

# The Regime of Contracts under Execution within the Insolvency Procedure



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**Abstract.** According to the Romanian law the debtor that faces financial difficulties of a certain extent can be the object of the insolvency procedure, regulated by Law no. 85/2006 concerning the insolvency procedure. Because the insolvent debtor is no longer trustworthy to its contractual partners and cannot execute the assumed obligations, there is a risk that these contracts cease, or the services that are incumbent on contractual parties are not executed. This is why, it is very important to know within the insolvency procedure and, especially during the judicial reorganization period, what will be the treatment of contracts concluded prior to the opening of this procedure and still not executed, the so-called “contracts under execution”. Also, after clarifying the concept of contract under execution, it is important to establish who has the right to opt between their continuation, or their cancellation. On the other hand, there are presented the special rules provided by Law no. 85/2006 for some categories of contracts concluded prior to the opening of the insolvency procedure, such as: labor, lease, commission contracts, master of netting agreement or contracts concluded *intuitu personae* or by a debtor that is the owner of a leased building, etc.

**Key words:** contracts under execution; judicial reorganization; option right; labor contract; lease contract; commission contract; master of netting agreement; contract concluded *intuitu personae* by an insolvent debtor by a debtor that is the owner of a leased building.



In Romanian law, the debtor – merchant or not –, when faced with financial difficulties of a certain extent, can be the object of the insolvency procedure, regulated by Law no. 85/2006 concerning the insolvency procedure<sup>(1)</sup>.

Naturally, at the moment of opening the insolvency procedure, the debtor is already part of a multitude of contracts concluded prior to its opening, and still not entirely or substantially executed.

Because the insolvent debtor is no longer trustworthy to its contractual partners and cannot execute the assumed obligations according to common law obligations, there is

a risk that these contracts cease, or the services that are incumbent on contractual parties are not executed. Thus, the cessation of contracts concluded prior to opening the insolvency procedure can be made either through cancellation or annulment by one of the parties. On the contrary, the non-execution of obligations by the co-contracting party intervenes by way of invoking the exception of contract’s non-execution.

This is why, it is very important to know within the insolvency procedure what will be the treatment of contracts concluded prior to the opening of this procedure and still

not executed, the so-called “contracts under execution”. The knowledge of this judicial regime is important especially in case of judicial reorganization of the insolvent debtor, because according to the solution chosen, both parties (insolvent debtor and, respectively, its contractual partners) could have improved or have worsen their situation. Thus, if during the period of judicial reorganization the continuation of the contracts under execution is allowed, then the insolvent debtor has greater chances to recover and thus to execute the obligations assumed towards its contractual partners. If, however, the continuation of these contracts is not allowed, then the debtor’s recovery could not be possible and its partners could not obtain the fulfillment of their debt rights by way of execution in kind. On the other hand, it is true that some of the insolvent debtor’s co-contracting parties could be interested in ceasing their contractual relations with a partner whose situation is uncertain and who has not executed its contractual obligations.

Following, we will try to clarify the concept of contract under execution (1), who has the right to decide the future of these contracts (2) and what are the special rules stipulated by Law no. 85/2006 for some categories of contracts (3).

### 1. Contract under execution – conceptual delimitations

In order to explain the concept of contract under execution we have to refer to contracts with successive execution as well as to those with momentary execution under the condition that they have not been totally or substantially executed.

In this context, the words of art. 86 of Law no. 86/2006 refers to „*any contract, unexpired rentals or other long-term contracts, as long as these contracts will not have been totally or substantially executed by all the parties involved*”.

Thus, the legal text takes into account the category of contracts with successive execution, but we consider that contracts with momentary execution – *uno actu* – cannot be excluded either.

As a consequence, the contracts that were totally executed at the moment of the opening of the insolvency procedure and those substantially executed are obviously excluded from the application of the above-mentioned provision. By substantially executed contracts we understand those agreements that produced their essential and characteristic effects before the opening of the insolvency procedure although some obligations generated by the contract have not yet been executed.

Equally, the contracts repealed prior to the opening procedure either by cancellation or by annulment are

excluded from the application of the above-mentioned text. Obviously, these contracts cannot be considered under execution as they have already been ceased.

