Short considerations about legal obligations, insolvency and insolvability

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Abstract: *The author's following paper is designed to present an overview of legal institutions like civil obligations, insolvency and insolvability. The study starts with a short presentation of the Romanian economic context before and in the aftermath of the 2009 financial crisis, having been one of the main causes of the increase in insolvency procedures. The paper's findings present the practical and moral need for legislative action in the matter of codification of personal bankruptcy as none of the legal mechanisms available today can repair some of the injustices natural persons face financially.*

Keywords: *insolvency; insolvability; legal obligations.*

Introduction

The Romanian economy has got through numerous challenges throughout time – from the lack of national currency before 1867, doubled by the existence of numerous foreign currencies in circulation [1], to the weakening of the capitalism worldwide by the two world wars and, last but not at least, the change from a centralized economy to a "wild capitalism" [2].

One of the most important pieces of this puzzle represented by macroeconomic state's policies is the *fiscal policy*. The doctrine [3] defines the fiscal policy as being "*an assembly of state's intervention instruments, generated by specific financial and fiscal processes: fiscal income obtained from tax and taxation, allocation of fiscal expenses, maintaining of financial balance*". Fiscal policy can also be defined as "*the volume and the sources of public funds, the drawing methods which will be used, the objectives, as well as the means of their realization*" [4]. The State must use this mechanism in order to ensure a positive economic growth.

In spite of all these, during the period of *economic boom*, a relaxed fiscal policy was allowed; this led to an encouragement of the consumerism, an increase of the economic recklessness (an apparent economic infallibility was gradually set up among economic agents and operators, even if it is known that any business has a certain risk) and irresponsible investments (for example the famous *real estate boom*), but, within the context of economic contraction [5], everything came back as a rebound, against the principles of a sane economy.

In order to fight against the effects of economic crisis, Romania asked for help from the International Monetary Fund in May 2009. This intervenes on the grounds of some financing agreements in order to recharge the economy. When elaborating a document - The First Evaluation of the Stand-By Agreement, Request for Derogation from Fulfilling the Performance Criterion and Request for Modification and Setting-Up the Performance Criterion drawn up by the European Department, 10 September 2009 - The I.M.F. notice that "the main reason of the decline is the acute contraction of home demands, especially the consume, while the bank credit decreased, the income increase stopped, and the trust collapsed" [6].

Under the I.M.F. guidance, Romania would have adopted in 2010 unpopular austerity measures, such as dismissals, salary cuts in public sector with 25%, together with an increase of Value Added Tax (VAT) from 19% to 24%.

All these measures had a negative impact and led to a systemic incapacity of debt repayment among not only professionals (usually legal entities) but also natural persons, thus having to take into account that not only the first ought to be enjoying the protection of the court in these conditions of financial difficulty.

Being aware of the legislation that regulates the professionals' insolvency, the present Law no.85/2006 [7], the question that can be asked is: Why only some victims of unpredictable economic circumstances can benefit from preferential treatment, and not all of them? [8].

1. About civil obligations and some causes of their non-payment

The origin of the term "obligation" can be found in the Explicatory Dictionary of Romanian Language as coming from the French term "obligation" and the Latin term „obligatio, - onis" (lat. „ob" - on account of + lat. „ligo, -are" - relation) and it refers to the civil right some persons have in order to pretend to other persons who are indebted to them to give, to make or not something; it can also be said that this bond has the purpose to get something or to achieve a certain interest for the owner.

Due to the meaning similarity this *bond* is also found in the Roman law under the expressions "*vinculum corporis*" and "*vinculum juris*", according to the historic evolution of its use. In early Roman law, the obligation had specific features regarding the owner's right on his property or (vinculum corporis) involving a physical connection which conferred the creditor the disposal over the debtor; the Roman law system is one of the most prolific law systems, and, as a result, the term has got a new meaning, closer to the present one, that of legal connection (vinculum juris) [9].

Instead, the New Civil Code has its own definition of the term "obligation" through the regulations of the article 1164: "… *it is a legal connection according to which the debtor is forced to produce a labour conscription for the creditor who has the right to get it*".

The obligations, no matter how their nature and origin may be, must be fulfilled. The presumption of good faith represents the base and, at the same time, the catalyser of a civil or commercial circuit which is functional and capable of fulfilling the socio-economical needs of every person.

