procedure. Thus, in accordance with the

stipulations of Decree no. 31/1954 regarding natural and legal persons and of Law no. 31/1990 regarding commercial companies, the dissolution leads to the opening of the liquidation procedure, during which the legal personality subsists only with the purpose to accomplish the liquidation procedures, and the debtor cannot initiate new activities<sup>(13)</sup>. Thus, even though the law did not expressly provide the withdrawal (retraction) of the debtor-legal person, his existence and activity could not continue because the dissolution had been pronounced in this respect.

Currently, this situation is no longer an issue because art. 133 of Law no. 85/2006 expressly provides that, with the closing of the bankruptcy procedure based on all claims being fully paid, the syndic judge also pronounces the retraction of the debtor-legal person from the register of trade where he was recorded. Needless to say, through this legal provision the legislator wanted to eliminate controversial and at least debatable solutions expressed by the judicial doctrine and practice based on the former provisions of Law no. 64/1995.

Nonetheless, we consider that this solution adopted by the legislator is not economically fair either in all the cases or in compliance with the spirit of the law that regulates the insolvency procedure. In this respect, no doubt that the retraction and, as a consequence, the cessation of the debtor-legal person's existence, are imposed under all hypotheses in which, after all the claims have been fully paid, the remaining assets are not sufficient to continue economic activity. Of course, given the insolvency state of the debtor, which triggered the opening of the bankruptcy procedure, this situation will be incidental in most cases. However, for the hypotheses under which the assets left after the full payment of claims would allow the debtor to continue his activity, we appreciate that the solution of his withdrawal and cessation of existence is not legally required, as it is not economically justified. Moreover, such a solution, under the stated hypothesis, is no longer in accordance with Law no. 85/2006, which, through its contents, attempts to harmonise the main purpose of the insolvency procedure – the creditors' payment – with a preventive scope of safeguarding and maintaining viable debtors. Or, as long as all debts have been fully paid, and the main objective of the procedure was achieved, there is no reason why the existence of the debtor cannot continue if the maintenance of its activities is possible and economically efficient.

In other words, we agree that the case of closing the insolvency procedure stipulated by art. 133 by Law no. 85/2006 has to be circumstantiated in the sense that the syndic judge should pronounce the closing of the procedure and the retraction of the debtor-legal person only in the situation when the remaining assets after all claims payment do not allow the continuation of its economic activities. In all the other cases however, the possibility of maintaining

the existence of the debtor should be expressly provided by the legislator through the cancellation of the decision of opening the bankruptcy procedure whenever, after full payment of all debts, the debtor has the necessary resources to continue the activity.

The solution of cancellation given by the syndic judge to his own resolution is specific to the insolvency procedure, although it is new in our law. This solution has already been explicitly consecrated in this field (through art. 134 of Law 85/2006) as well as concerning the solving of the creditors' objection to the opening procedure formulated by the debtor (through art. 32 par. 2 of the law).

The cancellation of the decision to open the procedure is imposed in order to discard of the consequences that can arise from the debtor-legal person's dissolution stipulated by art. 107 of Law no. 85/2006. The above mentioned solution is already used by the current judicial practice<sup>(14)</sup>.

Another case of closing the insolvency procedure is the one regulated by art. 134 paragraph 1 of Law no. 85/2006, which regards the hypothesis in which, subsequently to the opening of the procedure at the debtor's request, there have not been recorded any claim statements. In such a situation, the syndic judge rules the closing of the insolvency procedure both in its general and in its simplified form, as well as the dismissal of the decision to open it.

As far as the application of art. 134 of Law no. 85/2006 is concerned, we are wondering what will the syndic judge's solution be under the hypothesis that a single creditor registers his claim statement. The collective character of the insolvency procedure expressly consecrated by art. 2 of Law no. 85/2006 justifies our question. This collective and egalitarian character of the insolvency procedure has as consequence the traditional opening of the procedure (consecrated by art. 36 of the law), the stopping of all judicial and extrajudicial actions already started against the debtor and his assets in order to achieve the claims. In this way, the collective character of the insolvency procedure hinders the creditors from individually exerting the rights they have over the debtor. We consider this condition cannot be fulfilled in the situation in which there is only one creditor participating in the procedure. Thus, under such a hypothesis, the collective procedure would be transformed into a mere individual pursuit of the debtor, initiated by a single creditor, which cannot be achieved within the regulated framework of Law no. 85/2006; it can only be achieved by means of common law (civil law), respectively by forced execution procedure.

Given these arguments, under the hypothesis that only one creditor registers his claim statement within the time limit provided for this purpose, we also consider, alongside with other authors<sup>(15)</sup>, that the insolvency procedure should be closed based on art. 134 of Law no. 85/2006, and thus the application field of this legal provision should be extended.

