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Theoretical and Practical Provocations of the New Romanian Personal Insolvency Proceedings

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ABSTRACT: The legal framework that acknowledges personal insolvency in Romania has finally been adopted on 18 June 2015, after more than 25 years of hardships for the consumers, and only took effect, after many delays, on 1 January 2018. This paper aims to present what is meant to be a procedure that protects the consumers that contracted obligations and by no means of their fault are not able to cover their debts. Furthermore, of great importance is the analysis of the particularities of the Romanian procedure by comparing to similar procedures of other jurisdictions.

KEYWORDS: consumer protection, debt, Insolvency

Introduction

Having been long due, the Insolvency proceeding law of the private person, Law no 151/2015 (published in the Official Gazette no 464 of 26 June 2015, has finally taken effect on 1 January 2018 after many delays imposed by the need of establishing and preparing of the professional body that would conduct such proceedings.

Bankruptcy as a procedure, whoever the subject of such proceeding might be – a business, a natural person, or even a municipality – has one common denominator in each case: a debtor`s inability to pay ones overdue debts and the collective effort of said debtor and its creditors to cover most, if not all, of the owed obligations. One study has found that "the business bankruptcy rate is a significant determinant of the personal bankruptcy rate. Based on the estimated coefficient, a 10% increase in the business bankruptcy rate leads to a 3.43% increase in the personal bankruptcy rate" (Platt and Demirkan 2010).

It is essential for a stable and prosperous market that its over-indebted, of good faith, consumers be protected through clear and coherent regulations from situations where, due to none of their fault, the accumulation of debt is truly cumbersome.

The Romanian economic context that appeared after the financial crisis of 2008 was characterised by increasing numbers of people in a position of not being able to pay their bank loans. This led to a need for legislative resolution. Thus, the first draft of a personal insolvency law has been proposed and passed by the Senate in 2010. Unfortunately, the draft bill wasn't accepted by the Parliament having faced fierce critique. According to a study conducted by London Economics (London Economics 2012, 83), the 2010 bill was a cause of concern for the majority of the bank system in the sense that due to the crisis and austerity programs implemented, the potential for turning towards the personal insolvency law in bad faith was greater; also banks, in a worst case scenario, would have to increase their capital and also a larger volume of provisions. Lithuania shared Romania's difficulties in adopting a personal insolvency law, sharing some of the criticism from the commercial banks, even though the two countries were among very few to have such proceedings (Ambrasaitė and Norkus 2014, 177).

Having a personal insolvency law fail to be adopted, the Romanian consumer was left with only few tools to combat uncontrolled rise in payment instalments due to fluctuating exchange rates or fluctuating bank interest index, or inability to cover a debt:

i) The unpredictability legal clause, prescribed in article 1271 of the Romanian Civil Code. According to article 1271 paragraph 2, if the execution of the contract has become excessively burdensome due to an exceptional change of circumstances which would make it manifestly unfair to oblige the debtor to perform the obligation, the court may order, either the adaptation of the contract, in order to equitably distribute the losses and benefits resulting from changing circumstances, or, termination of the contract, at the time and

under the conditions it establishes. Some conditions still have to be met in order for the unpredictability clause to be duly invoked: the change of circumstances took place after the conclusion of the contract; the change of circumstances and its extent were not and could not be reasonably considered by the debtor at the time of the conclusion of the contract; the debtor did not assume the risk of changing the circumstances and could not reasonably be considered to have assumed this risk; the debtor attempted, within a reasonable time and in good faith, to negotiate the reasonable and equitable adaptation of the contract (Matefi and Zamfir 2019, 29).

ii) The law for abusive clauses, Law no. 193/2000 (published in Official Monitor no. 543 of 3 August 2012). According to article 4, a contractual clause that has not been negotiated directly with the consumer will be considered abusive if, by itself or in conjunction with other provisions of the contract, it creates, to the detriment of the consumer and otherwise to the requirements of good faith, a significant imbalance between the rights and obligations of the parties; also, a contractual clause will be considered as not being negotiated directly with the consumer if it has been established without giving the consumer the opportunity to influence its nature, such as pre-formulated standard contracts or the general conditions of sale practiced by traders in the market of the respective product or service (Lupu 2014, 82).