According to the use we discuss, the obligation can have several meanings. Firstly, when we refer to this term, we refer to the legal relation between the two aspects obligations have: active and passive. Secondly, in a broader sense, we understand that both general legal duties (to respect absolute rights, such as non-ancillary rights and non-property personal rights), as well as personal legal ones (property personal rights having as corollary duties of some individualized subjects and which can result from legal acts or facts) [10].

Depending on the intrinsic or extrinsic causes of the debtor's will, when a debt is not paid in due time, we can identify a bad faith which means that the debtor intentionally didn't respect the agreement, had a bad management of the wealth due to an irrational indebtedness because of "daring" loans, of alcoholism, gambling etc, and a non-payment in good faith, its subsequent causes being subjective (the denial of such debt [11], the false impression that he overtook a prescribed debt [12]) or objective (unemployment, natural disasters, third party's deed, the insolvency of a company that influences extensively the resources or the income of the debtor).

The equilibrium of the property balance between the active and the passive rights and obligations of any person didn't have to influence a third party on individual/singular level, but, if it becomes a domino phenomenon and gets systemic characteristics, it can influence the whole civil circuit. We have to emphasize that our lives are still influenced by the financial crisis started from the United State of America when a huge player on financial market, Lehman Brothers Holdings [13] went bankrupt and was spread all over the world.

The intervention of Romanian legislator in re-assuring the economic balance between the actions of a party and the counteractions of the other parties, taking place during the execution in good faith of a contract, led to the stipulation in the new Civil Code [in art. 1271 par. (2) and (3)] of the Theory of Unforeseeable. In this way the legislator wanted to avoid some unjust consequences due to exceptional consequences that can put the debtor in a difficult situation to fulfill his obligations. For this it is necessary to fulfill some conditions: a. the circumstances should change when the contract is terminated; b. the debtor shouldn't have assumed the risk of circumstances change or it can be reasonably considered that; c. the debtor didn't assume such a risk (in this case the reasonability is stated by a judge by resort to the courts); d. the debtor should have tried "in a reasonable term and in good faith, a negotiation of the contract for a reasonable and equitable adaptation" [14]. Once these conditions fulfilled, this legal state produces some effects, as they are presented in art. 1271 par. (2) from the Civil Code: the contract adaptation in order to equitably distribute to the parties all the losses and benefits that result from the circumstances changes or the contract termination at the moment and under the conditions established by the court; this last case is possible only if the contract can be maintained because otherwise an unjust situation can appear for one of the parties, debtor or creditor [15]; it is well known that the Civil Code is in favour of maintaining the contractual reports, not only in subsidiary, and, as a last resort, the convention can be annulled for not causing inequities.

We have to emphasize that the circumstance changes must not have been known by the debtor, the subjective aspect of the creditor being irrelevant in this respect – it is an institution developed in the favour of the debtor.

We may imagine a situation [16] where the creditor, a *professional* in the light of art. 3 par. (2) from the Civil Code, does not stipulate the circumstances that reduce the value of the debt existed against a person. In this situation the creditor will not be able to appeal to the unpredicted because the execution of the contract by the debtor will not be made in a visibly unjust manner, as it is required by the art. 1271 par. (2), but on the contrary. At the same time, the creditor can't appeal to the unjust enrichment - the just cause here being the contract.

Thus, taking into account the diversity of the legal normative mechanisms, common and special, that carry out the obligations according to their nature [17] or according to the legal subjects [18], we can affirm that the Romanian state is diligent enough regarding the coercion of the debtor to execute the actions he agreed upon. Nevertheless, there is a field that escapes from its intervention - the personal bankruptcy.

2. About insolvency and insolvability

When we analyse the bankruptcy procedures as statistical data [19] we can draw some certain conclusions about the country's socio-economic context. Thus, following the monthly, quarterly or annual official data regarding the number of requests for starting the insolvency procedures and the number of declared bankruptcies we can notice that there are some periods of economic contraction, increasing the number of such requests, and periods when the economy goes well, intensifying the economic circuits and increasing the incomes. Other aspects which can be analysed would be the value of the properties undergoing these procedures, emphasizing the intensity of the economic exchanges and the risks, as well as the fluctuations regarding the number of the traders.

Historically speaking, bankruptcies appeared previously the officially recorded data. Laws that assured the outgoing procedures, good or not, have existed for a very long time [20], being in a continuously process of transformation and streamlining.

Insolvency and *insolvability* have always been concepts which led to confusion due to their similar, but not identical meaning.

