PERSONAL INSOLVENCY

Diana DELEANU*

Abstract

In 2014 a draft bill on personal insolvency reached public debate, stirring controversy in both financial and academic environment. The current paper aims at analyzing the merits and weak points of the draft bill.

Keywords: *insolvency, debtor, creditor, restructuring, bankruptcy.*

1. Introduction

The international insolvency proceedings' regulation extends now not only to trade entities, but also to the municipal and individual proceedings.

Many European countries have a long standing practice in restructuring the financial situation for individuals who are unable to efficiently cover their debts.

2. Content

Personal insolvency, also known as "personal bankruptcy" (which is scientifically inaccurate) has been generating significant doctrine and ethical controversy, even in jurisdictions with an old and constant practice. The inaccuracy comes from the fact that –traditionally-the notion of bankruptcy proceedings ends with the dissolution / liquidation of the entity (such as in trade companies' case). Of course, this rule could not apply accordingly in insolvent individuals.

Therefore, this notion appeared from the need to protect the indebted citizen, a more understanding approach than the one which characterized the nineteenth century: the debtors prison.

Almost two centuries ago, in order to obtain a bank loan, Romanian traders had to be registered with the Trade Register, to be debt-free and not been sentenced to the debtors' prison.

The drastic approach from the nineteenth century (which characterized that historical time) left a strong imprint on society, as we see it reflected even in the literature of the time. The work of Charles Dickens would have clearly had another profile, would the author not been scarred as a child by his family's sentence in the debtors prison, after unnecessary expenses his parents made.

Therefore, individual insolvency requires a 'personal' approach, different from the "technical" one (appliccable to trade companies) because the regulation borderline touches upon individual rights and freedom and because, without aiming at that, the proceedings also affect the rights of third-party individuals, who need not be affected.

We cannot help wondering if regulating this procedure isn't a form of legislative regression after the human

* Lecturer Professor Diana Deleanu, PhD Candidate, The Faculty of Social and Administrative Studies, "Nicolae Titulescu" University of Bucharest (e-mail: **dianadel@univnt.ro**).

rights' expansion from the twentieth century.

Also, the current Romanian legislative bill breaks the rule according to which liability is personal, given the fact that the procedure affects third-party individuals who are dependent on the subject of the procedure (e.g.: minors, etc.). Given the fact that liability occurs where there is lack of responsibility, and dependent individuals had no contribution to the subject's deteriorated financial situation, one may notice that the grounds for liability is missing (the prejudicial deed).

The need for such regulations has been extensively debated in Romania. The procedure itself -theoretically- supports the individual debtor (non-trader), and its main creditors (in this historical stage) are the banks and the financial institutions. Under these circumstances, banking associations have been putting substantial pressure on the (not only) Romanian legislative against such proceedings.

This regulation blocks the banking creditors' direct foreclosure, including banks in the wider cathegory of guaranteed creditors.

This is one of the reasons why there were several attempt to regulate the issue in Romania, all far from materializing, given the existing agreement between Romania and the International Monetary Fund.

Critics argue that such a regulation could undermine the bank loan payments discipline, stating that that the credit discipline contributes to strengthening the country's financial stability.

As a consequence, the Romanian National Bank estimates an increase in the level of guarantees required by the financial and banking institutions for offerring a loan.

Studies conducted by the European Commission concluded Romania is a country with very weak protection for overindebted individuals.

Another aspect of the issue generated by personal insolvency is that of managing and protecting personal data during the restructuring plan's implementation, given the fact that international law takes stronger measures for securing data.

In other legal systems, the procedure was regulated by separate laws (e.g.: Australia, Italy), or as a mere section included in the insolvency proceedings law (e.g.: Germany, France, Czech Republic, Austria).

At the moment, the Romanian legislation, doctrine and consequently, practice are almost absent, with just the recently published project-bill to debate on.

Personal insolvency aims at ensuring a balance between the protection of the good faithed debtor and defending the creditors' interests.