iii) *Datio in solutum* Law – The law for credit payment in the form of transfer of property of immovable goods, Law no. 77/2016 (published in the Official Monitor no. 330/2016 of 28 April 2016). Being one of its kind in the world (Groningen, 2016), one of the main advantages of this law is that the consumer has the right to extinguish the debts arising from the credit agreements with accessories, without additional costs, by paying the mortgaged property in favour of the creditor, if within the stipulated term of 30 days from the notification of such intent, the parties to the credit agreement do not reach another agreement (Badiu and Nita 2016, 38). Pursuant to article 4 paragraph 1, in order to extinguish the debt arising from a credit agreement and its accessories by giving in payment, the following conditions must be met cumulatively: the creditor (credit institutions, non-banking financial institutions and the assignee of consumer debt) and the consumer belong to the categories provided in article 1 paragraph 1, as defined by the special legislation; the amount loaned, at the time of granting, did not exceed the equivalent in lei of 250,000 euros, the amount calculated at the exchange rate published by the National Bank of Romania on the day of the conclusion of the credit agreement; the loan was contracted by the consumer with the purpose of purchasing, building, extending, modernizing, arranging, rehabilitating a building with housing destination or, regardless of the purpose for which it was contracted, it is guaranteed with at least one building having the destination of home; the consumer has not been convicted by a definitive sentence for offenses in relation to the credit for which the application of this law is requested.

iv) For fiscal debts, the insolvability procedure in accordance to article 265 of Fiscal Procedural Code. It is considered insolvent the debtor whose incomes and / or assets are of a lower value than the tax liabilities or which has no incomes or assets. For the purpose of declaring the insolvency status of the debtors the enforcement bodies have certain obligations: to investigate the situation of the debtors` assets by requesting information from any relevant public register (City hall, Land Registry, Agricultural Registry etc.), from any banks the debtor might have accounts open, or even by first-hand ascertainment of the debtors` estate; to compare the aggregate value of the assets and incomes of the debtor with the total of the main fiscal obligations and accessories due and not paid at the date of comparison.

None however had the most sought after effect: debt release. As I will discuss further in more detail, the debt release system opted by the Romanian law-maker is congruent with the continental approach, being a lot different than the Anglo-American one. The prevalence of "earned fresh start"

over the already well established quick-and-easy American "fresh start" is evident in the eyes of Thomas Jackson, who considered that courts ought not to protect all of the earnings after an insolvency proceeding but only a determined level (Jackson 1986, 254-257).

1. Who does and who does not benefit from the prescriptions of the Romanian personal insolvency law?

While the commercial insolvency is meant to free the market from the bankrupt entities and to provide a rescue mechanism for the entities that can survive, the insolvency of the natural person aims to offer the consumers the possibility of debt discharge in the conditions provided by the law. Thus, according to article 1 of Law no 151/2015, the purpose of this law is to establish a collective procedure to rectify the financial situation of the natural person debtor, of good faith, to cover its liabilities as much as possible and to aim for discharge of debts, under prescribed conditions.

The procedures provided apply to the debtor, a natural person, whose obligations do not result from the exploitation by him of an enterprise, within the meaning of article 3 from the Civil Code. *Per a contrario* interpretation leads us to the conclusion that legal entities or professionals who exploit an enterprise fall out of the scope of regulation of this law. In view of the Civil Code, the operation of an enterprise is the systematic exercise, by one or more persons, of an organized activity that consists in the production, administration or alienation of goods or in the provision of services, whether or not for profit. If a natural person's financial distress is caused by obligations assumed in exploiting of an enterprise, for example him being an authorised natural person and conducting commercial activities, the remedy is that of Law no 85/2014, the Business Pre-Insolvency and Insolvency Act – the simplified procedure of liquidation. It can be noted that it seems a rather unjust regulation approach, leaving the professional natural person with only a procedure of liquidation while the consumer also has the possibility of arranging a court-backed debt repayment plan.

Besides the condition of being applicable to a non-professional natural person, the debtor must a) have his habitual residence, residence or residence for at least 6 months prior to submission

demand in Romania; b) be insolvent, and there is no probability reasonable to become, within a maximum period of 12 months, able to execute obligations as they were contracted, maintaining a reasonable standard of living for self and for the people he has to maintain; c) the total amount of its outstanding obligations is at least equal to the threshold value of 15 minimum monthly wages.