Insolvency is defined in art. 3 pct.1 from Law of Insolvency no. 85/2006 as being "*the state of debtor's property characterized by an insufficient funds for paying the certain debts*". Insolvency is presumed to be obvious when the debtor, after 90 days from the due payment date, didn't pay the debt to the creditor, and the insolvency is imminent when it is proved that the debtor will not be able to pay in due time the debts with the funds that are at his disposal.

The Law of Insolvency does not contain a definition of the term *insolvability*; however, we can find a definition in provisions of the article 1417 par. 2 from the Civil Code which, presenting the causes that generates it, namely *the inferior value of the active property that can be subjected to forced execution to the total value of the enforceable debts*, reports it at the provisions par.1 of the same article. Another definition, fundamentally identical, can also be found in art. 176 par. 1 from the Government Emergeny Ordinance 92/2003 from the Fiscal Procedure Code. According to the present code, "*… it is insolvable the debtor whose income or traceable properties have a smaller value than the fiscal debts or who does not have any income or traceable properties*".

In present insolvency legislation, the uncontested, liquid and enforceable is seen as the only grounds of starting the procedure. However, we have to notice the dichotomy of the debt-claim, in identifying its necessary conditions for starting the procedure at the creditors' request [21] and the conditions for it to be registered in the debt-claim lists stipulated by the insolvency law.

Thus, the first difference is represented by the legislator's obligation that is stipulated in art. 31 regarding the conditions of creditors' requests, at par. 2, as a condition for approving the debt, (the imperative note "*…will mention…*" being very clear), to present the supporting documents, forbidding the administration of other means. Consequently, once the procedure was started, the debtors whose debts can not be justified with titles are entitled to request their admission, being added in the preliminary table after the judicial administrator will request explanations to the debtor, will discuss with the creditor, requesting additional information if necessary. If the debt is contested, according to art 73 par.3, the administrative judge will answer to the appeals at the same time, issuing a sentence, even if for some solutions there is necessary the administration of proofs (not only written evidence).

Another difference is represented by the cut-off value of the debt which is pertinent only at the starting of the insolvency procedure, but only for entering the statement of assets and liabilities. Thus, art. 3 pct. 12

stipulates that the cut-off value represents the minimum value of the debt, *for the debtor's request to be handed*. This value is of 45000 lei, and for employees 6 gross salaries. In case of several requests for starting the procedure, coming from the creditors, the cut-off value will be reported as a value of all debts. For registering to the statement of assets and liabilities, a minimum value is not stipulated, all creditors, irrespective of the value of their debts, can ask to be registered against the creditors.

These debts are or aren't confirmed in a document, under condition or without maturity term, unsecured or guaranteed [22].

As in the hypothesis of forced executions [23] through the stipulations of article 662 of Civil Procedure Code, the start of insolvency procedure can be done only if a debt is uncontested, liquid, and enforceable. It is wrong to consider the insolvency procedure *a forced execution procedure special* [24] because this means that we would neglect the procedure of judicial reorganization [25]. This has a mixed judicial nature, being able to strongly motivate a contractual judicial nature taking into account that, in order to execute a reorganization plan, this plan should be voted by the creditors according to the law [26] and before being confirmed by a syndic judge; this plan has a judicial nature, taking into account the role of the syndic judge in confirming the plan according to the article 101, after this plan was voted by the absolute majority of every distinct category of creditors that are part of statement of assets and liabilities; the legal nature of the reorganization plan can be deduced from the fact that law prescribes its effects [27].

Conclusions

There are practical and moral reasons for a legislative action in the matter of codification of personal bankruptcy as none of the legal mechanisms available today, and presented throughout the paper, can repair some of the injustices natural persons face financially.

Due to the limited applicability of the Theory of unpredictability and the procedure of declaring the fiscal debtor's insolvability pursuant to art. 176 of the Fiscal Code, and the sometimes unjust results of a forced execution of the debtor, having taken in account the objective reasons for non-payment of a debt, the natural person is left unprotected.

Moreover, art. 149 of Law 85/2006 states that the law's provisions are to be supplemented by the dispositions of the EC Regulation on insolvency proceedings 1346/200, published in the Official Journal of the European Communities nr. L 160 on 30 June 2000. The EC Regulation clearly states in paragraph (9) of it's preamble that "This Regulation should apply to insolvency proceedings, whether the debtor is a natural person or a legal person, a trader or an individual.