## 2. The effects of closing the insolvency procedure

The cases of closing the insolvency procedure regulated by Law no. 85/2006 produce various effects with respect to the continuation of the activity of the debtor-legal person.

Thus, in the situation stipulated by art. 132 par. 1st of the law (the fulfilment of all payment obligations assumed in the reorganisation plan) it is obvious that the closing of the judicial reorganising procedure does not produce any consequence regarding the debtor's future so that he can continue his activity.

Insofar as the situations stipulated by art. 131 of the law (when there are no assets or they are not sufficient to cover all procedural costs) and by art. 132 paragraph 2 of the law (when the entire patrimony has to be liquidated to cover the claims) are concerned, the syndic judge is obliged to pronounce, together with the closing of the insolvency procedure, the retraction of the debtor-legal person from the register of trade where he is recorded. As such, the existence of the debtor as a distinct subject of law ceases.

A similar effect is produced in the case the insolvency procedure is closed according to art. 133 of the law (as a consequence of managing the bankruptcy) because, as we previously indicated, the syndic judge rules the retraction of the debtor-legal person through his decision to close the procedure. It means that the debtor ceases his existence.

By difference, in the case stipulated by art. 134 of the law (when as a consequence of opening the procedure at the debtor's request no claim statement was recorded) the closing of the procedure will not produce any effect on the existence of the debtor-legal person. Moreover, through the dismissal of the opening decision, the consequences stipulated by law that occurred once the debtor opened the procedure are eliminated.

Nevertheless, the dismissal of the decision to close the procedure does not eliminate the effects of the debtor's patrimony administration operations carried within the procedure and, according to art. 134, par. 2 of Law no. 85/2006, the acquired rights are won.

Under all hypotheses stipulated by law, the closing of the insolvency procedure also produces effects on the individuals who took part in its deployment. It means that the syndic-judge, the administrator or the liquidator, as well as the other persons who assisted them are free of any obligations or responsibilities regarding the procedure, the debtor or his patrimony, the creditors, shareholders or associates of the debtor (art.136 of Law no. 85/2006).

However, we consider that the most important effect of closing the insolvency procedure is the release of the debtor from all his obligations he would normally have towards his creditors.

Thus, it is possible that within the procedure some creditors are not fully paid after the distributions have been made from the debtor's patrimony. As a consequence, it has to be determined whether they will still keep a claim towards the debtor (whose value represents the difference between the debt recorded and the amount already distributed within the procedure) or if he is going to be entirely freed of any payment obligation.

In this respect, art. 137 par.1 of Law no. 85/2006 stipulates that the debtor-natural person will be freed of all obligations arising before the opening of the procedure through the closing of the procedure under the reserve that he had not acted fraudulently. This means that by closing the insolvency procedure the creditors that have not been fully paid lose their right to directly and individually pursue the debtor-natural person's patrimony. In other words, by regulating this effect of closing the insolvency procedure, the Romanian legislator favours debtors having a fair attitude of reducing the damages incurred by creditors.

The issue of freeing the debtor-legal person from the obligations he normally has does not apply in the case of bankruptcy because he ceases his existence once the closing procedure decision is irrefutable.

By contrary, the issue is of interest in the case of reorganisation of the debtor-legal person. With respect to

this situation, art. 136 par. 2 of the law stipulates that "*at the date of confirming a reorganisation plan, the debtor is freed from the difference between the value of obligations he had before the confirmation of the plan, and the one provided in the plan*". In other words, within the judicial reorganisation procedure, the debtor will be subject to pay only those obligations that result from the confirmed reorganisation plan; and for the rest, he is freed.

Moreover, unlike common law (civil law) where, by the virtue of the principle *accessorium sequitur principale*, the freeing of the debtor has as effect the freeing of the personal guarantor or of the co-debtor. Indeed, according to art. 137 par. 3 of the law, the freeing of the debtor from his obligation does not lead to freeing the fideiussor or of the main co-debtor, so that unpaid creditors can force them to pay the guaranteed claim after closing the procedure. In other words, debtors who can be safeguarded by the procedure of judicial reorganisation are absolved of what they still owe over the amount written in the reorganisation plan, while the guarantors or co-debtors are "sanctioned" and forced executed for covering the differences. It is about a little peculiar and certainly unfair legislative solution that punishes creditors, guarantors or co-debtors of a bad-debtor because they trusted him, some of them doing business or offering credit, and the others guaranteeing for his payment.