Should the restructuring procedure end with full debt coverage, the good-faithed debtor (confirmed with such conduct) is given the chance for a „fresh start", as stated in Chapter 11 of the US Insolvency Code.

The doctrine follows two contrary directions: the strict enforcement of the "*pacta sunt servanda*" principle and sharing the debtor's responsibility with the contracting creditors. The first opinion denies the need to regulate this institution, while the second deems it as necessary.

There are three models for individual insolvency: the North-European one, the German one and the Latin one.

The advantages of regulating the procedure are: foreclosure suspension for procedures in progress on commencement of the proceedings; ceasing the flow of interest and penalties for late payment; all debs become chargeable and liquid and termination of all debtor's proxies (mandates).

The subject of the procedure will be an individual without entrepreneurial activities, insolvent, which will reimburse debts according to a plan and/or due to asset capitalization.

The terms to meet for undergoing this procedure are: residence in Romania; assets or sources of income in Romania; the individual does not act as an entrepreneur at the time of application and the absence of debt resulting from commercial activities conducted in their own name.

The debtor is deemed to be unable to pay its debts, two or more claims, towards two or more creditors within 30 days of the due date.

The creditor might also apply for insolvency for an individual debtor, but will need to prove that the debtor is unable to pay its due debts and its claim against the debtor exceeds the amount of Lei 25000.

In other legal systems, the threshold is Pounds 750 (in the UK) or AUD 5000 (in Australia).

In case the procedure is initiated at the debtor's request, they will state the reasons for which they are unable to pay the due debts on their own responsibility .

The request to initiate the procedure will be accompanied by a report of available income and assets, including data on revenues expected to be achieved over the next five years and information on their income in the last three years, along with the debt situation and details of the involved creditors. All statements are given on own responsibility.

The debtor needs to highlight individual assets with a value over Lei 1000 they alienated in the four years before the application and draft a proposal for the debt payment plan.

In order to support the debtor and based on the above-quoted principle of joint liability of the creditor and debtor, at the debtor's request, creditors must provide a written statement on their claims against the debtor, to assist in preparing the report on property and income, highlighting the amount of debts, interest and other costs.

The only party allowed to suggest a plan is the debtor, even though it might add an extra responsibility for them.

This regulation generates a theoretical dilemma: if the debtor oneself is able to draw up a viable and efficient debt payment plan, then:

a. How did one become insolvent (excluding fraud)? and

b. Why would the whole procedure be necessary, if they can manage their financial restructuring alone? Under these circumstances, isn't the procedure a form of law abuse (to suspend foreclosure) and an additional, unnecessary expense?

Regarding the above-mentioned procedural expenses, these will be covered from the debtor's assets, and if the funds are insufficient, the court shall not be able to dismiss the application for commencing the proceedings on these grounds only, and the source of the funds will be a budgetary one.

From this point of view, one could conclude that the legislative applies the principle of (social) solidarity by covering private costs from budgetary sources, while this is a quite unfair to other taxpayers.

Concerning the application of the "good faith test", we might consider that the draft which is currently under consideration adopts the North-European model, given the fact that the court will refuse to open the insolvency proceedings in case the failure to pay is due to the debtor's fraudulent or irresponsible behavior.

The theoretical dilemma is generated by the exact definition of the debtor's irresponsible behavior of (the fraud is ruled by law).

How can one deem as irresponsible behavior the acts of an individual who freely exercises personal rights and