Insofar as contracts with momentary (*uno actu*) execution are concerned, they raise difficulties in establishing the obligations whose achievement makes the contract to be “under execution” and thus not executed, as well as the contracting party from which this non-execution has to come from. For this reason, the law expressly regulates the situation of certain contracts in terms of qualifying them as being under execution and in terms of exercising the right to choose between maintaining or denouncing it.

Unlike the solution adopted by the French jurisprudence<sup>(2)</sup>, art. 86 par. 4 of Law no. 86/2006 expressly stipulates that sale contract of a real estate with the reserve of ownership right in favour of the buyer until the full payment of the price is considered integrally executed by the vendor. Thus, this contract is not included in the category of contracts under execution and it is not the object of the option right regulated by art. 86 par. 1st. of the law.

In respect to this provision, it has to be mentioned that the legislator’s expression does not lack criticism as long as art. 86 par. 4 of the law refers to the vendor of a real estate who “retained the ownership right up to the full payment of the sale’s price”. As a consequence, from the legal provision cited we could understand that it is about the vendor who retained the proof document of the property right until the buyer has made the payment of the price. However, this situation does not produce any legal effects in regards to the qualification of the sale-purchasing contract as being under execution, because what is decisive for this assessment is the transfer of the ownership rights. As a consequence, alongside with other authors<sup>(3)</sup>, we consider that it is only the legislator’s inadvertence, which in fact took into account the sale-purchasing contracts of real estate where the property right is deferred until the payment of the price. Let us remember that, in this context, the sale-purchasing contract is a consensual act. Consequently, the transfer of the ownership right over the sold good is achieved by the simple agreement of the parties even if the good has not been handed over or the price has not been paid yet (art. 971 and art. 1295 civ.c). Or, within the sale-purchasing contracts of real estate with the reserve of the ownership right in favour of the vendor, the contracting parties agree, from the very moment their willing agreement was reached, to postpone the execution of their specific obligations until a future date (the transfer of the ownership right and the payment of the price, respectively). As a consequence, we have to understand that the deferral of the transfer of the ownership right from the vendor to the buyer affects only the execution of the

contract and not the validity of the operation itself. Moreover, the handing over of the document ascertaining the sale has no relevance on the transfer of the property right. In principle, the law imposes the writing of this document as a necessary formality in order to ensure the act's opposability towards third parties, and not to measure the validity of the parties' agreement<sup>(4)</sup>. This is how, through the effect of law, such a sale-purchasing contract is considered integrally executed at the opening procedure date so that it is excluded from the application of provisions of art. 86 par. 1 of Law no. 85/2006.

Unlike this situation, art. 87 of Law no. 85/2006 stipulates exactly the opposite solution for sale-purchasing contracts having as object movable goods.

As an example of contracts with successive execution, Law no. 85/2006 regulates the credit and supply contracts respectively.

Regarding the credit contracts, they are considered as being under execution if the amounts have not been fully given to the debtor before the opening of the procedure<sup>(5)</sup>. Moreover, according to art. 86 par. 3 of the law, during the observation period and with the co-contracting parties' agreement, the judicial administrator/liquidator will be able to maintain the credit contracts and to modify their clauses so that they ensure the equivalence of the future performances of the debtor. The modification of the credit contracts' clauses is made with the approval of the creditors' committee, which will ascertain whether they are to the benefit of the debtor as well as of the creditors.

If it is decided to maintain a contract that stipulates periodic payments from the debtor, the judicial administrator/liquidator will not be liable to make outstanding payments for the periods prior to the opening of the procedure. According to art. 86 par.7 of the law, such payments can be recovered through claims against the debtor.

For supply contracts, art. 38 of Law no. 86/2006 imposes several derogations meant to facilitate the debtor's recovery. Thus, it is stipulated that, if the debtor is a captive consumer<sup>(6)</sup>, the suppliers of electricity, gas, etc. necessary to continue the debtor's activity, cannot change, refuse or temporarily interrupt the supply of these services to the debtor. These interdictions last during the observation and judicial reorganization procedure period, even if there are remaining payments. But, at the supplier's request, according to art. 104 of the law, the syndic judge can oblige the debtor to lodge a bank security of up to 30% of the cost of the services supplied and not paid after the opening of the procedure.

Also, in order to complete the picture of the judicial regime of contracts under execution it is interesting to see what will be the solution if such an agreement contains a "*de jure*" cancellation or annulment clause of the contract

for insolvency of any of the parties.