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## Notes

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- (1) For example, in 2005, France adopted Law no. 2005-845/26 July 2005 regarding enterprise solvency. This law substantially changed The 6th Charta of the French Commercial Code which contained stipulations of Law no. 85-98/25 January 1985 regarding reorganisation and judicial liquidation of companies, by adopting solutions from the American legislation.
- (2) After 1990, once Romania returned to market economy, the bankruptcy institution was meant to receive a new regulation, more adequate to the new economic context and in accordance with the contemporary concept regarding the treatment of enterprises in distress. Thus, the result was the adoption of Law no. 64/1995 regarding reorganisation and judicial liquidation procedures (published in the Official Monitor of Romania, Part I, no. 130/29.06.1995). After its adoption, Law no. 64/1995 was repeatedly modified and completed, including being republished in 2004 (in the Official Monitor of Romania, Part I, no. 1066/17.11.2004); when the texts were given a new numbering.
- (3) See Y. Guyon, *Droit des affaires. Entreprises en difficulté – Redressement judiciaire – Faillite*, vol. 2, 4th edition, Economica Publishing House, Paris, 1993, p. 1
- (4) Published in the Official Monitor of Romania, Part I, no. 359/21.04.2006
- (5) Law no. 85/2006 repealed paragraph 6 and 7 of article 19.
- (6) Published in the Official Monitor of Romania, Part I, no. 944/22.11.2006.
- (7) For more details, see A.M. Lupulescu. *Reforme et presentation du nouveau cadre juridique du redressement judiciaire conformement a la Loi no. 85/2006*, in the volume of the AMIS Conference 2006, supplement of the *Revista de Contabilitate si Informatica de Gestiune*, ASE Publishing House, 2006, pp. 314-318.
- (8) In the French doctrine this case of closing the insolvency procedure is referred to as "closing the procedure due to insufficiency assets" in Y. Guyon, *op.cit.*, p. 355.

- <sup>(9)</sup> See S. Carpenaru, V. Nemes, M.A. Hotca, *Noua lege a insolventei – Legea nr. 85/2006. Comentarii pe articole*, Hamagiu publishing House, Bucharest, 2006, p. 40-41
- <sup>(10)</sup> In this respect, the similar provision existed in art. 4 of the former Law no. 64/1995 as modified and republished. Art. 9 of Methodological Norms for applying art. 4 of Law no. 64/1995 (published in the Official Monitor of Romania, Part I, no. 4/7.01.2000) explicitly stipulated that “available sums are created in the debtor’s account after liquidation... the financing will be made from the debtor’s patrimony account”.
- <sup>(11)</sup> According to Court of Appeal Cluj, Commercial, contentious, administrative and fiscal Section, Decision no. 5/111, January 2005, in *Revista de Drept Comercial*, no. 4/2005, p. 151
- <sup>(12)</sup> See I. Turcu, note for Decision no. 5/11 January 2005 of Court of Appeal Cluj, Commercial, contentious, administrative and fiscal Section, quoted.
- <sup>(13)</sup> More than that, the dissolution is qualified by art. 40 of Decree no. 31/1954 as a way of ceasing the existence of legal person.
- <sup>(14)</sup> See Bucharest Tribunal, S. VII com. Sentence no. 2843/24 July 2007, not published. The insolvency procedure in its simplified form was opened against the debtor-commercial company at the request of a creditor, justified by the fact that the debtor did not bring the documents stipulated by art. 28 paragraph 1 of Law no. 85/2006, including the statement through which the reorganization intent is made known. Actually, however, even before the first deadline, the debtor paid in full the claims of the creditor who requested the opening of the procedure, and consequently he did not fill the application to the open of the procedure and did not bring the documents required by law either. The creditor, however, persisted in their claim, even

though his claim had been satisfied. After the opening of the simplified procedure, all the creditors who formulated claim statements were paid even before starting any operation of liquidation of goods from the debtor’s patrimony. In this situation, taken into account the fact that the purpose of the insolvency procedure – the creditors’ payment – had been achieved, the syndic judge decided that the continuation of the procedure was no longer justified. Also, because the debtor had sufficient assets to continue its economic activity, and had fully paid all the claims before the beginning of any liquidation procedure, the closing of the insolvency procedure based on art. 133 letter a) of Law no. 85/2006 and consequently the withdrawal of the debtor would have been unjust and not economically justified. Moreover, making the assets the common property of the associates/shareholders is subject to VAT, and represents a taxable operation, as stipulated by art. 126 corroborated with art. 128 paragraph 5 of the Fiscal Code. Thus, according to art. 128 paragraph 5 of this latter normative act, it represents a delivery of goods which is paid, and thus a taxable operation “any distribution of goods from the assets of a taxable person by its associates or shareholders, including a distribution of goods concerning the liquidation or dissolution without liquidation of the taxable person... if the tax on the goods or part of them was totally or partially deducted.” In conclusion, with respect to the presented arguments, the syndic judge ruled the closing of the procedure and the dismissal of the decision to open it, applying by analogy stipulations of art. 134 of Law no. 85/2006.

<sup>(15)</sup> See I. Adam, C.N.Savu, *Legea procedurii insolventei. Comentarii si explicatii*. C.H.Beck Publishing House, Bucharest, 2006, pp. 749-750.