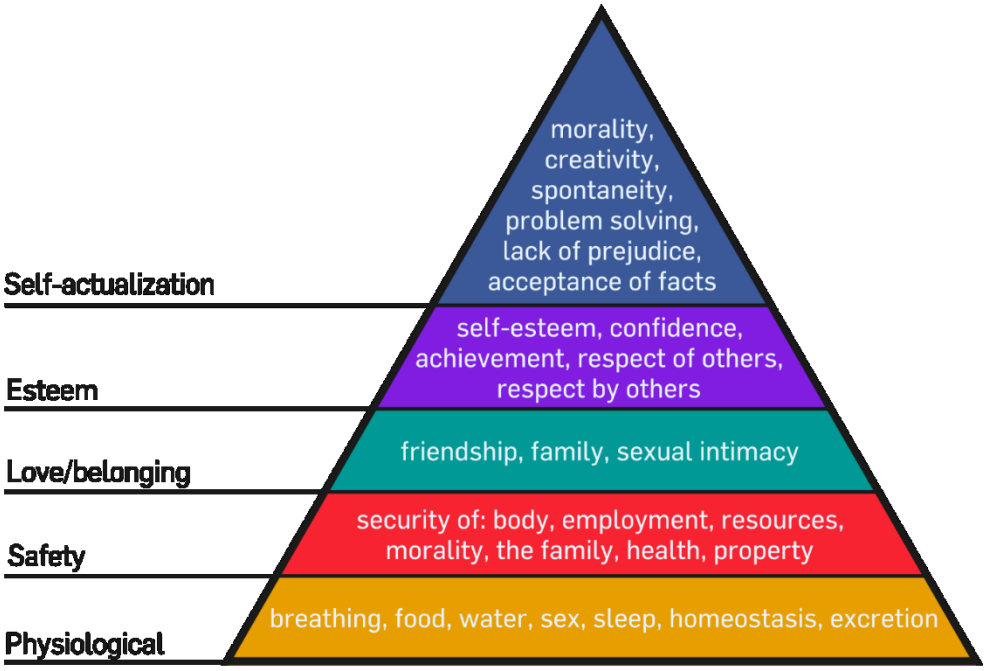
freedom, who cannot anticipate that (in 3 or 4 years) will undergo a strict financial evaluation procedure?

In the 21st century, the exercise of most individual rights (e.g.: access to culture, to higher education, etc.) is financially conditioned, so the draft bill does not state how one will appreciate the responsible / irresponsible investment in cultural or professional improvement, for instance.

Regarding the „personal" feature of these proceedings, one must emphasize that, given the complex character of the human being, a "technical", accounting assessment of previous expenses and of those recommended during the restructuring plan implementation cannot be a rigid, accounting one.

The individual features of the subject are a factor which must be taken into account in assessing the necessary costs of living, such as the bill indicates.

Abraham Harold Maslow's pyamid of needs[1] suggests a landmark which is necessary, but not sufficient in auditing financial statements of the previous three years and planning for the future.



The draft bill states that the judicial administrator shall approve the minimum allowance for the debtor and the people who depend on them which shall cover basic needs, and cannot be larger than the minimum wage.

Other reasons for dismissing the insolvency proceedings commencement application are: if the individual is in (financial) default or has undergone a similar procedure in the past 7 years.

By means of the restructuring plan, an unsecured creditor should receive

[1] Abraham Harold Maslow, The Pyramid of needs, source: Wikipedia.

compensation of at least 40% of the nominal value of its claim as recorded in the list, unless they agree in writing to a lower percentage.

One of the most controversial effects of the procedure regulated by the current project is the automatic cancellation of donations and other transactions carried out by the debtor free of charge within three years prior to the personal insolvency proceedings' commencement.

Such justified and very suitable measure in commercial insolvency cannot, however, be copied *mutatis mutandi*s in the personal insolvency proceedings.

It unreasonably affects the rights of an individual (quite solvent at the time who freely exercises their rights on private property), and of the beneficiary of the donation who did not know and could not anticipate the reinstatement of the parties in the initial situation by returning the property to the initial owner.[2]

In addition, any transaction with a related person (spouse, partner, children, grandchildren, parents, grandparents, siblings, their spouses, partners and children who live with them, as well as any other individuals who live with them and depend on the subject of the insolvency proceedings) will be considered a suspicious transaction according to the definition from the Romanian Insolvency Code.