The law allows any natural person that didn't fulfil legal formalities of registration to access it's provisions as long as he has lived "habitually" in Romania for at least 6 months and has income or assets here. The rather short term of habitual living condition imposed leaves room for forum shopping. For example an indebted student from Lithuania can apply for a 1 year Erasmus study grant in Romania and after at least 6 months of living and part-time working here can easily obtain the opening of insolvency proceedings. According to article 2 paragraph 2, Lithuanian personal insolvency law (Law no XI-2000 of 12 May 2012) imposes an indebtedness threshold of 25 minimum monthly wages, meaning around 13.875 Euro for 2019 and 15.175 Euro in 2020, as compared to Romania's 6.570 Euro, less than half of the Lithuanian threshold. So now, after being taken under the protection of the national Romanian court, demonstrating its Centre of Main Interests having moved here by moving most assets, studying and working, one can follow-up with a request for recognition of Romanian insolvency proceedings as main proceeding under EU Regulation 2015/848 on insolvency proceedings, thus leaving the creditors back home only to be satisfied in a secondary proceeding of liquidation of assets; pursuant to the last thesis of article 34 of the EU Directive, the effects of secondary insolvency proceedings shall be restricted to the assets of the debtor situated within the territory of the Member State in which those proceedings have been opened.

Certain limitations in accessing the proceedings are imposed through the provisions of article 4, paragraph 3-4 of the Romanian personal insolvency law due to protection of the good-faith principle of the natural person subjected to them. Thus, a debtor, in order to successfully file for an insolvency proceeding must, *inter alia*, not have benefited from such procedures prior 5 years. The reason is that, in the law's view, by the end of any procedure the natural person must be a more

financially responsible individual and be more careful to the perils of indebtedness. Other restrictions fall upon those who were definitively convicted for committing a tax evasion offense, a forgery offense or an intentional offense against the patrimony through abuse of confidence; who were dismissed from work in the last 2 years for reasons attributable to him; who, although able to work and without a job or other sources of income, did not submit the reasonable diligence required to find a job or who refused, in a manner unjustified, a proposed job or other income-generating activity; who have accumulated new debts, through voluptuous expenses while he knew or should have known that he is insolvent.

We can observe that the time the liabilities were contracted is not a factor in determining the applicability of the Romanian procedure of personal insolvency. But according to Ambrasaitė and Norkus (2014, 178) it was cause of debate when drafting the Lithuanian personal insolvency law. Finally it was established that the new Lithuanian law was not able to impose a worse treatment for creditors' rights due to the fact that, even though payment does in fact represent the prize in the creditors' race, if creditors would satisfy their claims individually it would lead to inequality amongst them; moreover, a debtor will try his best to hide his income and assets in turn minimizing the chances of covering creditors' claims to their fullest.

Even though Law no 151/2015 has been adopted for more than 4 years now, gaining enough publicity in the conscience of consumers, and although it has entered into force almost 2 years now, it still lacks the appeal one could imagine it would generate. In comparison to the *Datio in solutum* Law, which generated over 8.450 notifications in the first 2 years of implementation, Personal insolvency law, using the same period frame reference, generated merely 24 proceedings. This situation could be explained in part due to the fact that Romania has had good economic growth for some time now. This however is not the case everywhere. Zywicki (2005) finds that in the USA, during one of the most prosperous periods for the economy, with low unemployment and low interest rates, insolvency case filing soared from 250.000 in 1979 to over 1.5 million in 2004.