As a principle, the existence of such a clause gives the insolvent debtor's co-contracting party the right to request unconditioned annulment of the contract as the opening of the insolvency procedure signifies a non-execution of contractual obligations.

However, the majority of legislations opted for the solution of ongoing contract even taking the risk of added uncertainty in commercial relations. Thus, in order to enhance the debtor's chances of recovery, the annulment or the cancellation clauses are considered repealed and the contract continues even against the insolvent debtor's co-contracting party will.

For instance, the French legislation expressly excludes such clauses and declares them non-opposable against the administrator.<sup>(7)</sup> However, Romanian law does not expressly stipulate the nullity of the annulment or cancellation clauses of the contract, in the case of opening the insolvency procedure. But, these clauses should be considered void because they break the imperative provisions of art. 86 of Law no. 85/2006.<sup>(8)</sup>

## 2. The right to opt between maintaining or denouncing contracts under execution

By exception from the common law of obligations, most of the modern legislations restrict the categories of persons who can claim the execution or the renunciation of a contract concluded with a partner becoming insolvent. This limitation is explained by the legislator's concern to favour the debtor's recovery. As a consequence, the co-contracting parties of an insolvent debtor cannot claim the annulment or the cancellation of the contract for infringement or non-execution of contractual obligations.

The Romanian law has itself similar provisions for this situation. Thus, according to art. 86 of Law no. 85/2006, the only person who has the right to appreciate whether a contract is or is not substantially executed, and to opt between maintaining or denouncing it, is the judicial administrator/liquidator. But based on to art. 21 par. 2 of the law, this option can be contested at the syndic judge.<sup>(9)</sup>

Also, according to the Romanian law the option right of the judicial administrator/liquidator does not have to be exerted within a specific time period and by observing a specific form. This is why, we have to admit that the option for maintaining a contract under execution can be either express or tacit (when it occurs from maintaining the contract's execution or from not declaring its denunciation).

However, the legislator does not favour the insolvent debtor only, but it equally attempts to protect its co-contracting parties. Thus, the debtor's co-contracting parties can summon the judicial administrator/liquidator

to opt between maintaining or denouncing the contract and this one has to respond within 30 days (art. 86 par.1st of the law). The non-observance of this response deadline is sanctioned by contract denunciation and consequently its execution cannot be ever claimed.

On the other hand, we will note that the option right of the administrator is not discretionary and it has to be exerted only within the limits imposed by law.

Indeed, unlike other legislations in the field, such as the French one, the Romanian law imposes the criterion according to which the administrator can opt between maintaining or denouncing the contracts under execution.

Thus, according to art. 86 par.1 of the law, the exercise of option right is aimed to maximize the value of the debtor's wealth. In other words, the importance of the contract for the continuation of the debtor's activity is assessed. Equally, financial issues have to be taken into account.

Thus, if it is opted to maintain the contract, the judicial administrator has to ensure that the debtor will be able to execute his existent or new obligations. If, however, the contract is denounced, the other party may bring an action for damages against the debtor. Under this latter hypothesis, the co-contracting party has the right to obtain damages compensation because the ceasing of the contract is the consequence of the guilty non-execution by the debtor. Moreover, damages have their origin in the contract concluded prior to the opening of insolvency procedure and denounced by the judicial administrator/liquidator (art. 86 par. 2 of Law no. 85/2006).

### 3. Special rules applied to some categories of contracts

Similarly to the majority of modern legislations, Law no. 85/2006 sets special rules for some categories of contracts under execution, which cannot be the object of the option right of the administrator/liquidator.

The most important exception from the regime of contracts under execution is represented by labor contracts. The reason of such an exception is the particular relation between employee and employer set by legislative provisions belonging to labor law and the legislator's intention to avoid that the law of collective procedures affects the employees' protection.

The Romanian law devotes derogatory rules from the regime of contracts under execution for the following categories of contracts:

#### a) Labor contracts

Unlike other legislations that expressly limit the administrator's right to annul the labor contracts<sup>(10)</sup>, Law no. 85/2006 only stipulates that they can be denounced if

the legal terms regarding the notice period are observed (art. 86 par. 5). Also, in case of bankruptcy, either in simplified or general procedure, law expressly allows the liquidator to annul the individual labor contracts of the debtor's employees without proceeding to the collective dismissal stipulated by the Labor Code. But the judicial liquidator has to observe, according to art. 86 par. 6 of Law no. 85/2006, the notice period of 15 working days<sup>(11)</sup>.