Due to Romania joining the European Union (EU) on the 1st of January 2007 and in compliance with art. 288 of The Treaty on the Functioning of the European Union, the regulation is directly applicable in the member states.

References

[1] Situations which led to an intensification of speculative practices, daily variations, local or not, of currency exchange, the volatility of the real value of goods by using several prices according to the foreign standard. For details, see Victor Axenciuc, *Evoluția economică a României. Cercetări statistico-istorice 1859-1947* / *Economic developments in Romania. Historical statistical research 1859-1947*, Vol. III, Ed. Academiei Române Publishing House, Bucharest, 2000;
[2] The expression „time is money" has begun to be more and more meaningful in Romania after 1989 when *money was cheap* and the consuming market was very small due to the socialist economic policy that was specific to the Romanian communist regime;
[3] Dan Drosu Șaguna, Dan Șova, *Drept fiscal* / *Fiscal Law*, C.H. Beck Publishing House, Bucharest, 2006, p. 15;
[4] Gheorghe Manolescu, *Politici monetare și fiscale* / *Monetary and fiscal policies*, Ed. Universității Ecologice Publishing House, Bucharest, 1997, p. 144;
[5] România has officially entered the recession in 2009, when the economy dropped by 6,4% in the first semester;
[6] http://www.fmi.ro/img/File/Raportul%20Echipei.pdf - accessed on the 14th April 2013;
[7] Government emergency Ordinance no. 91/2013 from 02 October 2013 regarding the measures of preventing insolvency, published in Official Gazette no. 620 from 4 October, entered into force starting with 25 October 2013 (whose effects are suspended by the Romanian Constitutional Court by Decision no. 447/2013, regarding the admittance of the exception of unconstitutionality of the dispositions of Government Emercency Ordinance no. 91/2013, published in Romanian Official Gazatte, part I, no. 674 from 25 October 2013), represented a legal revival, with the exception of some aspects for economic field;

[8] None of the legal documents regarding the insolvency (Law no. 64/1995, Law no. 85/2006, Government Emergency Ordinance no. 91/2013) does not have any stipulations about the insolvency of persons. Not even the new code of insolvency adopted by the Parliament on 15 April (its entering into force depends from the promulgation by the President and its publication in the Official Gazette) doesn't discuss this problem;

[9] See Vladimir Hanga, *Drept privat roman* / *Roman Private Law*, Ed. Didactica si Pedagogica Publishing House, Bucharest, 1977, p. 345

[10] Liviu Pop, Ionut-Florin Popa, Stelian Ioan Vidu, *Tratat elementar de drept civil. Obligatiile* / *Basic Treaty of civil law. Obligations*, Universul Juridic Publishing House, Bucharest, 2012, pp. 12-13;

[11] This can happen in the case of overtaking the debts of the deceased by accepting the inheritance;

[12] The lapse of time for rights of claim (and for ancillary rights) offset only one component of the right of action - the possibility to get the obligation of the passive part to execute the correlative obligation or to admit the contested subjective right; at the same time, in case of ancillary rights and of non-property rights the lapse of time offset the subjective right itself. For details, taking into account the old Civil Code, see Gabriel Boroi, *Drept civil. Parte Generală. Persoanele* / *Civil Law. General Party. Peoples*, Hamangiu Publishing House, Bucharest, 2008, p. 341 and next, or for details in light of the new Civil Code, see Gabriel Boroi, Carla Alexandra Anghelescu, *Curs de Drept civil - Partea generală,* Editia a 2-a revizuită şi adăugită / *Course of Civil Law - General Part*, 2nd edition revised, Hamangiu Publishing House, 2012, p. 289 and next;

[13] Declared bankrupcy on the 15th of September 2008 with a debt of over 600 billion dollars;

[14] Article 1271 par. (3) Civil Code;

[15] Debtor or creditor; point out that the change of circumstances had not been nor could be considered by the debtor, the creditor is not relevant subjective aspect in this regard - is an institution regulated in favor of the debtor. I could imagine a situation where the creditor professional sense C. Civ., not provides circumstances that reduce the amount of the claim that it has against a debtor. In this situation, could not invoke unpredictability as performance of the contract has not become "overly burdensome" on the contrary. Also, the creditor can not invoke any unjust enrichment - act consisting of just cause ended with the principle of "*pacta sunt servanda*";