2. What are the applicable procedures?

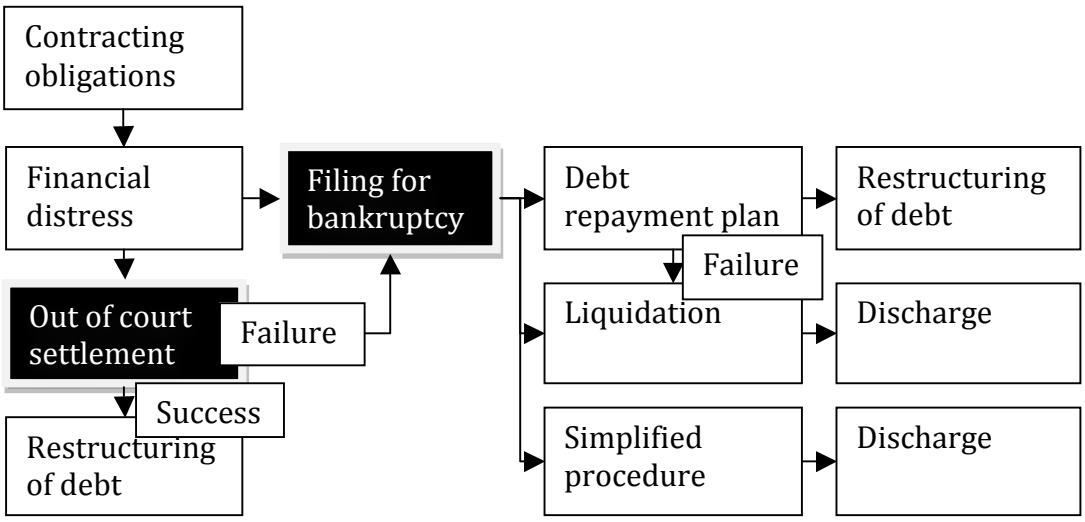

Figure 1. Overview of personal insolvency procedures

According to article 5 of Law no 151/2015, there are three regulated proceedings: the insolvency procedure based on a debt repayment plan; the judicial insolvency procedure by liquidation of assets; and the simplified insolvency procedure. (See fig. 1)

Debt repayment plan based procedures are administrative procedure, conducted under the supervision and control of the Insolvency Commission. The insolvency commission in whose constituency the debtor had his domicile, his residence or habitual residence at least 6 months

before submitting the application to open an insolvency proceeding is competent to exercise the attributions. One of its main obligations is to appoint an administrator of the procedure from the insolvency practitioners, court executors, lawyers and public notaries enrolled in the List of procedure administrators and liquidators for the insolvency procedure of natural persons.

The very first step taken by the debtor towards a debt repayment plan based procedure is through notifying its creditors 30 days prior, as per article 13 paragraph 4 of the law. Afterwards, the debtor must submit a formal request, which is a standardized form that contains data and information relating to a self-assessment of why he came to be bankrupt, the state of his wealth (including all bank accounts, all income revenues, assets, etc.), pertinent information regarding his creditors (names, amount of debt owed each, disputed or undisputed, etc.), personal information (past sentencing, proof of employment, if he held the position of administrator or shareholder in the past), past transactions (gratuities or any *quid-pro-quo* type contract), and, most importantly, a proposal for a debt repayment plan, which contains at least the amounts which the debtor considers that he will be able to pay his creditors periodically. Pursuant to these filings, the Commission must, in 30 days, decide whether to admit in principle the request and appoint an administrator or, noting that the financial situation of the debtor is irrevocably compromised can notify the court, with the consent of the debtor, in order to start the judicial insolvency procedure by liquidation of assets. The whole process engaged by the adoption of a payment plan can take up to almost 1 year, the implementation having to span on a maximum of 5 years from the admission of the request with a possibility of extension of 1 year in accordance with the conditions layed out in the plan.

The second applicable procedure is the judicial insolvency procedure by liquidation of assets. Such procedure ensues either voluntarily from the beginning, when the debtor knows there is no chance of restructuring of debt, or the commission refuses the repayment plan proposed or if no reimbursement plan was confirmed by court; voluntarily after the debt payment plan fails through no fault of the debtor or at the request of all creditors after the debtor fails to keep up with its payment plan due to his negligence (article 46 of Law no 151/2015). It mainly resembles that of Chapter 7 of US Bankruptcy Code.

A unique prescription by the Law no 151/2015 is that of the special *Datio in solutum* (article 59 of Law no 151/2015). In case that, even though all the measures provided for by law have been taken, the liquidator of the procedure has failed to liquidate an asset within 2 years after the inventory has been made and also the definitive table of receivables, it notifies the creditors about it, in view of exercising the option to acquire the property of the asset in the account of the debt. If a single creditor has exercised the option then he acquires the property of the asset in the account of a part or of the entire debt, depending on the value of the asset and the sum of the debt. If more creditors pursue the asset then the creditor with a preferential clause will have greater claim over the option of the others. If no creditor exercises his right of option, the asset will be excluded from the valorisation in the procedure, with the maintenance of the preferential causes, if any, and, until the date of the definitive stay of the decision to release the residual debts, this good can be valorised on the path of individual forced execution, under the terms of the common procedure. If until this date the good has not been redeemed, all the causes of preference which affected the good are extinguished.