#### b) Leasing contracts

If, within such contracts, the debtor has the quality of lessee, then the judicial administrator/ liquidator can denounce them only by observing the legal notice period (art. 86 alin.5 of Law no. 85/2006).

#### c) Contracts regarding movable goods in the process of delivery

Regarding these contracts, art. 87 of Law no. 85/2006 regulates the situation in which the vendor has reserved the property over the movable good sold to the debtor.

Thus, if the goods have not yet reached the debtor, and no other persons have acquired any right over it, the vendor can take them back under the condition of reimbursing the debtor for any pre-payment he has done.

If the vendor does not prevail himself of his right and accepts to deliver the goods he will record his debt regarding the price within the procedure.

If the judicial administrator/liquidator is the one opting for maintaining the contract and the goods' delivery, he will have to pay the seller its entire price.

#### d) Contracts included within a master of netting<sup>(12)</sup> agreement that regards merchandises and value titles listed on the stock exchange

According to art. 88 of Law no. 85/2006, within such contracts, a bilateral setoff operation is made and the resulting difference has one of the following possible destinations. If it is a positive difference (creditor) – it is paid to the debtor by increasing his patrimony; if it is a negative difference, meaning an obligation of the debtor's patrimony, it will be recorded in the debts' table that will be paid within the procedure.

#### e) Commission contracts

If the debtor has the quality of a commission agent in such contracts, then according to art. 89 of Law no. 85/2006, the principal can opt between retrieving the merchandises or their representative titles or recording the debts representing their value within the procedure.

#### f) Contracts that allow the vindication of some of the goods owned by the debtor

Art. 90 par.1st of Law no. 85/2006 expressly regulates

the category of consignment contracts. The rules enforced by this legal provision can, however, be applied to any contract within which the debtor has goods that are other persons' property.

For such contracts, the simplest hypothesis is when the debtor possesses the good. In this case, the owner can retrieve the good unless the debtor has no guarantee right over it (such as a pledge or possessory lien right).<sup>(13)</sup>

If the debtor, however, does not have the possession of the good and cannot retrieve it from the present possessor, the owner has the right to record his debt within the procedure (art. 90 of the law).

#### *g) Contracts where the debtor is the owner of a leased building*

With regard to these contracts, art. 91 of the law allows their cancellation as a result of the opening of the insolvency procedure towards the lessee only if the rent is inferior to the one usually practiced on the market.

Moreover, by difference of the common rules regarding the lease, the judicial administrator/ liquidator has the right to refuse the carrying out of any services owed by the lessor to the lessee. Under this hypothesis, the lessee may choose between contract cancellation and its continuation. If the lessee chooses to cancel the contract and evacuate the building then he can go against the owner of the building and record his debt within the insolvency procedure. If, however, the lessee chooses to continue the leasing contract then he has the right to deduct the value of the services owed by the owner (lessor)

from the rent, without having the opportunity to record his debt within the procedure.

#### *h) Contracts concluded intuitu personae by the debtor*

Regarding this category of contracts, in theory, they could not be continued because through their specificity they refer to the debtor's obligation to supply some strictly personal or specialized services that cannot be substituted. However, the specialized legislation and practice do not have a unitary position in this respect. Thus, although their existence is recognized, the French legislation does not organize within the insolvency procedure a special regime for this category of contracts. Moreover, the French jurisprudence has constantly refused to recognize their regime.<sup>(14)</sup>

On the contrary, according to art. 92 of the Romanian law (Law no. 85/2006), the judicial administrator/ liquidator is allowed to denounce the contracts concluded *intuitu personae* by the debtor unless the creditor accepts that another person named by the administrator executes the obligation assumed by the debtor.

Finally, art. 93 of Law no. 85/2006 stipulates special rules for the case when the debtor is partner/shareholder of a company or member of a cooperative society or of a group of economic interest.

Under these hypotheses, the judicial administrator/ liquidator can opt between requesting the liquidation of debtor's rights in the company, cooperative society or group of economic interest, or to suggest, in agreement with the other partners, that the debtor be kept as shareholder.