[16] Let us suppose a situation that opposes the actual reality: a debtor signs a contract for a bank credit in Swiss Francs (CHF) in installments, for 10 years. The payment is made at currency exchange rate in lei. After one year, the Swiss Francs value has dropped by 50% from its initial value;

[17] Fiscal obligations: Government Ordinance no. 92/2003 regarding the Fiscal procedure Code, re-published in the Official Gazette, part I, no. 513/31.07.2007; Order no. 539/18.05.2009 issued by the Minister of Labour, Family and Social Protection (MMFPS) for approving the Procedure regarding the insolvency state of debtors (persons or companies), according to the provisions of art. 176 from the Government Ordinance no. 92/2003. Civil obligations: Law no. 134/2010 regarding the Civil Procedure Code, republished in Romanian Official Gazette, part I, no. 545 from 03.08.2012 with subsequent modifications and completations;

[18] Professionals, as they are defined by art. 3 par. (2) from the Civil Code, with the exception of those who have liberal jobs, but inclusively to autonomous administration: Government Emergency Ordinance no. 91/2013 regarding the preventing measures of insolvency and insolvency itself, published in Romanian Official Gazette, part I, no. 620/04.10.2013. Territorial and administrative division: Government Emergency Ordinance no. 46/2013 regerding financial crisis and insolvency of territorial and administrative divisions published in Romanian Official Gazette, part I, no. 299/24.05.2013. Persons and pre-academic and academic educational units stipulated by art. 7 from Government Emergency Ordinance no. 57/2002: Law no. 134/2010 regarding Civil Procedure Code, republished in Romanian Official Gazette, part I, no. 545 from 03.08.2012 including subsequent amendments and additions;

[19] For a statistic analysis of the bankruptcies, according to the number and value of the property during 1869–1914, of the bankruptcies and moratoriums in Romania during 1925-1931 and of the bankruptcies and moratoriums in Ilfov county during 1925-1939, see Table 125 - 127 presented in Victor Axenciuc, *Evoluția economică a României. Cercetări statistico-istorice 1859-1947* / *Economic developments in Romania. Historical statistical research 1859-1947*, Vol. III, Ed. Academiei Române Publishing House, Bucharest, 2000, pp. 238-245;

[20] The Jewish laws stipulated a periodical discharge of debts from commercials;

[21] The procedure may also begin at the request of the debtor (the one most likely to know the moment of an insolvency state taking effect), moreso, having the obligation, in light of art. 27, to adress the court with a request in this sense in a timeframe no longer than 30 days from the installment of an insolvency state;

[22] We believe that when a commercial entity becomes insolvent with a property which is currently on auction according to the conditions of Civil Procedure Code, the buyer could ask the handover of the property by registering a form to the statement of assets and liabilities with the debt in question. See the stipulation of article 36 regarding the effects of the cancellation of judicial and extra-judicial actions with the court sentence of starting the insolvency procedure;

[23] See E. Oprina, I. Garbulet, *Tratat teoretic si practic de executare silita, Vol I – Teoria generala si procedurile executionale, Vol II – Explicatii, cereri, modele* / *Theoretical and practical treaty enforcement, Vol I - General Theory and executional procedures, Vol II - Explanations, applications, models*, Universul Juridic Publishing House, Bucharest, 2013;

[24] „...by forced execution it is understood the assembly of legal dispositions that regulates the way of accomplising the obligations stipulated enforceable titles", in *Noul Cod de procedura civila – Comentariu pe articole* / *New Code of Civil Procedure - Comment on articles*, Vol. II. Art. 527-1133, Hamangiu Publishing House, Bucharest, 2013, p. 88, coordinator prof. univ. dr. Gabriel Boroi, comment - Dumitru Marcel Gavriș;

[25] Unlike forced execution that is applied to any debtor, irrespective of his position, the insolvency procedure is applied according to article 1 only to commercial companies, building companies, agriculture companies, economic groups, persons, individual entrepreneurs and family associations. The persons can be subjected only to forced execution, without being subjected to insolvency legislation;

[26] However, according to article 100 par. 4, the acceptance of the majority of the creditors stipulated in par. 3 of the same article, defeats the opposition of the minority of the creditors from the same category; in these conditions the plan is considered to have been accepted by the distinctive category in question;

[27] I. Schiau, *Regimul juridic al insolventei comerciale* / *The legal regime of commercial insolvency*, ALL Beck Publishing House, Bucharest, 2001, p. 128;