The last procedure of personal insolvency is the special procedure. Besides the general conditions of residence, insolvency, minimum threshold it can be instituted under special conditions regarding the debtor: the total amount of its obligations is at most 10 minimum wages per economy; he does not have non-exempt goods or incomes; is over the standard retirement age or has lost all or at least half of its ability to work.

Careful observation of the conditions in which a personal insolvency proceedings commence leads us to an interesting conclusion: the fact that only debtors may initiate these proceedings may leave some creditors in a disadvantage if we take into account the beneficial regulation of annulment of past contracts. Thus, if a creditor feels that some of the debtors` past transactions seem detrimental to its interests, for example constituting security, privilege or guarantee towards another creditor (article 60 paragraph 1 point e from Law no 151/2015), outside the procedure of

personal insolvency it would be harder to prove. The same goes, for example, when the debtor has deeds of transfer of property to a creditor for the settlement of a previous debt (the case with *Datio in solutum* payments) or for its benefit, made within 6 months prior to the opening of the procedure, if the amount which the creditor could obtain in the proceeding is less than the value of the document of transfer; but during an insolvency proceeding few are the times when the satisfaction of a sole creditor from a certain asset is not lesser than in a multiple-party proceeding (article 60 paragraph 1 point e from Law no 151/2015).

In a different approach, Australian personal bankruptcy law, Bankruptcy Act of 1966, states that bankruptcy proceedings may also be commenced by the creditors; article 43 (1) of said law stipulates that certain conditions be met "[…] the Court may, on a petition presented by a creditor, make a sequestration order against the estate of the debtor". (Ramsay and Sim 2009, 29) Furthermore, article 44 (1) continues to state that "[a] creditor's petition shall not be presented against a debtor unless: a) there is owing by the debtor to the petitioning creditor a debt that amounts to $5,000 or 2 or more debts that amount in the aggregate to $5,000, or, where 2 or more creditors join in the petition, there is owing by the debtor to the several petitioning creditors debts that amount in the aggregate to $5,000; b) that debt, or each of those debts, as the case may be: i) is a liquidated sum due at law or in equity or partly at law and partly in equity; and ii) is payable either immediately or at a certain future time; and c) the act of bankruptcy on which the petition is founded was committed within 6 months before the presentation of the petition."

One other issue that might arise during proceedings is the ability of the debtor to select the Insolvency Commission and the insolvency court of his choosing. According to article 8 paragraph 2 of Law no 151/2015: "*The insolvency commission in whose constituency the debtor had his domicile, his residence or the habitual residence at least 6 months before submitting the application for the opening of an insolvency procedure is competent to exercise the attributions provided in paragraph 1*". Romanian phrasing can be used to interpret this article in two different ways: 1. The competence is granted to whichever insolvency commission`s constituency the debtor lived for more than 6 months consecutively; or 2. The competence is granted to the insolvency commission under which`s constituency the debtor found himself at least 6 month prior to the date of the proceedings not taking into account that he might have lived under said constituency no more than a few days. In Romania, jurisprudence is of less significance than in the common law states, *ergo* the importance of such forum-shopping possibilities.

One interesting finding in the study of US personal Bankruptcy is the level of exemptions compared to the one in Romania. There are two protection levels through exemptions available in the US: a federal bankruptcy exemption, and a state bankruptcy exemption, with the possibility for the state to choose either to adopt the federal exemption, or issue exemptions of their own or even let the debtors choose one of them. Some states are more generous than others. For example, Texas has a generous homestead exemption of unlimited value for a residence on 10 acres (roughly 40.000 sqm) or less in a town; Florida also offers unlimited exemption on properties of maximum 0.5 acres in a municipality and 160 acres elsewhere (Florida Statutes – Title XV – Chapter 222). It is no surprise that through these and other exemptions (motor vehicle exemption, pensions and retirement fund exemption, insurance policies and annuities exemptions, etc.) Americans can protect most if not all they own. However, there are exceptions of non-dischargeable debt that can really break a debtor`s spirit: student loans. John Pottow (Pottow 2007, 245) observes that the federal student loan is a multi-billion dollar system and that the "*[...] troubling trend of accelerating tuition, coupled with the fact that real income has stagnated for men and increased only modestly for women over the past two decades, means that more and more students are going to need to turn to borrowed money to finance their degrees absent a radical restructuring of the postsecondary education system*".