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## Notes

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<sup>(1)</sup> Published in the Romanian Official Monitor, Part I, no. 944/22.11.2006; for a brief presentation of the Law concerning the insolvency procedure, as well as concerning the succession of normative acts in terms of collective procedures in Romania after 1990, see C. Lefter, A.M. Lupulescu, The Closing of the Insolvency Procedure, in the Journal of Theoretical and Applied Economics, no. 12 (517), December 2007

<sup>(2)</sup> It considers the sale-purchase contract with the reserve of the ownership right as a contract under execution because, at the date of the opening procedure, neither the transfer of the ownership right, nor the payment of the price were achieved –

in this respect, see for instance, Cass com. the decision on February 1st 2000, Dalloz 2000, p. 144.

<sup>(3)</sup> See I.Adam, C.N. Savu, Legea procedurii insolvenței – Comentarii și explicații, Edition C.H. Beck, Bucharest, 2006, pp. 538-540.

<sup>(4)</sup> As an exception, for sale-purchasing contracts having as object the land, the genuine form of the document is required by law for the validity of judicial act itself (*ad validitatem*).

<sup>(5)</sup> Such a contract cannot be considered integrally or substantially executed as long as the characteristic performance is constituted by the remittance of the amount. In this respect the French case

law constantly agreed – see for instance Cass.com., the decision on April 13th 1999, in *Juris-classeur périodique* (JCP) E 1999, p. 738.

- (6) According to art.3 pct.32 of Law no. 85/2006 “by captive consumer it is understood the consumer who, for technical, economic or regulatory reasons cannot choose the supplier”.
- (7) Art. L 621-28 par.6 of French Commercial Code.
- (8) See also I.Turcu, *Tratat de insolvență*, Editura C.H.Beck, Bucharest, 2006, p. 451.
- (9) The mentioned text of law institutes the possibility for the debtor-natural person, for the special administrator of the debtor legal person, for any of the creditors as well as for any other interested person to contest against the measures taken by the judicial administrator/liquidator within 5 days’ period from the handing in of its report which comprises the contested measure.
- (10) For instance the French legislation according to art. L. 621-28 par. 7 of the French Commercial Code.
- (11) In this respect, in the Romanian law, the dismissal for reasons that are not connected to the person of the employee is regulated by art. 65-72 of Labor Code. Thus, according to the new form of art. 65, the dismissal for reasons that are not connected to the person of the employee is determined by the effective elimination (real and serious) of the place of employment occupied by him. Dismissal for reasons that are not connected to the person of the employee may be individual, when it affects less than five employees, or collective. Because collective dismissal is susceptible to affect a larger number of employees, the law imposes a series of obligations for the employer and a strict procedure. The collective dismissal procedure is provided

by art. 69-71 of the Labor Code and it basically assumes two steps. The first step concerns the employer’s information and his consultation with the unions and the employees’ representatives, while the second step takes place once the employer took the collective dismissal decision. This step concerns the notification of the collective procedure to the territorial labor inspectorate and to the territorial labor force employment agency – see for more details T. Ștefănescu, *Tratat de dreptul muncii*, Editura Wolters Kluwer, Bucharest, 2007, p. 366 and the following. After having performed this procedure, the employer can proceed with the collective dismissal procedure within 30 days. Also, according to art. 73 par. 1st of the Labor Code, the dismissed employee has the right to a notice period that cannot be shorter than 15 working days. As a consequence, it has to be considered that the text of art. 86 par. 5 of Law no. 85/2006 refers to the dismissal for reasons that are not connected to the person of the employee and affecting less than 5 employees. This dismissal takes place during the observation period or within the judicial reorganization. On the contrary, art. 86 par. 6 excepts collective dismissals within the bankruptcy procedure from the procedure stipulated by art. 69-71 of the Labor Code, but maintains the dismissed employee’s right to a notice period of 15 working days.

- (12) The “master of netting agreement” has the meaning given by art. 3 point. 34 of Law no. 85/2006.
- (13) See I. Turcu, quoted, p. 459.
- (14) Y. Guyon, *Droit des affaires. Entreprises en difficulté – Redressement judiciaire – Faillite*, vol.2, 4th edition, Editura Economica, Paris, 1993, p. 234.