As a result of commencing the personal insolvency proceedings, the debtor shall comply with the instructions on the judicial administrator regarding the assets which are subject to the procedure, will provide all the information requested, will not be able to alienate their assets and is required to identify additional sources of revenue, in case they are unemployed.

The debtor must refrain from any transactions and behaviors that may lead to the restructuring plan's failure (while the notion „improper behavior" is not deemed a proper definition), must submit the judicial administrator all amounts collected from legacies, donations, compensation and the extraordinary income and must not take on new responsibilities that they cannot meet to the due date (again, the notion of "new responsibility" is not defined in the draft bill).

The debtor may not refuse a reasonable opportunity to obtain income, and must inform the court and the judicial administrator on any and all changes of residence or their professional activity.

These last ideas of the draft bill (although possibly justified by the need to prevent the debtor from failure to observe the timetable) are more similar to the criminal measure of Court supervision (Court order), regulated in article nr. 215 of the new Criminal Procedure Code. But, such measures are justified in the criminal supervision area, based on the assumption of alleged crimes and aimed at controlling the social threat that the alleged criminal poses[3].

Another restriction of personal freedom may be the fact that should the a legal document by means of which the individual debtor refuses to accept a gift or inheritance without the judicial administrator's consent is not valid.

[2] One should take into consideration the irrevocable feature of a donation (from the Civil Code), with very few exceptions, which are not to be found in such cases.

[3] Article nr. 215 from the new Romanian Criminal Procedure Code states: […].

b) one must inform the authority of any change in their residence.

f) one must periodically inform the authority of their financial means.

k) one must not issue bank cheques.

Another unfounded consequence stated by the draft personal insolvency bill which breaches a number of rights is the fact that the debtor against whom personal insolvency proceedings were initiated and completed may not be the sole associate in a limited liability company for five years from the moment the personal insolvency proceedings end.

Or, the purpose of the procedure is that the individual becomes once again become a viable taxpayer, so that, the measure is unjustified, since it can not be a sanction for fraudulent acts, and, therefore, appears as an unjustified limitation.

As an exception to the rule that a debtor subject to personal insolvency proceedings may be acting as an entrepreneur (authorized), the insolvency proceedings may commence should the creditors agree, the main debt does not exceed Lei 45000 and the debtor has no more than 20 creditors at the time of the application is initiated.

The recorded claims shall be analyzed and reviewed by the judicial administrator within 15 days of the end of claims registration period, who shall draft a list of the debtor's assets within 20 days of the personal insolvency proceedings commencement.

Considering the fact that the draft insolvency bill aims at protecting the interests of debtors and sanctioning the less diligent creditors, the unrecorded claims cease to exist on the date the plan is actually enforced.

As a common feature of this project bill with the regulation concerning the municipal insolvency proceedings[4], we find the lack of a proper ending.

Namely, the draft bill does not state which is the consequence of failure in reimbursing all debt at the end of the period indicated by law.

If in commercial insolvency, failure to reimburse debt and restructure leads to bankruptcy (liquidating the entity), in the case of the other two subjects of law, the individual and the municipality, in which cases, liquidation is not an option, there is a legislative void.

Clearly, individual insolvency proceedings is resumed, and is not to be restarted, while the situation remains difficult for both creditors and debtor, with a lack of perspective of protecting and promoting the interests of both parties.

3. Conclusions

In terms of a rigorous multidisciplinary regulation, personal insolvency proceedings have the potential to be, along with the municipal and the commercial one, a legal solution for the high indebtedness level.

Such a law should observe the limits of individual rights and freedom (not only of the debtor, but also of those depending on them).

But more than that, it should be efficient, and so it should have a purpose (a trading one for creditors by covering liabilities), representing not merely a procedural extra cost and an opportunity for law (judicial) abuse, but a fair and advantageous solution for both debtor and its creditors.

[4] Government's Emergency Ordinance nr. 46/2013 published in the Romanian National Gazette nr. 299 from May the 24th, 2013.

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