By comparison to the American homestead exemption, in Romanian proceedings the administrator of the proceeding, after careful analysis of the living conditions of the debtor, may sell the house and until such time let the debtor live there; after selling of the house the debtor has a

preference for renting it (article 26 paragraph 2 point d). That's the only living facility the Romanian law has to offer.

Even so, we can see that the list of exempt goods can add up to quite a high amount. According to article 3 point 2 of Law no. 151/2015 the list of exempt goods consists of: "a) personal or household goods, including furniture, necessary for the debtor and the family for a reasonable living, but without the value of each exceeding 5,000 lei; b) cult objects, if they are not more of the same kind, but without the value of each to exceed 2,000 lei; c) a vehicle, if it is indispensable to the debtor and his family including for commuting from / to the workplace and worth at most 5,000 euro, and the cost of its acquisition is not subject to a claim against the debtor's assets; d) the objects reasonably necessary for the debtor suffering from a disability or the maintenance persons in this situation and the objects intended for care patients; e) the foods necessary for the debtor and the persons in his maintenance for the duration conducting the procedure; f) the goods that serve the pursuit of the occupation or profession of the debtor; g) agricultural inventory, including working animals, feed for these animals and seeds for the culture of the land, if the debtor deals with agriculture, to the extent necessary to continue the works in agriculture, unless on these goods have a real guarantee right or a privilege to guarantee the debt; h) personal or family letters, photographs and pictures and the like." Also, article 3 point 25 deals with the list for exempt income: "a) the amounts necessary to provide the housing, food, transport, health and other current needs of the debtor and the persons to whom they are currently providing maintenance; b) the amounts necessary for the debtor and the persons to whom they provide maintenance in order to attend the compulsory education courses, as well as the amounts necessary to start or continue the post-secondary, university or post-university studies; c) the amounts necessary to pay the compulsory insurance premiums".

The value of the monthly minimum consumption basket represents the minimum threshold below which the expenses cannot be set to ensure a reasonable standard of living. This value represents the amount of money from the debtor's income that cannot be stopped for debt payments because it is necessary to cover the expenses necessary to ensure daily living for himself and his family.

Killborn (Killborn 2005, 33) argued that debt payment is morally fair, but so is maintaining a reasonable standard of living. But what is reasonable standard of living? The Central Insolvency Committee approved for 2019 the General criteria to establish a reasonable standard of living (Decision 7/2018). It sets out, for a family of 2 active adults and 2 children, an income of 2.600 lei (approximately 550 euro) of which the amounts allocated to each member of the family look like so: Adult – husband 797 lei; Adult – wife 797 lei; Child over 14 years old 587 lei; Child under 14 years 419 lei.

According to article 3 of Decision 7/2018, in any of the insolvency procedures used, the amount of expenses to ensure a reasonable standard of living can be equivalent to the value of the minimum monthly basket of consumption or may exceed this value depending on the particular needs of each debtor and his family members that cannot be covered by this amount and whose satisfaction is imperative to ensure respect for their human rights, fundamental freedoms and dignity.

Conclusion

Multiannual payment plans specific to the European personal insolvency procedures, as opposed to the American ones, which involve an immediate debt discharge, most of the time lead to the same effect: no creditor will be paid out of non-exempt amounts but the procedure comes as a warning for the consumer in order not to reach the same situation again.

The debt repayment plan system of 5 years I believe should stimulate the debtor into finding a responsible solution by getting a job and not risking the debt discharge he is owed for good-faith. If there is no incentive for the debtor, he is left to concentrate all of his efforts into not paying his debts, and trying to hide all of his income by not declaring it – this would be a real social and psychological downturn for the personal and professional evolution of any person.

The personal insolvency procedure also seems to be a true spiritual path for the debtor of good faith who, in essence, extracts the necessary economic-financial education, thus helping and thus helping the long-term economic environment to be a stable environment, profitable to all parties involved. , with informed consumers making decisions dimensioned on their real needs.

It has been a long journey since the Roman`s approach to personal insolvency by cutting ones insolvent debtor into pieces on the third market day or even selling him to foreigners beyond Tiber (Norton and Walker, 2013). Modern times saw penalties shift application from the body to the rights of the individual.

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